

**IN THE HIGH COURT OF THE COOK ISLANDS
HELD AT RAROTONGA
(CIVIL DIVISION)**

OA NO. 4/2013

IN THE MATTER of the Declaratory Judgments Act 1994

AND

IN THE MATTER of certain Deeds of Lease made between
APEX AGENCIES LIMITED, APEX
PROPERTIES LIMITED AND MEATCO
LIMITED as Lessor and COOK ISLANDS
TRADING CORPORATION LIMITED as
Lessee

AND

IN THE MATTER of a certain Deed of Lease between JLW
GROUP LIMITED as Lessor and COOK
ISLANDS TRADING CORPORATION
LIMITED as Lessee

BETWEEN **Apex Agencies Limited, Apex Properties
Limited, Meatco Limited and JLW Group
Limited**

(Applicants)

AND **Cook Islands Trading Corporation Limited**
(Respondent)

Date of hearing: On the papers

Counsel: Mr T Manarangi for Apex Agencies Ltd, Apex Properties Ltd
and Meatco Limited
Mr H Matysik for JLW Group Limited
Mr T Arnold for Cook Islands Trading Corporation Limited

Judgment: 15 June 2013 (New Zealand time)

Reasons for Judgment

REASONS FOR JUDGMENT OF HUGH WILLIAMS J

Determinations:

- A. The Court confirms its Judgment delivered on 14 June 2013 (Cook Islands time) that the application by the Respondent for the declarations appearing in its Statement of Defence is granted and the application by the Applicants for the declarations appearing in their Statement of Claim is dismissed.
- B. Costs are to be dealt with in accordance with paragraph [44] of these Reasons for Judgment.

Introduction

[1]: The Applicants, Apex Agencies Limited, Apex Properties Limited, Meatco Limited and JLW Group Limited (collectively called “Apex”) are the lessors of four commercial properties in Rarotonga, and the Respondent, Cook Islands Trading Corporation Limited (“CITC”) is the lessee of those properties¹.

[2]: The parties arranged for an arbitration to be conducted in Rarotonga commencing on 17 June 2013 (Cook Islands time) concerning the rent to be paid by CITC on the Leases of the four properties in question for their first renewed term.

[3]: Arrangements had been finalised in respect of the arbitration; the arbitrators, their umpire and witnesses were booked to travel from New Zealand for the hearing; and all arrangements for the arbitration were in train when the parties realised that there may be doubt as to whether CITC could contend in the arbitration, as it has, that the rents for the properties for the new term could contractually be set at a rate less than that operative for the initial term. This was despite the parties having agreed, in a conference call with the arbitrators on 22 April 2013 (Cook Islands time), in reply to a question as to whether the dispute was solely about rent or extended to matters of interpretation of the lease that it was “basically a rent matter but there may be lease use provisions for consideration”.

[4]: As a result of the parties realising that there might be an interpretation of the Leases which permitted reduction in the rent, Apex, on 10 June 2013 issued these proceedings under the Declaratory Judgments Act 1994 seeking the following declarations:

“That the Leases between the Applicants (as lessor) and the Respondent (as lessee) –

- (i) provide for rent increases if the rent prior to the review date is less than current market rentals for buildings and land of a similar nature to the premises.
- (ii) only contemplate increases in annual rents at each review date with the effect that there can be no reduction in annual rents notwithstanding

¹ strictly the parties are sublessor and sublessee as all land in Rarotonga is leasehold, but it is convenient to describe them, as the parties did as lessors and lessees

current market rentals may be less than the rent prior to the review date.”

[5]: In its Statement of Defence filed on 11 June 2013, CITC sought declarations in the following terms:

“That each Lease on its true construction:

- b) contemplates a determination of annual rent if a right of renewal is exercised;
- c) that determination must be made in accordance with Clause 31;
- d) that since rentals are to be based upon “current market rentals” for other buildings and land, the arbitrators may, if satisfied that those current market rentals are less than the rent for the previous term of the Lease, determine a rental for the new term that is less than that for the prior term.”

