IN THE COURT OF APPEAL OF NEW ZEALAND

CA84/04

	BETWEEN	CASATA LIMITED Appellant
	AND	GENERAL DISTRIBUTORS LIMITED Respondent

Hearing: 14-15 September 2004

Court: Glazebrook, Hammond and Chambers JJ

Counsel: J E Hodder and S J Fairbrother for Appellant
R W Raymond and R A Morgan for Respondent

Judgment: 13 April 2005

JUDGMENT OF THE COURT

A The appeal is dismissed except that the question of costs on the (set aside) second award is remitted not to the arbitral tribunal but to the High Court.

B The application for special leave to appeal is declined.

C The respondent will have costs of $12,000, together with reasonable disbursements (including the travel and accommodation costs of two counsel) to be set by the Registrar if necessary.

REASONS

Glazebrook and Hammond JJ (given by Glazebrook J) [1]

GLAZEBROOK AND HAMMOND JJ

(Given by Glazebrook J)

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Introduction

[1] Casata Limited (the lessor) leases land in Johnsonville to General Distributors Limited (the lessee). A Countdown supermarket operates on the site. At the rent review date the parties could not agree on the current market rent for the period 17 January 1998 to 16 January 2003 and referred the matter to arbitration. The arbitral tribunal produced an award, dated 11 September 2002, which determined the current market rent and dealt with some aspects of costs (the first award). Subsequently, on 28 April 2003, the arbitrators purported to produce a second award on costs (the second award).

[2] Both parties made a number of challenges to these awards in the High Court. In December 2003, Ellen France J, in a decision now reported at [2004] 2 NZLR 824, rejected the lessor's various challenges to the first award in relation to the determination of current market rent. She set aside the second award and remitted the issue of costs back to the arbitral tribunal for further consideration.

[3] On 7 April 2004, Ellen France J declined an application by the lessor for recall of the part of the December judgment that recorded her decision to remit the question of costs back for further consideration. Ellen France J also granted leave to appeal to this Court on two of the questions proposed by the lessor. These questions are:

> **Question One:** Whether the arbitral tribunal erred in approaching its task on a "prudent lessee" basis, and not the "willing but not anxious (ie rational)" lessor and lessee basis expressly agreed by the parties.
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> **Question Six:** Whether the remittal back to the arbitral tribunal of the plaintiff's appeal against the award dated 11 September 2002, and of questions of costs related to the 28 April 2003 award, was contrary to the Arbitration Act 1996 where the arbitral tribunal was functus officio, was held to have no jurisdiction to make the 28 April 2003 award, and was not held to have made any error of law in not reserving questions of costs in its award of costs dated 11 September 2002.

[4] The lessor also seeks special leave to appeal, under cl 5(6) of the Second Schedule to the Arbitration Act, on four further questions where leave was refused. Another question posed by the lessor where leave was declined is no longer pursued. The four remaining questions are:

> **Question Two:** Whether the arbitral tribunal erred by failing to take into account relevant considerations, and acted irrationally, in rejecting the propositions that (1) at the date of a new lease the value of the freehold interest will invariably equate to the value of the lessor's interest, and (2) no rational lessor would enter into a new lease which involved an immediate wealth transfer to the lessee.
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> **Question Three** Whether the arbitral tribunal erred by failing to take into account relevant considerations, and acted irrationally, in rejecting the relevance of market evidence of sales of lessor's interests in long term leases.
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> **Question Four:** Whether the arbitral tribunal erred in admitting as evidence and having regard to earlier arbitral awards determining ground rentals for unrelated properties.
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> **Question Five:** Whether the arbitral tribunal erred in failing to give reasons for its preference of the evidence of certain lessee's witnesses over the competing evidence of the lessor's witnesses – in particular, its preference for the evidence of Mr Stewart on Buckle street leasings, and of Dr Lally and Dr Gale on economic model inputs and assumptions.

[5] For ease of reference the relevant provisions of the Arbitration Act 1996 are set out in the Appendix.

The lease

[6] The lease, which is generally on similar terms and conditions to the majority of commercial ground leases of its kind, provides for a term of 20 years starting on 17 January 1993, renewable to a total of 100 years. The leased area is 8739m^2 and

the annual rent set in the lease is $397,624.50 plus GST payable quarterly in advance by payments of $99,406.12. Rent review dates are five yearly from the commencement of the lease.

[7] The rental review clause (cl 2.3) relevantly provides as follows:

a) The lessor may give written notice to the lessee not earlier than four months before the rent review dates, setting out what the lessor considers to be the current market rent at that date. Unless the lessee disputes this amount within one month of receipt, this amount becomes the annual rent payable from that review date (cl 2.3.1).

b) Even if the lessee disputes the rent in the lessor's notice the lessor must still pay the amount in the lessor's notice, if substantiated by a valuer's report, pending determination of the current market rent by negotiation or arbitration and subject to adjustment once the determination is completed (cl 2.3.2).

c) The current market rent is defined as "the full current market rental value of the Land assessed as a vacant site and ready for development to its fullest potential and the land shall be treated as a notional optimum shaped lot of [8739 m²] capable of being separately developed to its highest and best use according to zoning. For the purposes of this cl 2.3 it is agreed that the influence of any easement granted over the Land shall be disregarded" (cl 2.3.3).

d) If the lessee disputes the lessor's notice the current market rent is to be determined by the arbitration, in accordance with the Arbitration Act, of two valuers of the New Zealand Institute of Valuers, one appointed by each party. If the valuers cannot agree, they are to appoint an umpire to determine any points of difference. The decision of the valuers or the umpire is binding on both parties (cl 2.3.4).

e) The annual rent following rent review will never be less than that paid before the review date (cl 2.3.5).

f) All costs of the determination by the valuers or the umpire of the current market rent are to be borne equally by lessor and lessee unless the valuers or the umpire consider it appropriate for one party to bear a greater share because of some impropriety or lack of co-operation or unreasonableness (cl 2.3.6).

Agreement of parties on arbitration

[8] On 13 May 2002, the parties agreed certain matters in relation to the arbitration which were then recorded in a letter that was to be provided to the arbitral tribunal. The letter (on Chapman Tripp letterhead) recorded that:

(1) this arbitration is being conducted in accordance with the Arbitration Act 1996 (the "Act");

(2) the task for the arbitral tribunal is to determine the "current market rent" in terms of cl 2.3.3 of Schedule C of the lease (B352356.13 Wellington Registry) for the period from 17 January 1998 to 16 January 2003;

(3) the "traditional" method of determining the revised ground rental is appropriate;

(4) there is a typographical error in clause 2.3.3 of the lease: the correct land area is 8,739 m^2 not 8,379 m^2;

(5) the freehold value of the land at review date shall be taken as $5,250,000.00 (8,739 m^2 at $600per m^2);

(6) the assessment of the current market rent is to be undertaken on the basis of a hypothetical willing but not anxious (ie, rational) lessor entering into a new lease for the estate in fee simple on the same terms of the subject lease (save for commencement date) with a hypothetical willing but not anxious (ie, rational) lessee where both parties are not captive and have full knowledge of the market and other options available: the actual parties to the transaction are ignored; and

(7) any party may appeal to the High Court on any question of law arising out of the award, relying on clause 5(1)(a) of the Act.

The first award

[9] After describing the lease and the land in question and setting out the parties' agreement set out above, the arbitral tribunal recorded, as integral to the arbitration, the lessor's submission that, whilst the parties and arbitrators are to assess the current market rent for the site, the ground rental to be determined should acknowledge that the market would act logically and rationally in determining the rental rate to apply, particularly where there were few or no directly comparable new market lettings. The determination of this rent must therefore reflect the orthodox economic analysis of market behaviour by analysis of, and reference to, other specific market transactions, rather than "slavish adherence" to, and reliance upon, previous arbitration awards. Indeed, it was submitted, on the basis of *Land Securities PLC v Westminister City Council* [1993] 4 All ER 124 (ChD), that these should be totally disregarded.

[10] The tribunal rejected the lessor's submission that previous arbitral awards should be totally disregarded, being of the view that regard should be had to the totality of the relevant evidence available but with appropriate weight applied to that evidence. The tribunal said that, although an arbitrator's award is merely opinion based on evidence before the arbitrator, if there was little or no new open market letting evidence available then evidence of other negotiated rental agreements and determinations by arbitration or otherwise might have some relevance. In this case, where such evidence was available, the tribunal accepted that the reference to previous arbitral awards in the valuers' evidence provided "a small but not necessarily integral component of the total body of evidence available to both Lessee and Lessor".

[11] The tribunal described the other principal issue as one of methodology. The lessor had submitted that, with the lack of any directly comparable new market lettings or leasings, the valuers and experts should place reliance on the evidence of sales of lessors' interests which would then be analysed to provide an indicative rental rate. Coupled with this approach, the rental rate to be adopted should reflect the orthodox economic analysis of market behaviour underpinning modern valuation principles. An economic and investment analysis was put forward, adopting a capital

asset pricing model (CAPM) where the evidence of economic experts was submitted to confirm and substantiate a ground rental rate ranging from 9.0% to 10.38%.

[12] The lessee accepted the hypothesis of the economic experts that in a perfect market the present value of the rental stream for the term of a lease equals the current freehold land value. It also accepted that the CAPM pricing model was a useful tool to be considered in the determination of the rental rate and compared with an analysis of market transactions undertaken by the valuation experts. It submitted however, that it is the value of the inputs into the CAPM which have to be carefully considered to ensure that the answer so derived does truly reflect a rental rate which would apply to a leasehold site, having regard to the specific terms and conditions of the lease.

[13] The lessee's expert, Mr Hanna, presented evidence that the tribunal accepted as providing a clear authoritative summary of the fundamental valuation principles to be applied. Mr Hanna had said:

> [T]he rent should be assessed as if the land were vacant on 17 January 1998 and available in the open market for immediate lease to and occupation by an hypothetical tenant (not General Distributors Limited) from an hypothetical landlord (not Casata Limited), all under a new lease of similar terms and conditions to the present deed but for the period until 16 January 2013 at a current market rental, …
>
> that whether there were few or many potential lessees for this land is irrelevant, but it is an underlying assumption that there is at least one for whom the tenancy is well suited, and who is prepared to pay rent at the current market level for the land at its highest and best use, whatever that may be;
>
> that both the hypothetical lessor and the hypothetical lessee meet the tests of willingness, reasonableness and prudence, while each is possessed of the management skills necessary to successfully fulfil their contractual duties and neither is affected one way or the other by other commercial or financial circumstances, nor by any constraint, obligation pressing need or imprudent action;
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> that the negotiations between them must be assumed to have regard to all of the legal precedents and authorities which may be relevant, and to be conducted with full awareness by both parties of all of the factors which affected both the market and the subject land at the review date;
>
> that the best evidence of the condition of the market and its relativity to the subject is desirably to be drawn from new open market leasings of other similar land in this or other comparable locations as closely

> contemporaneous to 17 January 1998 as is possible, all other evidence being considered where it helps define the level of the market, but weighted below the benchmark of new leasings as is appropriate;
>
> that the parties must agree a rent, which will be that amount which in all of the circumstances is the lowest the lessor will willingly accept and the highest which the lessee will willingly pay; and
>
> that there can only be one rent which successfully meets all these criteria.

