IN THE COURT OF APPEAL OF NEW ZEALAND CA 25/94

BETWEEN AUSTRALIAN MUTUAL PROVIDENT SOCIETY Sublessor

Appellant

AMP vs National Mutual Life Ass

AND NATIONAL MUTUAL LIFE ASSOCIATION OF AUSTRALASIA LIMITED Sublessee

Respondent

Coram Cooke P
Hardie Boys J
Tompkins J

Hearing 10 October 1994

Counsel B Bornholdt and S J Galloway for Appellant
R J Craddock QC and T S Sissons for Respondent

Judgment 18 November 1994

JUDGMENT OF THE COURT DELIVERED BY HARDIE BOYS J

This appeal from a judgment delivered by Barker J on 16 December 1993 is about the true meaning of rental review provisions in a sublease of a Wellington commercial building of which the appellant is sublessor and the respondent is sublessee.

The sublease is dated 11 June 1991 and is expressed to be for a term of 13 years 9 months from 1 March 1991

> at a yearly rental (hereinafter called 'the Base Rent') of SIX HUNDRED AND SIXTY ONE THOUSAND, SIX HUNDRED AND

SIXTY NINE DOLLARS ($661,669.00) (plus Goods and Service Tax) for the period from the Date of Commencement until the 30th day of November 1992 (and thereafter as determined in accordance with the provisions of Clause 3.06 hereof).

It was not contended that the expression "the Base Rent" has any particular significance in the case. It simply distinguishes the rent for the premises themselves from other rents - the Fixed Rent for fixed partitions and the Name Rent for the right to name the building.

Of the covenants as to the payment of rent, the following need to be set out:

3.01 The Lessee shall pay to the Lessor during the term of this Lease the Base Rent at the rate hereinbefore specified or where increased in accordance with the express provisions of this Lease at the increased rate.

3.06 (a) At any time not earlier than four (4) months (in which regard time shall not be of the essence) prior to each of the successive dates stated in Item 3 of the First Schedule (each of such dates being called "the review date") [the Schedule gives the review dates as (i) 1 December 1992, (ii) 1 December 1995, (iii) Thereafter at intervals as agreed or determined in accordance with Clause 3.06(d)] the Lessor may give notice in writing to the Lessee setting out the amount which the Lessor considers to be the current market rent of the Land and the Building as at that particular review date and unless within one (1) month after the date of service of the said notice the Lessee shall by notice in writing to the Lessor (herein called "the Lessee's Notice") dispute the rent so fixed and set out in the Lessee's Notice the amount which the Lessee considers to be the current market rent of the Land and the Building as at that particular review date then the rent so fixed by the Lessor shall be the Base Rent as from that particular review date in substitution for the amount specified in this Lease or where applicable the rent determined at any previous review date PROVIDED ALWAYS that notwithstanding that the Lessee may dispute the Lessor's notice of the current market rent pending determining of the current market rent either by negotiation or as provided in Clause 3.06)b) the Lessee shall pay Base Rent for the Land and the Building at the current market rent set out in the Lessor's notice from the review

date SUBJECT ALWAYS to adjustment between the parties.

(There then follow fairly standard provisions for the rent to be fixed by negotiation or failing that by representatives of the parties or by their umpire; and for the lessor not to forfeit its right to a review by failing to give notice within the stipulated time.)

3.06 (c) The Lessor shall not by reason of its failure to give notice prior to the review date of the rent which it proposes to fix for that review date forfeit its right to have the rent reviewed from the review date and if the Lessor gives such notice later than the review date then the said notice whenever given shall be of the same force and effect as if it were given prior to the review date, and the rate at which the rent is payable from the review date shall date back to and be payable from the review date.

3.06 (d) After the rent review on 1 December 1995, rent reviews for the remaining nine (9) years of the term of the Lease shall take place at intervals as may be mutually agreed by the Lessor and the Lessee (but such intervals to be in no circumstances more than three years apart) such intervals to be the usual intervals for rent reviews being incorporated in leases granted by the Lessor of similar commercial premises in the part of the City of Wellington in which the Building is situated as at 1 December 1995. If the Lessor and the Lessee cannot agree on the intervals at which the rent reviews shall take place after 1 December 1995 as hereinbefore provided the matter shall be determined by arbitration.

The words "shall take place" are repeated in cl 3.08 which deals with the postponement of rent reviews by statute or regulation and their resumption following the lifting of any moratorium.

It will be noted that there is no ratchet provision, whereby the rent fixed on any review is to be not less than the rent for the period immediately preceding. There is however such a provision in cl 2.04 which gives the sublessee the right at the expiration of the term to a new sublease at a rent no less than that payable in the immediately preceding year.

The issue in the case may be put very simply. It is whether the sublessor is obliged to set the rent review procedure in train at each review date or whether it has the option of doing so or not; in other words whether the words "may give notice" in cl 3.06(a) mean "shall give notice". The issue arises because on 30 September 1992 the appellant informed the respondent that "it had decided not to review the rent on 1 December 1992". The reason plainly was that the current market rent had by then fallen below the commencing rent. For that same reason the respondent naturally desired a rent review, and when the appellant persisted in its refusal to embark on one, instituted this proceeding seeking declaratory relief.

