HIGH COURT OF AUSTRALIA

GLEESON CJ,
KIRBY, HEYDON, CRENNAN AND KIEFEL JJ

GUMLAND PROPERTY HOLDINGS PTY LIMITED APPELLANT

AND

DUFFY BROS FRUIT MARKET (CAMPBELLTOWN) PTY LIMITED & ORS RESPONDENTS

Gumland Property Holdings Pty Limited v Duffy Bros Fruit Market (Campbelltown) Pty Limited [2008] HCA 10
27 March 2008
S395/2007

ORDER

1. *Appeal allowed.*

2. *Special leave to cross-appeal granted; cross-appeal treated as instituted and heard instanter and dismissed.*

3. *Set aside the judgment for the appellant against the first respondent in the amount of $362,232 and, in its place, restore the judgment, given by the trial judge, for the appellant against the first respondent in the amount of $2,096,514, plus interest on that sum from 28 March 2006 calculated in accordance with s 101 of the* Civil Procedure Act *2005 (NSW).*

4. *Set aside the order relating to costs between the appellant and the first respondent and, in its place, order that the first respondent pay the appellant's costs of the proceedings before the trial judge, of the appeal to the Court of Appeal of the Supreme Court of New South Wales and of the appeal and cross-appeal to this Court.*

5. *Set aside the judgment for the appellant against the second and third respondents for $362,232 and, in its place, give judgment for the appellant against the second and third respondents in the amount of $2,096,514, plus interest on that sum from 28 March 2006 calculated in accordance with s 101 of the* Civil Procedure Act *2005 (NSW).*

6. The second and third respondents to pay the appellant's costs of the appeal and cross-appeal to this Court.

On appeal from the Supreme Court of New South Wales

Representation

J N West QC with N J Kidd for the appellant (instructed by PricewaterhouseCoopers Legal)

G C Lindsay SC with R G H Keller for the respondents (instructed by MJ Lawyers)

CATCHWORDS

Gumland Property Holdings Pty Limited v Duffy Bros Fruit Market (Campbelltown) Pty Limited

Contracts – Termination for breach – Damages – Ability to recover substantial damages after termination where termination based on express provision making contractual term essential.

Contracts – Lease – Breach of term by lessee – Whether lessor entitled after terminating lease to recover loss of bargain damages where but for express contractual provisions providing for the consequences of breach the lessor would not have been entitled to terminate.

Real property – Lease – Covenants that touch and concern the land – Whether the right to seek damages for breach of covenant to pay rent touches and concerns the land – Whether the assignee of a leasehold reversion is entitled to terminate a lease and recover loss of bargain damages, notwithstanding the absence of privity of contract between the assignee and lessee.

Real property – Lease – Guarantors – Whether guarantor's covenant to guarantee payment of rent by the lessee touches and concerns the land and passes with the leasehold reversion.

Conveyancing Act 1919 (NSW), s 117.

1 GLEESON CJ, KIRBY, HEYDON, CRENNAN AND KIEFEL JJ. The question in this appeal is whether a commercial lease was validly terminated on the ground of the lessee's failure to pay rent, and, if so, what the monetary consequences were. In the Equity Division of the Supreme Court of New South Wales the trial judge (Macready As J) held that it was[1]. The Court of Appeal, in reasons for judgment delivered by Giles JA, with which Santow JA and Tobias JA concurred, held that it was not[2].

The factual background

2 *The Lease.* Transit Management Pty Ltd ("the Lessor") owned premises in a shopping centre ("the Demised Premises"). The Lessor granted a lease of the Demised Premises ("the Lease"). The lessee, who is the first respondent in this appeal, was Duffy Bros Fruit Market (Campbelltown) Pty Ltd ("the Lessee"). In the Lease the expression "Lessor" was defined as meaning "the Lessor its successors and assigns". The term of the Lease was 15 years. The commencing date was 30 March 1993. The Demised Premises were subject to the *Real Property Act* 1900 (NSW) ("the Real Property Act"), and the Lease was registered pursuant to that Act. By cll 1.18 and 14.1 of the Lease, the "Permitted Use" of the Demised Premises, which were described as "Shop 10" and comprised 19.65 percent of the shopping centre, was that of a fruit, vegetable and meat market. The base rent was $245,343 per annum. In addition, by cl 4, the Lessee was obliged to pay 19.65 percent of the Lessor's "Outgoings". By cl 5, the rent was subject to increase in the light of the Consumer Price Index. By cll 1.21-1.22 and 6, the rent was also subject to review every five years. By cl 3.1, the Lessee covenanted to pay to the Lessor and the Lessor's "assigns" the base rent, together with any CPI increases pursuant to cl 5 and any review increases pursuant to cl 6[3]. Clause 3.2 provided:

> "The Lessee covenants to pay the annual rent by equal monthly instalments in advance and to pay the rent and other monies hereby

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1 *Gumland Property Holdings Pty Ltd v Duffy Bros Fruit Market (Campbelltown) Pty Ltd* [2006] NSWSC 10.

2 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153.

3 The Lease, cl 3.1, erroneously stated "7" instead of "6".

> secured within seven (7) days of the day on which each monthly instalment of rent falls due or the other monies secured become payable ..."

3 The Lease contained several provisions which, it was contended, bore on the essential character of the obligation to pay rent and the entitlement to damages if that obligation were broken. Clause 1.13 provided:

> "It shall be a fundamental obligation of the Lessee to ensure that the Lessor shall receive the rental provided for in the Lease during the full term thereof."

Clause 7.1 provided:

> "Each of the covenants by the Lessee which are specified in this clause are essential terms of this Lease."

The first of the covenants specified in cl 7.1 was cl 3, for cl 7.1.1 provided:

> "The covenant to pay rent throughout the lease term at a date not later than seven (7) days after the due date for the payment of each monthly instalment of rent and any other monies payable under the terms of this Lease (clause 3)."

Clause 7.1.3 specified as another of the covenants which were essential terms "[c]lause 12 regarding the right of the Lessor to terminate the Lease"[4]. Clause 7.2 provided:

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4 Clause 12 provided:

> "The Lessor may re-enter the Demised Premises or any part thereof in the name of the whole and thereby determine the estate of the Lessee therein not only on the happening of the events entitling the Lessor so to do under the terms of the Real Property Act, 1900, and/or the Conveyancing Act, 1919, but also on the happening of any of the following events ... "

The first of the events listed was described thus in cl 12.1:

> "Upon the Lessee being in arrears for a period of seven (7) days in the payment of any monthly instalment of rent or any other monies payable under the terms of the Lease and notwithstanding that no formal demand has been made."

> "In respect of the Lessee's obligation to pay rent and other monies payable under the terms of the Lease including the Memorandum, the acceptance by the Lessor of arrears or of any late payment of rent or other monies payable shall not constitute a waiver of the essentiality of the Lessee's obligation to pay rent and any other monies in respect of the Lessee's continuing obligation to pay rent and all monies payable hereunder during the Lease term."

Clause 7.4 provided:

> "In the event that the Lessee's conduct (whether acts or omissions) constitutes a repudiation of the Lease (or of the Lessee's obligations under the Lease) or constitutes a breach of any Lease covenants, the Lessee covenants to compensate the Lessor for the loss or damage suffered by reason of the repudiation or breach."

Clause 7.5 provided:

> "The Lessor shall be entitled to recover damages against the Lessee in respect of repudiation or breach of covenant for the damage suffered by the Lessor during the entire term of this Lease."

Clause 7.6 provided:

> "The Lessor's entitlement to recover damages shall not be affected or limited by any of the following:
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> 7.6.1 If the Lessee shall abandon or vacate the Demised Premises;
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> 7.6.2 If the Lessor shall elect to re-enter or to terminate the lease;
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> 7.6.3 If the Lessor shall accept the Lessee's repudiation; or
>
> 7.6.4 If the parties' conduct shall constitute a surrender by operation of law."

Clause 7.7 provided:

> "The Lessor shall be entitled to institute legal proceedings claiming damages against the Lessee in respect of the entire Lease term, including the periods before and after the Lessee has vacated the Demised Premises, and before and after the abandonment, termination, repudiation,

acceptance of repudiation or surrender by operation of law referred to in paragraph 7.6, whether the proceedings are instituted either before or after such conduct."

Clause 7.8 provided, relevantly:

"In the event of the Lessee vacating the Demised Premises, whether with or without the Lessor's consent, the Lessor shall be obliged to take reasonable steps to mitigate his damages and to endeavour to lease the Demised Premises at a reasonable rent and on reasonable terms ..."

Clause 16 provided:

"The determination of the Lease shall not prejudice or affect any rights or remedies of the Lessor against the Lessee or any person or company jointly liable with the Lessee on account of any antecedent breach by the Lessee of any of the terms, covenants and restrictions on the part of the Lessee. Further the Lessee acknowledges that it is the Lessee's fundamental obligation to ensure that the Lessor shall receive the rental provided for in this Lease during the full term thereof and in the event that the Lease is determined consequent upon default of the Lessee then the Lessee shall be liable to the Lessor for the full loss and/or damages suffered by the Lessor by reason of the non-receipt of such rental for the full term or the non-receipt of any part of it ..."

4 *Guarantees.* On 25 March 1994, Ferdinando Pisciuneri ("the second respondent") and Natale Pisciuneri ("the third respondent") each entered a guarantee ("the Guarantees"). Clause 2 provided:

"The Guarantor guarantees to the Lessor the payment to the Lessor of all monies now or hereafter to become payable to the Lessor by reason of the use or occupation of the said premises or by reason of any provisions of any relevant lease whether for rental, interest, damages, mesne profits or otherwise and on any account and whether by the Lessee or any other person during the term of operation of this agreement as defined in clause 4 hereof and guarantees also the payment to the Lessor of all monies now or hereafter to become payable to the Lessor by reason of or arising out of any breach of an agreement to lease the said premises."

Recital B stated:

"It is intended that the benefit of this Guarantee shall subsist for the benefit of not only the First Lessor but any person or company who may

> become the Lessor of the said premises to the Lessee (as hereinafter defined)."

Clause 1(f) provided:

> "'Lessor' shall mean the First Lessor whilesoever the First Lessor owns the freehold of the said premises without granting a concurrent lease thereof and thereafter shall mean the person or company who shall be the owner of the freehold of the said premises to the Lessee or holder of the leasehold estate subject to the lease to the Lessee hereinafter defined but with the intent that rights accrued in favour of the First Lessor or any subsequent Lessor as at the date of change of ownership of the freehold or granting of any such concurrent lease shall remain enforceable against the Guarantor."

