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IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

No. CP118/89

BETWEEN BURNETT TRANSPORT LIMITED

Plaintiff

A N D LAWRENCE JOHN DAVIDSON

First Defendant

A N D GARY ROBERT FAIL and JANET ALICE WALKER

Second Defendants

Hearing: 6 September 1990

Counsel: G.M. Brodie for Plaintiff
S. Hembrow for First Defendant
D.I. Jones for Second Defendants

Judgment: 21 SEP 1990

JUDGMENT OF HOLLAND, J.

These proceedings are brought by the plaintiff seeking, pursuant to s.12 of the Arbitration Act 1908, or to the inherent jurisdiction of the Court, an order setting aside an award.

Until the introduction of the new High Court Rules such an application would have been brought to the Court by way of notice of motion and heard on affidavit evidence subject to the right of an opponent to cross-examine deponents.

The new Rules require the proceedings to be brought by way of notice of proceeding with statement of claim and statement of defence. Rule 496 of the High Court Rules requires evidence to be given orally except where otherwise directed by the Court. Applications of this kind under the Arbitration Act are not included in the types of proceedings for which special procedure is prescribed under

Part IV of the Rules. I think that this exclusion is a pity. In most cases such applications will be dealt with more expeditiously and satisfactorily on affidavit.

The plaintiff did not apply to the Court under Rule 449(d) for directions that Part IV should apply. Had it done so, an order would probably have been made directing that service on the first defendant, the maker of the award, was unnecessary, as well as orders for the evidence to be given by affidavit. If the proceedings had been brought in the Auckland Registry with an application for them to be brought under the umbrella of the Commercial List such orders would undoubtedly have been made. Such forms of procedure should not be restricted solely to those dealt with in that Registry, or indeed, be limited only to arbitrations which have a "commercial flavour".

I mention this because there was some evidence of inconvenience to a possible witness, who was overseas at the date of hearing. Although in the end that person was not called as a witness, he could have given evidence by affidavit if the Rules so provided.

Further, when the case was called I asked counsel for the first defendant what part he was to take and why he could not leave the matter to be resolved between the parties. The reply was that the plaintiff sought relief against the first defendant by way of costs. This claim for costs was immediately abandoned by the plaintiff and counsel for the first defendant was granted leave to withdraw. There is no allegation as to the integrity or honesty of the first defendant raised in the proceedings and it is

unfortunate that costs have been incurred by his being named as a party.

The grounds relied upon by the plaintiff to have the award set aside are misconduct of the proceedings and error of law shown on the face of the award.

The foundation of the first defendant's jurisdiction as an arbitrator or umpire is a provision in a memorandum of lease dated 15 February 1985, of business premises in Ashburton owned by the second defendants and leased to the plaintiff. Clause 1.19 of that Memorandum of Lease provides:-

> "The rental payable hereunder shall be reviewed once every three years during the term of the lease to such rental as shall be mutually agreed upon between the lessor and the lessee and failing such agreement aforesaid then at a rental to be determined by Arbitration in accordance with the provisions contained herein PROVIDED HOWEVER that the rental as determined shall not be less than the rental payable in respect of the preceding 3 year period."

The lease was for a term of 12 years from 15 February 1985 with rights of renewal for three further terms of six years each. The original rental was $42,000 per annum. The arbitration provisions contained in the lease are contained in Clause 3.09(1) of the Memorandum of Lease, as follows:-

> "Every reference to arbitration contained in this lease shall be deemed to be a reference to the arbitration of a single arbitrator in case the parties can agree upon one, and otherwise to two arbitrators or to their umpire in case of disagreement (one of the arbitrators to be appointed by each party in

dispute) and in either case in accordance in all respects with the provisions in that behalf contained in the Arbitration Act 1908 or any statutory modification or re-enactment thereof for the time being in force."

There are ancillary powers given to arbitrators in sub-paragraphs (2) and (3) but they have no bearing on the issues arising in these proceedings.

The evidence as to the arbitration was brief indeed. It consisted solely of the oral testimony of Mr Thomas, a real estate agent engaged by the plaintiff and the production of some relevant documents.

