Jefferies v R C Dimock Ltd

High Court (Commercial List) Auckland
2, 16 June 1987
ker J

Property law – Lease – Rent review – Rent payable on review to be such rental as agreed between parties or fixed by arbitrator if they could not agree – Whether the rent should be assessed on a subjective or on an objective basis – Whether tenant's improvements should be taken into account in assessing rent.

By cl 3.13 of a lease entered into between the first respondent landlord and the second respondent tenant the parties agreed that, "The rental fixed at each review shall be such rental as is agreed upon by the Landlord and the Tenant and if they cannot agree to be determined by Arbitration . . .". By cl 1.17 the parties had agreed that the landlord would accept liability for modifications to the demised premises not exceeding $200,000. In the event, the tenant's expenditure on modifications had totalled $479,222. The parties could not agree on whether the tenant's extra expenditure should be taken into account in assessing rental on the review. The applicant was subsequently appointed arbitrator. He conducted a hearing and produced an interim award. In his award the arbitrator assessed the annual rental at $189,400 on the basis that the tenant's excess expenditure was ignored, but he also made an alternative assessment of $162,900 per annum on the basis that the tenant's excess expenditure ought to be taken into account. At the request of the parties, the arbitrator stated a case to the High Court pursuant to s 11 of the Arbitration amendment Act 1938. The point in issue was which assessment should be adopted.

Held: The rent review clause required a subjective assessment by the arbitrator which would take into account all the considerations that would have affected the minds of the parties if they had been negotiating for the rent themselves. In this case these considerations included the improvements effected and paid for by the tenant which improvements had become the property of the landlord. As the arbitrator had made his award in the alternative, the Court determined that the rental to be paid for the period under consideration should be $162,900 per annum.

.her cases mentioned in judgment
Thomas Bates & Son Ltd v Wyndham's (Lingerie) Ltd [1981] 1 All ER 1077; [1981] 1 WLR 505 and *Lear v Blizzard* [1983] 3 All ER 662 applied.
Ponsford v HMS Aerosols Ltd [1979] AC 63; [1978] 2 All ER 837 distinguished.

Case stated
This was a case stated from an arbitrator pursuant to s 11 of the Arbitration Amendment Act 1938. It was dealt with on the Commercial List pursuant to 24B(1)(b) of the Judicature Act 1908.
H C Keyte for the applicant (R L Jefferies) (given leave to withdraw).
P M Salmon QC for the first respondent (R C Dimock Ltd).
N J Carter for the second respondent (Giltrap Group Holdings Ltd).

Cur adv vult

Barker J: This judgment on a case stated by an arbitrator pursuant to s 11 of the Arbitration Amendment Act 1938 represents the first occasion on which a proceeding entered in the Commercial List has reached a final hearing. The Commercial List was established at the Auckland Registry of this Court on 1 April 1987; these proceedings were filed on 2 April 1987.

At a directions hearing on 14 April 1987 counsel agreed that all relevant documents had been placed before the Court by the arbitrator and that no interlocutory steps were required. On that

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

occasion, Mr Keyte, who had prepared the case stated on behalf of the arbitrator, was given leave to withdraw; the dispute was clearly between the first respondent, R C Dimock Ltd (the landlord) and Giltrap Group Holdings Ltd, the second respondent (the tenant).

Section 24B(1)(b) of the Judicature Act 1908 includes, as a class of proceedings eligible for entry on a Commercial List, applications to the Court under the Arbitration Act 1908. This present dispute deals with the interpretation of a rent review clause for the rental of commercial premises; it is thus eminently suitable for inclusion in the Commercial List. Both counsel have been of considerable assistance in preparing detailed submissions and I record my gratitude to them. The arbitrator's case stated arises from a submission to arbitration under the terms of an agreement to lease, dated 22 April 1982, between the landlord and the tenant. The lease was of premises at 103 Great North Road, Auckland and the term was for 21 years. The rental payable for the first three years of the lease was fixed by agreement at $6250 per annum; in accordance with the rent review clause (which will be quoted later) there had to be an arbitration in lieu of agreement to fix the rental to be paid for the second period, from 28 May 1985 to 27 May 1988. The parties appointed Mr R L Jefferies, registered valuer, as the sole arbitrator. He issued an interim award on 5 February 1986 (details of which will be mentioned later); at a subsequent hearing on 4 June 1986, he was requested by counsel for the parties to state a case to this Court, which he did.