Clause 1(g) provided:

> "'Lessee' shall mean the First Lessee until the First Lessee shall assign its right of occupation of the said premises with the consent of the Lessor and thereafter shall mean each person or company who is in occupation or shares in the occupation of the said premises during the term of operation of this agreement as defined in clause 4 hereof."

The "First Lessor" was defined as the Lessor (ie Transit Management Pty Ltd).

5 *The 1999 Deed.* By 1999 the Lessee had experienced difficult trading conditions, and had fallen into arrears with rent and outgoings. On 2 March 1999 the Lessor and the Lessee entered a Deed ("the 1999 Deed"). The 1999 Deed relevantly did four things.

6 First, it contemplated the creation of a sub-lease over part of the Demised Premises. To that end the Lessee appointed each of the directors of the Lessor as its attorney to locate sub-lessees and enter sub-leases on such terms and conditions as the Lessor saw fit. It also agreed, by cl 4.2, that it would be a term of any sub-lease that the sub-lessee pay all rent and outgoings direct to the Lessor (including the Lessor's assigns).

7 Secondly, the 1999 Deed, while providing for the payment of arrears of rent and outgoings, reduced the rent payable by the Lessee. In the events which happened, it was reduced to $156,000 per annum. But the reduction was subject to conditions appearing in cll 10.1 and 10.2. If the Lessee did not commit any further breach of the terms of the Lease defined as essential in cl 7 of the Lease,

or any breach of the 1999 Deed itself, the Lessee would not be obliged to pay the full monies due as rent and outgoings under the Lease, but only arrears up to the time of the Deed (cl 10.2(a)), the sum of $156,000 per annum from that time (cl 10.2(b)), and rent and outgoings recovered under any sub-lease (cl 10.2(c))[5].

8 Thirdly, in cl 11 the parties agreed that "the Lease is further varied" by the deletion of cl 21, which was a covenant by the Lessor not to permit other fruit or meat markets in the shopping centre.

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5 Clause 10.1 provided:

> "For the purpose of interpreting clause 10.2 any payment due by [the Lessee] under Clause 10.2(d) is not due and payable until the 29th March, 2008 or upon an earlier Scheduled Breach of the Lease by [the Lessee] or an earlier breach of this Deed by [the Lessee] which subsists for a period of 7 days after [the Lessor] has given notice to [the Lessee] of such breach."

Clause 10.2 provided:

> "[The Lessee] shall pay to [the Lessor] the aggregate of the following sums for rent and outgoings payable by [the Lessee] under the Lease:
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> (a) the arrears in accordance with clauses 6 and 7 of this Deed,
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> (b) the First Higher Sum, Higher Sums and the Final Higher Sum in accordance with clause 8 of this Deed,
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> (c) all rent and outgoings under any such sublease entered into pursuant to clause 4 of this Deed, and
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> (d) the Sum by which the rent and outgoings payable by [the Lessee] under the Lease up to the date the Lease terminates exceeds the aggregate of sums received under clauses 10(a) (b) and (c).
>
> PROVIDED THAT if the Lease terminates on the 29th March, 2008 without any continuing Scheduled Breach of the Lease or breach of this Deed by [the Lessee] then [the Lessor] shall accept the sums payable under clause 10(a), (b) and (c) hereof in satisfaction of rent and outgoings payable by [the Lessee] under the Lease."

A "Scheduled Breach" was defined as a breach of the Lease defined in cl 7 of the Lease as an essential term.

9 Finally, by cl 2, the 1999 Deed provided:

> "Subject to the terms of this Deed the parties ratify and affirm the terms of the Lease."

10 *Confirmations by the second and third respondents.* On 2 March 1999 the second and third respondents each entered deeds with the Lessor acknowledging that the Lessor and the Lessee had that day entered the 1999 Deed "whereby the terms of the Lease are varied".

11 *The Sub-Lease.* Pursuant to the 1999 Deed, on 3 December 1999 the Lessee sub-leased to Austie Nominees Pty Ltd the part of the Demised Premises identified for the purpose of sub-letting in the 1999 Deed ("the Sub-Lease"). As had been contemplated by the 1999 Deed, the Sub-Lease was executed for and on behalf of the Lessee by the directors of the Lessor. The term was three years, with two options to renew for three years.

12 *Transfer of the sub-lessee's interest in the Sub-Lease.* On 30 October 2001, Austie Nominees Pty Ltd transferred its interest as sub-lessee in the Sub-Lease to Woolworths Ltd ("Woolworths").

13 *Transfer of freehold in Demised Premises.* On 6 September 2001 the Lessor agreed to transfer the Demised Premises to Gumland Property Holdings Pty Ltd, the appellant in these proceedings ("the appellant"). This agreement ("the Sale Contract") was completed on 5 December 2001.

14 *The prelude to litigation.* The initial term of the Sub-Lease was to expire on 31 July 2002. Woolworths then informed the Lessee that it did not wish to exercise its option to renew the Sub-Lease. However, it remained in occupation under the holding over provisions of the Sub-Lease, while choosing unilaterally to pay only half the rent payable. The Court of Appeal described this decision as "a stark breach" of Woolworths' obligations, and no party in this Court disputed that finding. The consequence of Woolworths' breach was to put the Lessee into breach of cl 10.2(c) of the 1999 Deed, since the Lessee did not pay the shortfall itself. By a notice served on the Lessee on or about 3 July 2003 the appellant contended that the shortfall in rent under the Sub-Lease occasioned by Woolworths' failure to pay the full rent was a breach of the Lease entitling it, inter alia, to terminate the Lease. It demanded payment of the amount of the shortfall, $57,893.55. The Lessee did not pay, and on 1 August 2003 the appellant gave a notice terminating the Lease.

15 *The litigation begins.* On 5 March 2004 the appellant commenced proceedings against the Lessee. It sought arrears of rent up to the date of termination of the Lease (1 August 2003). It also sought loss of bargain damages for the rest of the 15 year term (which was to expire on 29 March 2008). And it sought damages for the costs of reletting the Demised Premises after termination of the Lease ("the reinstatement damages"). In addition, it sued the second and third respondents as guarantors of the Lessee's obligations under the Lease.

16 *The Deed of Assignment.* On 5 May 2005 the Lessor and the appellant entered a Deed of Assignment, pursuant to which the Lessor transferred all its rights under the Lease and the 1999 Deed to the appellant. The Lessee was given notice of the assignment by letter of 5 May 2005.

The trial judge

17 Those aspects of the trial judge's reasoning which relate to the issues raised in this appeal are as follows.

18 First, the failure of Woolworths and of the Lessee to pay the whole of the rent under the Sub-Lease put the Lessee in breach of cl 10.2 of the 1999 Deed. Since cl 10.2 commenced with the words "[The Lessee] shall pay to [the Lessor] the aggregate of the following sums for rent and outgoings payable by [the Lessee] under the Lease"[6], cl 10.2 was an amendment of cl 3 of the Lease, and hence the Lessee was also in breach of cl 3 of the Lease. Since cl 7.1.1 of the Lease made cl 3 an essential term, the appellant was entitled to terminate the Lease.

19 Secondly, he found that the Lessee's failure to pay the rent which Woolworths had not paid was a breach of an express essential term of the Lease, giving rise to a right to loss of bargain damages as well as arrears of rent.

20 Thirdly, he gave judgment for the appellant against the Lessee in the sum of $2,096,514 with effect from 28 March 2006. This figure had four components.

(a) The first was the shortfall of payments by Woolworths payable under cl 10.2(c) of the 1999 Deed: $57,415 with interest of $21,220, a total of $78,635.

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6 See above, n 5.

(b) The second was the arrears of rent and outgoings payable under cl 10.2(d) of the 1999 Deed: $215,724 with interest of $67,873, a total of $283,597.

(c) The third was the quantum of loss of bargain damages (the difference between the rent and outgoings payable to the appellant under the Lease after 1 August 2003 until 29 March 2008 and those amounts it had received or was likely to receive from new tenants, discounted down to present value). With interest, the relevant figure was $1,624,737.

(d) The fourth was the reinstatement damages: $62,411.34 which with interest totalled $109,545.

21 Finally, the trial judge dismissed the appellant's claim against the second and third respondents on their Guarantees. He held that they were discharged by reason of the fact that the 1999 Deed required a sub-lease under which the sub-lessee was to pay the rent directly to the Lessor, and the Sub-Lease entered did not contain that term.

The Court of Appeal

22 Of the four components making up the judgment sum set out above[7] the Court of Appeal did not disagree with the trial judge's award in relation to arrears of rent (ie items (a) and (b)). However, it held that the appellant was not entitled to loss of bargain damages (item (c)) or reinstatement damages (item (d)) because it was of the view that the appellant had not been entitled to terminate the Lease. It took that view because it treated the Lessee's failure to pay the shortfall in payment by Woolworths as being only a breach of cl 10.2(c) of the 1999 Deed, not a breach of cl 3 of the Lease.

23 In those circumstances the Court of Appeal did not deem it necessary to consider certain issues which the Lessee had raised[8]. However, the Court of Appeal did reverse the trial judge's decision in relation to the Guarantees. Accordingly it reduced the judgment sum against the Lessee to $362,232, but also gave judgment in that sum against the second and third respondents.

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7 See [20].

8 In particular, questions (c) and (d) below.

Issues in this Court

24 The appellant relied on a Notice of Appeal and the Lessee on a Notice of Contention. The Lessee also sought special leave to cross-appeal. That leave should be granted. To examine the issues in the order in which they appear in the Notice of Appeal, the Notice of Contention and the Notice of Cross-Appeal is not the most rational course. A more rational order is as follows.

(a) Was the Lessee in breach of cl 10.2(c) of the 1999 Deed?

(b) If yes to (a), was that breach a breach of cl 3 of the Lease?

(c) If yes to (b), did cl 7.1.1 of the Lease render that breach of cl 3 a breach of an essential term of the Lease entitling the appellant to terminate the Lease and (subject to question (d)) obtain an award of loss of bargain damages?

(d) If yes to (c), did s 117 of the *Conveyancing Act* 1919 (NSW) ("the Conveyancing Act") entitle the appellant to recover loss of bargain damages for breach of cl 3?

(e) If no to (d), was there an assignment by the Lessor to the appellant of the benefit of all the covenants in the Lease and the 1999 Deed by:

(i) the Sale Contract; or

(ii) the Deed of Assignment?

(f) If no to (d) and (e), was the Lessee estopped from denying that the appellant could take advantage of the Lease and the 1999 Deed?