Paragraphs 6, 7 and 8 of the amended statement of claim were admitted in the statement of defence. They are as follows:-

"6. THAT the plaintiff and the second defendants were unable to agree on the rental to be paid for the period of three years commencing on the 15th day of February 1988, and pursuant to clause 3.09(1) of the lease the issue was then referred to the arbitration of COLIN MALCOLM McLEOD of Ashburton, Valuer (appointed by the second defendants) and RUPERT TREVOR THOMAS of Christchurch, Valuer (appointed by the plaintiff) as arbitrators and the first defendant as umpire.

7. THAT the arbitrators were unable to agree on the rental for the premises, and the issue was then determined by the first defendant as umpire.

8. THAT by his award dated the 16th day of January 1989 the first defendant determined that the annual rental for the premises for the period of three years commencing on the 15th day of February 1988 should be $89,900 per annum exclusive of Goods and Services Tax."

Mr Thomas said that he and Mr McLeod were each appointed by the plaintiff and second defendant respectively and that the first defendant was appointed by them as umpire. He produced what he described in response to a

leading question of counsel for the plaintiff as an agreement to submit to arbitration. It is as follows:-

" APPOINTMENT OF UMPIRE

IN THE MATTER of Memorandum of Lease Dated 15th February 1985

B E T W E E N

GARY ROBERT FAIL & JANET ALICE WALKER Lessor

A N D

BURNETT TRANSPORT LIMITED Lessee

IN THE MATTER of the Valuation to be made in accordance with and under the provisions of the said Memorandum of Lease to ascertain the fair annual rental of the Premises, and Land corner Dobson, East & South Streets Ashburton demised thereby for the new term of three (3) years from the 15th day of February 1988 mentioned in the said Lease to commence from the expiration of the term created by the said Lease.

WE, the undersigned COLIN MALCOLM McLEOD, Registered Valuer of Ashburton, and RUPERT TREVOR THOMAS, Real Estate Agent respectively appointed by the above-mentioned Lessor and Lessee in respect of the abovementioned valuation, do hereby appoint LAWRENCE JOHN DAVIDSON of Christchurch, the Umpire in accordance with the provisions contained in the said Memorandum of Lease.

SIGNED this 3rd day of August 1988

C.M. McLeod
.....

Rupert T. Thomas
.....

I accept this appointment and agree to act.

L.J. Davidson
.....
L.J. Davidson"

There was then produced what was described as the written submissions of Mr Thomas and Mr McLeod each addressed to the first defendant and dated 17 August 1988 and 26 October 1988 respectively. There was an informal meeting held by the first defendant with Messrs Thomas and McLeod on an unspecified date some weeks after the submissions were presented but there was no evidence of anything of significance occurring at that meeting.

On 16 January 1989 the first defendant made his award determining that the annual rental for the three year period from 15 February 1988 should be $89,900 plus goods and services tax.

Originally I had some doubts as to whether there had been an arbitration at all. I infer that once the plaintiff and the second defendants appreciated that a rent review was necessary the plaintiff instructed Mr Thomas and the defendants instructed Mr McLeod, a Registered Valuer, and henceforth matters were left to them. Mr Thomas and Mr McLeod separately made assessments resulting in different rentals in respect of which they were unable to agree. They appointed the first defendant to be their umpire. They each prepared submissions which were no more than valuations of a rental for the building and presented their submissions in writing separately to the first defendant. Although the first defendant held a meeting with Messrs Thomas and McLeod together, nothing of a material nature was discussed at that meeting. In particular neither Mr Thomas nor Mr McLeod sought, or were shown, the valuations or submissions of the

other. The first defendant thereupon made his own valuation which he subsequently released as an award.

Had this matter been free from authority I might well have been persuaded that what transpired was not an arbitration at all, but no more than an agreement by the plaintiff and the second defendants that each would appoint a valuer and in the event of their not agreeing the valuers should appoint another valuer to make a final and binding assessment of the rental. That, notwithstanding the admitted allegation in the statement of claim that there was a reference to arbitration.

However, the matter is not free from authority. In Steele v Evans (No. 2) (1949) N.Z.L.R. 548, O'Leary C.J., in the Court of Appeal, in somewhat similar circumstances said at p556:-

> "In my opinion, the valuation was a submission to arbitration - cl. 2 of the agreement says so - and this, I think disposes of the argument that it was not really a submission but a valuation, and, being the latter, the finding could not be disturbed. I think it was a submission with an award."