1st decision

Barker J found for the respondent. He said he was heavily influenced by the absence of a ratchet clause; acceptance of the appellant's case would have had the result of including one when it was legitimate to infer that the parties had deliberately gone out of their way not to include one. He considered that the central and dominant provision is what he called the demise clause in which the parties had stipulated that the rental of $661,669 plus GST applied only for the period to 30 November 1992, and that thereafter the rental was to be the amount determined by the review procedure. To regard use of that procedure as being at the election of the lessor was, he thought, to render the demise clause meaningless:

> To give the demise provision some meaning, the parties must be taken to have assumed that the lessor should give the notice in writing triggering the review process and with that notice should have stated the lessor's view of the current market rent. At the very least, it must be that the lessor is required to trigger the process should the lessee require it.

It is apparent that neither party to this document has thought through the implications of the combination of provisions that have been incorporated in it. Thus the expectation created by the use in what in strict parlance is the reddendum, of the

phrase "determined in accordance with the provisions of cl 3.06 hereof" is frustrated by the use of the permissive "may" in para (a) of that clause, for if that word is given its ordinary meaning there is no certainty that anything will be "determined". And if "may" in cl 3.06(a) does not mean "shall", "shall" in cl 3.06(d) cannot mean "shall" either, at least without some qualification. On either construction contended for by the respective parties it will be necessary to read down or qualify or even alter the ordinary meaning of words.

Court of Appeal

With respect, we cannot agree with Barker J that the deciding factors in the construction of the document are the wording of the demise clause and the absence of a ratchet clause. In determining which construction to adopt, the Court must look at the document as a whole, rather than give emphasis to any particular part. And it must endeavour to ascertain the intention of the parties by reference to the commercial purpose, and to the practicalities, for the parties obviously intended that what they provided for should work in a sensible and realistic way. Those principles are not easy to apply in this case, for all there is is the sublease. There is no evidence of surrounding circumstances that may have provided some assistance in judging what the parties intended by the words they used. Nor is it suggested that the words used did not correctly record their agreement; there is no application for rectification or for a remedy under the Contractual Mistakes Act 1977. The case turns entirely on the sublease itself, and any inferences that may properly be drawn from it. But these are very limited. It is understandable that the sublessor may have desired rent reviews to be optional. It is equally understandable that the sublessee may have desired them to be obligatory. There are valid reasons for both alternatives. The same may be said of the short period during which the commencing rent is expressed to be payable, and of the unusual term of the lease. There are doubtless several possible explanations for both. Even if, as Barker J held, it is a reasonable inference that the omission of an express ratchet provision from cl 3.06(a) was deliberate, it does not necessarily follow that the parties must have intended that the sublessor was required to give a notice

under cl 3.06(a), whether it wished to do so or not. It is quite possible that what they intended was that, while the sublessor would not be required to invoke cl 3.06(a) at each review date, if it elected to do so it would accept the risk that despite its expectations the result would be that the rent was fixed at less than the rent previously applicable. That approach may well accord with commercial reality.

The respondents' case is based, as was Barker J's judgment, on the proposition that the rental of $661,669 was payable only until 30 November 1992; and that as from that date another sum was to be fixed in substitution for it. Mr Craddock's submission was that that could not be done unless the next review procedure were undertaken. He contrasted this with a form of lease whereby the initial rent is payable throughout the term, subject to review at the lessor's option, but with a ratchet clause. Although this lease is not in that form, the appellant's construction would, he submitted, give it the same effect. To make the lease work by ensuring the rent is fixed after 30 November 1992, "may" must be read as "shall"; and no other modification is needed.

For the appellant, Mr Bornholdt submitted that the absence of a ratchet clause is no indication that a mandatory rent review was contemplated; rather, its absence strengthens his case, for the possibility that rent will be decreased on a review supports a construction that review is at the sublessor's sole option. His essential submission was that "may" is to be given its ordinary and natural meaning, and that if it is, the rest of the document can be read consistently with that meaning.

We agree with that submission. It would be permissible to construe the word "may" as "shall" if the document as a whole plainly requires that departure from its ordinary meaning. But in our view it does not; and indeed so to construe it results in a straining of the meaning of the document as a whole.

To read "may" as permissive is to give effect to the concept expressed in cl 3.06(c) that review is a right of the lessor. And although it means that following 30 November 1992 there may strictly be no determination pursuant to cl 3.06, that contingency is covered by cl 3.01 which applies during the whole term of the lease and not merely until that date. The word "determined" is thus qualified by the optional nature of the review process, as is the expression "shall take place" in cl 3.06(d). The former is accordingly to be read as referring both to a new rent being fixed upon a review and to the existing rent continuing following the sublessor's decision in accordance with cl 3.06 that there should be no review. Putting it in another way, the rent is determined by the decision not to review. Correspondingly, the expression "shall take place" is to be read as applicable if the sublessor so requires.

Obviously these conclusions are not free from difficulty and doubt, but they are preferable to an interpretation which denies "may" its ordinary meaning, and has no regard to cl 3.01. Mr Bornholdt did not claim that that was in effect a ratchet clause, but although it may not negate a possible rent reduction, it certainly does not contemplate one. It therefore gives support to the conclusion that the sublessee cannot insist on a rent review in order to obtain the advantage of a falling market.

For these reasons the appeal is allowed, with costs to the appellant of $5,000 together with disbursements, including the cost of printing the case, as fixed by the Registrar.

Solicitors

Rudd Watts & Stone, Wellington, for appellant
Simpson Grierson Butler White, for respondent