Legal Decisions

Lease - rent review clause - whether time is of the essence when objecting to notice setting new rent.

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY 4 JUL 1995

M. 84/94

UNDER	the Declaratory Judgments Act 1908
IN THE MATTER	of Memorandum of Lease dated 3 June 1983
BETWEEN	MOBIL OIL NEW ZEALAND LIMITED Plaintiff JILL LANCASTER MANDENO First defendant
AND	EDWARD CAROL LIMITED Second Defendant
Hearing	26 April 1995
Counsel:	J.R.F. Fardell and Ms M. Bradford for plaintiff T.R.P. Hunt for first defendant G.J. Turner and G.J. Heath for second defendant
Judgment:	May 1995

JUDGMENT OF BARKER J

Solicitors: Russell McVeagh McKenzie Bartleet & Co, Auckland, for plaintiff
Jackson Russell Dignan Armstrong, Auckland for first defendant
Fortune Manninq, Auckland, for second defendant

The plaintiff seeks declarations as to its rights under a rent review clause contained in a memorandum of lease dated 3 June 1983, concerning a service station at Balmoral Road, Auckland.

The plaintiff is now the lessee and the first defendant the lessor. The second defendant became the lessor on 16 December 1986. On 16 August 1988, the plaintiff purchased a previous lessee's interest.

There is no dispute concerning the facts; the dispute revolves around clause 3.11 of the lease which is in the following terms -

"The yearly rental for the time being may be altered with effect from the expiration of two (2) years from the date of commencement of the term and from each second anniversary thereafter (each such date hereinafter called "the rental review date") in the following manner:

(a) At any time not earlier than, the period commencing three (3) months prior to any rental review date the **lessor may give notice in writing to the lessee of the new yearly rental proposed by the lessor which the lessor considers is or will be the current market rental of the demised premises as at such rental review date.**

(b) In the event of the lessee not **giving notice in writing to the lessor within twenty-eight (28) days after receipt of the lessor's notice that he disputes that the proposed new yearly rental is the current market rental for the demised premises then the lessee shall be deemed to have accepted the proposed new yearly rental** and as from, such rental review date the yearly rental shall be that proposed by the lessor.

(c) **If the lessee gives the lessor written notice disputing the proposed new yearly rental** then the new yearly rental from such rental review date shall be fixed and settled by **arbitration** but such yearly rental shall not at any time be less then [sic] the yearly rental payable immediately prior to such yearly review date.

(d) if the lessee disputes the amount of the new yearly rental proposed by the lessor the **lessee shall nevertheless make rent payments to the lessor** in the manner hereinbefore provided **at the rate stipulated in the lessor's proposed new yearly rental on account of whatever rent is finally settled or determined** by agreement or arbitration as the rent for the demised premises from the relevant rental review date and **any overpayment or underpayment shall be the subject of an immediate adjustment between the lessor and the lessee as and when the rent for the following two year period is determined** as aforesaid.

It is acknowledged by and between the lessor and the lessee that the failure of the lessor to give notice pursuant to cl. 3.11(a) hereof shall not prejudice the right of the lessor to give such notice subsequent to a rental review date then the lessee shall pay such yearly rental as is thereafter agreed upon by the parties or determined by arbitration from the yearly rental review date (Emphasis added)

By letter dated 10 May 1990 the then lessor, the second defendant, advised the plaintiff in writing that the proposed rental for the next rental period, i.e. from 18 June 1990 to 17 June 1992, was to be $95,554 per annum exclusive of GST. By letter dated 19 June 1990, the second defendant advised the plaintiff that, because it had not received a response from the plaintiff within the 28 day period stipulated in clause 3.11(b), the plaintiff was deemed to have accepted the lessor's proposed annual rental.

By letter dated 23 June 1990, the plaintiff advised the first defendant that it did not accept the proposed rent. It had requested a valuer to appraise the property and would advise its attitude to the first defendant's proposal once that report had been received. The plaintiff further acknowledged its obligation to pay rental at the proposed

rate until agreement had been reached. Correspondence was exchanged during July and August 1990 between solicitors then acting for the plaintiff and the second defendant which did not advance matters. In these exchanges, each party maintained its previously stated position; the plaintiff indicated its willingness to arbitrate the quantum of the rental.

By agreement dated 3 April 1991, the second defendant sold the demised property to the first defendant. Included in the written agreement for sale and purchase were the following details concerning the subject lease -

Rent:	$95,554
Term:	12 years
Right of Renewal:	6 years

Subject to existing tenancy (Mobil Oil NZ Limited)

The plaintiff had no knowledge that this representation as to rental had been made to the first defendant. The first defendant knew nothing of any rental dispute between the plaintiff and the second defendant when she agreed to purchase the land. By letter dated 9 April 1991, the second defendant informed the plaintiff that it had sold the property and sought the plaintiff's confirmation as to the amount of rental it was paying.