(g) If the appellant were entitled to recover loss of bargain damages, was the quantum to be limited by assuming that the Lessee complied with cl 10 of the 1999 Deed?

(h) Were the second and third respondents liable on the Guarantees for the whole of the judgment against the Lessee?

(a) Was the Lessee in breach of cl 10.2(c) of the 1999 Deed?

25 This question was raised in the Lessee's Notice of Cross-Appeal. An answer favourable to the Lessee would result in the Court of Appeal's orders that the Lessee pay arrears of rent up to the date of termination of the Lease being set

aside, giving both the Lessee and the second and third respondents complete success in the proceedings. That answer, however, is one which both courts below declined to give.

26 The Lessee advanced three arguments for the view that it had never breached cl 10.2(c).

27 *Clause 10.2(c) as an accounting provision?* The Lessee noted that cl 4.2 of the 1999 Deed required that it be a term of any sub-lease granted under cl 4 that the sub-lessee pay all rent and outgoings directly to the Lessor. The Lessee submitted that, when cl 10.2(c) was read with cl 4.2[9], its context indicated that any sub-lessee would pay rent and outgoings to the Lessor, and that the obligation in cl 10.2(c) would arise only if the Lessee rather than the Lessor (or the appellant) received monies from a sub-lessee. The Lessee in fact withheld no monies from the appellant which were received from Woolworths.

28 In rejecting that argument, the Court of Appeal pointed out that the 1999 Deed contemplated that thereafter the Lessee would only occupy part of the Demised Premises and that the other part, which the Court of Appeal called "Shop 10A", would be sublet. Until subletting, apart from arrears, dealt with in cl 10.2(a), cl 10.2(b) provided that the Lessee was only obliged to pay the amounts described in cl 8 as the "First Higher Sum", "Higher Sum" and the "Final Higher Sum". These "Higher Sums" were calculated as being whichever was the higher of a percentage of the Lessee's gross receipts, or $156,000 per annum. Thus they were referable to the Lessee's own trading on the part of the Demised Premises it continued to occupy. It was obliged to pay nothing in relation to the other part, Shop 10A, until it was sublet. The Court of Appeal said[10]:

> "The purpose of cl 10.2(c) was that, when Shop 10A was sub-leased, there should also be payable by [the Lessee] for rent and outgoings the cl 10.2(c) amount, an amount referable to the rent and outgoings for which the sub-lease provided but payable for rent and outgoings payable under the Lease. In short, if the right to possession of Shop 10A became

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9 See above at [6].

10 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 159 [120].

> remunerative because Shop 10A was sub-leased, then what [the Lessee] had to pay was correspondingly increased."

The Court of Appeal also said[11]:

> "Clause 10.2(c) ensured that [the Lessor] would be paid by [the Lessee] an equivalent amount to the rent and outgoings payable under a sub-lease if, contrary to an expected direct payment term, the sub-lessee did not pay [the Lessor]. It was concerned with payment of what was not paid, not with passing on what was paid."

Finally, the Court of Appeal said that if cl 10.2(c) were given the construction advocated by the Lessee, and a sub-lessee failed to pay the Lessor direct, the Lessor would only have a right of action against the Lessee in relation to sums it actually received. Any claim the Lessor might make against any sub-lessee would be a "doubtful" claim as "third party beneficiary". The Court of Appeal said[12]: "[I]t would not have been sensible for [the Lessor] to accept under the 1999 Deed a doubtful ability to sue the sub-lessee as a third party beneficiary in lieu of a clear right of action against [the Lessee]". That clear right of action lies on the Court of Appeal's construction. The Court of Appeal saw the non-sensible result of the Lessee's submission as pointing against its correctness.

29 The Court of Appeal's reasoning should be accepted.

30 *Sub-Lease not a "sub-lease pursuant to cl 4" of the 1999 Deed?* The Lessee argued that the Sub-Lease was not a "sub-lease pursuant to clause 4" of the 1999 Deed, because it did not contain the term required by cl 4.2. The Court of Appeal held that cl 4.2 "did not state a condition of achieving a valid sub-lease, but an expectation of a term that 'will be' in the sub-lease"; it merely reflected the Lessee's agreement that the Lessor could put a direct payment term in any sub-lease it entered in exercise of the power conferred by the Lessee on

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11 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 159 [119].

12 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 159 [121].

the directors of the Lessor to enter sub-leases[13]. The Lessee offered no answer to this reasoning, and in that state of affairs it should not be overturned. In addition, cl 4.2 was wholly for the benefit of the Lessor, and was capable of being waived by it, acting through its directors when they exercised their unlimited authority to enter the Sub-Lease.

31 *Liability of Lessee for sub-lessees?* The Lessee submitted on the appeal that it "had no primary or secondary liability under or by reference to clause 10.2(c) for moneys payable *by a sub-lessee*. It was the sub-lessor." Read one way, this does no more than state the desired conclusion without offering any reason for reaching it. Read another way, it appeals to the incongruity of a sub-lessor being liable for a sub-lessee's defaults: but, as the Court of Appeal suggested[14], that is to overlook the fact that the Lessee was not only the sub-lessor but also a lessee. It was lessee of, and liable under the Lease for, the area comprised by Shop 10A, and it was consistent with the scheme of the 1999 Deed that once Shop 10A was sub-leased, it should pay the rent and outgoings under any sub-lease. In this instance too no argument was advanced by the Lessee as to why the Court of Appeal's approach was wrong, and in those circumstances it should not be rejected.

32 It follows that question (a) must be answered "Yes".

(b) If yes to (a), was that breach a breach of cl 3 of the Lease?

33 The Lessee argued that the breach of cl 10.2(c) of the 1999 Deed was not a breach of cl 3 of the Lease. It argued that cl 10.2 did not operate as an amendment of the Lease in the sense that it substituted the sums referred to in cl 10.2 for the amounts of rent and outgoings referred to in cll 3-5 of the Lease. It argued that cl 10.2 was instead a separate personal contract between the Lessor and the Lessee in the nature of a side-agreement which merely suspended the operation of cll 3-5 and 7.1.1 of the Lease. It argued that the expression "sums for rent and outgoings payable by [the Lessee] under the Lease" in the opening

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13 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 157-158 [112].

14 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 159 [120].

part of cl 10.2 did not mean that the sums referred to in cl 10.2 were to be paid "as" rent and outgoings payable under the Lease, but "in lieu of" rent and outgoings payable under the Lease. Finally, it argued that cll 3 and 7.1.1 of the Lease could have no operation until cl 10.2 was terminated, which it never was.

34 To some extent the Court of Appeal's reasoning was inconsistent with the Lessee's argument. The Court of Appeal held that the Lessee "was liable as lessee for the cl 10.2(c) amount ... The 1999 Deed changed the timing and amount of what it had to pay 'for rent and outgoings payable by [the Lessee] under the Lease', but whatever it had to pay was still for rent and outgoings for the whole of" the Demised Premises[15]. The Court of Appeal further found that the change in timing and amount "could aptly be described as a variation of the Lease because [the Lessee's] obligations changed: at least as to timing and, depending on cl 10.1 and the proviso, also as to overall amount"[16].

35 Later, dealing with another issue, the Court of Appeal said that "the 1999 Deed provided a new regime for the timing and amounts for payment of the rent and outgoings payable under the Lease". It continued[17]:

> "But it did so in a manner plainly intended to preserve to [the Lessor] recovery of the rent and outgoings payable under the Lease, if there was breach within cl 10.1 or if at the time of termination there was continuing breach contrary to the proviso. That is apparent from the continuance of the Lease with [the Lessee] as lessee of the area of the original Shop 10, and its ratification and affirmation subject to the terms of the 1999 Deed in cl 2 of that Deed; from cl 10.1, the effect of which was to defer payment subject to a condition; from the reference to the amounts in cl 10.2 as sums for rent and outgoings payable by [the Lessee] under the

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15 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 159 [120].

16 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 162 [134].

17 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 165 [155].

> Lease; from the proviso referring to acceptance of the sums payable under cl 10.2(a), (b) and (c) in satisfaction of rent and outgoings payable by [the Lessee] under the Lease; and from the conditionality of the proviso."

36 The reasoning described in these passages referred to in the last two paragraphs is correct. Below it is referred to as "the Court of Appeal's correct reasoning". However, the Court of Appeal concluded that the failure of the Lessee to pay under cl 10.2(c) was only a breach of the 1999 Deed and not of the covenant to pay rent under the Lease in cl 3. It did so for reasons inconsistent with the Court of Appeal's correct reasoning. It drew to attention the definition of "Scheduled Breach of the Lease" in cl 1.1(p) of the 1999 Deed as meaning "a breach of the Lease as defined in paragraph 7 of the Lease as essential terms of the Lease". The Court of Appeal said[18]:

> "The definition of 'Scheduled Breach of the Lease' took up numbered clauses of the Lease as found in cl 7.1, not their subject matter independently of the numbered clauses. The source of [the Lessee's] obligation to pay the cl 10.2(c) amount was cl 10.2. It was not cl 3 of the Lease."

37 However, this reasoning does not detract from the force of the Court of Appeal's correct reasoning set out earlier. The failure to pay the cl 10.2(c) amounts was a failure to comply with the covenant in cl 3 of the Lease to pay rent and outgoings.

38 The Court of Appeal's correct reasoning is supported by the following further considerations. Clause 2 of the 1999 Deed provided that "the parties ratify and affirm the terms of the Lease". In cl 11 it was agreed that the Lease be "further varied" by deleting cl 21. The 1999 Deed did not purport to operate as a side-agreement to the Lease, or a suspension of it, but a variation of it. It did not purport to suspend the operation of any clauses of the Lease; in numerous respects it took the terms of the Lease as a starting point, and has to be construed with the Lease as an amendment of the Lease. Thus the 1999 Deed did not create a fresh independent obligation to pay rent; it amended the obligation to do so under cl 3 of the Lease. The obligations to pay the sums in cl 10.2 were in substitution for the potentially high obligations under the Lease, but they were

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18 *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd; Gumland Property Holdings Pty Ltd v Pisciuneri* (2007) ANZ Conv R 153 at 162 [136]; see also at 169 [177].

obligations to pay "sums for rent and outgoings payable by [the Lessee] under the Lease". This point is reinforced by the proviso to cl 10.2, which obliged the Lessor to accept the sums described in cl 10.2(a)-(c) "in satisfaction of rent and outgoings payable by [the Lessee] under the Lease".