The clauses of the lease upon which the interpretation of the Court is sought are as follows:

> "1.17 Notwithstanding anything contained in clause 1.10 hereof, the tenant shall forthwith proceed with partial demolition and reconstruction of the building forming part of the demised premises in accordance with plans prepared by Sinclair Johns Consultants Limited and initialled by the parties hereto for the purposes of identification. The Tenant shall as soon as possible submit detailed plans and specifications to the Landlord for approval, such approval not to be unreasonably withheld. The Tenant shall have the work completed in a good and tradesman-like manner and in accordance with Auckland City Council By-Laws and Regulations. Such work shall include electrical and plumbing services, painting and decorating, and the formation and paving of the forecourt. The completed structure including partitioning fencing and electrical fittings but not including carpets and drapes shall be the property of the Landlord. The Landlord agrees to refund to the Tenant the cost of such work, not exceeding $200,000. Payment of such refund shall be made by the Landlord to the Tenant without interest by equal monthly instalments during the fourth, fifth and sixth years of the tenancy hereby created.
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> . . .
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> 3.13 The rental herein before provided shall be the rental for the first three years of the term hereof. The rental hereunder shall be reviewed on the third anniversary of the commencement of the term and at every subsequent third anniversary thereof. The rental fixed at each review shall be such rental as is agreed upon by the Landlord and the Tenant and if they cannot agree to be determined by Arbitration in the manner herein provided but not in any case to be a rental less than the rental chargeable immediately prior to such review. During the fourth, fifth and sixth years of the term hereof, the rental payable each month shall be reduced by an amount calculated on the formula a/b x c where:
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> (a) Is the amount to be refunded by the Landlord to the Tenant in accordance with clause 1.17 hereof reduced by the amount actually paid In terms of that clause as at the rent date concerned.
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> (b) Is the total value of the demised premises fixed by the valuation on which the rental for the three years commencing on 20 April 1985 established .
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> (c) Is the rental for the demised premises as established by the foregoing valuation."

The arbitrator heard evidence from both sides and counsel made submissions he found that the landlord negotiated for the purchase of the premises in July 1981 and then almost immediately negotiated with the tenant who wished to take a lease of the property, modified for its own use. The tenant required extensive modifications; the landlord would not accept liability for the cost of modifications.

A preliminary document was signed setting out heads of agreement, this was subsequently translated into the formal lease document. The tenant wished partial demolition of the existing structure and its rebuilding as a motor vehicle dealer's showroom and forecourt. The $200,000 expenditure which the landlord agreed to accept was initially to be met by the tenant with the landlord repaying that sum over a three year period, after the fourth year of the tenancy had elapsed. Repayment was to be by way of rent rebate; no argument arises as to the operation of the formula set out in the formal lease agreement.

The present difficulty has arisen because the tenant's expenditure on reconstruction and modifications amounted to $479,222; an excess expenditure of $279,222 over and above the $200,000 which the landlord had agreed to repay to the tenant. The issue is whether, when fixing the rental for the renewed term, the arbitrator should have taken into account:

(a) the fact that the tenant had spent $279,222 on improvements for which it was to receive no reimbursement; and

(b) the fact that accordingly the tenant had paid for major improvements to the landlord's land but would in effect be paying rent on these improvements.

In his interim award, the arbitrator considered that if, as was his view, the correct interpretation of the lease was that the excess expenditure by the tenant must be ignored in fixing the rental for the three year term, the annual rental would be $189,400. If, however, the tenant's contention were correct and the tenant's expenditure ought to be taken into account, then the annual rental would be $162,900. The parties agreed to accept these assessments. The only point in issue is which assessment should be adopted.

The arbitrator also found:

(a) that the total value of the premises upon which rent was to be paid was $1,894,000;

(b) that when entering into the agreement to lease, the parties considered the likelihood that the costs of reconstruction of the building could exceed $200,000; and

(c) the terms of the agreement were framed with this possibility specifically provided for.

However, the arbitrator did not make any finding as to the amount by which the parties expected the $200,000 to be exceeded. In a case stated, reference to the evidence must be limited. However, for what it was worth, Mr Carter submitted that the modifications were completed substantially in accordance with plans attached to the original agreement and that the managing director of the landlord supervised the work under the direction of an architect. The managing director of the tenant stated in evidence that the landlord's architect had represented that the cost would be about $200,000. No contrary evidence was given by the landlord, although the arbitrator made no finding on the point.

Mr Salmon pointed out, that in another clause of the agreement, there is an option to purchase given to the tenant as a right of first refusal; there is nothing in the clause which requires the landlord, when nominating a price at which he is prepared to sell, to give a discount to the tenant for improvements.