[14] Mr Hanna then went on to cite a number of decisions relating to ground rental determinations, including *Wellington City v National Bank of NZ Properties Ltd* [1970] NZLR 660 (CA) and *Sextant Holdings Ltd v NZ Railways Corporation* [1993] 2 NZ ConvC 191, 556 (CA) where Richardson J said:

> I do not discern any significant difference between a prudent lessee and a hypothetical willing buyer/willing seller.

[15] The tribunal accepted this statement of principle and concluded that the rental to be determined in this arbitration must be assessed in accordance with the established valuation principles summarised by Blanchard J in *Granadilla Ltd v Berben* (1999) 4 NZ ConvC 192,963, in which he said that:

> …the fair rent is what the lessor can reasonably expect to be offered, not what the lessor would like to receive.

Later the arbitrators said:

> We confirm the fundamental principle that the basis on which a ground rental is to be determined, is to reflect a fair annual rental payable by a prudent informed lessee for the use of the land having regard to the lease terms, conditions and obligations contained therein. This "willing lessee" test assumes that the rent so determined will be the maximum sum a lessee will pay and the least amount that an informed lessor will willingly accept.

[16] The tribunal then set out the evidence in some detail. It recorded that the lessor's principal valuer, Mr Cameron, proposed a rent rate of 9.10% based on an analysis of a number of leases. After analysis, the tribunal rejected most of this evidence as not useful to the review. The tribunal also rejected the lessor's proposition that the lessor's interest equates to the freehold value of the land. The lessor's argument was recorded as follows:

the sale of a lessor's interest reflects the yield required by the lessor from the investment,

a willing lessor would not contemplate entering into a new lease on the basis of a rental return that was less than it would achieve by buying an alternative lessor's interest,

at the time a new lease is set in place, the lessor's interest equates to the freehold value of the land and

the yield derived from sales of Lessor's interests is the rent that the lessor requires to grant a lease.

[17] The tribunal said of this argument:

The price paid however, by an independent third party to acquire a lessor's interest created in terms of a ground lease, will have regard not only to the terms and conditions of the lease and rental determined, but also will recognise and have regard to the nature and substance of the lessee, as well as the other investment opportunities available vis a vis the purchase of a leasehold interest. The price paid or yield achieved on the acquisition of the lessor's interest is therefore influenced by other considerations, which would not necessarily be present or reflected in the rental value paid by a prudent informed lessee.

The majority of market transactions do reflect rental rates relative to freehold value which are consistently lower than yields indicated by the sale of lessor's interest. The purchase of the lessor's interest is determined by the intending purchaser/lessor who is acquiring an agreed income stream, a lease contract and its convenants and the strength of the lessee together with the projected reversionary interest in the leasehold property. This represents the lessor's focus to this specific type of investment. These same considerations are not necessarily reflected in the lessee's perception when either tendering or negotiating a ground rental. The determination of the ground rent is influenced by the lessee and what is reasonable for the lessee's to pay having regard to the terms of the lease and the circumstances prevailing. To suggest therefore, that the rental level payable by the lessee should equate the yield or return expected by a lessor/investor on acquisition of a lessor's interest, is to confuse these two fundamentally different investment options.

We accept that at the time of granting of a new lease it is possible, in the purest sense under an ideal and perfect market, that the value of the lessor's interest may equate to the freehold land value. The lessor's interest market however, is far from perfect. An analysis of sales, including those submitted at this arbitration, will invariably derive a wide range of prices and indicated yields.

Accordingly, the traditional method of analysing and assessing a ground rent based upon sales of freehold land is preferred, though it is acknowledged that some inconsistent patterns may also emerge. The traditional approach as such does not as a general rule provide for such a wide range of influences and variables which are inherent in the majority of sales of lessor's interests.

> We confirm, that in fixing the rent for the site, it is the factors motivating the lessees which are not necessarily consistent with nor reflective of the expectations and motivation of an investor acquiring a lessor's interest. We therefore do not accept the proposition of the lessor.

[18] On the basis of the rebuttal evidence presented by the lessee, the tribunal also rejected an argument that the lease history from 1993 represented a derived rate of 9.1%.

[19] The lessee's principal valuer, Mr Stewart, proposed a rent rate of 6.50% based on analysis of its market leasing evidence. The tribunal rejected some of this market evidence as of limited relevance and considered some as useful market rental data. From all of the evidence produced, market data from five properties, Miramar Ave, Buckle St, Stewart Duff Drive, Kings Wharf and Coastlands, was considered to be the most useful. This, in the tribunal's view, showed a trend indicating the rent rate to be within a range of 6.75% to 7%. The best available current market evidence was, said the tribunal, the new lease to BP and Mobil at Stewart Duff Drive at 6.85%.

[20] Both the lessor and the lessee also presented economic evidence designed to draw an independent conclusion as to the proper ground rental rate. The tribunal described the economic approach adopted by both lessor and lessee as generally consistent, all the economists agreeing that in a perfect market the present value of the rental stream for the term of the lease should equal the current freehold land value. The lessor's evidence resulted in rental rates ranging from 8.96% to 10.38% while the lessee's rates on this methodology were between 6% and 6.2%. This was because the lessee's economists adopted different rental growth projections to those of the lessor which, together with other variable components, resulted in the differing rates.

[21] The tribunal considered the evidence of the lessee's economist as the most compelling. It commented particularly on the forthright evidence of Dr Lally when he said that he did not think that "anyone should place an enormous amount of weight" on the economic approach to the exclusion of other approaches. Having considered the economic evidence and remarking that, in contrast to the lessor's evidence, the risks associated with the development and occupation of a leasehold

site lie principally with the lessee, the tribunal's view was that an appropriate rental was within a range of 6.5% to 7%. It also commented that it would have been of considerable benefit had the economic experts and valuers liased to ensure that the CAPM adopted was tested against specific market transactions to assist in the identification and weighing of the various inputs.

[22] The tribunal's conclusion was that the rental rate should have regard to the analysis of the market evidence, with particular emphasis placed on the Buckle St, Stewart Duff Drive, Miramar Ave, Kings Wharf and Coastlands transactions and that it should consider other lease rentals negotiated or determined in the wider Wellington market, including reference to arbitral awards (with less weight accorded, given that the majority predated the review date and were determined under different market conditions). The economic evidence should then be used as a robust cross check on the rental rate derived from the market sources. The tribunal acknowledged the paucity of new arms length open market lettings available and said that this made it essential to have regard to all factors known and available in the market in reaching a conclusion as to the appropriate rental rate.

[23] Applying this approach the tribunal therefore determined a market rental rate of 6.9% which, applied to the agreed land value of $5,250,000, resulted in a rental for the five year term commencing 17 January 1998 of $362,250.00 plus GST. Because the rental determined was less than the rental currently payable in the lease, cl 3.2.5 of the lease applied, in that the rent determined on review could not be less than the rental payable for the preceding term. The annual rent would, therefore, be $397,624.50 plus GST.

[24] With regard to costs, the arbitral tribunal directed that, pursuant to cl 2.3.6 of the lease, lessor and lessee were to pay 50% of the total costs of the determination, being $41,316 plus GST each. The tribunal said that, from its observation, there was no degree of impropriety or lack of co-operation or unreasonableness involved that could lead to another conclusion. As neither party made submissions in this regard, the arbitrators considered that this meant that both parties were satisfied that it was reasonable for the costs of the determination to be borne equally.

The second award

[25] After the delivery of the first award the lessee applied for an order of costs in its favour for the total costs of $245,533.81 inclusive of GST incurred in defending its position at the arbitration. The tribunal rejected the lessor's submission that it was now, having issued the rent award, functus officio, and considered it implicit in its first award that the issue of costs had been reserved and therefore that it had jurisdiction under art 33(3) of the First Schedule to the Arbitration Act to make an additional award for costs.

[26] The arbitrators began by noting the accepted rule that costs normally follow the event and determined that the lessee had been the successful party in the arbitration. They also recorded the lessee's disclosure after the first award was handed down that the lessee had made a compromise offer to the lessor to settle the review at a rent in excess of that ultimately determined by arbitration. After taking into account these factors and criticising aspects of the lessor's conduct, including a refusal to agree to a mutual exchange of independent valuation reports and a general lack of co-operation, the arbitral tribunal determined that the lessor was to contribute $95,000 plus GST towards the lessee's expenses along with 75% of the arbitrator's costs of considering the costs application (the remaining 25% to be paid by the lessee). The arbitrators' fee for considering the application for costs amounted to $18,675 inclusive of GST.

The judgment under appeal

[27] As noted above, both parties challenged aspects of both awards. The lessor challenged a number of aspects of the first award in relation to the determination of current market rent and sought to have the first award set aside. With regard to the issue of costs, the lessor sought to have the second award set aside on the basis that there was no jurisdiction to make it or, alternatively, that it be varied. The lessee sought an increase in the costs awarded to it under the second award, or, if the Court decided there was no jurisdiction to make it, that the first award was unreasonable for letting costs lie where they fall or for fixing costs without hearing from the parties.

[28] Ellen France J dealt first with the lessor's challenge to the rent determination. The first issue was whether the arbitrators erred in approaching their task on a "prudent lessee" basis and not the "willing but not anxious (ie rational)" lessor and lessee basis expressly agreed to by the parties. In Ellen France J's view, the arbitrators did not err in their approach. First, the award expressly set out the parties' terms of reference. Secondly, she could not see an error in the reference to Mr Hanna's evidence, which focused on willing reasonable (i.e. rational) and prudent parties as the reference provided. References made by Mr Hanna to a number of decisions in relation to ground rental determinations included the case of *Sextant Holdings Ltd v New Zealand Railways Corporation* (1993) 2 NZ ConvC 191,556 (CA) in which it was said that there was no difference between a prudent lessee and a hypothetical willing buyer/willing seller. Ellen France J concluded that there was no departure from the terms of reference and, on a reading of the cases, no error.

[29] The next question was whether the arbitrators erred in rejecting the propositions that (a) at the date of a new lease the value of the lessor's interest will invariably equate to the freehold value of the land; and (b) no rational lessor would enter into a new lease which involved an immediate wealth transfer to the lessee. Ellen France J agreed with the lessee that the adoption or otherwise of these propositions is, as the arbitrators said, a question of valuation methodology and not a question of law. The arbitrators had considered the lessor's argument on this point but rejected it, on the basis that, while in a pure sense the value of the lessor's interest may equate to the freehold, the lessor's interest market is far from perfect and a wide range of influences and variables were inherent in the majority of sales of lessors' interests.

[30] Turning to the question of the relevance of market evidence of sales of lessor interests in long term leases, Ellen France J was satisfied that this was a situation where the lessor took issue with the result, not any error of law. The arbitrators had had regard to this evidence and had made their own assessment of the weight to be attached to that evidence.

[31] Next, Ellen France J found no error of law in the arbitrators' admission of evidence of earlier arbitral awards. There was discretion to admit such evidence and the arbitrators approached the evidence with caution. In any event, it was not critical in the arbitrators' conclusions. It was again, said the Judge, a question of weight, not an error of law.

[32] The lessor also challenged the arbitrators' rejection of evidence of car yard leasings in the Wellington CBD commercial areas and their treating as "best evidence" a fuel leasing depot in a Miramar industrial area. Again Ellen France J found no error of law. Instead, in her view, the arbitrators had considered all of the evidence and had, on a reasoned basis, preferred one comparable over another, a choice open to them.

