IN THE COURT OF APPEAL OF NEW ZEALAND CA191/98

BETWEEN GRANADILLA LIMITED

Appellant

AND JOHN GERARD BERBEN

Respondent

Hearing: 10 March 1999

Coram: Richardson P
Blanchard J
Salmon J

Appearances: M R Camp QC and J L Marshall for the Appellant
J C Corry for the Respondent

Judgment: 10 March 1999

JUDGMENT OF THE COURT DELIVERED BY BLANCHARD J

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[1] These proceedings seek the setting aside of an umpire's award fixing the ground rent payable on the renewal of a registered lease of land at 70 Cable Street, Wellington, opposite Te Papa (the Museum of New Zealand), for a 14 year period commencing on 28 April 1996. The arbitrators appointed by each side having failed to agree, it was then for the umpire, Mr F M Shanahan, to determine the fair market rent. The lease was originally granted by the Wellington Harbour Board and, as described by the umpire, "is effectively a perpetual right of renewal with fourteen year rests....[with] the rental to be valued so as to be uniform throughout the renewed term and....no account is to be taken of the value of any improvements made upon the land by the lessee".

[2] The lessor, Granadilla, is a property investor. The lessee, Mr Berben, has a garage and repair business in an old building on the subject land. The existence of

the building was of course to be disregarded, the rent being fixed on the hypothesis that the land is bare and vacant.

[3] The parties and their respective arbitrators had widely differing views. The lessor's arbitrator was of the opinion that the rent should be $147,800 per annum. The lessee's arbitrator's figure was $44,340 per annum. Mr Shanahan, in a closely reasoned award running to some 18 pages, determined that the rental be fixed at $51,000 per annum.

[4] In the High Court Goddard J was confronted by procedural and jurisdictional arguments with which this Court is not concerned. Counsel for the lessor alleged seven errors of law in the award, all of which the Judge rejected. Three only have been pursued to this Court:

(1) That the umpire misinterpreted the prudent lessee test (it being common ground that was the applicable test) by considering the fair rent largely from the lessee's perspective, instead of equally from the perspective of both parties.

(2) That the umpire erred as a matter of law by failing to have regard to, and give primary weight to, all relevant market evidence, not just "directly comparable" evidence.

(3) That the umpire erred in law by taking too narrow an interpretation of "comparable leases"; in particular, by excluding consideration of rents set in new open market leases which are "terminating" leases, rather than perpetually renewable leases.

Application of prudent lessee test

[5] It is long established in New Zealand that a valuer determining a fair annual ground rent must ascertain "what a prudent lessee would give for the ground-rent of the land for the term, and on the conditions as to renewal and other terms, etc, mentioned in the lease" (*The Drapery & General Importing Co of NZ Limited v The*

Mayor, etc, of Wellington (1912) 31 NZLR 598,605). That test was most recently confirmed in this Court in *Sextant Holdings Limited v New Zealand Railways Corporation* (1993) 2 NZ ConvC 191,556 in which Richardson J (as he then was) and McKay J saw no difference between a prudent lessee test and one which posited a willing but not anxious lessor and a willing but not anxious lessee. We would add that for every abstract prudent lessee there obviously must be an abstract willing but not anxious lessor who has the premises on offer and must be assumed to be willing to "take a ground rent which a reasonable but prudent lessee thinks proper to give" (*In re A Lease, Wellington City Corporation to Wilson* [1936] NZLR s110 at s113).

[6] Importantly, the question is not so much what rental would give the lessor proper interest upon the value of the land but, rather, what rental would a prudent lessee give for the land for the term and subject to the conditions of the lease (*Ziman v Auckland Grammar School Board* [1929] GLR 208). In the application of this test or standard the rent is to be determined on the basis of the open market – a rent which is fair for the premises. What would the hypothetical prudent lessee pay for these particular premises available for the term for which they are available to the actual lessee and on the lease terms and conditions (other than rent) which are to be applicable to the actual lease? In the present case we are not concerned with any modification to the test such as is sometimes required by a particular rent review provision.