In subsequent correspondence with solicitors for both defendants, the plaintiff affirmed its view that the rental was being paid on a provisional basis in terms of the lease and that the plaintiff wished to arbitrate the question of rental.

On 24 May 1991, the second defendant wrote to the plaintiff -

> "Your continued inaction on this matter gave us every reason to believe that you had accepted you were wrong in the matter of the rent review. In good faith we sold the property bearing the rent we had correctly reviewed. You were aware we were selling the property and still remained silent."

Desultory subsequent correspondence between solicitors achieved nothing. It was not until 31 January 1994 that the plaintiff, with new solicitors acting, filed a claim for declaratory relief. The plaintiff seeks a ruling that time is not "of the essence" in relation to clause 3.11(b) (supra); that the plaintiff was entitled to have given notice disputing the level of rental proposed by the lessor within a reasonable time after the period specified in the clause. Other matters were raised in the pleadings but at the hearing before me, the "time of the essence" point remained the only matter for determination.

I was referred to many authorities on "time of the essence", particularly those in relation to rent review clauses. The starting point is a presumption that the specification of a time limit does not necessarily make time of the essence. In *United Scientific Holdings Ltd v Burnley Borough Council* [1973] AC 904, 958 the following passage in the speech of Lord Diplock has been accepted in subsequent authorities as correctly stating the modern rule about the construction of time limits in rent review clauses -

> "...in the absence of any contra-indications in the express words of the lease or in the interrelation of the rent review clause itself and other clauses or in the surrounding circumstances the presumption is that the time-table specified in a rent review clause for completion of the various steps for determining the rent payable in respect of the period following the review date is not of the essence of the contract"

A helpful summary is to be found in a judgment of Chilwell J in *Wing Crawford Holdings Limited v Lion Corporation Limited* [1989] 1 NZLR 562, 565, 569. This summary was approved by the Court Of Appeal in *Zodiac Printing Company Limited v Invincible Life Assurance Limited* [1991] 1 NZ ConvC 190, 761 190,769.

The cases show the essential point is whether time of the essence was intended as a matter of construction. Three cases of particular applicability reed to be considered two decisions of the English Court of Appeal and one of the New South Wales Court of Appeal.

In *Trustees of Henry Smith's Charity v AWADA Trading & Promotion Services Limited* [1983], 47 P & CR 607, time was held to be of the essence in a lease which contained a strict timetable for arbitration after the parties failure to agree on a market rent for the next rent period. The timetable stated the consequences of failure to follow the timetable. Accordingly, the presumption that time was not of the essence was displaced.

There the lessor had served a review notice within the time prescribed. The tenant served a counter-notice. The parties were unable to agree upon a market rent with a given required time-frame. The lessor failed to appoint a surveyor within the two month period required by the lease after service of the tenant's counter-notice. The lessor sought to appoint a surveyor outside the two-month period; the tenant contended that the market rent was that nominated in its counter-notice. Paragraph 7 which read "if on the expiration of two months from the date of service of such counter-notice the landlords and the tenant shall not have agreed in writing an amount to be treated at the market rent and the landlord shall not have applied for the appointment of a surveyor in accordance with paragraph (6) of this schedule the amount stated in such counter-notice shall be deemed to be the market rent".

Donaldson M.R. stated aT 615 -

> "In neither case would it be possible seriously to write into the clause after each specified period of time words such as "or such longer period as shall elapse before the expiration of reasonable notice making time of the essence of the contract". Accordingly, in my judgment, the parties must be deemed to have intended that in the case of their lease the general rule should not apply and that time should be of the essence of the contract."

Griffiths L.J. (as he then was) found sufficient contra indications in the lease before him to require time to be of the essence. The third member of the Court, Slade L.J, considered that the deeming provision in the clause cited (similar to that in the present case) was sufficient to indicate that time was of the essence.

In *Mecca Leisure Limited v Renown Investments (Holdings) Ltd & Anor* [1984], 49 P & CR 12 (a case not referred to by Chilwell J in Wing Crawford), the majority of the Court of Appeal held that time was not of the essence despite a "deeming" clause which stated that, if the lessee failed to serve a counter-notice, within the period of 28 days after the receipt of the landlord's notice the lessee would be deemed "to have agreed to pay the increase specified in the rent notice as from the review date". The counter-notice was first designed to require the lessor to negotiate with the lessee; a further 28 days after service of the counter-notice was given for the parties to use their best endeavours to reach agreement; failing agreement, the

dispute was immediately to be referred to arbitration.