[33] The final issue was whether the arbitrators had erred in failing to give reasons for preferring the evidence of certain of the lessee's witnesses over the competing evidence of the lessor's witnesses. Ellen France J found no error in the approach of the arbitrators. Her view was that the evidence had been considered in detail and, in that context, it could not be said more was needed either in terms of Mr Stewart's evidence on the Buckle St leasings or that of the economists. This was not a case where the arbitrators gave no reasons at all for their overall approach and the preference for this evidence was, she said, explicable in the context of the decision as a whole.

[34] Turning to the issue of costs, Ellen France J disagreed with the arbitrators' view in the second award that costs were implicitly reserved. She did not consider that either arts 33(1) or 33(3) of Schedule 1 of the Arbitration Act applied here. There was no error of the nature contemplated by art 33(1)(a). Nor was there a claim presented in the first proceeding but omitted from the award in terms of art 33(3). Accordingly there was no jurisdiction to make the second award. That left the lessee's challenge to the first costs award and any question of the parties' costs on the second award, both of which Ellen France J remitted back to the arbitrators who, she said, would be able to hear full argument, assuming the parties could not themselves reach some agreement.

[35] The remaining matter was an application for leave filed by the lessor in case the failure to give reasons had been categorised as a matter going to natural justice, in which case it would fall to be determined under art 34 and not by way of an appeal under cl 5 of Schedule 2. Ellen France J accepted the lessor's submission that the question of failure to give reasons was a question of law in terms of the Act so that leave was not required.

Further decision of Ellen France J on recall and leave to appeal

[36] As noted above, a further decision of Ellen France J dated 7 April 2004 dealt with the lessor's application for recall of part of her earlier judgment and an application for leave to appeal to this Court.

[37] Ellen France J declined the Lessor's application for recall of the part of the judgement that recorded her decision to remit the questions of costs on the arbitrators' substantive award back to the arbitrators for further consideration. Her view, which she described as not having been clearly expressed in the earlier judgment, was that, if cl 2.3.6 of the lease captures all costs (not just those of the arbitral tribunal), the arbitrators did not realise that and so operated under an error of law. There was accordingly an error engaging the power to remit. Having reviewed the matter in light of the further argument, that remained her view and she did not recall the judgment because, if she did, it would only be to set out the reasons for reaching the same outcome. This was not a proper basis for recall. It was enough to make it clear to the arbitrators that the Court considered that all questions of costs should have been dealt with by them at first instance.

[38] The application for leave to appeal was brought by the lessor in respect of seven questions, namely the six questions set out above at paras [3] and [4] and one further question that is no longer pursued. As to the first question of whether the tribunal erred in approaching its task on a "prudent lessee" basis rather than the "willing but not anxious (ie rational)" lessor and lessee basis, Ellen France J considered that this question was potentially an issue of general significance and granted leave on that point. On the question of costs, Ellen France J considered that

her approach to the recall application meant that leave should also be granted on that issue.

[39] The other questions were not, however, in the same category, in Ellen France J's view. The second and third questions, relating to failure to take into account relevant considerations, arguably flowed from the first but were matters of methodology not law. The question relating to the admission of earlier arbitral awards was not, in her view, sufficiently serious, as it was a question of weight. The same applied to the failure to give reasons, which was also very much directed to the facts of the case and did not raise issues of more general application. Ellen France J considered whether the second and third questions were so closely related to the first as to mean that fairness required leave to be given. She concluded that this was not the case.

Lessor's submissions

Question One – arbitral tribunal's approach

[40] Mr Hodder, for the lessor, submitted that arbitral errors of law may include misconception of the task (ie misunderstanding contractual language), misidentifying the characteristics of the objective of the task and, on the basis of *Edwards v Bairstow* [1956] AC 14 (HL), reaching a conclusion which is perverse (ie cannot reasonably be entertained).

[41] The lessor's position remains that both awards were fatally flawed and should be set aside. This would result in the ground rental review beginning afresh before a new arbitral tribunal. In essence, the main submission is that the arbitral tribunal departed from the correct approach, as agreed by the parties, thereby leaving its conclusions unsound and unsafe.

[42] Mr Hodder submitted that this case is not about the Court substituting its view for that of the arbitrators. Nor is it about undermining the objectives of the Arbitration Act. At its heart, in his submission, the case is about clarifying the correct approach to be taken to ground rental determinations. The correct approach should emphasise market forces rather than the lessee-driven analysis of the "prudent

lessee" approach, which was adopted by the arbitrators in this case, contrary to the parties' instruction.

[43] In his submission, a fundamental feature of the context for this ground rent review is the paucity of new long-term ground leases. As a result, the "market" rent for a long term ground lease cannot be readily established by the "classical" method of direct comparison with a substantial number of contemporaneous arms length new leasings of similar properties on similar terms. This means that the rental review must involve a substantial hypothetical exercise. In these circumstances, Mr Hodder contended that the valuation process should involve a more explicit application of established and logical economic concepts.

[44] On the first question posed (but addressing questions two and three to some extent due to a degree of overlap) Mr Hodder contended that the tribunal erred in law in disregarding the parties "willing/not anxious/rational" instruction and applying a "prudent lessee" approach, contrary to the parties' instruction. He also contended that the tribunal erred in law in reaching conclusions which cannot be supported by the evidence or are perverse. He reiterated that the arbitrators' task was stated explicitly in the parties' agreed terms of reference at para (6). No reference was made to a "prudent lessee" and yet that concept influenced the award. He said further that that task was narrowed by the other terms of reference. In para (3) of the terms of reference, the "traditional" method was declared appropriate, that is, applying a proper ground rental rate percentage to the freehold land value and, in para (5), it was provided that the freehold value was agreed as $5.25 million.

[45] Mr Hodder traversed the "prudent lessee" line of authority that began with *The Drapery and General Importing Company of New Zealand Ltd v Mayor of Wellington* (1912) 31 NZLR 598 (CA). He concluded that this approach, with its counter-intuitive bias in favour of lessees and non-recognition of supply and demand forces, is plainly antithetical to the parties' terms of reference and has never featured in English law. Mr Hodder submitted that modern New Zealand authorities have distanced themselves from it, in particular in the decision in *Sexton Holdings*. He also, however, pointed to what he submitted is an apparent restatement of the concept by Blanchard J in *Granadilla.*

[46] Mr Hodder analysed the evidence of the lessee's witness, Mr Hanna, the unambiguous thrust of which was, he submitted, that the primary and crucial factor was the "prudent lessee" test. Mr Hodder accepted that the notional lessor was not completely ignored but submitted that this was merely a secondary consideration. At no point did Mr Hanna refer to the "willing/not anxious/rational" instructions of the parties to arbitration. Despite the lessor's submissions to the arbitrators pointing to the parties' agreed approach, the first award nevertheless included an extended endorsement of Mr Hanna's evidence. We note at this point, however, that Mr Hodder did not take issue with the contents of the passage actually quoted by the tribunal set out at para [13] above, accepting that that passage sets out the correct approach.

[47] As the tribunal explicitly adopted the "prudent lessee" approach, Mr Hodder submitted that the arbitrators cannot have followed the parties' instructions. Thus, in his submission, the arbitrators' approach is properly characterised as perverse. Further the arbitrators' error is manifest in relation to the specific topics of sale of lessors' interests and transfers of wealth from lessor to lessee, the focus of the second and third questions for which special leave is sought. In Mr Hodder's submission, the High Court judgment does not engage fully with those difficulties in the first award. In his submission, it was not possible for the arbitrators to found themselves on the Hanna evidence and *Granadilla*, to reject the evidence of sales of lessors' interests, and yet to have complied with the fundamental instruction recorded in the parties' agreement.

Questions Two and Three – sales of lessors' interests

[48] With regard to question two, Mr Hodder submitted that the arbitrators' non-compliance with the "willing but not anxious (ie rational)" instruction is reflected by their rejection of the lessor's evidence of sales of ground lessors' interests. This also deprived the arbitrators of compelling evidence supporting the lessor's case for a markedly higher ground rental. Of obvious importance within the lessor's analytical framework is the economic reality that alternative access to the site for a lessee is by way of purchase, here of the estate agreed to be worth $5.25 million on review date. In this context, one of the options for the notional willing/not anxious/rational lessor

is to sell that estate, with, conversely, the option for the notional lessee to purchase such an interest. Therefore identical considerations affect the willing/not anxious/rational lessor and lessee.

[49] The lessor's evidence had covered 28 sales of lessors' interests supplying a rental rate of 9% to 9.5%. The relevance of these sales was, in Mr Hodder's submission, threefold. First, the market rate of return for lessors' interests represents the floor of the range of rates any rational lessor would be willing to accept for its investment. Secondly, and as a corollary, returns in the market for new leases and returns in the market for lessors' interests can be expected to be equal. Thirdly, lessors' interest sales are relevant to rent review arbitrations for what they reveal about rational lessees who, it would be assumed, would purchase a lessor's interest if it could get a better return than from renting. The High Court's treatment of this issue as no more than a question of weight to be given to evidence failed to appreciate, in his submission, that the exercise is one involving economic concepts and a rational hypothesis. It was, therefore, perverse for the arbitrators to dismiss market evidence because the market is "not perfect" or to disregard the opportunity cost analysis and the identical considerations affecting the willing/not anxious/rational lessor and lessee.

[50] Mr Hodder also submitted that the interrelationship of questions one, two and three, and the arbitrators' failure to follow the approach directed by the parties, is further illustrated by the first award's conclusion that the hypothetical parties would have agreed to an effective transfer of wealth from lessor to lessee upon entering into the hypothetical new leasing. In Mr Hodder's submission, "traditional" method was misdescribed and perhaps misunderstood by Ellen France J, in that freehold sales do not themselves provide any indication of ground rental rates. The traditional method is only a valuers' tool used where "classical" comparability is (as here) not available. In Mr Hodder's submission, the High Court was effectively endorsing the arbitrators' wrongful use of the "prudent lessee" test.

Question Four – earlier arbitral awards

[51] On the fourth question, relating to the admission of evidence of earlier arbitral awards, Mr Hodder submitted that the arbitrators exercised their discretion to admit this evidence in an unprincipled and irrational manner and that their decision to admit and place weight on such evidence involved an error of law. Mr Hodder relied on the decision of Hoffman J in *Land Securities plc v Westminster City Council* [1993] 4 All ER 124 (ChD) in which he held that evidence relating to another arbitral award was inadmissible in an arbitration, an approach that has been accepted consistently in the leading texts and followed in England, New Zealand and Australia. Mr Hodder submitted that Ellen France J's treatment of this issue, as a matter of discretion for the arbitrators, meant that the powerful *Land Securities* exposition of the problems in admitting evidence of this kind was simply disregarded. As a result, the arbitrators had relied on "captive" transactions, which were not new leasings determined on the hypothesis of "willing/not anxious/rational" parties and where the evidential and intellectual foundations could not be properly tested in this arbitration. This was not, in his submission, a proper use of the discretion conferred upon the arbitral tribunal by art 19(2) of Schedule 1 to conduct the arbitration in such manner as it considers appropriate, including determination of the admissibility, relevance, materiality, and weight of any evidence.