[7] Accordingly, the valuer is to be concerned only with matters which would affect the mind and ultimately the judgment of the prudent lessee in making an offer of rental to the lessor. It is the motives which would inspire such a hypothetical person, willing but not anxious, which are relevant. They include of course a consideration of the use to which the lessee may put the premises consistently with any restriction in the lease or the District Plan. Looking at the matter from the hypothetical willing but not anxious lessor's perspective, it is what that party can reasonably expect to be offered which must be assessed, not what that party would like to receive (*Wellington City v National Bank of New Zealand Properties Limited* [1970] NZLR 660). In the *Wellington City* case Turner J, in this Court (at p.670) commented helpfully, if somewhat apologetically, upon the economics of rent fixing in the open market. He observed that the amount which tenants are willing to pay,

not the return to lessors on their investment, is the factor which, economically speaking, determines rental. "The level of rent is fixed, according to economists, purely by the margin of advantage which the given land enjoys over marginal land". Even when no other comparable property is available, Turner J said, so that "rent may be regarded as similar to the price of a monopoly....it is demand which ultimately exclusively determines the price level." Whilst accepting the validity of this position, it is necessary to add the qualification that in practice evidence of comparable rental arrangements may not be available or those ground rents which can be found may themselves have been set by a different method. In the absence of such evidence the valuer necessarily has to proceed by an approach which determines from comparable recent transactions a market value for the property and applies to it a percentage appropriate to the circumstances to arrive at a figure for the rental to be paid. A perusal of relevant decisions suggests that because relatively few new long-term ground rent leases are established, this approach may have become the predominant method of fixing ground rents on renewals of perpetual leases. The umpire called it the traditional approach.

[8] With these observations we turn to the criticism made of the umpire's application of the test. Essentially, it is contended for the appellant that the umpire lost sight of the lessor and considered only, or almost only, the position of the lessee; that he treated the prudent lessee test as if it were different from the willing lessor/willing lessee test. He is criticised for referring to the dictionary definition of "prudent" ("careful to avoid undesired consequences; circumspect, discreet": Concise Oxford) but not looking at any definition of "willing", which the same source gives as "disposed to consent or undertake". It seems to us, however, that this criticism is selective, and that if one were to attempt to define "willing but not anxious", the above definition of prudent would broadly convey the desired flavour.

[9] The umpire was next taken to task for referring to the passage from Smith J in *Wellington City Corporation to Wilson* quoted above and the statement of Henry J in *Feltex International Limited v JBL Consolidated Limited* [1988] 1 NZLR 668 that the lessee ought to pay "a fair consideration". We need do no more than say that the umpire certainly did not err in following the guidance of those authorities.

[10] Then, it is said, the umpire was wrong to say that the prudent lessee "would allow to his Lessor a fair but not excessive return on the capital value of the land having regard to all the circumstances of the Lease". The umpire is said to have here got the matter the wrong way round because in reality the value of the land depends upon the rent obtainable for it in the market place. A fair return on capital may bear little or no relationship to the market rent. We will return to this point.

[11] In the High Court Goddard J concluded that, looking at the whole of the award, and in particular the final matters considered by the umpire under the heading "The Prudent Lessee's View", the umpire had not overlooked the position of the willing lessor. The umpire had said:

> Finally, that the rental the Lessee should determine to pay must not only take account of the Lessee's own interest but, within the overall concept of prudence, also meet the tests of reasonableness and fairness to the Lessor.

[12] Mr Camp argued that this passage was influenced by the earlier reference to return on capital. He said that, accepting that the umpire made reference to the lessor, the manner in which he did so, and what counsel said was a clear bias towards the interests of the "prudent" lessee, tainted the award and the Judge failed to recognise this.

[13] The result, it was submitted, was a very low rental. We were referred to an affidavit sworn on 15 April 1998, just before the hearing in the High Court, in which it is said that less than a year after the award Mr Berben offered his leasehold interest for sale for $600,000 on the basis that he would commit to a rent of $104,000 per annum. We say at once that the Judge was right to disregard this material. It referred to an offer only and the Court has no knowledge of how the figures were arrived at. More importantly, it relates to the situation about two years after the date at which the rent had to be assessed and, as is well known, in the meantime Te Papa had opened with a success surpassing all prior expectations. That may well have had considerable impact on surrounding properties.

[14] It is important, we think, to see the umpire's resort to a return upon the value of the land in the context of the evidence before him and of the award as a whole. A

valuer should preferably begin by considering comparable lettings, making adjustments for differences in time, physical factors (like location, size and dimensions) and lease terms, including duration. This is what was called by the umpire the classic approach. But if, as frequently happens, in a specific case the valuer reaches the conclusion that there are no, or no adequate, comparable lettings he must perforce adopt another approach which accords with settled valuation practice. As we have indicated, the traditional approach is such a settled practice. It was adopted for example, in *Wellington City v National Bank* where nearly all the comparable leases had expired at the same time.