(CITC also raised the possibility of an action for rectification of the Leases should its views concerning the construction of the same not be upheld but the parties, sensibly, set that issue to one side pending completion of these proceedings and the arbitration.)

Decision

[6]: On 15 June 2013 (NZ time) the Court advised the parties that, on its interpretation of the Leases between them, the declarations sought by CITC were the correct ones and accordingly that those sought by Apex required to be rejected. It also advised the parties that it would deliver the reasons for that judgment as soon as practicable thereafter.

[7]: These are those reasons.

The Leases

[8]: Apart from necessary exceptions relating to differences in descriptions of the properties and the rent payable, the parties agree all four Leases between them are identical. All are dated 20 August 2008. All contain identical provisions as to the permitted uses. All provide for an initial term of four years from “Commencement Date” which the schedule defines as the date of settlement of a contract dated 1

August 2008 for the purchase of the premises by CITC. All provide for five rights of renewal, each for four years.

[9]: As far as rent is concerned, the recitals to the Leases provide for the essential details to be “as set out in the Schedule hereto” with Clause 1.1 providing, in the usual way, for CITC to pay the rent and VAT “for the time being payable (or in the case of the rent as varied pursuant to any rent review) by equal calendar monthly payments in advance...” The remaining provisions of the Lease are those customarily found in leases of commercial premises but the main provisions for the purpose of these proceedings are Clauses 31 and 32.1 which read:

“31. RENT REVIEWS

31.1 On each review date specified in the Schedule a new rental shall be determined by agreement of the Lessor and the Lessee or failing agreement by arbitration in accordance with the arbitration provisions of this lease such rentals to be based upon current market rentals for the relevant rental period for buildings and land of a similar nature to the premises excluding any improvements made by the Lessee and having regard to all matters relevant to the determination of such rental.

32. RENEWAL: TENANCY AFTER EXPIRATION OF TERM

32.1 If the Lessee has not been in breach of this lease and has given to the Lessor written notice to renew the lease at least three (3) calendar months before the end of the term then the Lessor will at the cost of the Lessee renew the lease for the next further term from the renewal date as follows:

- (a) The annual rent shall be agreed upon or failing agreement shall be determined in accordance with Clause 31.
- (b) The renewed lease shall otherwise be upon and subject to the covenants and agreements herein expressed and implied except that the term of this lease plus all further terms shall expire on or before the final expiry date.
- (c) Pending the termination of the renewed rent the Lessee shall pay the rent proposed by the Lessor. Upon determination an appropriate adjustment shall be made.”

[10]: The Leases then provide, in Clause 36.1.6, that;

“Headings of paragraphs and bar or marginal notes have been inserted for the sake of convenience and guidance only and shall not be taken to form any part of the context or to assist in the interpretation of the paragraphs.”

[11]: Clause 36.1.6 is relevant to these proceedings because the provisions in the Schedule relevant to rent read:

“Dates for increase of Annual Rent	As at the date of commencement of each renewed term.”
---	---

Principles of Interpretation of Leases

[12]: The principles of contractual interpretation in relation to Leases are not in contention. they were conveniently summarised in *Wellington Racing Club v Harnett & Wedde Limited*² as follows:

“It is true, as [*Melanesian Mission Trust Board v AMP Soc* [1997] 1 NZLR 391 (PC)]... emphasises, that in the first instance commercial instruments such as leases are to be given their plain meaning. Where words on their face are plain, surrounding circumstances are not to be invoked to produce some ambiguity; with that ambiguity then resolved by reference to surrounding circumstances so as to produce some less than obvious true meaning. However, that plain meaning approach is subject to questions of absurdity. Parties to commercial instruments generally do not intend the commercially absurd. As the *Melanesian Mission* case itself accepts... plain meaning may give way if ‘an absurd result would be produced if their ordinary meaning was to be given to the (relevant) words’. The question did not arise in the *Melanesian Mission* case, as either interpretation of the clause in question was commercially realistic, outcome either way being within the range of negotiation. That should not be allowed to disguise the principle recognised. The Court will look for an alternative and commercially sensible result within the semantically possible.”