Question Five – failure to give reasons

[52] The submissions on question five and the alleged failure to give reasons were that it was a requirement of the Act (see art 31 of the First Schedule) and of the parties' agreed terms of reference that the first award state the reasons on which it was based. Correctly understood, that requirement meant that the arbitrators could not merely state a preference between competing expert evidence without engaging with that evidence and explaining why the evidence of one side's experts was preferred. In Mr Hodder's submission, the arbitrators in the first award failed to state more than a mere preference for the lessee's expert witnesses' evidence on the two crucial issues of the land value (and hence the implied rental rate) of the Buckle St new leasings; and the inputs and assumptions (and thus outcome) of the capital asset pricing model (CAPM). These failures, in his submission, constituted errors of law.

[53] In Mr Hodder's submission, the line of authority, relating to the adequacy of reasons given by first instance courts, must state the minimum requirements applicable to arbitrators. The arbitrators were thus required to provide a "coherent reasoned rebuttal" of the lessee's experts in the manner Bingham LJ regarded as necessary in *Eckersley v Binnie* (1988) 18 Con LR 1, 77-78 (CA). In his submission, Ellen France J did not explain why that should not be so and, in this context, her observation that this was not a case where the arbitrators gave no reasons at all does not advance matters.

Application for special leave

[54] With regard to the application for special leave, Mr Hodder submitted that questions two, three, four and five are of clear significance to the question of whether, overall, the High Court's upholding of the arbitral award was in error. They are also (and in particular questions two and three) closely linked with the resolution of question one and involve significant public and private interests. In essence, Mr Hodder contended that it is appropriate for all of the questions to be determined by this Court in the interests, not only of the lessor, but to provide guidance for all parties involved in ground rental reviews on a regular basis.

Question Six - costs

[55] On the issue of costs, Mr Hodder submitted that the first award was, on its face, the final award which, in accordance with art 32(1), terminated the arbitral proceedings, subject only to arts 33 and 34(4). The award incorporated a determination of the ground rental and dealt with the costs of the arbitrators and umpire. It did not reserve the question of party/party costs. Nor was it invited to do so, by either the lessor, in reflection of a more or less established practice in this area of not awarding party/party costs, or by the lessee, apparently by counsel's oversight. Mr Hodder submitted that party/party costs must therefore lie where they fall given the default provisions of cl 6(1)(b) of the Second Schedule. This is because there was no agreement about party/party costs, the award did not fix such costs, the arbitrators' mandate had terminated with their final award and there was no basis for an additional award under art 33. Article 33(1) has no present relevance and the

finding by Ellen France J as to the non-applicability of art 33(3) is not subject to appeal.

[56] It was Mr Hodder's submission that the High Court should not have remitted the question back to a tribunal that was *functus officio* because no error of law was identified. In Ellen France J's substantive decision, she said that she did not need to decide any question on the scope of cl 2.3.6. In Mr Hodder's submission, the scope of cl 2.3.6 was expressly not decided in her substantive judgment. However, in the recall/leave judgment, Ellen France J articulated an error of law on the basis that, if cl 2.3.6 captures all costs (and not just those of the arbitral tribunal), the arbitrators did not realise that.

[57] The lessor's position now is that cl 2.3.6 covers the arbitrators' costs but does not cover party/party costs at all. If cl 2.3.6 does not cover party/party costs, then the default provisions of cl 6(1)(b) of the Second Schedule must apply to let costs lie where they fall. There was no error of law. If the lessee wanted to argue for a costs award to be made in its favour this should have been signalled before the first award and a request made for the arbitrators to reserve the question of costs. As that was not done, the lessee must suffer the consequences.

[58] To the extent that in *Opotiki Packing & Cool Storage Limited v Opotiki Fruit Growers Limited (in receivership)* [2003] 1 NZLR 205 (HC and CA) Fisher J, in the High Court at [25](d), may be taken to indicate that there is an independent exception to the termination of the tribunal's jurisdiction for "costs awards under cl 6 to the Second Schedule", it was submitted that this is incorrect. In Mr Hodder's submission it is not clear that Fisher J was focussed on this issue, but, in any event, it is plain from the language of cl 6(1)(a) that costs will be fixed and allocated under an art 31 award or an art 33 additional award. In his submission, cl 6(1)(a) cross-references to the First Schedule jurisdictional bases for the making of awards and does not create a separate and independent jurisdiction to make an award other than under art 31 and art 33(3).

[59] On the costs of the second award, which was made without jurisdiction and despite the lessor's objections on the point, remittance back to the arbitrators is, in

Mr Hodder's submission, both inappropriate and unnecessary. The High Court should simply have directed that costs were payable by the lessee on a two-thirds basis.

Lessee's submissions

Question One – arbitral tribunal's approach

[60] Addressing the issue of whether the arbitrators approached their task on an incorrect "prudent lessee" basis rather than the "willing but not anxious (ie rational)" basis agreed to by the parties, Mr Raymond submitted that there is in fact no discernable difference between the two tests and further that neither party has identified any difference, either before the arbitrators or before this Court. In Mr Raymond's submission, this Court's decisions in *Sextant Holdings* and *Granadilla* confirm this lack of difference. Responding to Mr Hodder's suggestion of a retreat from the "prudent lessee" line of authority, Mr Raymond pointed to statements of Richardson and McKay JJ in *Sextant Holdings* at 191,561 and 191,563 where they both said that they did not discern any significant difference between the two approaches. As well, *Granadilla* does not, in his submission, represent a restatement of the test or a retreat from that position when the judgment is read as a whole.

[61] At the arbitration, both parties had called evidence to the effect that there was no difference between the two tests. Mr Raymond also drew attention to the closing submissions of counsel for the lessor in which Mr Hodder referred to the parties' agreement and stated that it was now settled law that the "prudent lessee" test is no different from the "willing but not anxious lessor and lessee" tests. In Mr Raymond's submission, as there is no difference between the two tests, the arbitrators cannot have departed from the terms of reference or misdirected themselves if they did apply the "prudent lessee" test.

Questions Two and Three – sales of lessors' interests

[62] Turning to the other questions, Mr Raymond submitted that question two relates to valuation methodology and is not a question of law. The arbitrators did not

act unreasonably or err in law in considering the lessor's evidence on its theory and the lessee's response before rejecting the lessor's propositions. The lessee's evidence with regard to the sale of lessors' interests argument, was that it was a methodology that has never been embraced by the valuation profession and that it is not one which is recognised in any publication, decision or guideline for or on behalf of the valuation profession. The market of trading in lessors' interests is also a recent phenomenon and is relatively unsophisticated. In addition, the property market is far from perfect and each transaction must be examined in detail.

[63] The lessee's evidence from Mr Stewart, was that there are fundamental differences between the sale of a lessor's interest and the ground rental calculation. The first is that the lessee is not a party to the sale. The second is that lessees, in offering rent, will be aware of the depreciation of their improvements over their economic life and also of the need to recover their capital without offset from growth in land value. By contrast, the purchaser of a lessor's interest is concerned with cash flow or residual land value. Thirdly the market or market perception may have changed between the setting of the rent and the sale.

[64] Mr Stewart's evidence was that the market evidence clearly reflects the difference between freehold and leasehold possession. An example given by Mr Stewart was the large number of ground leases sold by the Wellington Regional Council in 1996 to the incumbent ground lessees. They were sold at 85% of the assessed land value used in the rental calculation in recognition of the fact that the Council was not in possession of all the freehold rights. Further, Mr Stewart's evidence was that it is necessary, when analysing sales of lessor's interests, to make adjustments to market rentals. When the necessary adjustments have been taken into account the initial yield on a sale of a lessor's interest decreases significantly. The other experts for the lessee, Mr Bunt and Mr Hanna, noted that it is generally acknowledged that the rights acquired by the lessee are something less than the fee simple. It followed that the worth of a leasehold interest will be something less than that of a fee simple interest and consequently that a ground lessor cannot expect his or her interest to be equivalent to a full freehold value. This is because he or she has transferred part of the bundle of rights by granting a perpetual lease.

[65] In Mr Raymond's submission, all of the above matters relate to issues of opinion/methodology/evidence, all of which were fully traversed before the arbitral tribunal and which the tribunal was entitled to accept or reject. Question three, submitted Mr Raymond, is also related to a question of valuation methodology not one of law. The matters canvassed above apply equally to this question. The arbitrators did not act unreasonably or err in law in rejecting the evidence of sales of lessors' interests but fully addressed and considered such evidence. It was for the arbitrators to determine what weight to attach to it.

[66] Mr Raymond also pointed out that arbitrators are appointed because of their qualifications and experience in the field. Mr Raymond submitted that the authorities overwhelmingly support a strong bias towards finality of arbitral awards. There was clearly evidence upon which the arbitrators based their conclusions and there was nothing perverse in their findings. Questions of evidence should, in any event, be the exclusive domain of the arbitrators. The considered declinature to adopt a "sales of lessor's interest" methodology for assessing a ground rental rate is not a question of law. Arbitrators have a wide scope in determining what methodology to adopt. After considering all of the factors raised by the lessor, they were entitled to consider that the evidence of sales of lessor's interests should not be taken into account. Such a decision is, in any, event, one of fact and not law. Mr Raymond pointed to the comment of McKay J in *Sextant Holdings* at 191,565:

> However, as was said by North P in *Wellington City v National Bank of New Zealand Properties Limited* [1970] NZLR 660 at p 669, "the Courts have consistently declined to be drawn into considering principles of valuation save insofar as they depend on purely legal considerations...the method of valuation which finds favour with the arbitrators or the umpire is essentially a matter for them".

Question Four – earlier arbitral awards

[67] With regard to question four and the issue of earlier arbitral awards, it was submitted that it was for the arbitrators to determine the admissibility, relevance, materiality and weight of any evidence and that, in any case, their approach to this evidence was careful. It cannot thus be said that they exercised their discretion on an improper basis. The lessee relied on the decision of the Rt Hon John Henry in the award of the arbitrator (confidentiality over which was waived by the parties) in

Casata Limited (lessor) and Tower Property Nominees Limited (joint lessee) and Johnsonville Shopping Centre Limited (joint lessee) 23 July 2001. The Rt Hon John Henry considered the *Land Securities* case and the provisions of art 19 of the First Schedule to the Act, which recognises that, whether evidence is to be received, is a matter for the arbitral tribunal. He concluded that the restriction which applied in *Land Securities* had no application in the case before him and he also made reference to art 3(1)(b) of the Second Schedule to the Act which gives the tribunal the power to draw on its own knowledge and expertise.

Question Five – failure to give reasons

[68] With regard to question five, the allegation of a failure to give reasons, Mr Raymond submitted that the arbitrators considered all of the evidence and the award reflects that fact. The arbitrators did give reasons for their approach and their preference for some evidence over others is explicable in the context of the decision as a whole. For example, the Buckle St leasings were relied on by both parties. These leases were fully considered by the tribunal which correctly identified the difficulties with these comparables and that any analysis of the leases to suggest a rental rate relied on the accuracy of the land value assessed. The arbitrators, as they were entitled to, preferred the lessee's analysis, which, as they noted, adopted higher land values than those of the lessor and consequently derived lower rent rates. The arbitrators also preferred the evidence of the lessee's economists on economic model inputs and assumptions but clearly gave full consideration to the evidence tendered by the lessor. In Mr Raymond's submission, the tribunal was not required to give a full explanation for its preference of one witness over another on every issue or comparable.