The other two Judges treated the matter before them as an award in an arbitration.

A decision more directly in point is that of Reed J. in Hamill v Wellington Diocesan Board of Trustees (1927) G.L.R. 197, confirmed by the Court of Appeal in Hunt v Wilson (1978) 2 N.Z.L.R. 261. Reed J. in Hamill's case said at p199:-

"The first and main question to be decided is whether the clause in the deed of lease, providing for the method to be adopted in assessing the rent for the second term of 21 years, constituted a submission to arbitration within the meaning of the Arbitration Act, 1908. Prior to the Arbitration Act, 1906, this question would have been of some importance; the English authorities, which were followed in New Zealand, making a very clear distinction between an agreement for a valuation and a submission to arbitration. The intention of the parties had to be gathered from the terms of the contract. Was it evident that the intention was that the valuer should, without taking evidence or hearing argument, make his valuation according to his own skill, knowledge and experience? If so, then that intention had to be given effect to, and a formal arbitration was negatived. On the other hand, if the contract disclosed that the parties contemplated a difference or dispute, either existing or prospective, the inference was that it was their intention that it should be determined in a quasi-judicial manner: 1 Halsbury 440. By the Arbitration Act, 1906, repeated in the consolidating Act of 1908, this distinction was done away with in New Zealand, it being provided that a submission to arbitration included:

> 'A written agreement ... under which any question or matter is to be decided by one or more persons named in the agreement.'"

Reed J. went on at p200 to say:-

"The law in this respect has not been altered by the Arbitration Act - arbitrators must act judicially. In my opinion, an arbitrator, before making an award, must give the parties an opportunity of being heard and of calling any witnesses they desire in support of their claim. Certain affidavits were filed, in which it was stated that it was not the custom or usage in the Masterton district, in valuations of the nature of that required in the present case, to hear the parties or take evidence. Convincing proof of a well-known and established custom or usage might be an answer. It was said by Erle, J., in Osward v Earl Grey (24 L.J., Q.B. 69, 72):

> 'I can understand that there might be a reference between an incoming and outgoing tenant, where an inspection of the farm itself would afford every information necessary. In such a case it might be, if the usage were so, that the referees need not give notice of their meetings to the parties or have their attendance, but might make their award on a view of the farm.'
>
> The evidence in the present case, however, contained in the affidavits mentioned, is quite insufficient to warrant finding that there is any such established usage or custom."

In the present case before me there is no evidence of usage or custom.

It follows that I am bound to hold that the first defendant was conducting an arbitration as umpire and that what he has produced is an award.

I have set out this aspect of the matter at some length because I am suspicious that what occurred here is not uncommon when rent reviews are conducted. I was surprised that neither party sought to make anything of the fact that the first defendant received submissions from each of the valuers separately and neither was told what the content of the submissions of the opposing party or valuer were.

In the normal course of events it is misconduct to take evidence in the absence of one party or to take instructions from one party in the absence of the other or to fail to give a party the opportunity of considering the other party's evidence (Halsbury's Laws of England 4th Edition, Vol. 2 para 622). Certainly such apparent misconduct can be waived but clear evidence of such waiver

would be required. The only evidence of waiver in this case may be that in these proceedings the plaintiff does not rely on such matters in seeking to set aside the award.

The only issues raised by the plaintiff are an alleged error of law on the face of the award and an allegation that the valuer appointed by the second defendants acted improperly in contending before the first defendant for a higher rental than the rental he had originally proposed before an umpire was appointed.

In its amended statement of claim the plaintiff alleges that the umpire in making his award made an error of law shown on the face of the award:- "in that the award stated that prevailing economic conditions were irrelevant to the fixing of the rental for the premises and that if the rental as fixed was excessive then it was for the plaintiff and the second defendants to agree on a lower rental".

That allegation arose from a passage in the award as follows:-

> "1. The rental to be fixed can only be determined from comparable rental information and cannot consider the viability of the tenant. If outside factors, such as economic downturn cause the rental to be excessive a lower rental must be agreed between Lessor and Lessee - It is outside the authority of my appointment to allow for such variations."

