Feltex International Ltd v JBL Consolidated Ltd

High Court Auckland
24 March, 5 May 1988
Henry J

Property law – Lease – Rent review – Lease for 30 years with "annual rental" to be reviewed every five years – Arbitrator fixed rent by reference to comparable properties, most of which had three yearly rent reviews, and added 10% for longer term of five years – Whether the word 'fair" should be implied into the term "annual rental" – Whether arbitrator was entitled to add 10% for a longer term – Whether award should be set aside.

The plaintiff as tenant sought to set aside an arbitration award fixing the rental to be paid for a five year period of a lease of a property in Auckland. The lease was for a term of 30 years with rent reviews every five years. The rent review clause provided that the "annual rental" should be reviewed every five years and fixed for the ensuing five years by agreement between the parties, or, failing agreement, by arbitration pursuant to the Arbitration Act 1908. For the rent review due 30 June 1985 the parties were unable to agree and the matter was referred to arbitration. In fixing the rent the arbitrator chose to have regard to rent payable under leases of reasonably comparable properties, in the great majority of which rentals were fixed for a three year period. The arbitrator proceeded to analyse the selected rentals into rates per annum for a square footage of building. He then selected an appropriate rate for each of the differing types of structure of building included in the premises, such as office, mezzanine and warehouse, and applied that to the actual square footage in question. The resulting total was adjusted for various relevant factors and finally to allow for the fact that the rent was being fixed for a five year term. The plaintiff challenged this adjustment for a five year term, representing an effective increase of 10%.

Held: 1 It was proper to imply the word "fair" into the words "annual rental" so as to give the rental review clause business efficacy. To determine a fair annual rental the "prudent lessee" test should be applied. The inquiry was as to what a prudent lessee would pay for those premises having regard to the term and conditions of the lease.

Devonport Borough Council v Robbins [19791] NZLR 1, *Beer v Bowden* [1981] 1 All ER 1070; [19811] WLR 522 and *Drapery & General Importing Co of New Zealand Ltd v Mayor, etc, of Wellington* (1912) 31 NZLR 598 applied.

2 The arbitrator was correct in having regard to the fact that he was fixing the fair annual rental for a five year period. To give the period of review no weight would result in actual or potential unfairness, leaving out of account one of the very basic provisions of the lease itself. The lessee had the benefit of a five year term during which the rent could not be increased, and when comparable properties with three yearly rental reviews were used as the basis for fixing the fair annual rental, it was proper in this case that the additional value of the five year period should be reflected in the annual rent. The additional value recognised in the award did not amount to an attempt to vary indirectly the terms of the lease by imposing an intermediate review to add a premium to compensate for possible inflation. The application to set aside the award was dismissed.

National Westminster Bank Ltd v BSC Footwear Ltd (1980) 42 P & CR 90 distinguished .

Lear v Blizzard [1983] 3 All ER 662 discussed.

Other cases mentioned in judgment

Brechin & Drapery Importing Co Ltd Re [1928] NZLR 241.
Lund's Lease Re [1926] NZLR 541.
Thomas Bates & Son Ltd v Wyndham's (Lingerie) Ltd [1981] 1 WLR 505 - [1981] 1 All ER 1077.
Wellington City Council v National Bank of New Zealand Properties Ltd [1970] NZLR 660.

Source: New Zealand Institute of Valuers (1993). Land valuation cases 1965-1992. Hutcheson Bowman & Stewart Ltd, Wellington.

Civil proceedings

This was a civil proceeding to set aside an award made under the Arbitration Act 1908 determining rent under a rent review clause in a lease.

C R Dunning for the plaintiff (Feltex International Ltd).
R J Moody for the defendant (JBL Consolidated Ltd (in receivership)).