Application for special leave

[69] Mr Raymond submitted that special leave should not be granted on any of questions two to five. In the alternative, he submitted that, if the Court takes the view that the arbitrators did misconceive their task or misunderstood the characteristics of the objective of their task, it is open to this Court to reject the *Edwards v Bairstow* approach in the arbitration/appeal context. While the High Court applied the *Edwards v Bairstow* approach, this Court has not decided the question but has

observed that there is "some force" in the argument that whether there was any evidence to support a particular finding of fact made by the arbitrator is not a question of law in the context of the Act. In addition, it was submitted that the correct approach to this issue is that encapsulated by the Law Commission in its 2003 report, *Improving the Arbitration Act 1996* (NZLC R83, 2003) in which it concluded that, in the context of an appeal for an arbitral award, it would be inappropriate to include a perverse finding of fact within the term 'error of law'.

Question Six - costs

[70] With regard to the issue of costs, Mr Raymond submitted that the High Court's remittal of the costs issue back to the arbitral tribunal was appropriate. The arbitrators had only made an award in respect of their costs in determining the award, not the legal and other expenses of the parties. The Second Schedule, in Mr Raymond's submission, draws a distinction between the two. The arbitrators are not *functus officio*, as they still have to determine costs under cl 6 – see *Opotiki Packing*. They did not do so, purporting instead to issue a second award which it is accepted was without jurisdiction.

[71] Mr Raymond pointed out that cl 6(2)(b) of the Second Schedule prevented the tribunal from being advised of the fact of the offer made by the lessee until after final determination of all aspects of the dispute other than the fixing of costs. He submitted that costs could therefore not be dealt with at the time of the award without breaching this obligation. Clause 6(1)(a) provides that the "legal and other expenses of the parties" shall be as fixed and allocated by the arbitral tribunal in its award. It failed to do so or to reserve the question of costs or even to consider party/party costs at all. It now needs to do so.

[72] The lessee's alternative argument is that it is an error of law for the tribunal not to have dealt with costs, whether or not the lessee asked for costs to be reserved - see *Fyfe v Devonport Borough Council* (1990) 15 NZTPA 26. The lessee was the successful party and the arbitral tribunal is the appropriate forum for determination of the costs issues. It was submitted that the tribunal can also conveniently (and appropriately) deal with the question of costs on the purported second award.

Discussion

Arbitral tribunal's approach

[73] As indicated above, leave to appeal was granted in respect of two questions and the lessor seeks leave to appeal with regard to four more questions – see paras [3] and [4] above. The first question, on which leave was granted, is whether the arbitral tribunal erred in approaching its task on a "prudent lessee" basis and not the "willing but not anxious (ie rational)" lessor and lessee basis expressly agreed by the parties.

[74] The parties agreed the basis on which the arbitrators were to undertake their task and this was recorded in the Chapman Tripp letter dated 13 May 2002 set out at para [8] above. In the first award the arbitrators set out the terms of the 13 May letter but did not analyse the terms of that letter. Rather they appear to have analysed the case law as to the factors that should be taken into account in determining the current market rental for a ground lease. This would have been unexceptional if there had been no agreement between the parties as to how the arbitration was to proceed and the question had merely been what was the current market rent in terms of the lease. Where there is such an agreement, however, it must be the terms of that agreement that define the task and not the case law.

[75] Having said this, the parties considered that their agreement, and in particular para 6 of that agreement, was a restatement of the test as set out in *Sextant Holdings*. This is clear from the submissions made by both parties, not just before the arbitral tribunal but also before Ellen France J and before this Court. It would be inappropriate for us in such circumstances to undertake an independent analysis of what the parties' agreement meant and the extent to which that may or may not have differed from the test set out in the case law.

[76] The lessor's concern is that the *Sextant Holdings* test (and, therefore, the test set out in para (6) of the parties' agreement) was misapplied by the arbitrators. The nub of the submission appears to be that a one-sided test was used by the arbitral tribunal, one that concentrated on the hypothetical lessee rather than on both the hypothetical lessee and lessor. The tribunal's error is shown, in Mr Hodder's

submission, by its acceptance of Mr Hanna's evidence, which endorsed the prudent lessee test. It is also shown by the tribunal's mention of the prudent lessee test and the fact that it quotes from the *Granadilla* case, which Mr Hodder submitted was a retreat from the test in *Sextant Holdings***.** Finally, it is shown by the fact that the arbitrators accepted the evidence presented by the lessee and rejected the evidence presented by the lessor, particularly with regard to sales of lessors' interests. In this regard, questions two and three, for which leave to appeal is sought, are, in Mr Hodder's submission, integral to the alleged error set out in question one.

[77] There are a number of difficulties with Mr Hodder's arguments. As regards the evidence of Mr Hanna, the problem is that the passage that the arbitrators quoted from his evidence (as set out at [13] above) is accepted by Mr Hodder not to contain any errors. Indeed, that passage clearly recognises that the rent must be assessed from the point of view of both parties and that it must be the lowest the lessor will willingly accept and the highest that the lessee will willingly pay.

[78] It is true that the arbitral tribunal referred to the prudent lessee test as set out in the *Wellington City* case – see [14] above. It, however, stated, citing *Sextant Holdings*, that there was no discernible difference between that test and the willing lessor/willing lessee test articulated in *Sextant Holdings*. It then later in the award (see at [16] above) clearly articulated the willing lessee test as assuming that the rent determined will be the maximum sum a lessee will pay and the least amount that an informed lessor will willingly accept, effectively the test in *Sextant Holdings*, which Mr Hodder accepts accords with para (6) of the parties' agreement. This was after the tribunal had quoted from *Granadilla* and shows that it saw no retreat from *Sextant Holdings* in that decision. Neither do we.

Sales of lessors' interests

[79] We turn now to Mr Hodder's contention that it was obvious the arbitrators were using the wrong test because they accepted the lessee's evidence and rejected the lessor's evidence on the sales of lessors' interests. The alternative explanation is that the lessee's evidence was accepted because the tribunal used the correct test but nevertheless considered the lessee's evidence to be preferable. To assess which of

these explanations is the correct one would require us to make our own assessment of the evidence. That would be a quite unsuitable task for the Court to undertake in an appeal of this nature. Indeed, Mr Hodder did not suggest that we should do so.

[80] Mr Hodder submitted further that it was obvious that the wrong test was focussed on because the tribunal had rejected an economically rational market assessment. In his submission, para (6) of the parties' agreement required that the tribunal treat the hypothetical lessor's position as an investment owner (with options) equally with the hypothetical lessee's position as one who sought to lease comparable land as an alternative to purchasing it. Where, as here, direct market comparables are not available, this means, in his submission, the evidence of sales of lessors' interests should have been compelling.

[81] The lessor's economists and those called by the lessee agreed that, in theory, returns in the market for new leases and returns in the market for the sale of lessors' interests would be expected to be equal. The difficulty with Mr Hodder's argument is the lessee's evidence that in the actual market returns differ between the two. The arbitrators' task was to set the current market rent. This is clear from both the lease itself and para (6) of the parties' agreement. The lessor and lessee may be hypothetical but the market is the real market. That the arbitrators preferred evidence about the behaviour of the real as against a hypothetical market cannot be criticised in these circumstances.

[82] Mr Hodder also submitted, however, that the arbitrators' acceptance of the lessee's evidence was perverse. This is because it ignored the only real cogent market evidence in this case, that of sales of lessors' interests and the economic evidence relating to them. The reasons for the rejection of that evidence do not, in his submission, withstand scrutiny. In addition, it is clear, he submitted, that rejection of that evidence means that there is acceptance by the arbitrators that a hypothetical willing but not anxious (ie rational) lessor will tolerate an immediate wealth transfer to the lessee, in this case in excess of $1m (although, as Mr Raymond pointed out, that figure would be much less or not exist at all if Mr Stewart's evidence (for the lessee) were accepted).

[83] Mr Hodder's submission depends on *Edwards v Bairstow* applying in the context of arbitration appeals – see the discussion of the opposing submissions at [40] and [69] above. This Court in *Gold and Resource Developments (NZ) Ltd v Doug Hood Ltd* [2000] 3 NZLR 318, 335 doubted that they did. The Law Commission has recommended that it be made clear in the Arbitration Act that perverse findings of fact or findings based on no evidence do not constitute errors of law for the purposes of cl 5(1)(c) of the Second Schedule to the Act. This is because the Commission saw a difference in kind between consensual resolution of disputes by arbitration and resolution by a judicial officer of a court or tribunal who happens to sit on the particular case. From a pragmatic point of view it also considered that many of the advantages of arbitration in relation to cost and timeliness could be outweighed and the streamlined leave to appeal process circumvented if, on an application for leave to appeal, it was necessary to transcribe and traverse the evidence to demonstrate that no evidence existed or that any finding was perverse in light of that evidence – see NZLC R83 at para 122. The Commission noted (at paras 123-124) that these views were supported by contemporary judicial comments concerning the role of appeals in arbitration in *Pupuke Service Station Ltd v Caltex Oil (NZ) Ltd* [2000] 3 NZLR 318, 338 and *Geogas SA v Trammo Gas Ltd* [1993] 1 Lloyd's Rep 215, 231. This recommendation has been subject to criticism, however – see DAR Williams QC "Arbitration and Dispute Resolution" [2004] NZ Law Rev at 115-6.

[84] We do not need to decide whether the *Edwards v Bairstow* principles apply to arbitration appeals as it is clear that those principles are not engaged here. There was evidence on which the arbitrators could come to their conclusions on the points raised by Mr Hodder – see the evidence of the lessee discussed at [61]–[63] above. The arbitrators clearly considered the evidence of the lessor on the sale of lessors' interests and rejected it – see at [16] and [17] above. There are no obvious difficulties with the evidence relied on by the arbitrators, coming as it did from experienced valuers from established firms and from well-qualified and experienced economists. We have not been pointed to any texts or valuation standards which state that evidence of sales of lessors' interests must be taken into account in the manner contended for by the lessor. Indeed, the lessee's evidence was that these sources have concluded that such evidence is not helpful. We have no way of assessing

Mr Hodder's submission without a thorough review of the evidence. This in itself makes it clear that the findings cannot be seen as perverse in the sense required by *Edwards v Bairstow*, especially as we are dealing with the findings of an expert tribunal.

Application for special leave

[85] Mr Hodder's argument on the second and third question was put to us on two bases. The first was that the arbitral tribunal's approach to the matters raised in those questions showed that it must have been approaching its task on a wrong basis. No special leave was needed to make this submission as it was effectively subsumed in the leave given with regard to Question One. We have dealt with that submission at [79]-[81].

[86] The other basis was that the second and third questions were not questions of methodology as held by Ellen France J in her leave judgment, but questions of law. To succeed in that argument Mr Hodder had first to convince us that the tribunal's approach to the sales of lessors' interests was without any evidential foundation or irrational in the *Edwards v Bairstow* sense. He has not done so and special leave is declined. If we had come to the conclusion that the approach had been without evidential foundation or irrational, however, then we would have granted special leave. Whether *Edwards v Bairstow* applies in New Zealand to arbitrations would have been a matter of sufficient importance to have justified that course.

Earlier arbitral awards

[87] With regard to question four and the admission of evidence of earlier arbitral awards, we agree with Ellen France J that this question relates to the weight to be given to evidence and thus is not sufficiently serious to warrant a second appeal. In accordance with art 19(2) of the First Schedule to the Arbitration Act, it was for the arbitrators to determine the admissibility, relevance, materiality and weight of any evidence. We also accept Mr Raymond's submission that, in any event, the artbitrators' approach to that evidence was careful and that it was accorded limited weight.

