Lease Incentive claw backs – Can they be enforced?

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A decision of the Victorian Civil and Administrative Tribunal (VCAT) late last year has raised great uncertainty for landlords in Australia in their ability to claw black fit out costs and other incentives from tenants.

In its reasoning, VCAT applied an earlier decision of the Queensland Supreme Court which was previously thought to be an anomaly and unique to the facts of that case. The tribunal's decision however, creates serious doubt on the ability to negotiate claw back clauses with tenants.

Claw back clauses

Landlords will often offer an incentive to a tenant to enter into a lease.

The incentives usually take the form of a fitout contribution, or a rent free period/rental abatement.

Typically, incentives are offered on the condition that the tenant is to repay the incentive (or a proportion of the incentive) if the lease is terminated or assigned before the expiry date, i.e. a claw back of the incentive.

The rationale for the claw back is that the landlord has provided the incentive in exchange for the tenant's covenant to occupy the premises and comply with the lease during the term.

Position in Queensland

In the 2014 case of *GWC Property Group Pty Ltd v Higginson & Ors*[1] ('Higginson'), a lease and incentive deed were entered into.

The incentive deed required the tenant to repay a proportion of the landlord's fit out contribution and abatement amounts if the lease was terminated for any reason other than by the landlord's default.

The Queensland Supreme Court held that the claw back clause was excessive, deeming the clause a penalty and therefore not enforceable.

The court stated that the relevant test was whether the claw back was extravagant and unconscionable in comparison to the maximum loss suffered for breach of contract. The court found that this was the case and stated that:

> *"The repayment clauses were wholly penal in their operation: providing for significant sums to be paid over and above damages which would be payable to the landlord at common law."*[2]

The court stressed that by granting the incentive, the landlord would have been placed at a great advantage:

> *"The impugned clauses do not restore the landlord to that pre-contractual position; they give it an advantage which it would never have had if the lease had uneventfully run its term."*[3]

Position in Victoria

In October 2019, an incentive claw back was considered in *Finetea Pty Ltd v Block Arcade Melbourne Pty Ltd (Building and Property)*[4] ('Finetea)'.

The landlord agreed to a rent free period and a cash contribution for the tenant's fitout. The lease included a clawback clause requiring the tenant to repay to the landlord the proportion of the incentive for the remainder of the term if the lease was terminated early.

Member R Walker relied on Higginson and determined that the rent free period and cash incentive were part of the consideration for entering into the lease, and had there been no breach of the lease there would have been no responsibility to repay the landlord.

The court utilised the same test in determining that such clauses are a penalty:

> *"The Landlord now seeks an order that, in addition to those damages, it should receive back the value of these incentives. That is "extravagant and unconscionable in amount" and out of all proportion to the damage it has suffered. To allow such a claim would be to enforce a penalty."* [5]

The tribunal further stressed that allowing the landlord to recover the incentives would result in double recovery, and would punish the tenant.

What does this mean for landlords in Australia?

Although the law is not settled, these decisions create uncertainty around the ability to claw back incentives on early termination and suggest that these clauses are not likely to be enforced at law.

Previously it could be argued that Higginson was an anomaly. However, its application in Finetea waters down this argument.

Courts may view the recovery of such incentives as extravagant when damages for breach of contract are considered. They may be seen to punish a tenant by forcing payment of amounts which were otherwise not payable if the lease took its term.

Whilst Finetea comes from VCAT, and there are no other current binding decisions as in Queensland, the two decisions perhaps reflect a shift in the general attitude of the courts when considering lease clawbacks.

Landlords may want to reconsider how they will offer and structure lease incentives to tenants.

For struggling tenants, particularly in the current economic climate of Coronavirus (COVID-19), it just may be worth thinking twice before paying back any lease incentive.

[1] [2014] QSC 264
[2] [2014] QSC 264 [49]
[3] [2014] QSC 264 [36]
[4] [2019] VCAT 1529
[5] [2019] VCAT 1529 [337]

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