INDEFEASIBILITY OF TITLE UNDER TORRENS: *LEROS PTY LTD V TERARA PTY LTD*

TONY WILSON*

INTRODUCTION

The recent High Court decision in *Leros Pty Ltd v Terara Pty Ltd*[1] ("*Leros v Terara*") affirms the strict "immediate indefeasibility" principle enshrined in Sir Robert Torrens' legislative scheme for the simplification of title to and dealing with land.[2] This reaffirmation comes at a time when the foundations of the indefeasibility principle have been nationally surveyed and pronounced shaky[3] and even rocked by revisionist decisions in three State Supreme Courts.[4]

The central issue in the case was whether an option to renew contained in a lease of business premises was enforceable against a successor in title to the original lessor in circumstances where the lease had not been registered and the lessee had not sought to protect the option by caveat until after two intervening transfers of the freehold estate had been registered. The High Court held by a majority that the option was not enforceable.

---

* LLB(Hons); Lecturer in Law (part-time), The University of Western Australia.

1. (1992) 106 ALR 595; [1992] 66 ALJR 399.
2. The ruling relates to Western Australia's Transfer of Land Act 1892. The indefeasibility provisions in the Torrens legislation of other States differ in material respects: infra n 5.
3. See, for instance, P Butt The Conveyancer (1991) 65 ALJ 611; P Butt "System Stands on Shaky Foundations" (1992) 27 *Australian Law News* 12.
4. *Chasfild Pty Ltd v Taranto* [1991] 1 VR 225; *Rogers v Resi-Statewide Corporation* (1991) 32 FCR 344; *Mercantile Mutual Life Insurance Co Ltd v Gosper* (1991) 25 NSWLR 32 but see now *Vassos v State Bank of South Australia* (unreported) Supreme Court of Victoria 5 August 1992 (Hayne J); *Elcom Credit Union Limited v Mitsu*, (unreported) Supreme Court of New South Wales 25 August 1992 (Master Greenwood) and *Arcadi v Whittem* (unreported) Supreme Court of South Australia (Full Court) September 1992.

FACTS

Henry Africa's Tavern is an inner suburban "watering hole" located in the Subiaco Village Shopping Centre in Perth. The relevant facts were that in 1987 the registered proprietor of the freehold granted the lessee an extension of lease for five years with further options to renew. The lessee's interest was assigned to Terara in 1988. The National Australia Bank took security over the premises and lodged a caveat, claiming an interest as mortgagee by way of sub-demise. The lessor's reversionary interest was then transferred twice between August 1988 and July 1989.

After the second of these transfers, Terara lodged a "subject to claim" caveat[5] in respect of the option to renew. Leros then became registered proprietor of the freehold in March 1990 with its transfer expressed to be subject to two caveats, the Bank's and Terara's.

ISSUES

Although a variety of issues were raised by the case the central question was: did Terara have a valid and enforceable option to renew? Or, from Leros' point of view, was its registered interest subject to the option for renewal?

The interpretation of section 68 of the Western Australian Transfer of Land Act 1892 ("TLA"), dealing with the requirements for the protection of options for renewal against the paramountcy of registered interests, was crucial:

> No option of ... renewal in any ... lease ... shall be valid against a subsequent registered interest unless such lease ... is registered or protected by caveat.

The judge at first instance,[6] and the Full Court of the Supreme Court of Western Australia,[7] upheld the validity of the option reasoning, amongst other things, that the Bank's caveat "necessarily asserted the validity and efficacy of the lease as against the registered proprietor and those dealing with him subsequent to the lodgement of the Bank's caveat".[8]

As far as the majority[9] in the High Court was concerned, the efficacy of

5. "Subject to claim" caveats have no counterparts in the Torrens legislation of Queensland, New South Wales and Tasmania. In addition, the indefeasibility provisions in all States of Australia, insofar as they relate to leasehold interests, are different from each other. See P Butt "Waste of Every Kind of Energy" (1992) 27 *Australian Law News* 28.
6. *Terara v Leros* (unreported) Supreme Court of Western Australia 13 July 1990 (Rowland J).
7. *Leros v Terara* [1991] ANZ Conv R 511.
8. [1991] ANZ Conv R 511, 515.
9. Mason CJ, Dawson and McHugh JJ. Gaudron J held the Bank's caveat protected the lease

the Bank's caveat to protect the option turned on the purpose and function of caveats as set out in section 137 of the TLA and on the actual claim expressed on the face of the Bank's caveat, which referred only to the lease "as renewed or extended from time to time".