Alleged failure to give reasons

[88] Mr Hodder did not wish to pursue his application for special leave to appeal with regard to question five, the alleged failure to give reasons, if he did not succeed on the other questions. It would be helpful, however, for future arbitrations if we make some brief remarks on this topic.

[89] First, it is clear that the reasons given by an arbitral tribunal must not be so economical that a party is deprived of having an issue of law dealt with by the Court if necessary. Mr Hodder accepted that the particular areas where he asserts adequate reasons were not given would not give rise to such concerns. He pointed, however, to the requirement in art 31(2) of the First Schedule that an award shall state the reasons upon which it is based. We agree that this is wider than merely ensuring that any legal issues can be identified.

[90] We do not consider, however, that there is a requirement for arbitrators to give elaborate reasons for each and every component of the award. In particular, we doubt that an expert tribunal is necessarily required to provide a "coherent reasoned rebuttal" (as Bingham LJ put it in *Eckersley v Binnie* (1987) 18 Con LR 1 at 77–78 which was cited with approval by the English Court of Appeal in *Flannery v Halifax Estate Agencies Ltd* 1 WLR 377, 381 (CA)) of all aspects of the expert evidence in the same way that a non-expert judge may be required to do. After all the arbitrators are chosen for their expertise. We consider that Rogers CJ in *Imperial Leatherware Co Pty Ltd v Macri & Marcellino Pty Ltd* (1991) 22 NSWLR 653, 657 (citing an unreported decision of Smart J in *Menna v HD Building Pty* Ltd (1 December 1986)) set out the correct principles:

> Elaborate reasons finely expressed are not to be expected of an arbitrator. Further, the Court should not construe his reasons in an overly critical way. However, it is necessary that the arbitrator deal with the issues raised…and make all necessary findings of fact.…The reasons must not be so economical that a party is deprived of having an issue of law dealt with by the Court.

[91] We observe that the English Court of Appeal in *Flannery* stressed the differing extent of the duty to give reasons, depending on the nature of the case. It, subsequently, in *English v Emery Reimbold & Strick* Ltd [2002] 1 WLR 2409,

attempted to discourage a large number of applications, following the *Flannery* decision, for leave to appeal on the ground of inadequacy of reasons.

[92] It follows that, had this question been before us, we would have been in agreement with Ellen France J's analysis at [116] – [130] of her judgment and, therefore, with her conclusion at [131] of her judgment that the reasons expressed by the arbitrators in this case were sufficient.

Costs

[93] The final question is whether Ellen France J was correct to remit the question of costs back to the arbitrators. She appears to have done this with regard to party/party costs on the basis that the costs and expenses of the parties were included within cl 2.3.6 of the lease. The fact that the arbitrators were unaware of this meant that they had made an error of law, justifying the remission back. The parties are now, however, agreed that party/party costs are not covered by cl 2.3.6 of the lease (see at [7]f) above) but that they came within cl 6 of the Second Schedule to the Arbitration Act.

[94] As indicated above, Mr Hodder's submission was that the tribunal was *functus officio* and that therefore the question of costs should not have been remitted to it. Mr Raymond's submission was that the tribunal had failed to make an award of party/party costs under art 31 and cl 6. Referral back was therefore appropriate to enable such an award to be made. Mr Raymond pointed to the remark of Fisher J in *Opotiki Packing* where he said, at [25], that termination of an arbitrator's jurisdiction upon the issue of an award is subject to a number of exceptions, including, inter alia, the "slip rule" in art 33(1)(a) of the First Schedule and costs awards under cl 6 of the Second Schedule. This Court, on the appeal from Fisher J's judgment, made no comment on this statement.

[95] In our view Mr Raymond's contention must fail. The scheme of the Arbitration Act is that there can only be one award under art 31 (subject to referral back for errors of law and arts 33 and 34). Clause 6 of the Second Schedule cross refers to art 31 and art 33(3) and does not in our view confer an independent jurisdiction to award costs. We also note that, if Mr Raymond's submission were

correct, there would be no time limit on the period during which costs matters could be raised after promulgation of an award. This would be in contrast to the position where the quantum of a costs award is challenged - see cl 6(5). The question of when the default provision of cl 6(1)(b) of the Second Schedule would apply would also arise.

[96] This does not end the matter. Mr Raymond's next submission was that the remission back was justified because there was an error of law by the tribunal when it failed to deal with party/party costs. Mr Raymond relies for this proposition on *Fyfe v Devonport Borough Council* (1990) 15 NZTPA 26. In that case Tompkins J held that, even though the Planning Tribunal was *functus officio* once its decision had been sealed and was thus unable to deal with the question of costs if these had not been reserved, its failure to reserve the question of costs could amount to an error of law. Such an error could be rectified on appeal and this was the case even if counsel at the hearing had made no application with regard to the reservation of costs. We note that the same principle appears to have been applied in an arbitration context – see the brief discussion in *Sutherland Shire Council v Kirby* [1961] NSWR 718 at 721.

[97] In this case, the arbitral tribunal failed even to consider the question of party/party costs. In our view, failure to consider costs can amount to an error of law and, in some circumstances, whether or not there was an explicit request by counsel to consider costs or to reserve the question of costs. There is no doubt in our view that the costs associated with an arbitration are an integral part of that arbitration. Costs necessarily fall to be dealt with, however, once the arbitral tribunal has come to its decision. Traditionally, subject to any agreement of the parties, in arbitrations as in courts, costs usually followed the event. It may be that, under the current Arbitration Act, this position is not quite so clear but the result of an arbitration would, in any event, remain a relevant consideration in the setting of costs. Further, because the parties complied with cl 6(2)(b), the arbitrators did not know about the settlement offer made by the lessee until after the first award. They thus did not consider that settlement offer, which was a relevant factor in the costs decision – see cl 6(2)(a) of the Second Schedule.

[98] Mr Hodder's submission was that the default provision in cl 6(1)(b) automatically applies if costs are not expressly dealt with in an award or additional award or reserved. We are unpersuaded that the default provision was meant to apply to exclude an argument that there has been an error of law in a situation where the tribunal had not turned its mind to costs and a party has a legitimate claim for costs that could not realistically have been pursued before the award was finalised. We note that, where a settlement offer has been made, there is a major practical difficulty in requiring a party to ask the arbitrators, before the award is made, to reserve costs. It would be impossible to tell the arbitrators why that submission was being made without breaching the obligation under cl 6(2)(b) that the tribunal must not be told that an offer to settle has been made until all other matters are determined. Asking the tribunal to reserve costs would thus not have been an appropriate course for the lessee to take in this case.

[99] We are, therefore, of the view that the tribunal's failure to consider party/party costs in its award of 11 September 2002 amounted to an error of law, justifying the remission back to the tribunal of that issue.

[100] It is not entirely clear from the High Court judgment whether the question of the tribunal's allocation of its own costs was challenged by the lessee and whether that question too was remitted to the tribunal. The question of law identified by the lessee in its application to the High Court was wide enough to encompass the question of the tribunal's own costs. From the description of the opposing contentions at [138] of Ellen France J's judgment, however, the issue, as argued, appeared to be restricted to party/party costs. This was also the manner in which it was argued before us. We assume, therefore, that the remission back on costs related only to party/party costs. If, however, contrary to this assumption, there was a remission back on the question of the tribunal's own costs, it would in our view have been justified for much the same reasons as set out in [97]. The arbitral tribunal made an error of law in determining how their costs were to be paid, because they concentrated solely on cl 2.3.6 of the lease and did not take into account cl 6(2)(a) of the Second Schedule.

[101] For completeness, we remark that we have some doubt as to whether the setting aside of the second award was justified, although that setting aside has not been challenged in this Court. The tribunal's second award was purportedly an additional award under art 33(3). This was on the basis that it was dealing with a claim presented in the arbitral proceedings but omitted from the award. It is arguable that costs will, unless explicitly excluded, be a claim presented in the arbitral proceedings and thus, if not dealt with in an award, a proper subject for an additional award under art 33(3) of the First Schedule.

[102] In the case of *Re Becker, Shillan and Company and Barry Brothers* [1921] 1KB 391 it was held that a reference to arbitration under the then English Arbitration Act incorporated a claim for costs, whether made explicitly or not. This was because a submission to arbitration, subject to the agreement of the parties, necessarily included the provisions of the First Schedule to the then Act. The First Schedule provided that the costs of the reference and award would be in the discretion of the arbitrators. No such discretion had been exercised and the award was remitted back for that discretion on costs to be exercised. See also *Mavani v Ralli Bros Ltd* [1973] 1 WLR 468, 475 [QBD].

[103] Under cl 6(1)(a) of the Second Schedule the costs and expenses of an arbitration are to be as fixed and allocated by the arbitral tribunal. They are thus at the discretion of the arbitral tribunal, although cl 6(1)(b) provides a default position if that discretion is not exercised (which may be a point of distinction with *Becker*). Clause 6.2 may also be of relevance as pointed out by Chambers J. We do not need to examine this further, however, as, for the reasons given above, we consider that there was, in any event, an error of law in the first award, justifying remission back. If we had not taken this view, we would have had some doubt as to whether the approach suggested by Chambers J at [150](b) would have been available, given that the setting aside of the second award was not challenged in this Court.

[104] We turn now to the question of costs on the second award. While it would no doubt be convenient for the arbitral tribunal to deal with such costs, we see no jurisdictional basis for the tribunal to deal with the question of costs on an award that

has been set aside. That issue should have been dealt with in the High Court and we remit it to that Court.

[105] Finally, we remark that we have not found the issue of costs in this case straightforward. In our view, this is a matter that may require some legislative clarification, particularly on the question of whether a failure to deal with costs would justify an additional award under art 33(3) and, if so, when it would do so.

Conclusion and costs in this court

[106] We answer Question One as follows. The arbitral tribunal did not err in its task. The tribunal correctly applied the lease provisions as amplified by the agreement of 13 May 2002.

[107] Leave to appeal is refused in relation to Questions Two to Five. We note that we do not endorse the remarks of Chambers J at [155] – [160]. It is inappropriate in our view to say more as we heard no argument on the general principles for the granting of special leave.

[108] Turning to Question Six, we agree that the question of party/party costs should be remitted to the arbitral tribunal, although we differ, in the respects set out above, from Ellen France J's reasoning in that regard.

[109] The question of costs on the second award should not have been remitted to the arbitral tribunal. It is remitted to the High Court.

[110] Mr Raymond submitted that the lessee's reasonable costs on this appeal should be granted. This is because the whole thrust of arbitral law is designed to prevent appeals from parties merely unhappy about the result of an arbitration. He conceded, however, that costs were set, by agreement, in the High Court on a scale basis. As this was the case, we see no reason to depart from the usual method of setting costs in this Court.

CHAMBERS J

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Question One

[111] I agree with the answer Glazebrook and Hammond JJ have given to Question One: at [106].

[112] The tribunal's task was to assess the "current market rent" in terms of cl 2.3.3 of Schedule C of the lease. That was confirmed in para (2) of the parties' agreement. It was further agreed in para (3) of the parties' agreement that the "traditional" method of determining the revised ground rental was appropriate. And then there was para (6), as set out at [8] of the majority's judgment. These three clauses must be read together. Paragraphs (2), (3) and (6) must also be read in light of recent case law.