[15] In the present instance the umpire was of the view that, because of a lack of evidence of comparable new open-market, perpetually-renewable lettings, he could place only limited weight on the classic approach. (Later we consider whether he erred in law in coming to that conclusion.) The umpire obviously felt that in the particular circumstances he had little realistic choice of approach and must apply the traditional approach, assessing a value for the subject land and multiplying it by a rate of rental return expressed as a percentage. We have already indicated that this approach is available to a valuer where there is insufficient market evidence of comparable lettings and is often used. It also provides a method of checking an assessment made by reference to such lettings.

[16] It was in this context, having felt obliged to put the classic approach to one side, that Mr Shanahan opined that "within the bounds of his prudence....[the lessee] would allow to his Lessor a fair but not excessive return upon the capital value of the land having regard to all the circumstances of the Lease". In that context it is an unexceptionable statement. Similarly understood, the umpire was not astray in the passage quoted in para [11] of this judgment which does appear to reflect the traditional approach and to be directed to the question of the appropriate rate of return.

[17] We agree with the Judge that, looking at the whole of the award, the umpire cannot fairly be said to have neglected the position of the lessor. We repeat that the fair rent is what the lessor can reasonably expect to be offered, not what the lessor would like to receive. There is more than just a hint of the latter, and a generous application of hindsight as well, in the appellant's position. As Mr Corry pointed

out, in arriving at his conclusions the umpire listed some 13 circumstances which he believed a prudent lessee would have borne in mind. A good number of these looked at the situation substantially from the viewpoint of the lessor (for example, the likely impact of the Museum opening which was, in April 1996, very nearly two years in the future). The award included a 15% upwards adjustment of the land value for the potential effect of that and other projects.

[18] Taking the same view as the Judge, we are not persuaded that the umpire erred by misinterpreting the prudent lessee test.

Failure to have regard to relevant evidence

[19] The other two alleged errors of law can conveniently be taken together – failure to have regard to all relevant evidence and, particularly, excluding from "comparable leases" those new open-market lettings which were not on a perpetually renewable basis.

[20] It is, of course, the province of the valuer, and the valuer alone, to decide what market evidence is or is not comparable. It will only be when it can be said that no reasonable person in the valuer's position would have excluded or disregarded some material that the Court will say that the valuer's decision amounted to an error of law. That is not an easy burden for an applicant to the Court to discharge.

[21] The appellant submits that the umpire did not give primary weight to market evidence of rental levels. The umpire took the view that for such evidence to be relevant it must be of comparable, new, open-market, perpetually renewable leasings and held that no evidence of this sort was available. Instead of analysing the market evidence concerning rentals for new leasings, the appellant submits, the umpire disregarded them and instead laid some weight on evidence of rentals agreed on renewals of perpetual leases for the adjoining land at 50-68 Cable Street which is leased to the Museum. That was said to be wrong because the Museum was an existing lessee and hence a "captive".

[22] It was further submitted that when listing circumstances a prudent lessee would have borne in mind the umpire did not refer to market rentals. And, in expressly rejecting the general thrust of the closing submissions made to him on behalf of the lessor by Mr Marshall, the umpire is said to have rejected a submission that he should have prime regard to the market evidence. Mr Marshall had referred to four leasing transactions (New World Supermarket in 1992, Museum Hotel in 1994, Shelly Motors in 1995 and the Tory/European site at the beginning of 1996). These transactions, counsel had submitted to the umpire, illustrated the dynamic nature of the market, a trend for ground rentals to increase, and to do so rapidly since 1 January 1994, that the market perception of fair rentals had consistently been far ahead of ground rentals fixed by valuers and that tenant demand drives ground rentals.

[23] In response to these arguments, Mr Corry submitted that the appellant did not call evidence from a valuer and did not proffer any analysis to the umpire. He said that there are obvious differences in the four sites which have been mentioned as compared with the subject lease. The appellant accepts that adjustments would therefore need to be made but did not suggest to the umpire how this could usefully be done. The New World Supermarket and Museum Hotel sites were fully developed. The Shelly Motors lease contained a demolition clause and was for two years only (with rights of renewal up to six years) and that for Tory/European was six years only. Mr Corry said that the weight to be given to the four leases was a factual matter to be determined by the umpire. He was entitled to prefer other evidence and cannot be said to be wrong in law in what he did.

