

## Commercial Leasing: Exercising an option to renew

The recent Supreme Court of Western Australia (Court of Appeal) decision in *Whitegum Petroleum Pty Ltd v Bernadini Pty Ltd* [2010] WASCA 229 has highlighted the need for a tenant to use clear and unambiguous language when giving notice of its decision to exercise an option to renew in a lease.

### Real Estate Update

#### Key Principles

A notice must clearly and unequivocally convey that a tenant has elected to enter into a lease for the renewed term.

The key question is whether a reasonable person, having received the notice and being aware of all the circumstances, would fairly understand that the tenant has exercised the option.

#### Background

Whitegum Petroleum Pty Ltd (**Tenant**) entered into a lease with Bongiovanni Nominees Pty Ltd (**Original Landlord**) who was then the owner of the land.

The lease was for an initial term of 7 years with 3 options to renew of 5 years each.

The Original Landlord then sold the land to Bernadini Pty Ltd (**Landlord**) which became bound by the terms of the lease.

A dispute arose as to whether the Tenant had correctly exercised its second option to renew.

The relevant clause in the lease required the Tenant to provide two notices to the Landlord:

1. a notice of its intention to exercise the option (**First Notice**); and then
  2. a notice of the exercise of the option (**Second Notice**),
- by no later than 31 August 2009.

#### Who does this affect?

Landlords and tenants of commercial property.

#### Article Highlights

- Tenants must use clear and unambiguous language when giving notice to enter into a lease for a renewed term.
- Tenants and their agents must pay careful attention when preparing renewal notices to ensure compliance with the relevant lease clause.



The Tenant provided two letters to the Landlord (the first letter on 25 August 2009 and the second letter on 26 August 2009). There were differences between the two letters, but the operative paragraph in both letters was identical:

*"We hereby give notice... of our intention to exercise our second option for a term of 5 years commencing 1 December 2010".*

The Tenant argued that the first letter was notice of its *intention to exercise* the option (i.e. the First Notice), and the second letter was notice of the *exercise* of the option (i.e. the Second Notice).

The Landlord argued that a reasonable recipient of the second letter (which uses the language *"intention to exercise"*) would not have thought that the second letter was notice of the exercise of the option and therefore the Tenant had not validly *exercised* the option to renew.

### The Initial Decision

The arguments of both the Tenant and the Landlord relied heavily on the subtle difference between the first letter and the second letter and the context in which the letters had been sent.

The Tenant argued that a reasonable recipient of the second letter would have understood that the Tenant had *exercised* the option because:

1. the clause contemplated that the Tenant would provide 2 notices (the First Notice and Second Notice);
2. the Landlord had already received the first letter advising the Landlord of its *intention to exercise* the option (i.e. the First Notice); and
3. the second letter was sent shortly before 31 August 2009 deadline.

The Landlord argued that a reasonable recipient would have thought that the second letter was a replacement of the first letter because:

1. the first letter referred to an "intention to exercise" and included a request that the landlord sign and return the document (which was not a formal requirement of the First Notice); and
2. the second letter also referred to an "intention to exercise" but did not include a request that the landlord sign and return the document (and therefore the Tenant must have re-issued the first letter without the request).

The trial judge agreed with the Landlord and concluded that a reasonable person would have been left in doubt about whether the second letter was sent by the tenant as a replacement of the first letter.

### Contact



**Graham Georke**  
PARTNER

t: +61 8 9426 6756  
e: ggeorke@jacmac.com.au



**Simon Moen**  
PARTNER

t: +61 8 9426 6757  
e: smoen@jacmac.com.au



**Ryan Chorley**  
SENIOR ASSOCIATE

t: +61 8 9426 6891  
e: rchorley@jacmac.com.au



### The Appeal

The Court of Appeal (split 2:1) overturned the trial judge's decision and concluded that the Tenant had validly exercised the option to renew.

The Court of Appeal concluded that a reasonable person would have understood that the Tenant had elected to exercise the option because:

1. the first letter was clearly and unequivocally the First Notice;
2. there was no reasonable basis for supposing that the Tenant had sent the second letter as a substitute for the first letter (the Tenant had requested the Landlord's signature merely for the purpose of confirming receipt of the first letter);
3. there were subtle differences between the first letter and second letter; and
4. the Tenant had to issue the Second Notice by the 31 August 2009 deadline.

### Conclusion

Tenants and their agents must pay careful attention when preparing renewal notices to ensure compliance with the relevant clause in the lease. This is particularly relevant in the context of an accelerating rental market, where landlords may be able to achieve higher rents by re-letting their property on the open market.

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### Contact Us

**t** +61 8 9426 6611 **f** +61 8 9321 2002 **e** [jacmac@jacmac.com.au](mailto:jacmac@jacmac.com.au)

**a** Level 25, 140 St Georges Terrace, Perth, Western Australia 6000  
GPO Box M971, Perth, Western Australia 6843

[www.jacmac.com.au](http://www.jacmac.com.au)