[113] I have no doubt that the tribunal was correct to apply the "prudent lessee" test. There is no distinction between that test and the parties' agreement here, as explained by this court in *Sextant Holdings* and *Granadilla*.

[114] I do not think Question One was properly formulated. The question is drafted on an assumption that there is a difference between the "prudent lessee" test and the "willing but not anxious (ie rational) lessor and lessee" test. The question in truth is whether there is a difference between those two tests. Advocates do not assist the court by loading the questions.

[115] Secondly, when a second appeal is being pursued, the question should focus on alleged errors of law in the High Court's decision. A second appeal is not just a second round of the original appeal, before a differently constituted court. Second

appeals focus on alleged errors made by the first tier appellate judge. Of course, it will still be necessary to look closely at and evaluate what the arbitrators did, but that is no longer the primary focus.

[116] This question should have been worded along the following lines:

> Was the High Court correct in holding that the arbitrators' valuation approach conformed with the parties' agreement, and in particular, with para (6) of the agreement?

Question Six

[117] Unfortunately, I do not agree with all of the majority's reasoning on the question of costs. The analysis which follows is not on all fours with the submissions of either the lessor or the lessee.

The steps up to the hearing before Ellen France J

[118] The parties' agreed position on rent reviews was originally set out in cl 2.3 of Schedule C of the lease. That clause provided for arbitration in accordance with the provisions of the Arbitration Act 1908. Clause 2.3.6 dealt with how "costs of the determination by the valuers or the umpire" were to be fixed.

[119] That position was varied by the 13 May 2002 agreement. The significant feature of that variation for current purposes was that the parties agreed that the arbitration was to be conducted in accordance with the Arbitration Act 1996, not the Arbitration Act 1908. That meant that cl 6 of the Second Schedule of the Arbitration Act 1996 became incorporated into the arbitration procedure. Clause 6 dealt with costs. It is set out in the appendix to the court's reasons.

[120] The parties' agreed position became as follows:

a) So far as "all costs of the determination by the valuers or the umpire" are concerned, the guiding principles were to be those found in cl 2.3.6 of the lease, as supplemented by cl 6(2) of the Second

Schedule. At the hearing before us, the parties were agreed that "costs of the determination by the valuers or the umpire" in cl 2.3.6 meant the arbitral tribunal's costs. I agree with the stance adopted by the parties. I respectfully disagree with Ellen France J's contrary interpretation of that phrase.

b) Party and party costs would fall to be determined according to normal principles, as supplemented by cl 6(2) of the Second Schedule.

[121] It is normal practice for arbitrators to fix their costs in the award, as almost invariably they want their costs paid before the award is uplifted. But, unless the parties agree to the contrary at the arbitral hearing, the arbitrators must not allocate their costs or determine party and party costs in their award. That is because of cl 6(2) of the Second Schedule. Those costs matters must be dealt with (in the absence of agreement) in an additional award.

[122] In this case, the arbitrators in their first award did fix their total costs at $82,632 plus GST. They were entitled to do that. What they then went on to do, however, was allocate those costs as between the parties. They were not entitled to do that because of cl 6(2) of the Second Schedule. The arbitrators appear to have overlooked that provision. Unless the parties at the arbitral hearing had agreed that the arbitrators could allocate their costs as between the parties, that step had to wait for further submissions and for ultimate determination in an additional award. It is common ground that there was no agreement at the arbitral hearing for a costs allocation in the award.

[123] When the lessee received the first award, it immediately objected to the fact that the arbitrators had allocated responsibility for their costs in that award. The lessee filed an appeal in the High Court raising the following error of law:

> Did the arbitrators err in law by omitting to reserve and seek submissions on the issue of costs and expenses of the arbitration (as defined in cl 6(1)(a))?

[124] The lessee, in its notice of appeal, said that the arbitrators' 50/50 allocation of their costs was unreasonable in the circumstances, as it did not take into account "an

offer made by the [lessee] to the [lessor] on 13 October 2001 (that offer being more favourable to the [lessor] than the arbitrators' determination of the appropriate rental rate…contained in the Award)". The lessee relied on, among other things, cl 6 of the Second Schedule of the Arbitration Act.

[125] The lessee sought the following relief:

> The issue of costs be remitted to the arbitrators.

[126] It will be apparent from the above discussion that I think the arbitrators did err in failing to reserve the question of the allocation of their costs until they had heard submissions, and in particular until they had found out whether there had been an offer to settle.

[127] At about the same time as the lessee was filing its appeal, the lessee went back to the arbitrators and asked for an additional award to cover party and party costs. I consider they were entitled to do that, provided there was compliance with art 33(3) of the First Schedule of the Arbitration Act. That would mean that the request had to be made within 30 days of the receipt of the award and that costs would have had to have been claimed in the arbitral proceedings.

[128] I think both requirements were satisfied. Although there is no definite evidence before us that the request was made within 30 days of receipt of the award, I am prepared to infer that it was. No timing point ever appears to have been taken by the lessor, and certainly the arbitrators believed they had jurisdiction to deal with the request for party and party costs. I am also satisfied about the second aspect. The parties had, by virtue of cl 6(1)(a) of the Second Schedule, agreed that the legal and other expenses of the parties were to be fixed and allocated by the arbitral tribunal, either in its original award or in an additional award. I therefore consider that the arbitral tribunal did have power to make an award of party and party costs.

[129] The tribunal did make such an award. It ordered the lessor to contribute $95,000 plus GST towards the lessee's expenses. It also fixed its own costs with respect to the second award. They came to $18,675, inclusive of GST. The

arbitrators ordered the lessor to pay 75% of their fee, with the lessee being responsible for the remaining 25%.

[130] The lessor then applied to the High Court to have the second award set aside on various grounds, including that there was no jurisdiction to make it.

[131] The lessee appealed against the second award under cl 6(3) of the Second Schedule. The lessee sought to have the lessor pay a greater proportion of its actual costs incurred in the arbitral proceeding. That is to say, it considered the award of $95,000 plus GST to be insufficient.

Ellen France J's decision

[132] All applications then came before Ellen France J.

a) Lessor's application to have the second award set aside

[133] Ellen France J set aside the second award because she considered the arbitrators had no jurisdiction to make it. That was because she considered that neither art 33(1) nor art 33(3) of the First Schedule applied.

[134] I respectfully disagree. I agree that art 33(1) did not apply. But in my view art 33(3) did apply. A claim for costs had been presented, from the moment the parties agreed that this would be an arbitration under the Arbitration Act 1996 and did not contract out of cl 6 of the Second Schedule of that Act. In my view, the second award was wrongly set aside.

(b) *Lessee's appeal against allocation of arbitrators' costs*

[135] Her Honour remitted this matter back to the arbitrators for further consideration: first judgment at [152]. In that judgment, it was not particularly clear, with respect, what that reconsideration was to cover. But Her Honour crystallised that in her recall judgment. It was her view that cl 2.3.6 of the lease captured "all costs (not just those of the arbitral tribunal)": at [15]. She thought that the arbitrators had not realised that (as indeed they had not) and that accordingly they had operated

under an error of law. She wanted them to reconsider that matter, correcting that error.

[136] Presumably, therefore, the arbitrators were to reconsider the whole question of costs, applying the criteria of cl 2.3.6 of the lease to the assessment.

[137] There are, with respect, difficulties with this reasoning. First, it is now common ground between the parties that Her Honour's interpretation of cl 2.3.6 is erroneous, a view with which I agree. Clause 2.3.6 applies only to the arbitrators' costs. It does not dictate criteria for the allocation of party and party costs.

[138] Secondly, there is an inconsistency in Her Honour's reasoning. She set aside the second award because, in her view, no claim for party and party costs had been presented in the arbitral proceedings. Hence, art 33(3) could not, in her view, be relied upon. Yet here she was saying that cl 2.3.6 was broad enough to cover party and party costs, and the arbitrators had erred in not considering party and party costs in their first award. If Her Honour were correct that cl 2.3.6 mandated party and party costs, then clearly a claim for such costs had been presented in the arbitral proceedings, and Her Honour was wrong to find art 33(3) inapplicable and to strike out the second award.

[139] I agree with Her Honour's decision to remit the first award for further consideration by the arbitrators on the question of costs. But I disagree with the scope of the task set for them and with the reasoning which led to the remission.

[140] In my view, the lessee's appeal against the first award should have been allowed. The scope of the arbitrators' exercise should have been limited to a reconsideration of the allocation of their costs, taking into account cl 6(2) of the Second Schedule and the submissions of the parties. The remission should not have covered party and party costs, as they were dealt with in the second award (which should not have been set aside).

(c) *Lessee's appeal under clause 6(3) of the Second Schedule*

[141] Ellen France J dismissed this appeal because she had set aside the second award altogether.

[142] For the reasons given above, I am of the view that she was wrong to set aside the second award. She should have considered the lessee's appeal.

The appeal to this court

[143] On 7 April last year, Ellen France J granted leave to appeal to the Court of Appeal on the following question:

> In relation to the remittal back to the arbitral tribunal of the plaintiff's appeal against the award dated 11 December 2002, and of questions of costs related to the 28 April 2003 award, whether such remittal back was contrary to the Arbitration Act 1996 where the arbitral tribunal was *functus officio*, was held to have no jurisdiction to make the 28 April 2003 award, and was not held to have made any error of law in not reserving questions of costs in its award dated 11 December 2003.

[144] Again, as with Question One, I regard this question to be inappropriately worded. The wording appears to have been lifted from ground (c) of the lessor's application for leave to appeal to the Court of Appeal.

[145] We are not bound, however, by the form of the question. The question introduces the topic, but answering the questions is not part of the court's official determination. The High Court's powers on an appeal under the Arbitration Act are set forth in cl 5(4) of the Second Schedule. The High Court may, by order:

a) confirm, vary, or set aside the award; or

b) remit the award, together with the High Court's opinion on the question of law which was the subject of the appeal, to the arbitral tribunal for reconsideration or, where a new arbitral tribunal has been appointed, to that arbitral tribunal for consideration.

[146] Clause 5, while conferring an appeal by leave to this court, does not specify this court's powers on the further appeal. For those powers, one turns to r 19 of the

Court of Appeal (Civil) Rules 1997. Two subclauses of those rules are particularly pertinent here:

> (5) The Court may give any judgment and make any order which ought to have been given or made, and make such further or other orders as the case may require.
>
> (6) The powers of the Court may be exercised even though the notice of appeal or cross-appeal may state that part only of a decision is appealed from, and may be exercised in favour of all or any respondents or parties although they may not have appealed from the decision or contended that it should be varied.

[147] In my view, those powers are sufficiently broad to enable the errors that have been made by the arbitral tribunal and the High Court to be corrected.

[148] In summary, I consider that the arbitrators erred in allocating their costs without considering cl 6(2) of the Second Schedule and without seeking submissions on costs. I consider the High Court erred in setting aside the second award, in the form of the remission to the arbitrators, and in its failure to consider the lessee's appeal under cl 6(3).

[149] The above analysis appears to be similar to that which the lessee advanced in the High Court. The lessee's argument before us changed. That seems to be because the lessee was happy with Ellen France J's decision to remit "all costs (not just those of the arbitral tribunal)" to the tribunal. The lessee no doubt considered that that would sufficiently meet its objectives, even though Her Honour reached her decision by reasoning different from that which the lessee's counsel had propounded. However, it now seems to be accepted on both sides that Her Honour's reasoning on this issue was incorrect. That left the lessee in the position of not having challenged Ellen France J's setting aside the second award. To get around that problem, Mr Raymond developed an argument which was clearly different from that which he presented to Ellen France J. I think, with respect, his refined argument was wrong. His initial approach was much closer to a correct legal analysis.