[24] Goddard J commented in relation to these arguments, which were canvassed in front of her in several ways, that recent decisions of this Court (*Modick R C Limited v Mahoney* [1992] 1 NZLR 150, *Re Dickinson* [1992] 2 NZLR 43, and *Sextant Holdings*) make it clear that only truly comparable market evidence can confidently be taken into account in assessing any appropriate level of rental, but that where such evidence is available, it ought to be taken into account because of its relevance to such an assessment. None of the cases, however, imposes a requirement on an arbitrator to place prime weight on allegedly comparable transactions which are in fact inconclusive.

[25] The Judge considered that the umpire had not erred to any degree, let alone to one constituting an error of law, in finding that it was not possible to go beyond comparison of comparable new open-market leases in the circumstances of the instant case. Nor was it an error of law for him to make a considered choice in favour of one conventional approach rather than another. In rejecting the general thrust of the appellant's counsel's closing submission, the umpire was not rejecting the validity of a market approach. Rather, the Judge said, "he simply found the so-called market evidence adduced on behalf of Granadilla of limited use because it was neither directly nor truly comparable". That finding, Goddard J said, was open to the umpire on the evidence.

[26] We are satisfied that it has not been shown that the Judge was wrong. Indeed, we agree with the view she has expressed. The parties chose to submit their dispute to the decision of arbitrators or their umpire. That decision is impeachable only for misconduct, which is not suggested, or error of law. The assessment of a value or a rental level is a question of fact. Provided the valuer applies a correct test or standard, then, as we have said earlier, the award can be called into question only when no reasonable valuer could have reached it upon the evidence or, which is really perhaps saying the same thing, no reasonable valuer would have failed to have taken account of and be influenced by particular evidence.

[27] This is not such a case. The view taken by the umpire of the evidence was one open to him. He referred in the award to the evidence which the appellant relies upon but was entitled to form the opinion that it did not provide truly comparable rental evidence capable of being adjusted so as to have useful application to the subject land. He had evidence about the New World Supermarket and Museum Hotel sites but said that it "revealed circumstances peculiar to these two properties which seemed to me to minimise their usefulness for comparative purposes".

[28] The umpire did not ignore the evidence altogether but said he could give it "only limited weight.". He actually referred to the New World Supermarket in his list of circumstances which a prudent lessee would have borne in mind. We agree with Mr Corry that the umpire was not given the assistance of an analysis of transactions said by the appellant to be comparable, accompanied by a suggested

adjustment so that they would fit the matter in front of him. That being so, the approach he took on the material before him was an understandable one. It was no doubt somewhat easier to compare land sales in the vicinity of the site than to compare leasings where numerous factors may have come into play, especially the suitability of a site for a specific occupation by a tenant at a particular time. Commercial properties, on the other hand, may be bought for a variety of reasons. It is to be noted, however, that even when considering land sales in the vicinity to the property the umpire was troubled by the fact that none was an ideal comparison.

[29] We are not at all persuaded that a reasonable umpire would or should have been guided by the rental levels apparent in the four transactions to which the Court has been referred and which Mr Marshall's submissions emphasised. There are obvious differences between the subject property and the much larger sites involved in the supermarket and hotel site leases. Those properties had also much more road frontage. They were suitable for the specialised uses for which the lessees required them. The present site, in contrast, is relatively small (739m²) with only one road frontage.

[30] It has adjacent to it land which in 1996, and even now, appears dedicated to a particular business or purpose. The possibility of future amalgamation of the subject property with one of its neighbours, raised by Mr Camp, is merely a speculation. The umpire was entitled to place little or no weight on it.

[31] We have already been tempted to stray into a discussion of factual questions and perhaps should not have done so. They were a matter for the umpire to assess. We therefore say nothing about the other two leases alleged to be comparable, other than to remark that Mr Corry was able to point to aspects of those transactions which fully entitled the umpire to conclude that they were not helpful.

[32] On the other hand, although the leases to the Museum were renewals, and caution was needed in relation to them for that reason, they related to immediately adjacent land and had occurred quite recently. The umpire was not acting unreasonably in giving them some limited weight, expressly noting the "captive" element as he did so.

[33] We find no error of law in the umpire's approach to the evidence.

Result

[34] The appeal is dismissed with costs of $5,000 payable by the appellant together with the respondent's reasonable disbursements.

Solicitors
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Foot & Co, Wellington, for Respondent