Eveleigh L.J. considered that the parties intended to provide machinery for the determination of fair rent and regarded it as desirable that the rent be determined by mutual agreement. He also thought it important that there was an absence of a provision, as found in the present case, for the payment of the lessor's proposed rent in the interim pending determination. Eveleigh L.J. at 16 distinguished the ***Henry Smith*** case on the following basis -

"There was also an important provision for the payment of provisional rent at the figure stated in the landlord's notice pending determination of the market rent by a surveyor. There was also a provision for adjustment of the positions between the landlord and the tenants once the market rate had been determined, but no interest was recoverable by the party who had been out of pocket. In that case, time was said to be of the essence."

May L.J. considered that, whilst there was some element of finality in the deeming provision, he held that in the light of the scheme of the rent review as a whole, the deeming provision did not rebut the presumption that time was of the essence.

In a strong dissent, Browne-Wilkinson L.J. (as he then was) held that the deeming clause was sufficient to make time of the essence. The statements of his reasoning are as follows -

(a) at 23 - "First, it can be said that the provision for a default rent is the clearest possible indication of the parties' intention that the service of the notice in time should be of the essence, because the parties have expressly fixed that is to happen if no proper notice is served within that time limit."

"Hitherto the doctrine has only operated so as to allow one party to perform obligations laid down in the contract at a later date; it has never operated so as to alter the substantive terms of the contract entered into between the parties, other than the terms as to time..."

(b) at 24 - "It is not clear to me how this conflict between the expressed terms of the bargain and the rent that will be payable if the tenants' counter notice is held to be valid is to be reconciled. **To hold that time was not of the essence of the tenants' counter notice would involve not simply extending the time limits within which the parties' bargain could be performed but an alteration of the parties' bargain itself.**" (Emphasis added)

(c) at 24 - "It would in my judgment be most undesirable if in every case where a notice was served out of time, the parties were in doubt as to the legal consequences. In commercial and property law it is, in my judgment, of the highest importance that the parties should know the legal consequences of their acts without having to go to court for them to be determined."

The case which in my view is clearly decisive is *G.R. Mailman & Associates Pty Limited v Wormald (Aust) Pty Limited*, [1991] 24 NSWLR 80; the relevant parts of the lease there provided -

(a) "...the lessor may give notice in writing in the form set out hereunder to the lessee increasing the yearly rental to an amount which the lessor considers the current market rent ...

(b) Prior to the expiration of 14 days from the service of any such notice from the lessor, the lessee may, by notice in writing to the lessor, dispute that the amount set out in the notice referred to in paragraph (a) above is the current market rent and in such notice the lessee shall nominate one of the firms from the following panel of valuers...

(c) Upon receipt of such notice of dispute from the lessee, the lessor shall appoint the nominated valuer to give a written opinion of the current market rent...

(d) In the event that the lessee does not serve notice of dispute on the lessor within the time prescribed in paragraph (b) above the lessee shall be deemed to have agreed that the amount set out in the notice referred to in paragraph (a) above is the currant market rent...

(e) If either the lessor or the lessee dispute the level of the current market rent determined by the valuer then such party shall be entitled to obtain a further written opinion ...

(f) If the parties are still unable to agree as to the current market rent after the procedures in paragraphs (a) to (e) above have been exhausted, then the lessor will request the president of the Australian Institute of Valuers... to appoint a qualified valuer to determine the current market rent...

(h) The amount nominated pursuant to paragraph (a) or determined or deemed to be determined pursuant to the procedures set forth in paragraphs (b) to (f) (as the case may be) shall be the yearly rent payable by the lessee as from the relevant review date for the next immediately succeeding review period provided always that unless and until such a determination of the current market rent shall have been made, the lessee shall pay to the lessor monthly on account of rent amounts equal to the monthly rental payable by the lessee prior to the review date together with an amount equal to 80% of the increase as set out in the notice referred to in paragraph (a) ...

(I) If the lessor shall fail to give notice within the period of 60 days referred to in paragraph (a) the lessor may nevertheless give such notice at any time during the ensuing review period..."

All three Judges in the New South Wales Court of Appeal considered the English authorities and came to the conclusion that time was "of the essence" when the lessee did not serve a counter-notice within the stipulated time.

Gleeson CJ at 90 stated -

"I am unable to accept that [the commercial considerations invoked ... by the House of Lords] can be taken to the length of entitling a court to disregard, or fail to give effect to, the language of an express stipulation such as that contained in the lease. It is one thing to treat a stipulation as to time as directory rather than mandatory, it is, however, another thing to treat a contractual provision which spells out the agreed consequence of failing to do something within a particular time as not meaning what it says."