39 Certain arguments of the Lessee to the effect that the covenant to pay rent on the Lease was not an essential term are considered below and rejected[19]. In those circumstances, the Lessee's arguments on the interrelationship between the Lease and the 1999 Deed have a strange result. When the parties originally arrived at agreement on the status of the covenant to pay rent, they made it essential. But when, to use the words of Recital L to the 1999 Deed, "[a]fter extensive negotiations", the parties expressed a "wish to continue their commercial relationship" based on the circumstances as they developed over the six years from 1993, and arrived at the new arrangements in the 1999 Deed, they made the cl 10.2 covenant to pay "the following sums for rent and outgoings payable by [the Lessee] under the Lease" non-essential. In short, if the Lease and the 1999 Deed are read as having the relationship favoured by the Lessee, the 1999 Deed makes the covenant to pay rent, which they had taken much trouble to make essential in 1993, non-essential in 1999. This is a highly unlikely outcome. That is so particularly where the lesser and supposedly non-essential obligations of the 1999 Deed were contingent upon there being not only no "breach of this Deed" but also no "continuing Scheduled Breach of the Lease" by the Lessor – and the obligations breached by any "Scheduled Breach" were essential obligations[20]. The change which the Lessee's argument entails is so unreasonable and so difficult to explain as to suggest that the Lessee's argument is invalid.

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19 At [46]-[48].

20 See note 5 above. In the course of argument a suggestion arose that cl 15 supported the Court of Appeal's conclusion: it revealed that the Lessor wanted its compromise with the Lessee not to be recorded on the register, so that other tenants would not be encouraged to seek similar concessions. The Lessee did not adopt this suggestion, and in any event the appellant correctly pointed out that cl 15 was neutral in that it was capable of operating in favour of the Lessee as well as the Lessor: the 1999 Deed amended the Lease by omitting cl 21, so as to permit the Lessor to introduce another fruit and vegetable seller to become a tenant of the shopping centre and cl 15 prevented any such new competitor of the Lessee to learn of the weakened competitive position of the Lessee which was revealed by its need to enter the 1999 Deed.

40 For those reasons the answer to question (b) is "Yes".

(c) If yes to (b), did cl 7.1.1 of the Lease render that breach of cl 3 a breach of an essential term of the Lease entitling the appellant to terminate the Lease and (subject to question (d)) obtain an award of loss of bargain damages?

41 For the Court of Appeal this question did not arise, since it held that the breach was a breach only of cl 10.2(c) of the 1999 Deed, not of cl 3 of the Lease.

42 The starting point of the Lessee's arguments was the following proposition, enunciated by Gibbs CJ in *Shevill v Builders Licensing Board*[21]:

> "It is clear that a covenant to pay rent in advance at specified times would not, without more, be a fundamental or essential term having the effect that any failure, however slight, to make payment at the specified times would entitle the lessor to terminate the lease."

The Lessee also referred to the next sentence in Gibbs CJ's reasons for judgment[22]:

> "However, the parties to a contract may stipulate that a term will be treated as having a fundamental character although in itself it may seem of little importance, and effect must be given to any such agreement."

The Lessee described stipulations of that kind as "anti-*Shevill* clauses", and submitted that cl 7 of the Lease was an extreme example of one.

43 The Lessee then put two alternative propositions. The first was that the parties cannot give the landlord a right to terminate a contract for breach of a term merely by declaring it to be "essential", unless the tenant's breach was repudiatory, or the tenant's breach was a fundamental breach, or the term was in truth essential in the sense of going to the root of the contract. The second, narrower, proposition was that it is open to the parties to declare a term to be essential, entitling the innocent party to terminate for breach, but that that declaration is incapable of giving a right to sue for loss of bargain damages, unless the non-innocent party's conduct amounted to repudiation or fundamental breach. The Lessee submitted that if a clause went so far as to provide not only

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21 (1982) 149 CLR 620 at 627; [1982] HCA 47.

22 (1982) 149 CLR 620 at 627.

that the covenant to pay rent was an essential term but also that on termination for breach an action for loss of bargain damages lay, it would be ineffective. In this case, of course, cll 7.3-7.8, 12 and 16 did go that far[23].

44 In relation to each proposition, the Lessee contended that there was here no repudiation and no fundamental breach. That may be accepted: the appellant was not given special leave to contend in this Court that there was.

45 The Lessee endeavoured to support the two propositions by various arguments. In the end these arguments fell back on attempts to support the second proposition only, because early in oral argument counsel for the Lessee accepted that it was open to the parties to a lease to stipulate that a contract could be terminated for a particular breach, however minor, and that this effect was achieved by agreeing that the term was "essential".

46 *Proper construction of Lease as a whole.* The first argument of the Lessee was that on the proper construction of the Lease as a whole, in view of the fact that a tenant's failure to pay rent is not necessarily repudiatory, the obligation to pay rent within the time limited by cll 3 and 7.1.1 was not truly a fundamental or essential term. It was not enough to "attribute a particular legal characterisation" to a term, and it was not enough that the contract "labels" the term "essential".

47 A fundamental difficulty with the Lessee's submission is that it is not correct to describe the appellant's claim to loss of bargain damages as one which depends on treating cl 7.1.1 only as attributing to the obligation to pay rent a characterisation as "essential". Nor is it correct to say that cl 7.1.1 merely fixed a "label" to that effect. The essentiality of the obligation in cl 3.3 does not rest only on cl 7.1.1. It is reinforced by several other provisions. One is the stipulation in cl 1.13[24] that it was a "fundamental obligation" of the Lessee to ensure that the Lessor received the rental. Another is cl 12.1, giving the Lessor the right to re-enter the Demised Premises and determine the Lease where the Lessee is in arrears for seven days in the payment of rent, without formal demand[25]. A third is the acknowledgment by the Lessee in cl 16 of the

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23 See above at [3].

24 Quoted at [3] above.

25 Quoted at n 4 above.

fundamental obligation imposed on it by cl 13[26]. Further, essentiality is not waived by the Lessor accepting arrears or late payment: cl 7.2[27]. The duty of the Lessee to pay damages – loss of bargain damages – for breach of an essential term is the subject of a specific covenant in cll 7.3, 7.5, and 7.7, as well as cl 16[28]. The Lessor's entitlement to recover damages is not to be affected or limited by any of the events described in cl 7.6[29]. Whether or not the mere description of a covenant in a lease as essential, however trivial it may be thought to be, can make it essential is a question which need not be decided. The duty to pay rent punctually is not in itself necessarily a trivial one, and this congeries of provisions reveals it as having the characteristic of essentiality in this Lease. As the appellant submitted, the Lease reveals a "preoccupation" with the issue, which is scarcely surprising in a commercial lease creating an economic relationship.

48 Hence, if the issue is treated simply as one of construction, many clauses point overwhelmingly to the conclusion that on the true construction of the Lease the covenant to pay rent was an essential term.

49 However, although this and other arguments of the Lessee treated the issue as one of pure construction, the Lessee's case was not based on pure construction. It was based on positive rules of law said to be inherent in the nature of a lease, or on various forms of repugnancy, which were said to lead to the conclusion that whatever the express terms of the lease say, they must either be ignored or be read down so as to preclude recovery of loss of bargain damages for a breach of a term which is not in truth essential unless the breach is a repudiation or a fundamental breach. On the Lessee's arguments, a contractual term that a particular provision was essential was thus to be read as an agreement that breach could justify termination, but not as an agreement that it would justify recovery of loss of bargain damages.

50 *Mischaracterisation of transactions.* The Lessee supported its proposition that a covenant in a lease cannot be made essential merely by reason of the parties' agreement that it is by alluding to authorities holding, for example, that to

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26 Clause 16 is quoted above at [3].

27 See above at [3].

28 See above at [3].

29 See above at [3].

describe what would otherwise be a licence as a "lease", or vice versa, does not prevent the courts from going behind the label and assessing the true nature of the transaction[30]. Cases of that kind are often cases where the parties have attempted to gain the advantage of some statutory regime or other rule of law applying to one particular type of relationship by saying their relationship is of that type. There was no attempt of that kind here. There is no doubt what the legal relationship of the parties was; the only question is whether one term of that relationship was "essential".

51 *Interdependency of grant of possession and right to rent.* The Lessee submitted that a lease imposed on the landlord the obligation to grant the tenant exclusive possession over the whole term, and that that obligation was interdependent with the tenant's obligation to pay rent over the whole term. If the landlord decided to terminate the lease for reasons other than repudiation or fundamental breach, the damage flowing from loss of bargain was not caused by the tenant's breach, but by the landlord's decision to terminate. So expressed, the argument was a causation argument.

52 The Lessee supported the argument by reference to *AMEV-UDC Finance Ltd v Austin*[31] and *Esanda Finance Corporation Ltd v Plessnig*[32]. It is true that in these cases there are passages that say in reference to chattel leases, as Gibbs CJ said in the *AMEV-UDC* case: "[I]t is the actual damage which flowed from the breach which alone can be recovered."[33] And in the same case Mason and Wilson JJ said[34]:

> "The point is that when the lessor terminates pursuant to the contractual right given to him for breach by the lessee, the loss which he can recover for non-fundamental breach is limited to the loss which flows from the lessee's breach. The lessor cannot recover the loss which he sustains as a result of his termination because that loss is attributable to his act, not to the conduct of the lessee."

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30 *Radaich v Smith* (1959) 101 CLR 209; [1959] HCA 45.

31 (1986) 162 CLR 170 at 174-176, 186 and 194; [1986] HCA 63.

32 (1989) 166 CLR 131 at 143-148.

33 (1986) 162 CLR 170 at 175.

34 (1986) 162 CLR 170 at 186.

But that case, like *Shevill*'s case, was a case where there was no fundamental breach, repudiation or breach of an essential term, and as Mason and Wilson JJ said in the passage immediately succeeding the last one quoted[35]:

> "It is otherwise in the case of fundamental breach, breach of an essential term or repudiation."

They were distinguishing between termination pursuant to a contractual right to do so and termination on grounds of breach of condition (ie breach of an essential term). For the proposition last quoted, Mason and Wilson JJ cited what Mason J said in *Progressive Mailing House Pty Ltd v Tabali Pty Ltd*[36]. His Honour there said that loss of bargain damages could be recovered for repudiation or "fundamental breach". He defined "fundamental breach" to mean "breach of a condition or breach of another term or terms which is so serious that it goes to the root of the contract". The second sense of the term "fundamental breach" as used by Mason J corresponds with what this Court recently described as "a sufficiently serious breach of a non-essential term"[37]. Mason J said, contradicting the Lessee's submission, that it cannot be said in the case of repudiation or fundamental breach (as he defined it, including breach of a condition) that:

> "loss of the bargain is attributable to the innocent party's exercise of his contractual power to terminate. It is different in the case of termination for non-essential breach, as *Shevill* demonstrates, because, by terminating pursuant to the contract at that stage, the innocent party puts it beyond his power to insist on performance, thereby bringing to an end any possibility

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35 (1986) 162 CLR 170 at 186.