Chief Justice Malcolm's subordinate argument concerning Terara's caveat was based in part on a narrow and restrictive interpretation of the relevant part of section 68 (viz, that "a subsequent registered interest" did not mean "*all* subsequent registered interests"). But that interpretation reveals an underlying inconsistency in its recognition of the substantive efficacy of Terara's claim in its caveat lodged after two preceding registrations which had taken effect, according to section 68's clear words, "absolutely free of any prior encumbrances", save those protected by registration or by lodging a caveat.

The validity of Terara's lease and the interests contained in it, and in turn, the effect of its caveat, posed important questions of principle. Can a caveat lodged in these circumstances revive a prior encumbrance against the "absolutely free" title created by a subsequent registration? The majority judgment in the High Court holds not and firmly restates the central role and place of indefeasibility under the TLA.

It also draws a line against further extensions to the exceptions to indefeasibility, particularly through the "incidents in instruments" theory and the development of personal equities following *Bahr v Nicholay*.[10] Interestingly, in the latter case, Chief Justice Mason and Justice Dawson jointly delivered the most expansive judgment holding that failure to honour an undertaking to recognise a prior contractual obligation by a vendor in an earlier contract amounted to fraud on the part of the purchaser, prevented indefeasibility of title and created a constructive trust in favour of the plaintiff. *Bahr v Nicholay's*[11] spawn are examples of the "personal equities" exception to indefeasibility.[12]

The Bank's caveat did not, as a consequence of the express words of

---

and, by reason of her interpretation of the concluding part of s 68 of the TLA, the option to renew. Deane J agreed that the Bank's caveat protected the lease but only to the extent necessary to sustain the Bank's interest in it.

10. (1988) 164 CLR 604.
11. Ibid.
12. See, for example, *Mercantile Mutual Life Insurance Co Ltd v Gosper* (1991) 25 NSWLR 32 (equity of redemption entitling mortgagor to redeem on payment of original amount secured or the unauthorised production of the duplicate Certificate of Title), *Snowlong Pty Ltd v Choe* [1992] ANZ Conv R 144 (undertaking to recognise unregistered lease containing options to renew).

sections 137 and 68 of the TLA, give notice of or in any other way bind Leros to recognise and give effect to the option. Neither did the registration of Leros' transfer subject to Terara's claim create an "equity" in the sense of an undertaking to recognise and honour Terara's exercise of the option.

Implicit in the judgment is the rejection of any further extension of the principle in *Mercantile Credits Ltd v Shell Co of Australia Ltd*[13] in which the High Court, interpreting the provisions of the Queensland Torrens legislation, decided that a registered lease, containing details of further options to renew, was binding on a subsequent registered proprietor. That decision rests on the fact that the Torrens system of land title registration is based on the registration of instruments not interests. The registration of the lease, therefore, bound any person dealing with the title in relation to *all* the interests contained in it. The High Court recently refused special leave to appeal the decision of the Queensland Supreme Court in *Re Eastdoro*[14] which appears to take the position in *Mercantile Credits Ltd v Shell Co of Australia Ltd*[15] one step further by extending the protection to options to renew under leases to a situation where, following the exercise of an option to renew under a registered lease, further options for renewal were enforceable against a subsequent registered proprietor of the freehold although no new lease or extension of lease had been registered. That protection, following *Leros v Terara*,[16] certainly does not extend to options claimed in caveats lodged after an intervening registration.

THE GENERAL PROPERTY STATUTE AND THE TLA

The relationship between the Torrens legislation and the general property law statute in Western Australia was also reviewed by the High Court in *Leros v Terara*. The option to renew under the lease ran with the reversion by virtue of section 78 of the Western Australian Property Law Act 1969. That statute applies to leases (including unregistered leases) under the TLA. Did this general statutory provision override the specific direction as to the invalidity of unprotected options to renew in section 68 of the TLA?

In the Full Court of the Supreme Court of Western Australia, Chief Justice Malcolm interpreted the phrase "a subsequent registered interest" in section 68 as not necessarily referring to "all" subsequent registered interests. This view allows caveats to have a "reviving" effect and comes dangerously close

13. (1976) 136 CLR 326.
14. [1990] 1 Qd R 424.
15. Supra n 10.
16. Supra n 1.

to recognising that caveats may operate as a statutory form of notice.[17]

But, as the majority judgment in the High Court points out, "the indefinite article "a" in section 68 of the TLA is quite capable of meaning "any". When the provision is read in the light of its content and purpose, this is how it should be understood.[18] This interpretation of section 68 is central to and intrinsically connected with the recognition of the essential principle of the Torrens system. The majority, by interpreting the relevant provisions of the TLA and other legislation so as to give section 68 the dominant role, reinforces the orthodox "immediate indefeasibility" line.