The award then goes on:-

> "2. Mr Thomas contended that the rental should be based on a market value of $353,000 being capitalised at 12% resulting in a rental of $46,600 plus G.S.T.

This appears to be a reverse calculation with the capitalised market value resulting in the market rental, instead of the capitalised market rental resulting in the market value.

3. Comparable sales and rental information from Ashburton and outside areas have been used in the submissions. My research shows that information from outside Ashburton distorts values and cannot be used directly for comparative purposes.

4. Mr McLeod has provided comparable rentals from a number of properties on which he has based his calculations. Generally I agree with the rentals employed in these calculations, but have made some adjustments in arriving at my decision.

By considering the above factors relating to the submission and considering evidence provided in the submissions it was possible to obtain a clear direction in concluding this Arbitration.

AWARD

I made this award as follows:

That the annual market rental for a three (3) year period should be:-

EIGHTY NINE THOUSAND NINE HUNDRED DOLLARS ($89,900.00) Plus G.S.T."

There has been presented before me, with the consent of both parties, the submissions of each valuer or arbitrator to the first defendant.

They are presented on a totally different basis. Mr Thomas describes the property, refers to existing rates and rental and says that the factors which he has taken into consideration are (1) the economic state of the country, (2) the desire not to put at risk the ability of the lessee to pay, (3) the need for the lessor to receive a safe and reasonable return on his capital outlay and (4) to

decide the capital value of the property and assess an acceptable return thereon.

It appears that he considered that a reasonable return would be between 10% and 11% on capital outlay, valued the property at no more than $383,000 and assessed at a maximum return of 12% thereon a reasonable rental of $46,000 plus G.S.T. or $51,260 including G.S.T.

Mr McLeod on the other hand concentrated his submissions on a breakdown of the lettable areas in the property, gave comparable rentals for what he described as similar lettable areas in and around Ashburton, fixed appropriate rentals for each categorised lettable area in the property based on the comparable rental figures, reached a total of $106,912, deducted 10% for volume and assessed a total rental for the property of $96,220.80 per annum excluding insurance, rates and G.S.T.

Great care must be taken not to treat these proceedings as if they were an appeal from the decision of the umpire. The parties have chosen to have the rental fixed by arbitration and are so bound. The Court can only interfere if misconduct is established or the umpire has made an error of law apparent on the face of the award on a question of law which was not expressly or impliedly referred to him. It has been necessary to set out the basis of the contending submissions in order to understand the legal issues. The temptation to indicate the Court's views as to the merits of the contentions must be resisted.

It was entirely for the umpire to decide what weight he gave to the various factors raised by Mr Thomas on the one hand and Mr McLeod on the other. However it appears to me from reading the award that the umpire has not taken into account any matter relating to what he describes as the economic downturn, the economic viability of the tenant, and other outside factors, on the grounds that such matters could not properly be considered by him. The decision to exclude evidence must be a matter of law. It may well have been a matter of fact if the umpire had considered the factors and rejected them as being of insufficient weight to affect other factors relied on by him in assessing the rental. He does not appear to have done that. In effect he has ruled that these factors are irrelevant to his enquiry.

The manner in which rental is to be calculated on a review pursuant to a clause of the nature contained in this lease is relatively clear. It was settled by the Court of Appeal in England in Thomas Bates & Son Ltd v Wyndham's (Lingerie) Ltd (1981) 1 All E.R. 1077, as stated in the headnote as follows:-

> "Since the rent review clause referred to such rent 'as shall have been agreed' between the parties, and not to the rent 'agreed for the demised premises', the rent to be agreed under the clause or to be fixed by the arbitrator in default of agreement was to be the rent which it would be reasonable for the particular parties to agree having regard to all the circumstances (such as tenant's expenditure on improvements) which were relevant to their negotiations for a new rent, and was not to be a rent assessed objectively on the basis of the market rent at which the premises might reasonably be expected to be let."