Cur adv vult

Henry J. In this action the plaintiff seeks to set aside an arbitration award published on 19 November 1986. The arbitration was to determine the rental payable for a five year term commencing 30 June 1985 for industrial premises situated at 15 Gabador Place, Auckland. The award of the arbitrator, Mr R P Young, a registered valuer, fixed the rent at $211,831 per annum. Although there may well be defects in the way the matter has come before the Court, both parties are desirous of obtaining a definitive ruling on what is said to be a matter of general as well as particular importance. The procedural difficulties can I think best be met by treating the annexure to the award as constituting part of the award, and then inquiring whether there is error of law on the face of the record such as to require the intervention of the Court under its general jurisdiction. The annexure sets out in detail the reasons of the arbitrator. As I understood him Mr Moody for the defendant consented to such an approach if it would enable the Court to make a determination.

The lease in question is dated 30 June 1970 and is expressed as being for a term of $17^1/_2$ years as from that date and ending on 30 December 1987 but with a compulsory right of renewal for a further $12^1/_2$ years, giving a final expiry date of 30 June 2000. Clause 2 of the lease provides for the rent to be reviewed every five years and is in these terms:

> "2. At the expiration of each five (5) year period during this Lease or any renewal or extension thereof the annual rental payable hereunder shall be reviewed and fixed for the five (5) year period following each such date of review by agreement between the parties or failing agreement shall be fixed by arbitration pursuant to the provisions of the Arbitration Act 1908 and its amendments but in any event shall not be less than the annual rental payable for the five year period immediately preceding each such date of review."

Accordingly a rent review was due as at 30 June 1985. The parties were unable to agree and the determination was left to the arbitration of Mr Young. The error of law relied upon by the plaintiff concerns one of the steps taken by the arbitrator in the course of reaching his final award figure. The method of assessment to be adopted in such circumstances as these where no formula is laid down in the contractual documentation is the prerogative of the arbitrator. Here the arbitrator, as he was entitled to do, chose to have regard to rent payable under reasonably comparable leases of reasonably comparable properties. The great majority of those selected concerned leases executed some years after the execution of this lease and were instances in which rentals were fixed for a three year period. The arbitrator proceeded to analyse the selected rentals into rates per annum for a square footage of building, as is commonly done. Having done that, he selected what he considered to be an appropriate rate for each of the differing types of structure of building included in the premises, such as office, mezzanine and warehouse, and applied that to the actual square footage in question. The resulting total was adjusted for various relevant factors and finally to allow for the fact that the rent was being fixed for a five year term. It is this last adjustment, representing an effective increase of 10%, which the plaintiff now challenges. In the course of his reasons, the arbitrator also found that there was nothing in the lease or in the evidence adduced before him to show that fixing a "fair rent" would have given a different result from fixing it as being "fair market rental" or "current market rental". I turn now to the test properly to be applied by this arbitrator.

There are no express provisions in the lease governing the assessment of the rent under review, cl 2 merely stipulating for an "annual rental". It is therefore necessary to place some qualification

on those words in order to give the clause: business efficacy, because clearly the fixing of the rental of an arbitrator was not intended to be left to the capricious whim of the appointee. It is proper to infer a qualification to the written words, and that is done by inserting the word "fair" before the words "annual rental" where they first occur in cl 2. The necessary criteria for the implication (*Devonport Borough Council v Robbins* [1979] 1 NZLR 1) are made out, and such a construction has authority if it be needed (see for example *Beer v Bowden* [1981] 1 All ER 1070). It is also the construction sought to be placed on the clause by Mr Dunning, and one which was not in any way challenged by Mr Moody.