COMMERCIAL REALITIES

Besides providing the necessary background for the considerations of principle and interpretation under the TLA, the facts in *Leros v Terara*[19] illustrate a common commercial practice in the 1980's by the purchasers of, for instance, shopping centres. As tenants in the past were often discouraged (or prohibited) from lodging caveats (as was the case in the original lease here), a new registered proprietor could effectively ignore any options under existing leases, terminate the leases at the end of the current term and renegotiate them. The Western Australian Commercial Tenancies (Retail Shops) Agreements Act 1985 was introduced in part to address this problem. The Act provides a statutory minimum term of five years for all "retail shops" and also contains provisions with respect to options to renew.[20]

In addition, amendments to this Act in 1990 strengthen the protection of retail shop lessees. Section 13(10) now provides that "an option to renew is exercisable against any person with a reversionary interest in the premises ... *whether or not the lease is registered or protected by caveat*" (emphasis added). This provision ensures that the decision in *Leros v Terara* will not apply to "retail shops" and circumvents the effect of contractual prohibitions against registration of leases or lodging caveats.

Further, section 13B provides a procedure which enables a "retail shop" tenant to seek renewal by giving a notice to that effect to the landlord and observing the timetable requirements of the section. An interesting question will arise when this provision takes effect in 1995 as to whether further terms created under section 13B will also be exceptions to indefeasibility binding

17. [1991] ANZ Conv R 511, 516. Pigeon J clearly embraced that view, ibid 517.
18. (1992) 106 ALR 595, 600; [1992] 66 ALJR 399, 403.
19. Supra n 1.
20. (WA) Commercial Tenancies (Retail Shops) Agreements Act 1985, s 13 (minimum term); s 13B (procedure for extending term where no option granted).

on successors in title.

Notwithstanding the special statutory protection for interests contained in leases of "retail shops",[21] the practical effect of the High Court's decision is that all leases for a term *exceeding* five years should be registered and options to renew should at least be protected by caveat.

THE ESSENTIAL PRINCIPLE: TITLE BY REGISTRATION

It has been said that the Torrens system is not a system of registration of title but a system of title by registration. Similar epigrammatic descriptions of the system (for instance, "title is not historical or derivative") can be traced back to Torrens' *A Handy Book on the South Australian Real Property Act 1862* in which the legislation was described as "cutting off the retrospective or derivative character of the title upon each transfer".[22]

The whole point of the Torrens system is to encourage registration of instruments for the protection of the estates and interests created by them and thereby to eliminate the unpredictable and potentially unfair operation of the doctrine of notice. The defeat of a prior inconsistent unregistered interest, neither protected by caveat nor falling within the limited exceptions to indefeasibility, by a subsequent registration, extinguishes that interest for all purposes. It cannot be revived and asserted against some later proprietor.

In 1989, the Supreme Court of Western Australia's decision in *Osborne Park Co-operative Society Limited v Wilden Pty Ltd*[23] had firmly established that the failure to lodge a caveat to protect an option to renew could not be overcome by arguments that a subsequent purchaser of the freehold was bound to recognise the option on the basis of notice or estoppel. The primary indefeasibility rule was reinforced in that decision: registration creates an indefeasible title subject only to the exceptions set out in section 68 of the TLA. The High Court decision in *Leros v Terara* reaffirms that view.

CONCLUSION

The decision in *Leros v Terara*[24] provides a salutary lesson about the consequences of failure to protect an option for renewal in a lease. The lesson is that leases should be registered and, at the very least, caveats should be

21. Note also the rights protected under s 17 of the (WA) Retirement Villages Act 1992).
22. (1992) 106 ALR 595, 601; [1992] 66 ALJR 399, 403.
23. (1989) 2 WAR 77.
24. Supra n 1.

lodged in respect of options to renew. The benefits of protecting options by registration are well illustrated by the decisions in *Mercantile Credits Ltd v Shell Co of Australia Ltd*[25] and *Re Eastdoro*.[26]

The decision also clarifies the practical rules relating to the role and function of caveats under the TLA as recently elaborated in *Kuper & Kuper v Keywest Constructions Pty Ltd*.[27] The administrative function of the caveat as a title-freezing mechanism or statutory injunction leading to the adjudication of a caveator's claim is emphasised, the purpose of "subject to claims" caveats has been explained, and the important consequences of failure to lodge a caveat are underlined.

As a direct practical result of the decision in *Leros v Terara*, finance institutions should insist on registration or the lodgement of caveats in respect of leases by borrowers to protect security interests. Failure to do so may be financially and commercially disastrous for lenders and their customers.

25. Supra n 13.
26. Supra n 14.
27. (1990) 3 WAR 419.