Samuels JA at page 97 said -

"If in this case the Court were to hold that time was not of the essence in par (b) and par (d), this would in effect

require the Court to rewrite the express terms of par (d). This is not a case where the parties have failed to set out the consequences of a "breach". Thus, there is no room for the Court to apply the presumption considered in United Scientific."

Meagher JA at 100 was critical of the English approach saying -

"Certainly English dicta suggests that such 'deeming provisions' are not conclusive, but as a matter of logic, I cannot see how this can be so. Once a contract expressly spells out the consequences of non-compliance with a time limit, I cannot see how it can be argued that the time limit is nonessential."

The Court approved the dissenting judgment of Browne-Wilkinson L.J. in the *Mecca* case.

The New South Wales Court of Appeal opted for certainty in commercial contracts. Meagher JA at 101 observed that little point was to be made by stigmatising the operation of the clause as "draconian", emphasising that, if parties agree on the terms of a contract, it is irrelevant whether on not they are draconian. The provisions in the lease under consideration in the *Mailman* case, whilst more elaborate than the present provisions, share with the present lease the basic feature that, if the lessee does nothing within a specified time limit then the lessee is deemed to have accepted the lessor's statement of the rent payable. It is difficult to see what else the parties could have done to have made this consequence clearer.

It is also a significant matter, as was acknowledged by Samuels JA in the *Mailman* case at 97, that the provisions of the lease allow a lessor to have a "second chance" to initiate a review if it fails to exercise its right to do so by the date originally stated. However, the same leniency was not intended by the parties to be extended to the lessee. I consider that there is a very clear indication in the present case, as clear as it was in the *Mailman* case.

Nor is there any provision, as in the *Mecca* case, for the parties to determine the rental amicably. In summary the situation is not dissimilar to that which I found in *Weight Watchers International Inc v Hansells (NZ) Ltd* (unreported, C.L.60/93, 22 November 1993). There I reviewed authorities on "time of the essence", acknowledging that rent review clauses seemed to be in a special category. However, following American authority (i.e. *Brown Method Co v Ginsberg* 138 Atlantic Reporter, 402, a 1927 decision of the Court of Appeals of Maryland) even a day out in giving a notice where time is of the essence was seen as "being small in one view but it is the distance across the necessary boundary in relations under the contract and must be taken as decisive or there will be no boundary".

Though the contract situation was different in the *Weight Watchers* case, I think the following words at page 8 of my unreported judgment have some applicability here -

"Looking at the contract as a whole, I consider that the parties considered there was a need for certainty; the contract itself provided the means for its renewal by inaction. Come 1 November 1992, either party, not having received a notice from the other, could immediately assume that the other party was satisfied that their relations should continue for the next 5 years on the existing basis. There is no room for a concept of reasonable notice. Such would alter the contract. The fact that a 13 day delay may, on one view, be thought to have a draconian effect is not the point:. To paraphrase the words of the Maryland Court, there has to be a boundary. Had the parties intended that their contract be renewed by overt act: i.e. by formal notice of renewal then they could easily have made provision to that effect."

For the reasons stated in their judgments, I prefer the unanimous decision of the Court of Appeal of New South Wales in *Mailman* and the dissenting judgment of BrowneWilkinson LJ in Mecca. I am driven to the same conclusion as the Judges in those cases by holding that the parties intended that time should be of the essence, particularly when dealing with the response of a lessee to whom the contract did not give the same leniency in the matter of notice as to the lessor. The plaintiff's application for a declarations will be dismissed. The plaintiff must now live with the rental indicated in the notice to which it failed timeously to respond.

Both defendants are entitled to costs. The first defendant was a proper party and of course knew nothing of these arrangements, not having been told by either of the other two parties. The first defendant is entitled to costs of $1500 plus disbursements. The second defendant to costs of $3,000 plus disbursements.

Recent Appointments

Valuers Registration Board

John Larmer of Taranaki has been appointed to the Valuers Registration Board. He replaces Mr Peter Tierney of Tauranga who has retired. Mr Larmer is Immediate Past President and a Fellow of the New Zealand Institute of Valuers. He is also a Fellow of the Arbitrators Institute and a Councillor of the the NZ Society of Farm Management.

The South African Institute of Valuers

C.H. Hablutzel has recently taken up the position of General Secretary of The South African Institute of Valuers. The contact address is 13 Piers Rd, Wynberg, Cape Province. PO Box 18041 Wynberg 7824. Telephone 0027 021 762 3313. Fax 0027 021 797 2235.