The term "fair annual rent" occurs in the Public Bodies' Leases Act 1969, and has been the subject of judicial consideration. It is now well established law in New Zealand that what is required to determine a fair annual rent is the application of the so-called "prudent lessee" test, which is said to have been laid down in *Drapery & General Importing Company of New Zealand Ltd v Mayor, etc, of Wellington* (1912) 31 NZLR 598. In that case it was held that the valuers, in order to determine the fair annual ground rent of the land in question "must ascertain what the prudent lessee would give for the ground-rent of the land for the term, and on the conditions as to renewal and other terms, etc, mentioned in the lease" (p 605). That was followed in *Re Lund's Lease* [1926] NZLR 541, and then by the Court of Appeal in *Re Brechin & Drapery Importing Co Ltd* [1928] NZLR 241. More recently the same principle was adopted again by the Court of Appeal in *Wellington City Council v National Bank of New Zealand Properties Ltd* [1970] NZLR 660. In particular at p 671 North P stated:

> "In my opinion, what the umpire was saying was this: the principle laid down in the *DIC* case required him to ascertain what a prudent lessee would give as a ground-rent of the land for the new term of 21 years. This being so he was obliged to consider what factors would be taken into account by a prudent lessee. In short he was only concerned with matters which will affect the mind and ultimately the judgment of a prudent lessee in making his offer to the landlord."

Turner J expressed similar views at p 678.

It is, however, necessary to keep in mind that the valuation must still be fair. The requirement of fairness means that it is not simply a matter of determining the least amount which the lessee will pay, as obviously he will pay as little as he can. Rather the inquiry is as to what a prudent lessee would pay for these premises having regard to the term and conditions of the lease. This must represent the amount which he can reasonably expect to pay for the rights and obligations which are undertaken in the lease. That is where the element of fairness lies as the lessee cannot expect to receive the benefits without payment of a fair consideration for them.

A similar test was applied by Tudor Evans J in *Lear v Blizzard* [1983] 3 All ER 662. In that case it was held that renewal of a lease at a rent to be agreed between the parties and in default at a rent to be determined by an arbitrator required the arbitrator to determine subjectively what would be a fair rent for the lessor and the lessee in all the circumstances taking into account all the considerations which would have affected the minds of the parties if they had been negotiating the rent themselves.

Such an approach also accords with that taken in *Thomas Bates & Son Ltd v Wyndham's (Lingerie) Ltd* [1981] 1 All ER 1077 where the rent review clause was in terms similar to that contained in the present lease. There Buckley LJ said at p 1088:

> "In my judgment in default of agreement between the parties the arbitrator would have to assess what rent it would have been reasonable for these landlords and these tenants to have agreed under this lease having regard to all the circumstances relevant to any negotiations between them of a new rent from the review date."

The use of the word "reasonable" as opposed to "fair" is not significant although I think it preferable to adhere to the latter terminology in the New Zealand context where the word now has a recognised meaning in determining leasehold rentals.

Mr Dunning went on to submit and I think rightly so that "market rent" does not necessarily equate "fair rent" because the former may exclude the subjective factors which could influence the

determination of what is fair as between two particular parties. Although the distinction between market and fair rent does exist in some circumstances the market rent may also represent the fair rent and in others ascertainment of the fair rent may well warrant consideration of market rent. Here it was for the arbitrator to give such weight to evidence of market rent as he thought fit.

In applying the proper test it was therefore necessary for the arbitrator to have regard to the terms of this lease and the rights and obligations both of the lessor and the lessee. Of particular relevance is the duration of the lease which was for a 30 year term starting at an agreed annual rental figure and requiring that to be reviewed every five years. The arbitrator cannot ignore the fact that the rent he is fixing will be the fair annual rent for a period of five years. To put that factor to one side and to give it no weight would be wrong because it would leave out of account one of the very basic provisions of the lease itself and thus result in actual or at the very least potential unfairness. To exemplify that one need only consider two extreme positions. For example the market or fair annual rent for certain premises under lease may well differ if the term for which it is to apply is one year from that which would apply if it were seven years and differ again from that which would apply if the term were 21 years. The substance of Mr Dunning's submission as I understood it was that in some way the lessee here was disadvantaged because it had a benefit under the contract of rent being fixed for five years which was somehow being lost because a so-called "premium" was being added to what would be a fair annual rental for a three year term. It is difficult to see what element of unfairness results from that process of assessment, particularly in the light of counsel's concession that the adjustment would be appropriate in assessing the annual market rental. The lessee has the benefit of a five year term during which the rent cannot be increased. If the market recognises that that is worth more on an annual basis to a lessee than for example is a three year limitation period, it is not a necessary consequence that something unfair results if that additional value is reflected in the annual rent. The fallacy in the submission lies in the resulting need to ignore that term of the lease, which would result in a failure to apply the proper test.