The crucial clause for interpretation is cl 3.13; the words there refer to the rental fixed at each three yearly review ie "shall be such rental as is agreed upon by the Landlord and the Tenant and if they cannot agree to be determined by Arbitration". The clause makes no reference to market rental; it was Mr Carter's submission that the words did not import an objective market rental assessment by reference to the "demised premises". He submitted that a subjective assessment of rental was required which took into account the improvements effected and paid for by the tenant which improvements became the property of the landlord. In other words, counsel's submission was that the rental should be assessed in the light of the surrounding circumstances in which the lease was negotiated.

Mr Salmon submitted that the present value of the premises was market-related and not determined necessarily by the cost of alterations. It was not possible to identify the excess costs which were not represented by any particular item or improvement but which formed part of the overall costs of demolition and upgrading of the premises.

Counsel for the tenant relied on the decision of the English Court of Appeal in *Thomas Bates & Son Ltd v Wyndham's (Lingerie) Ltd* [1981] 1 All ER 1077. I here the lease referred to the rent to be determined when the first term expired as:

> "a rent to be agreed between the lessor and the lessee but in default of such agreement at a rent to be fixed by [an] arbitrator . . ." (ibid, 1080).

The English Court of Appeal, distinguishing *Ponsford v HMS Aerosols Ltd* [1979] AC 63, held that since the rent review clause referred to such rent "as shall have been agreed" between the parties, and not to the rent "agreed for the demised premises", the rent to be fixed by the arbitrator was to be the rent to which it would be reasonable for the particular parties to agree, having regard to all relevant circumstances (such as tenant's expenditure on improvements). The arbitrator was not to fix a rent, assessed objectively, on the basis of the market rent.

Delivering the principal judgment of the Court of Appeal, Buckley LJ differentiated *Ponsford's* case. The relevant clause in *Ponsford's* case referred to rent "reasonable . . . for the demised premises for the appropriate period". There the majority of the House of Lords (Lords Dilhorne, Fraser and Keith) held that the words pointed unambiguously to a reasonable rent, assessed on an objective basis, without reference to a particular tenant or a particular landlord or to the history of how the premises came to be built or paid for.

Lords Wilberforce and Salmon took a contrary view; they considered that what had to be ascertained was what would be a reasonable rent between the particular parties. Buckley LJ, at p 1088 of the *Thomas Bates* case, considered that the clause in the *Ponsford* case was sufficiently different from the case before him in that the clause before him referred to nothing other than the rent to which the parties had agreed.

The *Thomas Bates* case was followed by Tudor Evans J in *Lear v Blizzard* [1983] 3 All ER 662. In that case, the rent review clause referred to "a rent to be agreed between the parties . . . or in default of agreement at a rent to be determined by a single arbitrator". The learned Judge held that the true construction of the lease which the arbitrator had to follow was to determine, subjectively what would be a fair rent for the parties to agree in all the circumstances taking into account all the considerations which would have affected the minds of the parties If they had been negotiating the rent themselves. The question at issue there was that the tenant had paid for some improvements to the property and the extent to which those improvements should be taken into account.

Tudor Evans J referred to the distinction between the two kinds of clause in these words:

> "It is contended on behalf of the landlords that the words in cl 3(2) 'a lease of the demised premises . . . at a rent to be agreed between the parties hereto' are the same, in effect, as the language in the review clause in that case. But It seems to me that there are material differences between the language of the two clauses. The clause in *Ponsford v HMS Aerosols Ltd* did not contain any reference to an agreement between the parties.
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> The importance of this distinction was emphasised in *Thomas Bates & Son Ltd v Wyndhams (Lingerie) Ltd* [1981] 1 All ER 1077, [1981] 1 WLR 505, on which the tenant relies. That case contained many points which are not relevant in the present case but the essential facts were these. Landlords let premises to predecessors of the tenants for seven years with an option for a further lease 'of the demised premises . . . at a rent to be agreed between the lessor and lessee'. There was provision for an arbitrator to fix the rent in default of agreement. In 1963 the option was exercised and a further lease was granted with an option in terms identical with the original lease. In 1970, when the tenant exercised the option, the landlords sought to introduce a review clause. A new lease was executed for 14 years with a review at the fifth and tenth years. By a mistake, the lease contained no provision for arbitration in default of agreement of the rent on review. The material language of the clause provided:
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> 'Yielding and Paying therefore during the first Five Years of the said term unto the lessor the rent of Two Thousand Three Hundred and Fifty Pounds and for the next period of five years of the said term and the final period of four years of the said term such rents as shall have been agreed between the Lessor and the Lessee . . .' "

