

**WHAT NOT TO DO IN FAMILY LEASING ARRANGEMENTS –
*Doueihi v Constructions Technologies Australia***

This recent case is another costly lesson on the importance of formalising leasing and other legal arrangements even if they are between family or friends. The case particularly considers the principles of estoppel by encouragement.

Estoppel by encouragement

Where a contract is found not to be legally enforceable at common law, equity may remedy the defects in the contract and grant relief. Estoppel by encouragement requires the claimant to show that they:

- assumed that a particular legal relationship existed between the parties; or
- expected that a particular legal relationship would exist between them and the other party would not be free to withdraw from that relationship.

The facts

Construction Technologies Australia ("**CTA**") was controlled by Mr Hogan. Mr Hogan had family ties with the company Marble Plus (by marriage with one of the shareholders). The shareholders and controllers of Marble Plus were Ms Hogan (Mr Hogan's spouse), Mrs Vatselias (Ms Hogan's mother), Mr Doueihl and Ms Scott (Ms Hogan's sister).

Marble Plus had been renting the premises it operated from for some time on an informal basis (as it was the practice of the family to not enter into formal leases). Mr Hogan proposed (in consultation with Mr Doueihl) that the shareholders of Marble Plus acquire land on which a purpose built facility could be constructed to accommodate both Marble Plus and CTA. Each company was to pay rent to the land owners (being the individual shareholders of Marble Plus). This proposal was later put into action and in 2008 Mr Doueihl, Ms Hogan, Mrs Vatselias and Ms Scott ("**the owners**") acquired a property at Seven Hills for \$2.9 million.

Following construction, CTA entered into possession of the premises in 2010 and installed its plant and equipment in the new premises at a cost of around \$1 million. There was never any formal lease or agreement to lease between the land owners and CTA. CTA moved into the premises on the basis of an understanding between Mr Hogan and Mr Doueihl that CTA would be given a lease of five years with a further five year option and to pay rent of \$120,000.00 per annum. Once CTA entered into possession of the premises it began paying rent to the owners.

This arrangement was in place until Mr Hogan's separation with Ms Hogan in 2011. Following this, CTA sought to formalise the leasing arrangement due to the change in the family relationship. Eventually, the owners offered CTA a formal lease, however it was for a significantly shorter term and included a 40% increase in rent.

When this offer was rejected by CTA, the owners issued CTA with a notice to quit the premises. CTA commenced proceedings seeking to enforce the lease.

Issues before the court

CTA argued that a binding lease or agreement to lease had been entered into or in the alternative that the land owners were estopped from denying a binding lease on the basis of equitable estoppel.

Decision

The court found on appeal (upholding the first instance decision) that:

- There was no binding lease or agreement to lease as the parties had no intention to be bound. The practice of the owners not formalising leasing arrangements and the subsequent conduct of the parties following Mr Hogan's separation with Ms Hogan supported the finding that the parties did not consider that a legally binding agreement was in place.
- The claim of equitable estoppel by encouragement was successful. The court found that:
 - the owners had encouraged Mr Hogan (and accordingly CTA) to assume that they would grant a lease interest to CTA. This was based particularly on the discussions between Mr Hogan and Mr Doueihy regarding CTA's lease requirements;
 - although the owners did not authorise Mr Doueihy to enter into any binding contracts on their behalf, the other owners allowed (and authorised) Mr Doueihy to engage in negotiations with CTA on their behalf. Accordingly, Mr Doueihy's knowledge was also that of the other owners;
 - the owners knew that CTA relied on the assumption (that it would have a right of occupation in the premises) through Mr Hogan's involvement in the construction of the premises and installing CTA's plant and equipment at a significant cost; and
 - it would be unconscionable for the owners to depart from the assumption because they had taken advantage of Mr Hogan's efforts. They knew of CTA's expenditure and they accepted CTA as tenant by accepting rent. Accordingly, it was reasonable for CTA to assume that they would occupy the premises for a long term.

In this case CTA did not make an assumption that a 'particular legal relationship existed' instead CTA (through Mr Hogan) assumed that it would be entitled to an 'interest'. Despite this, CTA was successful and the owners were estopped from denying the lease interest. The court made this finding based on the family ties between CTA and the owners.

Conclusion

While CTA was ultimately successful in enforcing its leasehold interest, the litigation, expense and time could have been saved if CTA entered into a lease agreement with the land owners. This case is a good example of how family arrangements can change and the importance of formalising arrangements even with family and friends.

Additionally, Mr Hogan was not the sole shareholder of CTA and arguably was in significant breach of his duties as director to the company by expending such a significant amount of money in installing plant and equipment without having a binding agreement in place.

For more information about this issue, please contact our property law department on 07 4036 9700.