It is proper valuation practice, and in accordance with legal principle, in making a valuation of this nature to have regard to comparable properties. That will usually involve a comparison of many factors as between the comparable property and the subject property, and making appropriate adjustments for any distinguishing factors – and there will often be many. Included in these, when dealing with leasehold property valuations, will be any relevant difference between the terms of the two leases being compared. Only in that way can like be compared with like and overall fairness be ascertained.

As an alternative submission, and what I think was really the basis behind the first submission of unfairness, Mr Dunning contended that what the arbitrator had done here was in effect to vary the terms of the lease by doing something equivalent to introducing an intermediate review period. The basis for the submission lay in two reported cases. The first is *National Westminster Bank Ltd v BSC Footwear Ltd* (1980) 42 P & CR 90, a decision of the English Court of Appeal. There a lease contained a right of renewal for a (further) term of 21 years "at the then prevailing market rent". It had been held in the Chancery Division that the arbitrator fixing the renewed rent was entitled to determine a rent which was subject to periodic reviews during the 21 year period. Not surprisingly, the Court of Appeal overruled the decision at first instance and held that there was no such power vested in the arbitrator, who was bound to determine the rent, and could not impose a formula and redraft the lease by virtue of his award. His duty was to determine the rent which was to be payable annually throughout the term of the new lease. That is clearly distinguishable from the present case, in which the award neither directly nor indirectly provides for any further review during the five year period. What the arbitrator has done here is to fix the annual rent for the whole of the review period.

The second case is *Lear v Blizzard* earlier referred to. Tudor Evans J there heard an application to determine questions of law which had arisen during the course of the arbitration involving a rent review, including the following at p 665:

"(d) Whether, having regard to the fact that a 21 year lease without further rent reviews during the currency of the term was provided for by clause 3(2) of the lease, a premium to take into account anticipated inflation during the currency of the term should be built into the new rent and, if so, whether it should be assessed at the level of the premium applicable in 1961 which should then be converted into a premium and applied to the current rental value or whether the percentage should be assessed by reference to the current market conditions at the date of renewal."

The Judge answered the question by holding that a premium is not to be added to take into account anticipated inflation during the currency of the new terms.

If the judgment is to be read as holding that an arbitrator cannot take into account the fact that he is fixing a rental for a 21 year period, then I respectfully disagree. On my reading however, Tudor Evans J was saying no more than a premium cannot be added to what is a fair annual rental over a 21 year period, a conclusion with which I do respectfully agree. One of the disadvantages of a 21 year term in times of inflation is that by the end of the term the rental is likely to be substantially less than current comparable market rentals, but that is something which is inherent in present day conditions. What cannot be done is indirectly to vary that term of the lease, by requiring an intermediate review or by adding a premium to compensate for possible inflation. That is not the present situation and does not represent the effect of this arbitrator's award. What he was required to do and what he did was to ascertain the fair annual rent to be paid by this lessee for these premises over the five year period, giving weight to evidence placed before him that a five year term could be expected to command a higher annual rent than would a three year term. In so doing no error of law was committed, and the terms of cl 2 of the lease on their true construction have been given effect by him. Indeed no question of law really arises.

The action to set aside the award is accordingly dismissed. Counsel can submit memoranda as to costs if necessary.

Application dismissed.

Solicitor for the plaintiff: *C R Dunning* (Auckland).
Solicitors for the defendant: *Buddle Findlay* (Auckland).