36 (1985) 157 CLR 17 at 31; [1985] HCA 14.

37 *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd* (2007) 82 ALJR 345 at 357 [49]; 241 ALR 88 at 102; [2007] HCA 61: the type of breach discussed by Diplock LJ in *Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha* [1962] 2 QB 26 at 69-70. Indeed this is a case to which Mason J in the *Progressive Mailing* case at 31 referred indirectly: he cited Lord Wilberforce in *Federal Commerce & Navigation Co Ltd v Molena Alpha* [1979] AC 757 at 779, and Lord Wilberforce cited the *Hongkong Fir* case at that point.

> of repudiation or fundamental breach with consequential damages for loss of bargain."[38]

53 The two passages quoted in the last paragraph from the reasons for judgment of Mason and Wilson JJ in the *AMEV-UDC* case were also quoted with approval by Brennan J in a passage relied on by the Lessee in *Esanda Finance Corporation Ltd v Plessnig*[39]. Mason and Wilson JJ also said in the *AMEV-UDC* case[40] that:

> "in *Shevill v Builders Licensing Board* there were indications that, if the lease clearly provided that whenever a lessor exercised the right of re-entry conferred by the lease he was able to recover such loss as he may have suffered by reason of the premature termination of the lease, such a provision might be effective"[41].

The present case is one in which cll 7.2, 7.3, 12 and 16 do clearly provide for the outcome described in that passage. It is thus plain that the authorities relied on by the Lessee do not establish the point which the Lessee sought to make, and in fact contradict it. And in *Shevill's* case Gibbs CJ said[42]:

> "[I]t would require very clear words to bring about the result, which in some circumstances would be quite unjust, that whenever a lessor could exercise the right given by the clause to re-enter, he could also recover damages for the loss resulting from the failure of the lessee to carry out all the covenants of the lease".

In this case there are very clear words, and, although the failure of the Lessee's commercial venture, caused partly by Woolworths' stark breach of its obligations, naturally attracts sympathy, there is no basis upon which a court

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38 *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 at 31.

39 (1989) 166 CLR 131 at 145; [1989] HCA 7.

40 (1986) 162 CLR 170 at 194.

41 (1982) 149 CLR 620 at 629, 637.

42 (1982) 149 CLR 620 at 628. See also Wilson J at 637 ("requiring a clear expression of intention").

could properly do otherwise than to give effect to the obligations to which the parties had bound themselves.

54 The Lessee's argument thus fails when considered as a causation argument. But the argument was also put in another form. The landlord, it was said, could not have it both ways: the landlord could not both regain possession and recover damages for unpaid future rent which would only have been received if possession had not been regained.

55 But why not? It is not the case that the appellant in this case by its conduct in terminating and suing for loss of bargain damages put itself in a position better than it could have been in if it had kept the Lease on foot and sued from time to time for arrears of rent as they piled up. The appellant could not unjustly advantage itself in that way. Clause 7.8 echoed the general law in obliging the Lessor to take reasonable steps to mitigate loss. The Lessor could not have got both damages (namely, the present value of the unpaid rent from the time of termination until the expiry of the Lease) and in addition any rent capable of being earned by a re-letting of the Demised Premises. The Lessor was only entitled to obtain, as damages, the present value of any difference between the rent not paid by the Lessee and the rent received or to be received on re-letting. That is all that the trial judge allowed.

56 To some extent the Lessee's argument rested on an idea of repugnancy – that there was a repugnancy between landlords having possession of property, but also being given a monetary equivalent for the rent they would have got had they not taken possession of the property and instead continued to allow it to be leased. But there is no true repugnancy. There can be no double recovery by landlords. If landlords obtain possession, they can only recover loss of bargain damages if they have tried unsuccessfully to obtain a new tenant at the rent stipulated in the terminated lease. The monetary equivalent of what they would have got if they had not taken possession of the property reflects the fact that they cannot obtain tenants, or cannot obtain tenants who promise to pay as much as the defaulting tenants promised.

57 The group of submissions under consideration did not comprise submissions based on the words used in the Lease. In one version they involved a submission that some rule of law stopped the clear meaning of those words from being given effect. Thus the Lessee submitted:

> "[The parties] can agree on things but the question of what are the legal consequences of what they agree upon and what are the legal

> consequences of action taken in accordance with their agreement is something that is governed by the law, not by their particular intention."

What proposition of law is referred to? This question was never answered.

58 Save for any applicable statutory requirements or rules of law, there is no reason in law why general contractual principles do not apply to leases in this respect. Under general contractual principles, an innocent promisee can terminate the contract, and recover loss of bargain damages, where there is repudiation, or a fundamental breach, or a breach of condition – ie a breach of an essential term. And under these principles it is possible by express provision in the contract to make a term a condition, even if it would not be so in the absence of such a provision – not only in order to support a power to terminate the contract[43], which the Lessee concedes, but also to support a power to recover loss of bargain damages[44]. No convincing reason was given to explain why the former outcome was sound in law but the latter was not.

59 *Relief against penalties and forfeiture.* The Lessee's next argument appears to have been an argument of construction in the sense that it contended that the consequences of the appellant's construction were so extreme as to make the construction an impossible one. The Lessee submitted that equity would relieve against forfeiture where a party sought both to hold property as a result of breach of an obligation and to recover money in relation to that breach; and by parity of reasoning a lessor could not have both possession of leased premises after terminating a lease, and damages based on the assumption that the premises were leased. The Lessee relied on *O'Dea v Allstates Leasing System (WA) Pty Ltd* where Brennan J said that if, under an agreement for the hiring of a vehicle, the lessor re-took possession, that lessor was not able to obtain rent for the unexpired duration of the hiring period[45]:

> "[T]he lessees are entitled to relief against the exaction of so much of the entire rental as is attributable to that period so that the lessor shall not

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43 *Bettini v Gye* (1876) 1 QBD 183 at 187; *Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26 at 70; *Financings Ltd v Baldock* [1963] 2 QB 104 at 120.

44 *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 849; *Lombard North Central plc v Butterworth* [1987] QB 527 at 535 and 545-546.

45 (1983) 152 CLR 359 at 393; [1983] HCA 3.

> recover or be entitled to retain both the whole of the entire rental and possession of the vehicle."

This does not support the Lessee's argument, for reasons given by Brennan J set out earlier. He said[46]:

> "[A] stipulation which provides for the forfeiture on breach by the buyer or hirer of both the price and the consideration for which it is payable is in the nature of a penalty and equity will relieve against it. The foundation of the jurisdiction to relieve against forfeiture is that the stipulation for the forfeiture is really in the nature of a penalty."

He said that the relevant clause in the case before him "is in the nature of a penalty, for the lessor who exacts the full measure of his entitlement under that clause receives more than the damages he would suffer by reason of many of the defaults which enliven that clause"[47].

60 In the present case in this Court the Lessee makes no claim that the Lease creates a penalty against which relief in the nature of relief against forfeiture should be given, although before the trial judge it contended unsuccessfully that cl 10.2(d) operated as a penalty. There were uncertainties in its position, but it seemed to be that if the appellant's contention that loss of bargain damages were recoverable is correct, that would operate as a penalty. The uncertainty rests in the fact that the Lessee said in argument, of the problems facing tenants: "The law of penalties comes very close to dealing with it but it does not deal with it fully and the law relating to forfeiture deals with these things, but not entirely." But, putting these uncertainties aside, if the contractual words clearly have one meaning, the consequence that in that meaning they create a penalty cannot cause them to be given another meaning. To make a contract containing a penalty has remedial consequences, but it is not contrary to the law. And even if the Lease, by reason of its stipulations for loss of bargain damages, operates as a penalty, relief against forfeiture on that ground would not be automatic. It would be a term of that relief that outstanding rent and outgoings be paid. The Lessee has not offered to do that, and indeed, by its cross-appeal, it actively resists that

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46 (1983) 152 CLR 359 at 391.

47 (1983) 152 CLR 359 at 391.

course, for, as was seen above[48], it contends that it was not in breach of cl 10.2(c). Where a person in the position of the Lessee can cure the phenomena which are said to render the arrangement a penalty by obtaining relief against forfeiture provided it complies with the condition of that relief, but it refuses to do so, it cannot rely on the allegedly penal character of the lease to compel a construction antithetical to its clear words[49].

61 *The authorities.* The Lessee contended that its argument was supported by authority[50]. In fact none of the cases it cited supports the Lessee's argument. In none of them was the present point in issue[51]. Most of them contain dicta against

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48 At [25]-[32].

49 In particular cases other principles of the general law (for example those relating to unconscionable dealing) or of statutory law (for example the *Trade Practices Act* 1974 (Cth)) could be invoked. They were not invoked in this case.

50 It cited *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 at 477-478; [1933] HCA 25; *Shevill v Builders Licensing Board* (1982) 149 CLR 620 at 627-628, 629 and 636-638; [1982] HCA 47; *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359 at 390, 391 and 393; [1983] HCA 3; *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 at 30, 31, 39-41, 46 and 55; [1985] HCA 14; *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 174-176, 186 and 194; [1986] HCA 63; *Esanda Finance Corporation Ltd v Plessnig* (1989) 166 CLR 131 at 143-148; [1989] HCA 7.

51 Thus, as Mason J said in *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 at 30, the Court in *Shevill v Builders Licensing Board* was not called upon to decide whether a lessor can sue to recover damages for loss of bargain when that lessor enters under a proviso for re-entry in consequence of the lessee's repudiation, fundamental breach or breach of an essential term.

the Lessee[52]. None of them contain dicta supporting the Lessee[53]. In the end counsel for the Lessee conceded that his researches had revealed no case in point, and said that the present case was the first case raising the issue.

62 *Difficulties of principle in the Lessee's submission.* There are other difficulties with the Lessee's contentions.

63 One is that they entail a sharp distinction between actions for damages on termination for breach of an express term and actions for damages on termination for repudiation. It can be adventitious whether a defaulting tenant simply fails to pay rent or accompanies the failure by a statement of inability and unwillingness to do so.