[13]: And in the handy compendium referred to by counsel Clarke and Adams “Rent Reviews and Variable Rents”³ the view is expressed that the proper construction of rent review clauses is a question of law; that the meaning of a particular word is a question of fact; that the construction of rent review clauses is a process of ascertaining the mutual intention of the parties from the meaning of the words used; that the words used are construed literally unless there is a clear contrary intention or

² 9 June 1997 Ellis & McGeach JJ, HC Wellington AP243/96 cited in Brookers Land Law para 11.1.02

³ 3rd ed Chapter 10, “The Principles of Construction of Rent Review Clauses” p297 ff

some manifest absurdity; that extrinsic evidence as to the actual or subjective intent is rarely admitted but the Court can take account of the “matrix of fact” surrounding or antecedent to the transaction; that the documents must be construed as a whole with repugnancy ignored in the last resort; that the commercial purpose of the contract may assist in construction following which the are examples of the means adopted by the Courts in other cases to resolve ambiguities. Of interest to the present case, in dealing with commercial purpose, the text says:⁴

“The modern emphasis recognises that such a clause is primarily designed ‘to give relief to’ (‘load the scales in favour of’) the landlord where, as is usual, the rent cannot be reduced on review (*Equity & Law Life Assurance Society v Bodfield* [1987] 1 EGLR 124); the overall aim is to combat both inflation and to obtain periodically the market value of the premises as if let on the same terms in the open market at the review dates (*British Gas Corporation v Universities Superannuation Scheme* [1986] 1 WLR 398). There is an increasing emphasis that the primary purpose is to ‘allow the rent to be adjusted to reflect changes (usually only upward changes) in the monetary value of the building’ per Hoffman J in *Tea Trade Properties Ltd v CIN Properties Ltd* [1990] 1 EGLR 155. This may reduce the emphasis and weight given to the idea of a rent review being a method of restoring the value of the bargain embodied in the lease – to both sides.”

Submissions

[14]: In submissions filed on behalf of all Applicants, Mr Manarangi first dealt with whether the Schedule was part of the Leases and whether the way in which that part of the Schedule earlier cited is laid out meant that the sidebar “Dates for increase of Annual Rent” was a marginal note and thus excluded from assisting in the construction of the Leases. He submitted such was not the case and the Leases’ use of the word “increase” as part of the provisions for renewed terms meant, on its face, that only increases in rent were permissible. He submitted that Clause 31.1 did not give CITC an avenue by which rents might be decreased on a rent review date as such a construction would ignore the provisions of the Schedule and the overall intent and purpose of the scheme of the Leases. He submitted that “the result is that a submission to arbitration in relation to a rent review only eventuates if a rent review is initiated by the lessor and the proposed increase in rent is not agreed to by the lessee”.

⁴ p310

[15]: Mr Manarangi relied on the distinction in the cases between Leases which said rentals must be at “current market rentals” and those where the renewed rent was required to be “based on current market rentals”.

[16]: That distinction relied on the observations of the New Zealand Court of Appeal in *Metal Sales Limited v Ettema*⁵ where the Court held:

“But when the express provision about rent reviews is examined it is notable that it does not direct that the rent upon review is to be the current market rent. Rather, it says that the reviews are to be *based on* current market rentals, which is not the same thing and is not inconsistent with a ratchet clause. In our view a rent fixed first by assessing a market level of rent by looking at comparable properties and then by taking the higher of the existing rent or the assessed rent can fairly be said to be fixed by a review process based on the market rent. The review, that is the process, is to be based on market rents. The agreement does not say that the rent fixed as a result is necessarily to be a current market rent.”

[17]: Relying on *Metal Sales*, Mr Manarangi made the submission that the rent between the present parties for the renewed term needs to be “based” on current market rentals but not necessarily set at that level. That, combined with the use of the word “increase” in the Schedule meant the rent in these Leases for the renewed term must be increased and the use of the word “based” on current market rentals did not decree that rent at current market rentals must be the result.