In proceedings for rectification, the court ordered that language should be inserted into the clause providing for an arbitrator to determine the rent in default of agreement. On appeal, one of the questions which arose was: on the lease as rectified, by what measure was the arbitrator to fix the rent if the parties failed to agree? Buckley LJ, having referred to the language of the review clause in *Ponsford v HMS Aerosols Ltd* said ([1981] 1 All ER 1077 at 1088, [1981] 1 WLR 505 at 518):

> "That form of clause, as it seems to me, focuses attention on what is there described as 'a reasonable rent for the demised premises' for the appropriate period, and that expression is first used without any reference to agreement between the parties to the lease at all. It then goes on to provide that such assessment (that is to say, the fixing of the amount of the rent to be charged) shall be either agreed or, in default of agreement, arrived at by valuation by an independent surveyor. That form of wording, in my judgment, certainly affected the views of the majority of the House of Lords in that case."

Buckley LJ then referred to passages in the majority opinions and continued ([1981] 1 All ER 1077 at 1088, [1981] I WLR 505 at 518-519):

> "But it appears to me that the terms of the clause there under consideration were noticeably different in important respects from the clause which we have, which refers to nothing other than such rent as the parties shall have agreed.... In my judgment, in default of agreement between the parties, the arbitrator would have to assess what rent it would be 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."

Everleigh LJ expressed the same opinion ([1981] 1 All ER 1077 at 1090, [1981] 1 WLR 505 at 521).

> "The arbitrator held that the decision in the *Thomas Bates* case was distinguishable because that was primarily a case to rectify a lease and the provisions to arbitrate had been omitted by mistake. The case was not in his view on all fours. I agree that the facts of the *Thomas Bates* and *Lear v Blizzard* cases were different; but in respect of the essential point of the interpretation of this kind of rent review clause, the English Court of Appeal and Tudor Evans J clearly support the submissions made on behalf of the tenant in the present case. The arbitrator's distinction that the *Thomas Bates* case was concerned with rectification is untenable. The relevant interpretation of the rent review clause applied to the lease as rectified. I find that the clause in the present case is indistinguishable in any material way from the clauses under consideration in those two cases. I consider that the *Ponsford* case does not apply, for the reasons given by the Court of Appeal and by Tudor Evans J; therefore, in my view the submission of the tenant must prevail."

Section 11 of the Arbitration Amendment Act 1938 provides:

> "(1) An arbitrator or umpire may, and shall if so directed by the Court, state –
> (a) Any question of law arising in the course of the reference; or
> (b) An award or any part of an award –
> in the form of a special case for the decision of the Court.
> (2) A special case with respect to an interim award or with respect to a question of law arising in the course of a reference may be stated, or may be directed by the Court to be stated, notwithstanding that proceedings under the reference are still pending.
> (3) A decision of the Court under this section shall be deemed to be a judgment of the Court within the meaning of section 66 of the Judicature Act 1908 (which relates to the jurisdiction of the Court of Appeal to hear and determine appeals from any judgment of the Court), but no appeal shall lie from the decision of the Court on any case stated under paragraph (a) of subsection (I) of this section without the leave of the Court or of the Court of Appeal."

The arbitrator has made his award in the alternative. Counsel have indicated that they can find no authority to suggest that the arbitrator should not have proceeded in this way. The parties agreed that the arbitrator should state a case in this form; counsel further agree that s 11(1)(b) above applies, therefore the case stated should be translated into a judgment of the Court. In accordance with s 11(3) therefore I determine, as judgment of the Court, that the rental to be paid for the period under consideration should be $162,900 per annum.

I direct that the costs of the arbitrator in respect of the case stated be paid by the landlord, with reference to me if counsel cannot agree as to quantum. The arbitrator's costs should be on a solicitor and client basis. I also award costs of $1500 to the tenant in respect of proceedings before me.

The arbitrator apparently decided that each party pay its own costs of the actual arbitration hearing and should share equally his costs. That decision seems to have been part of the award which was not part of the case stated. The arbitrator ruled that the landlord and tenant should meet his own further costs and his legal costs incurred in the presentation of this award by way of case stated to the High Court in equal shares unless the Court otherwise ordered. I have already indicated what should happen to the arbitrator's costs in the case stated.

I do not think I have jurisdiction to interfere with that part of his award dealing with the costs of the arbitration hearing and therefore decline to do so. The question of costs of the hearing for the arbitrator was a matter for him. If it is alleged he has made an error of law, then the tenant has other remedies.

Judgment for second respondent.

Solicitors for the applicant: *Kensington Swan* (Auckland).
Solicitors for the first respondent: *Burt Moodie Goold & Francis* (Auckland).
Solicitors for the second respondent: *McElroy Milne* (Auckland).