That has been applied in New Zealand in Jefferies v R.C. Dimock Ltd (1987) 1 N.Z.L.R. 419, in Feltex v JBL Consolidated Ltd (1988) 1 N.Z.L.R. 668, and in Mahoney v Madick R.C. Limited and Giltrap Holdings Ltd (unreported Auckland Registry CL65/89 Judgment 14 December 1989 Eichelbaum C.J.).

In some cases it has been suggested that the rental must be assessed subjectively determining what would be a fair rent for the parties to agree in all the circumstances taking into account all the considerations which would have affected the minds of the parties if they had been negotiating the rent themselves. For myself, I should have thought that the law would be clearer and more accurately stated if the word "subjectively" had been left out. As Eichelbaum C.J. said in Mahoney's case:-

> "Notwithstanding that the approach is described as subjective the factors which may permissably be taken into account are limited to those which a reasonable person would regard as bearing on the rental of the subject premises as between the particular parties."

In that regard, the financial circumstances of the respective parties generally must be irrelevant. Where, however, as in this case, the parties have entered into a long term lease with rent reviews and renewal rights it may be proper to give some consideration to the desire of the lessor for the lessee to continue in occupation at least to the extent of considering the possible loss of rent and cost of obtaining a new lessee in the event of the lessee being forced to surrender its lease.

Quite clearly general economic conditions must be relevant as also would be the economic condition of a particular industry if the building was peculiarly designed for that particular industry. Obviously, however, there must be some limitation and I again adopt what Eichelbaum C.J. said in describing that limitation as:-

> "It is that the factors which may be taken into account are limited to those having a connection with the demised premises, or (although generally this will be no different or wider) the relationship of landlord and tenant."

It follows that an error of law on the face of the award has been established in the decision of the umpire that he could not consider what he described as economic downturn both generally and in relation to the motor industry and the viability of the tenant in so far as a rental might cause the tenant to surrender the lease or not renew it and cause loss to the lessor.

I am satisfied that in the circumstances these errors amounted to misconduct of the proceedings. Although it was submitted that the award should be remitted back to the first defendant for reconsideration in the light of this judgment I do not consider that it would be just to do so. It is difficult to believe that the first defendant would be able to consider the matter afresh taking into account the new matters referred to without being much influenced by his earlier decision.

As the award is to be set aside it is unnecessary to consider the alternative arguments of the plaintiff. In short they may be summarised that subsequent to the award the plaintiff has ascertained that Mr McLeod submitted before the first defendant for a substantially higher rental than he had originally proposed to Mr Thomas as the plaintiff's valuer or arbitrator. I have not been persuaded that this was in any way misconduct. A valuer or an arbitrator is entitled to change his opinion. Clearly when he does adopt this course he may be cross-examined as to the reason why. This was not done in this case because the parties or the arbitrators had not sought to be shown or told what was being submitted to the umpire on behalf of the other party.

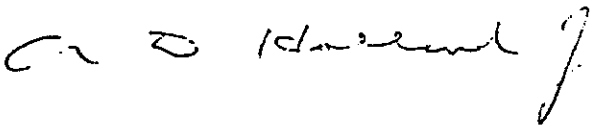
There is an application for further evidence to be received. The purpose of submitting this further evidence is to demonstrate that Mr McLeod's submission was factually wrong. The application was misconceived.

If the allegations were that the submission of Mr McLeod was tantamount to perjury or was given fraudulently then it may be that the further evidence is admissible on an application to set aside an award procured by perjury or fraud. No such allegation was made in the pleadings and counsel for the plaintiff did not wish to make any such allegation.

The award is set aside. Clearly the issue must be arbitrated again. I consider that a great deal of the cause for this litigation has arisen from the informality of

the earlier proceedings and the actions of their parties and arbitrators in leaving the matter in the hands of the first defendant without applying to be shown the evidence or submissions of the other side.

In those circumstances it is appropriate that the plaintiff and the second defendants should each pay their own costs. Although the first defendant has made an error of law on the face of the award, he has acted honestly and I consider that he is entitled to costs in relation to these proceedings. For the reasons I have expressed earlier he should not have been joined as a party. The first defendant is entitled to costs of $500 and disbursements to be fixed by the Registrar. Those costs are to be paid as to 2/3 by the plaintiff and as to 1/3 by the second defendants.



Solicitors:

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