[18]: Mr Manarangi also relied on the *Melanesian Mission Trust Board*⁶ decision. In that case the Privy Council was dealing with a lease which required the lessee to pay rent at a rate specified in a Schedule or an increase where the rent had been “increased in accordance with the express provisions of this lease”. At issue was whether the effect of that clause was that the base rent could not fall below the amount specified in the Schedule to the lease or was free to move up and down according to the state of the market at each review date. Their Lordships held the former to be the case because⁷ the Schedule used the word “increased” and that word was “susceptible of only one meaning” because it indicated that the amount of the “‘increased rent’ cannot be less than the amount which was previously payable”.

⁵ (1995) 3 NZ ConvC 192,191, 192,194

⁶ [1997] 1 NZLR 391

⁷ at 395

The Privy Council went on to observe, of a submission that part of the definition of the rent did not expressly prohibit decreases, that⁸

“the absence of an express prohibition against any decrease does not mean that decreases in rent are permitted. It is absence of a provision *for* a reduction in rent rather than a prohibition against such a reduction which is the critical feature of the clause, as its function is to define the extent of the lessee’s covenant in regards to the base rent”.

[19]: Mr Clarke, chairman of directors of CITC, filed an affidavit in both the arbitration and these proceedings claiming it had been a deliberate decision to omit a ratchet clause when the Leases the subject of these proceedings were drafted. Mr Manarangi submitted that evidence was inadmissible and, in any event, even if the absence of a ratchet clause was deliberate, that did not lead to the conclusion that the possibility of rent reductions on review dates was in the contemplation of the parties.

[20]: For CITC, Mr Arnold’s basic submission was that where, rental for these Leases for the renewed term was to be “based” on current market rentals then, if the evidence showed the market for commercial premises in Rarotonga had declined during the initial term of the Lease, it was inevitable that the rents should be reduced to a level which satisfied the formula in Clause 31.1

[21]: He contended that the phrase “Dates for increase of Annual Rent” was no more than a marginal note and thus could not affect the construction of the Lease particularly when the parties had, in the interpretation clause, Clause 36.1.6, expressly agreed that marginal notes were “for the sake of convenience and guidance only” and were not to “form any part of the context or to assist in the interpretation of the paragraph”.

[22]: Mr Arnold, recognising that some precedents suggested the need for affirmative words to negate the suggestion of an implied ratchet clause, made the point that those cases say that result only occurs where the terms of the Lease were ambiguous. Such was not the case here in Mr Arnold’s submission.

⁸ at 396

[23]: And, whilst the contents of Mr Clarke's affidavit could be taken into account in construing the matrix of fact or the context in relation to the point at issue in these proceedings, Mr Arnold accepted that all evidence relating to negotiations for the Lease was excluded.

[24]: He submitted that Apex' reliance on Melanesian Mission misconstrued that decision. The Applicants were, he submitted, striving to find an ambiguity in the present leases when, on proper construction, no such ambiguity arose.

[25]: In a further submission that the Applicants' reliance on Melanesian Mission was misguided, Mr Arnold pointed to the fact that basic to the Privy Council decision was giving meaning to the phrase "where increased in accordance with expressed provisions of this Lease at the increase rate", something which was not comparable to the present Lease

[26]: After detailed reference to the terms of the Leases, Mr Arnold submitted that none of the references to the documents listed to the Schedule would make sense if the words to the right of the marginal notes were deleted but all would make sense if the marginal notes were deleted.

Discussion and Decision

[27]: Because the Applicants place significant reliance on the inclusion of the word "increase" in the relevant section of the Schedule, it is convenient to commence with the Respondent's submission in that regard that it amounts to no more than a marginal note as, were the use of that word to be held unavailable to the construction of these Leases, the Applicants' task would be that much more difficult.

[28]: It is correct that the parties, in Clause 36.1.6 of the Leases agreed that headings and marginal notes were not to be taken to form any part of the context or to assist in interpretation, but that does not lead to a conclusion that the layout of the Schedule is such that the list of headings to the left must be regarded as marginal notes and therefore unavailable to assist in construction.