64 The need for a landlord to recover loss of bargain damages from a tenant only arises when the market is falling, for if the market is static or rising, the landlord can re-enter against the defaulting tenant, recover arrears of rent, and promptly install a new tenant at the same or a higher rent. The consequence of the Lessee's submission is that landlords are unable to protect themselves as satisfactorily in a falling market as distinct from one which is static or rising. It

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52 Thus the distinction drawn by the Lessee between terminations for repudiation or for fundamental breach, and terminations for breach of terms described as "essential" was not drawn by Dixon J in *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 at 477, when he said: "[W]hen a contract ... is dissolved at the election of one party because the other has not observed an essential condition or has committed a breach going to its root, the contract is determined so far as it is executory only and the party in default is liable for damages for its breach." And other illustrations have been given above of authorities which contain statements contradicting the Lessee's submissions: see [52]-[53].

53 Thus, for example, what Dixon J said in *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 at 477-478 is irrelevant: the case concerned the entitlement of a defaulting vendor of land to be repaid pre-payments upon termination of the sale contract. In *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 at 39-40 Brennan J said: "A lessor can recover damages for loss of the benefit of a lease only where the lessee has repudiated the lease before determination of the term." But it was his habit to use the word "repudiated" to refer to the commission of conduct which was a repudiation in the strict sense, a fundamental breach, or a breach of condition: *Esanda Finance Corporation Ltd v Plessnig* (1989) 166 CLR 131 at 143.

is difficult to see why landlords should bear the risks of a falling market rather than their defaulting tenants, particularly where, as the Lessor and the Lessee did in the Lease, the parties explicitly, in many places and in an integrated way, placed that risk on the tenant. It is also difficult to see why the law – whether the relevant rule which the Lessee was urging be a rule of construction or some rule of substantive law – should have the result of placing the risks of a falling market on landlords, and of depriving them of the opportunity by agreement to allocate the risk otherwise. The effect of the Lessee's submission is to cut down on party autonomy, to increase the chance of disputes and to reduce certainty. If the Lessee is wrong, it is open to parties to agree that a particular term is essential, and to agree on the consequences of breach. That avoids arguments about whether the term in question is or is not essential independently of the parties' agreement that it is, and what the consequences of breach of it are. If the Lessee is correct, these dangers increase.

65 *Conclusion.* For these reasons the Lessee has not made good its submission that the Lease does not permit the appellant to sue for loss of bargain damages. The answer to question (c) is "Yes".

(d) If yes to (c), did s 117 of the Conveyancing Act entitle the appellant to recover loss of bargain damages for breach of cl 3?

66 The appellant was not in contractual relations with the Lessee. It contended that it was entitled to recover against the Lessee for loss of bargain damages by recourse to the Conveyancing Act. Section 117 relevantly provides:

> "(1) Rent reserved by a lease and the benefit of every covenant or provision therein contained having reference to the subject-matter thereof and on the lessee's part to be observed or performed, and every condition of re-entry and other condition therein contained shall be annexed and incident to, and shall go with the reversionary estate in the land or in any part thereof immediately expectant on the term granted by the lease, notwithstanding severance of that reversionary estate, and shall be capable of being recovered, received, enforced, and taken advantage of by the person from time to time entitled, subject to the term, to the income of the whole or any part as the case may require of the land leased."

By s 116, s 117 applies to leases of land held under the Real Property Act.

67 The expression "having reference to the subject-matter thereof" is equivalent to "touching and concerning the land" – a necessary condition for a covenant to be one "which runs with the land".

68 *The appellant's first argument on s 117.* The appellant's submissions started with the propositions, conformably with the conclusions so far reached in relation to questions (a)-(c), that the breach of cl 10.2(c) of the 1999 Deed was a breach of the covenant to pay rent in cl 3 of the Lease, and that that covenant was an essential term. The first submission of the appellant concentrated on the first 21 words of s 117. The submission was that cl 3 was a covenant in a lease having reference to the subject-matter of the lease. That covenant gave a primary right to sue for rent if it was not paid at the due time. But, since cl 3 was an essential term, it also gave a right to terminate the lease, and that carried a secondary right to sue for loss of bargain damages. The benefit of all these rights was annexed and incident to, and liable to go with, the reversionary estate.

69 In 1963 the English equivalent to s 117 was s 141 of the *Law of Property Act* 1925 (UK). The appellant pointed to Diplock LJ's statement in *In re King, decd*[54], a case on s 141, that the benefit of a covenant by a lessee to keep premises in repair or reinstate them after fire is "the right to enforce the covenant by exercising such remedies for its breach as are expressly provided by the lease, for example, by forfeiture or entry to execute the repairs and recover their cost, or as are available at common law, namely, by suing for damages for breach". The appellant submitted that the right to sue for loss of bargain damages on termination of a lease was a common law right falling within the concluding words of that quotation. The appellant also referred to the following words of Diplock LJ[55]:

> "The measure of damages for breach of a covenant in a lease which runs with the land ... is the diminution in the value of the reversion consequent upon the breach and is sustained by the person entitled to the reversion."

70 In that form, the appellant's submissions did not depend on the existence of any express covenant to pay loss of bargain damages. But the appellant also submitted that s 117 applied to the express covenants to do so in cll 7.3, 7.4, 7.5, 7.7 and 16 of the Lease, and that those clauses satisfied the tests for "touching and concerning land" stated by Lord Oliver of Aylmerton in *P & A Swift Investments (A Firm) v Combined English Stores Group plc*[56].

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54 [1963] Ch 459 at 496-497.

55 [1963] Ch 459 at 497.

56 [1989] AC 632 at 642: the tests are quoted at [74] below.

71 *The Lessee's preliminary points.* The Lessee contended that there was no authority for the proposition that the right to recover loss of bargain damages for breach of a covenant to pay rent which was an essential term would pass with the reversion by virtue of the operation of s 117 alone. Equally, however, the Lessee did not refer to any authorities against it. The Lessee also stressed that in the absence of privity of contract between the appellant and the Lessee, no action for loss of bargain damages would lie at common law. But, however that may be, it leaves open the question of whether a statutory provision like s 117 alters that outcome. Beyond those arguments the Lessee made four primary submissions.

72 *Difficulty of assessing loss of bargain damages.* The first submission was put thus:

> "Where no privity of contract governs an entitlement to relief it is more difficult than otherwise to assess damages by reference to what was, or was not, within the contemplation of the original contracting parties, one or both of whom no longer has an interest in the property the subject of the 'contract' and might not be party to proceedings before the court."

In some circumstances it may be more difficult, but there is no such difficulty in the case of loss of bargain damages after termination for breach of an essential term in the form of a covenant to pay rent: the court simply compares the rent payable under the lease with that recovered or to be recovered from any new lease, discounting to obtain present value. In any event, the existence of difficulty in some circumstances could not compel a different construction of s 117 if the words were clear.

73 *Right to loss of bargain damages does not touch and concern the land.* The second submission was that a right to loss of bargain damages did not "run with the land" because it did not have "reference to the subject-matter" of the lease – it did not touch and concern the land. The Lessee referred to the test stated in *Rogers v Hosegood*[57]:

> "[T]he covenant must either affect the land as regards mode of occupation, or it must be such as per se, and not merely from collateral circumstances, affects the value of the land."

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57 [1900] 2 Ch 388 at 395 per Farwell J.

The Lessee submitted that an entitlement to loss of bargain damages is an entitlement which arises, if at all, upon termination of a contract between particular parties privy to the contract; that it is a personal right which does not satisfy either limb of the *Rogers v Hosegood* test; that it does not affect the landlord and tenant in their capacities as such; and that it is an entitlement to compensation based not upon a covenant but upon a secondary obligation imposed by law. It submitted that a legal obligation designed to secure performance of some other obligation which touches and concerns land does not necessarily take on from that relationship the same characteristics as regards transmissibility to or against successors in title.

74 Those arguments must be rejected. As the Lessee correctly conceded, a covenant to pay rent touches and concerns demised land[58]. It would be a strange result if the rights to enforce that covenant did not also touch and concern the land, whether they be rights to sue for arrears, to re-enter and terminate the lease, or to sue for loss of bargain damages. Application of the general tests as to whether or not a covenant touches and concerns the land indicates that that strange result does not follow in this case. In *P & A Swift Investments (A Firm) v Combined English Stores Group plc*, Lord Oliver of Aylmerton said that the relevant matters for consideration were these[59]:

> "(1) the covenant benefits only the reversioner for time being, and if separated from the reversion ceases to be of benefit to the covenantee; (2) the covenant affects the nature, quality, mode of user or value of the land of the reversioner; (3) the covenant is not expressed to be personal (that is to say neither being given only to a specific reversioner nor in respect of the obligations only of a specific tenant); (4) the fact that a covenant is to pay a sum of money will not prevent it from touching and concerning the land so long as the three foregoing conditions are satisfied

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58 McPherson JA said in *Simmons v Lee* [1998] 2 Qd R 671 at 675: "There is, of course, no doubt that a tenant's covenant to pay rent under a lease touches and concerns the land leased. That has long been the law: *Parker v Webb* (1700) 3 Salk 5 [91 ER 656]. Indeed, if a covenant to pay rent does not run with the land, it is difficult to imagine a covenant that does. Rent, in the language of the old books, issues out of the land and is incident to the reversion: see Co Litt 142a, 143a." See also *Auscott Ltd v Panizza* [1988] NSW Conv R ¶ 55-395.

59 [1989] AC 632 at 642.

and the covenant is connected with something to be done on, to or in relation to the land."

The Lessee did not dispute the correctness of these tests, which have been much applied in Australia[60].

75 Applying these tests to the Lease in turn, first, the covenants in cl 3 benefit the reversioner for the time being only, and if separated from the reversion they cease to be of benefit to the covenantee. This is because in cl 1.1 the term "Lessor" is defined as meaning "the Lessor its successors and assigns", and in cl 1.2 the term "Lessee" is defined as meaning "the Lessee and the executors administrators successors and permitted assigns of the Lessee". Further, the covenant in cl 3.1 to pay rent opens: "The Lessee covenants for himself, his heirs, executors administrators and assigns with the Lessor to pay unto the Lessor, his executors, his administrators or assigns ..."