[150] The orders I would have made are as follows:

a) The first award is varied by omitting the allocation of the arbitrators' costs of $82, 632 plus GST as between lessor and lessee.

b) The second award is confirmed and the High Court order setting it aside is itself quashed.

c) The High Court's decision to remit certain matters to the arbitral tribunal is confirmed, but with different directions to the arbitrators. The arbitrators must now:

i) Reconsider the question of how their costs of $82,632 plus GST on the first award are to be allocated as between lessor and lessee and make a further additional award concerning:

- the allocation of their fees and expenses up to the making of the first award;

- the fixing and allocation of their fees and expenses relating to work to be done pursuant to this remission; and

- the fixing of the contribution (if any) one party (**Party A**) is to make to the other in respect of Party A's legal and other expenses relating to work to be done pursuant to this remission;

ii) In determining allocations under order 3(a)(i) and (ii), consider cl 2.3.6 of the lease and cl 6(2) of the Second Schedule of the Arbitration Act 1996, and the parties' submissions thereon; and

iii) In fixing any contribution under order 3(a)(iii), consider normal principles relating to the award of party and party costs in arbitrations under the Arbitration Act 1996, including cl 6(2) of the Second Schedule of that Act, and the parties' submissions thereon.

d) The High Court must consider afresh the lessee's appeal against the second award under cl 6(3) of the Second Schedule of the Arbitration Act 1996.

[151] I hope the reasons why I differ from the majority's analysis are reasonably clear from the above discussion.

Special leave to appeal

[152] The lessor applied to the High Court for leave to appeal on four other questions. Ellen France J, in a considered judgment, declined leave. I cannot fault her reasoning.

[153] Clause 5 of the Second Schedule contains three different leave provisions. The first is contained in cl 5(1)(c): under that paragraph, a party may appeal to the High Court on a question of law arising out of an award "with the leave of the High Court". How that discretion should be exercised has been definitively determined by this court in *Gold and Resource Developments (NZ) Limited v Doug Hood Limited* [2000] 3 NZLR 318.

[154] The second leave provision is contained in cl 5(5). That provides for an appeal to this court "with the leave of the High Court". That provision gives rise to different considerations from those arising under cl 5(1)(c). Ellen France J adopted the test set out in *Cooper v Symes* (2001) 15 PRNZ 166. Although the principles enunciated in that decision have not been the subject of argument and determination in this court, Randerson J's test appears to have been widely accepted in the High Court and seems appropriate. There is one point in that judgment I specifically endorse. At [9], Randerson J remarked that the test for leave under cl 5(5) is not the same question as the test for leave under cl 5(1)(c). Rather, as Randerson J said, an application under cl 5(5) is more akin to an application for leave under s 67 of the Judicature Act 1908.

[155] The third leave provision is that contained in cl 5(6). It is that leave provision with which we are concerned in this case. It gives rise, in my view, to different considerations yet again. Clause 5(6) reads as follows:

> If the High Court refuses to grant leave to appeal under subclause (5), the Court of Appeal may grant special leave to appeal.

[156] I appreciate that that subclause does not in terms state that an applicant for special leave must demonstrate an error in the High Court judge's assessment, but in practice that is, in my view, what an applicant for *special* leave must demonstrate. An application for special leave will never be lightly granted. An application for special leave is not simply a second bite at the cherry. This is not the occasion, in a minority judgment, to set out precisely what the test should be on a special leave application under cl 5(6). I would simply at this stage make the following general comments.

[157] First, a special leave application under cl 5(6) has a different focus from a cl 5(5) application. It is inherent in the philosophy of the Act generally and in the structure of cl 5 particularly that an application for special leave will be granted only if the applicant demonstrates that the High Court judge's refusal to grant leave is clearly wrong and that the argument is one of real importance worthy of the Court of Appeal's attention.

[158] Secondly, any questions of law must concentrate on alleged errors in the High Court decision which is under challenge. It is the High Court's alleged errors in it substantive decision which must be shown to be of sufficient importance to warrant a further appeal.

[159] Thirdly, it is not in accord with the structure of the Act that the putative appeal should be considered in detail and then, if found to be wrong, leave to appeal is declined. In this regard, I strongly endorse what this court said in *Gold and Resource Developments* at [57]:

> The hearing of the application should be kept brief. It should merely be an opportunity for the Judge to ensure that he or she has a grasp of the arguments and so enabling a determination to be made whether the applicant has, in light of the nature of the point of law and the factors to be considered,

> established a sufficiently strong case to justify the grant of leave. As Lord Donaldson of Lymington MR said in *Ipswich Borough Council v Fisons plc* [1990] Ch 709 at 722:
>
> > …a decision on whether or not to grant leave to appeal to the High Court should be arrived at after only brief argument. It is not the function of the judge to hear the putative appeal, before deciding whether or not to grant leave.

[160] This view also finds support in the Court of Appeal (Civil) Rules 2005, due to come into force on 1 May. Under r 25, on an application for leave or special leave to appeal, the applicant's counsel will have 15 minutes in which to make his or her oral submission. The respondent's counsel will have 15 minutes as well. The applicant will then have a five minute reply. In this case, that course was not taken because the lessor and lessee agreed that there should be a single hearing, a view then ratified by a judge of this court. I make no criticism whatever of the judge who made that decision. But it is my view that generally it is preferable for leave applications to be dealt with separately. Otherwise, there is a strong probability that the court will become involved in the substantive issue raised by the leave application, as occurred here.

[161] I would decline special leave to appeal on all four questions. In my view, none of the questions is correctly focused on what is said to be in error in Ellen France J's judgment. Nor has any attempt been made to show how she erred in approaching the application for leave.

[162] Let me just give one example to illustrate the error in the lessor's approach to this court. Question Four before both the High Court and this court was framed thus:

> Whether the arbitral tribunal erred in admitting as evidence and having regard to earlier arbitral awards determining ground rentals for unrelated properties.

[163] Ellen France J dealt with that question. She noted that the lessor accepted that the arbitrators had a discretion to admit that evidence. She found that the arbitrators had not exercised this discretion on an improper basis. She said that it was clearly a question for them to determine what weight should be given to that particular evidence. She further noted that the evidence had not in any event been critical to their conclusions. She gave reasons for her views. Where did

Ellen France J go wrong? There is nothing in the question posed to indicate any error on her part. What she found on this topic seems completely orthodox and could not possibly give rise to a question of law worthy of further consideration in this court.

[164] For these reasons, I would decline the application for leave.

Solicitors:
Chapman Tripp, Wellington for Appellant
Duncan Cotterill, Christchurch for Respondent

APPENDIX

Arbitration Act 1996

Schedule 1

31 Form and contents of award—

(1) The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

(2) The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given or the award is an award on agreed terms under article 30.

(3) The award shall state its date and the place of arbitration as determined in accordance with article 20(1). The award shall be deemed to have been made at that place.

(4) After the award is made, a copy signed by the arbitrators in accordance with paragraph (1) shall be delivered to each party.

(5) Unless the arbitration agreement otherwise provides, or the award otherwise directs, a sum directed to be paid by an award shall carry interest as from the date of the award and at the same rate as a judgment debt.

32 Termination of proceedings—

(1) The arbitral proceedings are terminated by the final award or by an order of the arbitral tribunal in accordance with paragraph (2).

(2) The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when—

(a) The claimant withdraws the claim, unless the respondent objects thereto and the arbitral tribunal recognises a legitimate interest on the respondent's part in obtaining a final settlement of the dispute:

(b) The parties agree on the termination of the proceedings:

(c) The arbitral tribunal finds that the continuation of the proceedings has for any other reason become unnecessary or impossible.

(3) The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to the provisions of articles 33 and 34(4).

(4) Unless otherwise agreed by the parties, the death of a party does not terminate the arbitral proceedings or the authority of the arbitral tribunal.

(5) Paragraph (4) does not affect any rule of law or enactment under which the death of a person extinguishes a cause of action.

33 Correction and interpretation of award; additional award—

(1) Within 30 days of receipt of the award, unless another period of time has been agreed upon by the parties,—

(a) A party, with notice to the other party, may request the arbitral tribunal to correct in the award any errors in computation, any clerical or typographical errors, or any errors of similar nature:

(b) If so agreed by the parties, a party, with notice to the other party, may request the arbitral tribunal to give an interpretation of a specific point or part of the award.

If the arbitral tribunal considers the request to be justified, it shall make the correction or give the interpretation within 30 days of receipt of the request. The interpretation shall form part of the award.

(2) The arbitral tribunal may correct any error of the type referred to in paragraph (1)(a) on its own initiative within 30 days of the date of the award.

(3) Unless otherwise agreed by the parties, a party, with notice to the other party, may request, within 30 days of receipt of the award, the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award. If the arbitral tribunal considers the request to be justified, it shall make the additional award within 60 days.

(4) The arbitral tribunal may extend, if necessary, the period of time within which it shall make a correction, interpretation, or an additional award under paragraphs (1) or (3).

(5) The provisions of article 31 shall apply to a correction or interpretation of the award or to an additional award.

Schedule 2

6. Costs and expenses of an arbitration – (1) Unless the parties agree otherwise, -

(a) The costs and expenses of an arbitration, being the legal and other expenses of the parties, the fees and expenses of the arbitral tribunal, and any other expenses related to the arbitration shall be as fixed and allocated by the arbitral tribunal in its award under article 31 of the Schedule 1, or any additional award under article 33(3) of the Schedule 1; or

(b) In the absence of an award or additional award fixing and allocating the costs and expenses of the arbitration, each party shall be responsible for the legal and other expenses of that party and for an equal share of the fees and expenses of the arbitral tribunal and any other expenses relating to the arbitration.

(2) Unless the parties agree otherwise, the parties shall be taken as having agreed that, -

a) If a party makes an offer to another party to settle the dispute or part of the dispute and the offer is not accepted and the award of the arbitral tribunal is no more favourable to the other party than was the offer, the arbitral tribunal, in fixing and allocating the costs and expenses of the arbitration, may take the fact of the offer into account in awarding costs and expenses in respect of the period from the making of the offer to the making of the award; and

b) The fact that an offer to settle has been made shall not be communicated to the arbitral tribunal until it has made a final determination of all aspects of the dispute other than the fixing and allocation of costs and expenses.

(3) Where an award or additional award made by an arbitral tribunal fixes or allocates the costs and expenses of the arbitration, or both, the High Court may, on the application of a party, if satisfied that the amount or the allocation of those costs and expenses is unreasonable in all the circumstances, make an order varying their amount or allocation, or both. The arbitral tribunal is entitled to appear and be heard on any application under this subclause.

(4) Where—

(a) An arbitral tribunal refuses to deliver its award before the payment of its fees and expenses; and

(b) An application has been made under subclause (3),—
the High Court may order the arbitral tribunal to release the award on such conditions as the Court sees fit.

(5) An application may not be made under subclause (3) after 3 months have elapsed from the date on which the party making the application received any award or additional award fixing and allocating the costs and expenses of the arbitration.

(6) There shall be no appeal from any decision of the High Court under this clause.