[29]: The parties have headed each provision or collection of provisions in the Lease with a heading. That no doubt assists in those perusing the documents finding the provisions relevant to the point they are considering but those headings add nothing

to the construction of the Leases and is therefore entirely understandable the parties should have agreed they form no part of the interpretive process (though the headings to the lessees covenants – paras 1-18, the lessors clauses, 19 and 20 and the mutual covenants, clauses 21-42 – may fall into a different category as they form part of most standard leases).

[30]: What the parties intended by the Clause 36.1.6 reference to marginal notes is less obvious, though they may have intended the subparagraph numbering adopted throughout the Lease. It may also be that most of Clause 36.1 was simply transferred into these Leases from some other lease (or from the Acts Interpretation Act 1924) since, with the exception of Clause 36.1.7 and possibly Clause 36.1.1 the balance appear of doubtful relevance.

[31]: However, as far as the layout of the Schedule is concerned, the Court's view is that the Schedule must be viewed as a whole with each part integral to the Schedule itself and therefore to the Lease. Thus seen, the subheadings on the left would make no sense without the notations on the right and vice versa. It would be illogical to have an entry "Dates for increase of Annual Rent" without the phrase "as at the date of commencement of each renewed term" to complement the heading, and the reverse would be equally true. So the correct approach is to treat the Schedule as a whole including its use of the word "increase" with regard to rent payable at the beginning of each renewed term.

[32]: The questions then become: Does the use of the word "increase" in the Schedule mandate nothing other than an increase in rent at the commencement of each renewed term? Does the use of that word mean both that the rent payable from the commencement of each renewed term can never reduce below the rent payable for the preceding term and can never be set at the same level as previously, even though that might otherwise be the result of the operation of a traditional ratchet clause?

[33]: The answer, in the Court's view, is that the construction to be ascribed to the use of the word "increase" must be tempered by what should be regarded as the prime provisions as far as interpretation of the Leases is concerned, the provisions of Clauses 31 and 32.1, and the Court turns to those provisions.

[34]: Clauses 31.1 and 32.1 provide for differing situations. They provide two routes to the same means of conclusion: agreement or arbitration .

[35]: Clause 31.1 makes it mandatory for a “new rental” to be determined “on each review date”, that is to say the obligation on the parties to determine the “new rental” arises automatically every four years on expiration of the preceding term of the Lease.

[36]: Clause 32.1 obligates the lessor to renew the Lease for a further term from the renewal date if the lessee, not being in breach of the Lease, has given the lessor three calendar months notice of its requirement for a renewal.

[37]: Whether the determination of the “new rental” arises as a result of the arrival of each review date or whether the new “annual rent” arises from the lessee’s notice for renewal, the means of determining the rent for the ensuing term is identical; it must be determined either by agreement of the parties or by arbitration abiding by the principles appearing in Clause 31.1.

[38]: Since the means of determining the “new” or “annual” rent for a renewed term is identical in either case, the parties presumably included two modes of getting to the need for agreement or arbitration to cover the possibility of the lessee not giving notice of its requirement for renewal but holding over in terms of Clause 32.2. If the lessor omits to propose an increased rent the lessee holding over would only be obligated to pay rent at the previous level. In a time of rising rents, that might be an attractive option, so the lessee could withhold giving a notice for renewal. The requirement for determination of a “new rental” by the expiration of the preceding term ensures that either agreement or arbitration automatically follows the expiration of the previous term.