76 Secondly, while the covenant does not affect the nature, quality or mode of user of the reversioner's land, it does affect its value. If Diplock LJ was correct to say that the measure of damages for breach of a covenant which runs with the land is "the diminution in the value of the reversion consequent upon the breach"[61], which with respect he was, breach of a covenant to pay rent which is an essential term can diminish the value of the reversion. However, a seller of Blackacre at a time when a tenant of Blackacre is not in breach of any covenant to pay rent should obtain the same price, as reflecting the value of the land, as the seller would if the tenant committed a breach of that covenant just before sale, but the seller had the right to sue for loss of bargain damages, and assigned that right. Leaving aside questions of opportunity cost and of the tenant's solvency, the recovery of damages will overcome the diminution in the value of the reversion; if there were no right to recover damages, there would be diminution in the value of the reversion. But if there were no assignment, and if the right to sue for loss of bargain damages were held not to touch and concern the land, so that the transferee of the reversion could not sue under s 117, the diminution in the value of the land, whether it takes place just before completion or earlier, will be uncompensated. That there is a diminution in value of the land if the covenant is not enforceable by a transferee of the freehold supports the conclusion that a covenant to pay rent which is an essential term is in truth a covenant which affects the value of the land. Thus Lord Oliver's second test is satisfied.

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60 See cases cited in n 65.

61 See above at [69].

77 Thirdly, because of the terms of cll 1.1, 1.2 and 3.1, the covenant is not expressed to be personal: it is not given only to a specific reversioner, nor in respect of the obligations of a specific tenant[62].

78 Fourthly, although the covenant in relation to which the right to sue for loss of bargain damages arises is a covenant to pay sums of money, and although it is not connected with anything to be done with or to the land, those factors do not prevent it from touching and concerning the land, because the first three conditions are satisfied and the covenant is connected with something to be done in relation to the land.

79 *Section 117 directed only to continuance of Lease?* The Lessee's third submission was that the right to loss of bargain damages arose by operation of law on the termination of a contract. "Section 117 does not carry with it a right to loss of bargain damages that arises at the end of the lease because it is directed towards the continuance of the lease." However, there is nothing in the language of s 117 which limits the "benefit of every covenant" in a lease only to those benefits which arise during the continuance of the lease.

80 *Exclusion of s 117 by Special Condition 50.* The Lessee's fourth submission was that even if s 117 were capable of enabling the transferee of a reversion to claim loss of bargain damages on termination of a lease, Special Condition 50 of the Sale Contract excluded s 117. Special Condition 50 provided:

> "(a) The Purchaser acknowledges that under [the 1999 Deed] the Vendor may become entitled to payments properly attributable to the period prior to completion.
>
> (b) The Vendor shall upon the request of the Purchaser, or the registered proprietor of the Property from time to time cause to be executed all documents the Purchaser or registered proprietor, as the case may be, reasonably requests it to sign and which it is empowered to sign under ... clause 4 of the [1999] Deed.

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62 See at [75] above.

(c) The Purchaser takes the Property subject to the [1999] Deed and the Purchaser shall indemnify the Vendor against any breach of that deed by it.

(d) This Further Condition 50 shall not merge on completion."

The Lessee submitted that implicit in this and other provisions of the sale contract was an agreement between the Lessor and the Lessee that s 117 "did not operate as an assignment of [the Lessor's] rights and obligations under the 1999 Deed, reinforcing the character of that Deed as a side agreement in respect of which rights and obligations under clause 10.2 did not run with the land".

81 However, the question is not whether cl 10.2 considered in isolation ran with the land. The significance of the Lessee's breach of cl 10.2(c) of the 1999 Deed was that it was also a breach of cl 3 of the Lease, and the question is whether cl 3, and the right to sue for loss of bargain damages on termination for breach of it, ran with the land under s 117.

82 The Lessee submitted that Special Condition 50 "reserves rights to" the Lessor. The only right it reserves is the right to money payable under the 1999 Deed before completion. It leaves untouched all rights to money payable after completion of the Sale Agreement. And it also leaves untouched all rights to loss of bargain damages in the event that the appellant chose to terminate the Lease after completion.

83 Special Condition 50 is not inconsistent with the operation of s 117.

84 For the above reasons the appellant's first submission on the application of s 117 is to be accepted.

85 *The appellant's other arguments.* In view of the appellant's success on its first s 117 argument, it is unnecessary to consider a second one; nor to consider arguments which relied on ss 40(3), 51 and 52 of the Real Property Act.

86 Hence the answer to question (d) is "Yes".

(e) If no to (d), was there an assignment by the Lessor to the appellant of the benefit of all the covenants in the Lease and the 1999 Deed by (i) the Sale Contract or (ii) the Deed of Assignment?

87 In view of the answer to (d), this question does not arise.

(f) If no to (d) and (e), was the Lessee estopped from denying that the appellant could take advantage of the Lease and the 1999 Deed?

88 In view of the answers to questions (d) and (e), this question does not arise.

(g) If the appellant were entitled to recover loss of bargain damages, was the quantum to be limited by assuming that the Lessee complied with cl 10 of the 1999 Deed?

89 The Lessee submitted that if, contrary to those of its contentions which were rejected in relation to questions (a)-(d), the appellant was entitled to loss of bargain damages, the trial judge assessed them on the wrong basis. It submitted that the correct basis for calculating what the appellant lost in the period between the termination of the Lease and 29 March 2008 was to start with the rent and outgoings payable under cl 10.2 of the 1999 Deed, not the rent and outgoings payable under cll 3-5 of the Lease. This submission was supported by reference to what is sometimes called the "*Mihalis Angelos* principle"[63]. However, neither in writing nor orally did the Lessee explain why the submission should be accepted. The *Mihalis Angelos* principle has nothing to do with the present case. The principle is that where a contract-breaker has a choice of methods of performance, damages will be assessed on the basis of the contract-breaker's minimum legal obligation – the method which would have been least onerous to the contract-breaker in the sense that non-compliance with it attracts the lowest measure of damages. The Lessee's problem here is that it did not have a choice of methods of performance. Once the Lessee contravened cl 10.2(c) of the 1999 Deed, it was obliged to pay the cl 10.2(d) amount, and it was in breach of cl 3 of the Lease. The Lessee had only one method by which to perform the obligation created by cl 3 of the Lease as amended by cl 10.2 of the 1999 Deed: to pay as cl 10.2(a)-(c) required, and to avoid any continuing Scheduled Breach of the Lease or breach of the 1999 Deed before 29 March 2008. If it failed to avoid either of those types of breach, cl 10.2(d) came into play, and, more importantly, cl 3 was breached. Paying the sums listed in cl 10.2(a)-(c) was not an alternative method of performance to paying the sum listed in cl 10.2(d) as well; the duty to pay the latter was simply a remedial consequence of failing to avoid the relevant breaches, and breach of cl 10.2(c) was a breach of the 1999 Deed.

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63 *Maredelanto Compania Naviera SA v Bergbau-Handel GmbH; The Mihalis Angelos* [1971] 1 QB 164. See also *TCN Channel 9 Pty Ltd v Hayden Enterprises Pty Ltd* (1989) 16 NSWLR 130 at 150-156.

(h) Were the second and third respondents liable on the Guarantees for the whole of the judgment against the Lessee?

90 The liability of the guarantors is an issue raised in the Lessee's Notice of Cross-Appeal. Since s 117 of the Conveyancing Act deals only with covenants, provisions and conditions in a lease to be observed or performed by a lessee, it cannot apply to a covenant in a guarantee given by a third party guaranteeing performance of the lessee's obligation to pay rent. Hence the appellant relied on, and the Court of Appeal applied, a common law doctrine stated in 1583[64], after the precursor to s 117, the *Grantees of Reversions Act* 32 Hen VIII c 34, had been enacted in 1540.

91 The Court of Appeal held that cl 2 of the Guarantees applied to the monies owing under cl 10.2(c) and (d) of the 1999 Deed (a total of $362,232 as at 28 March 2006). It held, reversing the trial judge, that there was no variation of the Lease which so altered the obligations of the second and third respondents without their consent as to discharge the Guarantees. It also held that their covenants touched and concerned the land, and were enforceable by the appellant as assignee of the reversion without express assignment. This last conclusion was challenged in the Notice of Cross-Appeal. The second and third respondents, however, took no other point: it was accepted that if that point failed, they were liable for the totality of the judgment against the Lessee.

92 *The Court of Appeal's reasoning.* The Court of Appeal held that where the covenant of a guarantor to guarantee payment of rent by a lessee touched and concerned the land, it ran with the land, and could be enforced by a transferee of the reversion. It followed its own decision to that effect in *Ryde Joinery Pty Ltd v Zisti*[65].

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64 *Spencer's Case* (1583) 5 Co Rep 16a [77 ER 72].

65 (1997) 7 BPR 15,233 at 15,237-15,238. That case followed several like English and Australian authorities: *Kumar v Dunning* [1989] QB 193; *P & A Swift Investments (A Firm) v Combined English Stores Group plc* [1989] AC 632; *Lang v Asemo Pty Ltd* [1989] VR 773; *Showa Shoji Australia Pty Ltd v Oceanic Life Ltd* (1994) 34 NSWLR 548. See also *Coronation Street Industrial Properties Ltd v Ingall Industries plc* [1989] 1 WLR 304; [1989] 1 All ER 979 and *Simmons v Lee* [1998] 2 Qd R 671.

93 *Submissions of the second and third respondents.* The second and third respondents put only two submissions[66].

94 The first was that this Court should not follow the House of Lords decision in *P & A Swift Investments (A Firm) v Combined English Stores Group plc*[67] but "prefer the reasoning underlying [*Consolidated Trust Co Ltd v*] *Naylor* that a surety's covenant, being a collateral obligation not affecting land, does not run with demised land"[68].

95 The second submission is that *Swift's* case was distinguishable "as a case concerned only with 'arrears of rent', not a claim to loss of bargain damages arising ... on a secondary legal obligation imposed by law ... upon termination of a lease for breach".

96 *Can a guarantor's covenant run with demised land?* It is to be noted that the second and third respondents did not attack Lord Oliver of Aylmerton's statement in *Swift's* case of the tests to determine whether a covenant runs with the land[69]. They only attacked the conclusion reached by the House of Lords that those tests were satisfied by the obligation of the guarantor in that case. Those tests are satisfied in this case.

97 As to the first test, the relevant covenant in cl 2, read with Recital B and cl 1(f) of the Guarantees[70], benefits only the reversioner for the time being. That is because the Guarantees are guarantees to the "Lessor". The expression

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66 In oral address only the second and third respondents put an argument which was outside the Notice of Cross-Appeal to the effect that on their true construction the Guarantees did not apply to a liability to pay loss of bargain damages. The Court of Appeal said this argument was not put to it. There being no application to amend the Notice of Cross-Appeal with a view to seeking special leave in relation to the new ground, that argument, which the appellant had no effective opportunity to answer, need not be dealt with, beyond saying that it is plainly wrong for the reasons given by the trial judge.

67 [1989] AC 632.

68 *Naylor's* case is reported at (1936) 55 CLR 423; [1936] HCA 33.

69 [1989] AC 632 at 642, quoted above at [74].

70 Quoted above at [4].

"Lessor" is defined as meaning the "First Lessor" while the First Lessor holds the freehold, and thereafter means whoever is the owner of the freehold. Hence after the "First Lessor" (ie the Lessor under the Lease) sold to the appellant, it lost all benefits under the Guarantees (save for rights accrued before the change of ownership). Thus the covenant benefits only the reversioner for the time being, and once separated from the reversion it ceased to be of benefit to the covenantee (save for accrued rights).

98 As to the second test, the covenant affects the value of the reversioner's land: where land is sold subject to a subsisting tenancy, a guarantee of the tenant's rental obligations will commonly enhance the value of the land.

99 As to the third test, by reason of Recital B and cl 1(f) of the Guarantees, the covenant is not expressed to be personal to a specific reversioner and by reason of cl 1(g) it is not expressed to be personal to a specific tenant.

100 The fourth test is satisfied. The fact that the covenant is to pay a sum of money will not prevent it from touching and concerning the land, since the first three conditions are satisfied and the covenant is connected with something to be done in relation to the land, namely the payment of rent for its occupation.

101 There is a more direct route to the conclusion that the Guarantees touch and concern the land[71]:

> "A covenant by a surety that a tenant's covenant which touches and concerns the land shall be performed and observed must itself be a covenant which touches and concerns the land".

With respect, that is correct. As McPherson JA has said: "If rent runs with the land, it is not a long step to say that a guarantee of that rent also does so."[72]

102 Accordingly, contrary to the submissions of the second and third respondents, the covenants in the Guarantees cannot be regarded as collateral obligations not affecting land, and they run with the land.

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71 *P & A Swift Investments (A Firm) v Combined English Stores Group plc* [1989] AC 632 at 637 per Lord Templeman (Lords Keith of Kinkel, Roskill and Ackner concurring).

72 *Simmons v Lee* [1998] 2 Qd R 671 at 675.

103 So far as the submissions of the second and third respondents suggested that there was a contradiction between *Consolidated Trust Co Ltd v Naylor*[73] and *P & A Swift Investments (A Firm) v Combined English Stores Group plc*[74], that suggestion is to be rejected. *Naylor's* case concerned the assignment of a mortgage. It was held that the assignment did not transfer the benefit of a covenant by a guarantor that the borrower would repay the principal debt, on the ground that neither the borrower's covenant to repay the principal, nor the guarantor's covenant to pay if the borrower did not, could touch and concern the land. At least the second of Lord Oliver's tests, even if removed from the context of leases and modified so as to relate to mortgages, would not be satisfied in relation to the borrower's covenant. The value of the mortgaged land, and of the mortgagee's interest in it, is not affected by the covenant or its absence: the land as a whole would fetch the same price whether or not the guarantee covenant exists, and the mortgagee's interest in the land will fetch the same price, for the value of that interest depends on what can be realised when the land is sold pursuant to the mortgagee's power of sale, or on foreclosure.

104 In *Kumar v Dunning* the English Court of Appeal distinguished *Naylor's* case on a more general basis[75]:

> "A surety for a mortgage debt is a surety for the payment of the principal debt. The borrower's own covenant to pay the principal has nothing to do with the land and cannot touch and concern the land: there is, therefore, no reason why a covenant by way of surety for such a payment should touch and concern the land. It is quite different from a surety for the performance of a tenant's covenant which does touch and concern the land: such a surety covenant is necessarily and inextricably bound up with the tenant's obligations."

That reasoning, while it is with respect correct, has to be placed in the Torrens system context in which *Naylor's* case was decided. The case concerned the transfer of a mortgage over Torrens system land. That was a dealing in the land, and the Real Property Act, which Dixon and Evatt JJ described as "a statute ...

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73 (1936) 55 CLR 423.

74 [1989] AC 632.

75 [1989] QB 193 at 206-207.

concerned with dealings in land"[76], therefore applied to it, and prescribed how mortgages might be transferred and with what consequences. Section 51 provided:

> "Upon the registration of any transfer, the estate or interest of the transferor as set forth in such instrument, with all rights, powers and privileges thereto belonging or appertaining, shall pass to the transferee, and such transferee shall thereupon become subject to and liable for all and every the same requirements and liabilities to which he would have been subject and liable if named in such instrument originally as mortgagee, encumbrancee, or lessee, of such land, estate, or interest."

Section 52(1) provided:

> "By virtue of every such transfer, the right to sue upon any memorandum of mortgage or other instrument and to recover any debt, sum of money, annuity, or damages thereunder (notwithstanding the same may be deemed or held to constitute a chose in action), and all interest in any such debt, sum of money, annuity, or damages shall be transferred so as to vest the same at law as well as in equity in the transferee thereof."

Dixon and Evatt JJ said that the Act[77]:

> "is concerned with the mortgage transaction in its entirety as it affects the land, and, therefore, extends to the personal liability of the mortgagor for the mortgage debt because that liability is intimately connected with the rights of property arising out of the mortgage transaction. A surety's obligation stands in a different relation to the dealing. His liability is introduced by way of additional security. It is personal and, except as a result of subrogation, does not directly or indirectly affect the land ... A guarantee is thus collateral to the mortgage transaction."

McPherson JA has expanded the reasoning of Dixon and Evatt JJ as follows[78]:

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76 *Consolidated Trust Co Ltd v Naylor* (1936) 55 CLR 423 at 434.

77 *Consolidated Trust Co Ltd v Naylor* (1936) 55 CLR 423 at 434-435.

78 *Simmons v Lee* [1998] 2 Qd R 671 at 675-676.

> "[T]he underlying distinction between a guarantee of a mortgage debt and a guarantee of rent under a lease is ... that, although the mortgage debt is, as Dixon and Evatt JJ said ... 'intimately connected with a right of property arising out of the mortgage transaction', it is the debt which, in the case of a mortgage, is considered 'the principal thing', while the mortgagee's interest in the land is regarded as 'accessory only'. [In] *Haque v Haque [No 2]*[79] ... Kitto J described that conception of a mortgage as an 'ingrained principle' which had been 'absolutely settled and determined centuries ago'. Unlike rent, a mortgage debt is not something that issues out of, or is an incident of, the mortgagee's interest in the land; and a guarantee of such a debt cannot in that particular be in a stronger position than the debt itself."

105 In short, *Naylor's* case is distinguishable. It is not correct to say, as the second and third respondents submitted, that the "reasoning underlying" *Naylor's* case corresponded with its argument in this Court.

106 The only Australian case reaching a conclusion adverse to the proposition that guarantees of a lessee's covenant to pay rent pass with the reversion is *Sacher Investments Pty Ltd v Forma Stereo Consultants Pty Ltd*[80]. It is not in truth an authority adverse to the appellant. The reasoning turned on the non-application of s 117 of the Conveyancing Act. As has often been pointed out[81], no argument appears to have been advanced in that case that the guarantor's covenant could be enforced on the basis that it touched and concerned the land.

107 For those reasons the first argument advanced by the second and third respondents must be rejected.

108 Is Swift's case distinguishable as being only concerned with arrears or rent, not loss of bargain damages? Contrary to the second and third respondents' submissions, Swift's case is not capable of being distinguished as being concerned only with a guarantee in relation to arrears of rent, and as having nothing to do with loss of bargain damages arising on termination of a lease. The tests stated by the House of Lords go to the question whether a covenant touches

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79 (1965) 114 CLR 98 at 127; [1965] HCA 38.

80 [1976] 1 NSWLR 5.

81 *Kumar v Dunning* [1989] QB 193 at 207; *Lang v Asemo Pty Ltd* [1989] VR 773 at 775-776; *Ryde Joinery Pty Ltd v Zisti* (1997) 7 BPR 15,233 at 15,237.

and concerns the land so as to entitle a transferee of the reversion to the benefit of the guarantee covenant. There is no reason why this Court should not apply the principle stated by the House of Lords in this respect as part of the law of Australia. There is every reason why their Lordships' exposition of the applicable law should be accepted as part of the law of this country. Once it is concluded that those tests are satisfied, the question of whether the benefit of the guarantee covenant is limited to arrears of rent or extends to loss of bargain damages depends on what its scope is. As a matter of construction, the scope of cl 2 of the Guarantees in this case extends to loss of bargain damages.

Orders

109 Despite the ingenuity of the Lessee's arguments and the skill with which they were advanced, the decisive questions must be answered adversely to the Lessee. In the end the problems for the respondents derived from the language of the Lease, as varied, and the Guarantees. From their point of view this language was not propitious. Adhering to the obligations which the parties accept in writing is a purpose of the law to which this Court must give effect.

110 In view of the answer to question (a), the Lessee's challenge to the Court of Appeal's judgment sum against the Lessee fails. In view of the answer to questions (b) and (c), the figure for reinstatement damages should be added to that judgment sum. In view of the answer to questions (b)-(d) and (g), the figure for loss of bargain damages should be added as well, with the result that the appellant's claim that the trial judge's judgment should be substituted for that of the Court of Appeal succeeds. In view of the answer to question (h), the second and third respondents are liable to judgment in the same amount.

111 It follows that the respondents should bear the appellant's costs, both in this Court and the courts below. Since the second and third respondents were ordered by the Court of Appeal to pay the costs of the appellant at trial and in the Court of Appeal, it is unnecessary to alter these orders, and sufficient to order that they pay the appellant's costs in this Court.

112 The following orders should therefore be made.

1. Appeal allowed.

2. Special leave to cross-appeal granted; cross-appeal dismissed.

3. Set aside the judgment for the appellant against the first respondent in the amount of $362,232 and in its place restore the judgment, given by the

trial judge, for the appellant against the first respondent in the amount of $2,096,514 plus interest on that sum from 28 March 2006 calculated in accordance with s 101 of the *Civil Procedure Act* 2005 (NSW).

4. Set aside the order relating to costs between the appellant and the first respondent, and in its place order that the first respondent pay the appellant's costs of the proceedings before the trial judge, of the appeal before the New South Wales Court of Appeal and of the appeal and cross-appeal to this Court.

5. Set aside the judgment for the appellant against the second and third respondents in the amount of $362,232 and in its place give judgment for the appellant against the second and third respondents in the amount of $2,096,514, plus interest on that sum from 28 March 2006 calculated in accordance with s 101 of the *Civil Procedure Act* 2005 (NSW).

6. Order that the second and third respondents pay the appellant's costs of the appeal and cross-appeal to this Court.