[39]: It is correct, as Mr Manarangi submitted, that the “new” or “annual” rent for the renewed term is not required to be at current market rentals but is required to be “based” upon such rentals and, as *Metal Sales* makes clear, that is not the same as saying the new rent must be current market rent and is not inconsistent with a ratchet clause. But those observations do no more than deal with the result of a rent review: they do not say that the rent for the renewed term must be current market rent but that it must be “based” on current market rent and it must be “for buildings and land

of a similar nature to the premises excluding any improvements made by the Lessee and having regard to all matters relevant to the determination of such rental". That formula decrees the basis for determining the facts to be taken into account when setting the rent for the next four year term. Such a formula, as Metal Sales says, may not be inconsistent with a ratchet clause, should there be one in the particular case, but the point of distinction between the present case and Metal Sales is that, in that case, the parties could reach no agreement on the inclusion of a ratchet clause in their Lease and were therefore obliged by their contract to call evidence as to whether, in 1989 in New Zealand, ratchet clauses were normal in leases of properties similar to that under consideration in that decision. Here there is no express ratchet clause – deliberately or otherwise - but the parties included in their Leases a reasonably detailed formula to be complied with in determining the basis for the current market rents for the ensuing term. It must follow that, the parties not having included a ratchet clause to prevent determination of the rent for one renewal period being the same or more than that for the preceding period, the rents for these premises can be determined on renewal to be less than the rents for the preceding terms should such lowered level be proved to be the current market rent "for buildings and land of a similar nature" excluding lessee's improvements but including "all matters relevant to the determination of such rental".

[40]: The use by the parties of the word "increase" in the Schedule must be seen in that light. In its usual usage, the word "increase" is inapt because, clearly, the rent for a renewed term might be set at the rate current for the preceding term if that were the result of the application of the determination formula in Clause 31.1 even if rents for similar Rarotonga properties had fallen in the interim. It could certainly be the result had the Leases contained an express ratchet provision. On that view, the normal usage for the word "increase" must be regarded as applicable only if the determination of the "new" or "annual" rental for the renewed term in accordance with the formula in Clause 31.1 results in rents going up and the normal usage must be disregarded if compliance with that formula results in rents being set at the same or a reduced level. In the Court's view, for interpretation purposes, the detailed provisions of Clause 31.1 prevail over the single use of the word "increase" in the Schedule.

[41]: An additional reason leading to the same conclusion is that, as earlier noted, there is ample precedent for the commercial purpose of a rent review clause to be taken into account in determining the ensuing rent. As the passage from “Rent Reviews and Variable Rents” earlier cited demonstrates⁹, a prime commercial purpose of rent review clauses is to maintain the real value of the rent received, for the benefit of the landlord, especially when aligned with a ratchet clause. Such clauses are to ensure landlords receive an appropriate return on the capital employed. They are to restore the value of the parties’ bargain, but, as Clarke and Adams say, the restoration of the bargain’s value effected by rent review clauses is restoration “to both sides”

[42]: It follows that, if Mr Clarke is correct and rents of commercial premises in Rarotonga for properties comparable to those involved in this case have reduced since 2008, that reduction would not have been instantaneous. So it may well be the case that CITC has been paying more than current market rents for these premises for at least part of the period since the inception of these Leases. If that be correct, Apex has been over-compensated for the value of the bargain represented by these Leases for at least part of their initial term, and application of the formula in Clause 31.1 may restore both parties to their position.

Result

[43]: In the result, as the Court concluded in its judgment delivered on 14 June 2013 (Cook Islands time), CITC had made out a case for declarations in the form for which it contended (and which were earlier recited). It followed that Apex’s application for the declarations it sought had to be dismissed.

[44]: As to costs, if the parties are unable to agree, memoranda (maximum 5 pages) may be filed with the parties certifying, if they consider it appropriate so to do, that all issues of costs can be determined by the Court without a further hearing. Any memorandum from the Respondent is to be filed and served within 28 days of delivery of these Reasons for Judgment and any memorandum from the Applicants is to be filed and served within 35 days of that date.

⁹ and other authority eg. Hinde McMorland and Sim, *Land Law New Zealand*, looseleaf edition, para 11.110 p 65, 208 – 65, 210 and Brookers *Land Law*, looseleaf edition para 11.11.05

A handwritten signature in dark blue ink, appearing to read "H Williams". The signature is written in a cursive style with large, sweeping letters. A horizontal line is drawn beneath the signature.

Hugh Williams, J