IN THE COURT OF APPEAL
HELD AT RAROTONGA

CA 8/2013

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
BETWEEN	Apex Agencies Limited, Apex Properties Limited and Meatco Limited **Appellants**
AND	Cook Islands Trading Corporation Limited **Respondent**

Coram: David Williams P
Barker JA
Paterson JA

Hearing: By agreement of the Parties no hearing was held: Judgment on the papers
Judgment: 20 March 2015

JUDGMENT OF THE COURT OF APPEAL

Introduction

[1] This is an Appeal, on the papers, from the High Court decision of Hugh Williams J dated 15 June 2013. The reasons for judgment were dated 15 June 2013.

[2] The Appellants filed a Notice of Appeal on 23 August 2013. However, the Appellants failed to apply for a hearing date and file the case on appeal within the six month period under r 37 of the Court of Appeal Rules 2012. Under r 37, the appeal was therefore deemed to have been abandoned.

[3] As a result an application for Special Leave to Appeal was lodged on 20 October 2014, pursuant to r 13(5) of the Court of Appeal Rules 2012. On 20 November 2014, David Williams P allowed the Appellants' application for Special Leave to Appeal. However, this was subject to the Appellants paying costs of $2,000 to the Respondent to mitigate the trouble and the delay of proceedings.

[4] On 10 December 2014, Mr Matysik, on behalf of JLW Group Ltd, filed a Notice of Abandonment of Appeal. JLW Group notified the Court that it was not intending to further prosecute the appeal, and that it abandoned all further proceedings. Therefore, as noted in the intituling, the Appellants in this appeal consist of three of the four applicants from the High Court proceedings, namely: Apex Agencies Limited, Apex Properties Limited and Meatco Limited.

[5] The Appellants filed their Written Submissions in Support of the Appeal dated 11 December 2014 and the Respondent filed its Written Submissions in Response dated 23 December 2014.

[6] In response to the Minutes of the Court of Appeal dated 12 and 19 January 2015, counsel for the Appellants and the Respondent confirmed, by way of emails to the registrar on 19 January 2015, their consent to the appeal being dealt with on the papers.

Grounds of Appeal

[7] The grounds which the Appellants' appeal are based were as follows:

> "1. That His Honour erred in law by misconstruing the term "based on current market value" in clause 31.1 of the Deeds of Lease; and as a result
>
> 2. His Honour failed to give proper effect to the word "increase" in the Schedule to the Deeds of Lease."

[8] The Appellants seek from the Court of Appeal:

> "A An order quashing the decision of His Honour dismissing the Appellants application for declarations in the High Court; and
>
> B Declarations as sought in the High Court namely that the Leases –

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

C Costs"

The Deeds of Lease

[9] This appeal involves a question of interpretation of the terms of three identical Deeds of Lease between the Appellants and the Respondent (collectively referred to as the "**Leases**" or the "**Apex Leases**"). The relevant terms are as follows:

"1. PAYMENT OF RENT AND COSTS

1.1 The Lessee shall pay the rent and the applicable 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 in the amounts and on the rent payment dates all as set out in the Schedule hereto during the Term, the first such payment to become due and payable on the Commencement Date and all such payments to be made without any deduction whatsoever to the Lessor by way of automatic bank transfer to the Lessor's nominated bank account in Rarotonga or as otherwise specified in writing by the Lessor.

...

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 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 determination of the renewed rent the Lessee shall pay the rent proposed by the Lessor. Upon determination an appropriate adjustment shall be made.

...

36.1.6. Headings of paragraphs and/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.

...

Schedule

...

Term Four (4) years

Rent $21,083.33 per calendar month plus VAT (totalling $23, 718.75)

Dates for increase of Annual rent As at the date of commencement of each renewed term."

Written Submissions on Appeal

[10] The Court considers that it is not necessary to traverse all the submissions made by the parties. The central submissions have been set out below.

Appellants' Submissions

[11] The Appellants submitted that the declarations they sought turned on the following appeal points:

> "i. The terms of the Leases in question closely resemble the terms considered by the Privy Council in *Melanesian Mission Trust Board v Australian Mutual Provident Society*,[1] and for the reasons expressed in that judgment, the same result ought to follow here.
>
> ii. Although the Trial Judge correctly excluded any reference to extrinsic evidence and applied the terms used in the Schedule, the Judge erred in his analysis and interpretation of the Leases."

[1] *Melanesian Mission Trust Board v Australian Mutual Provident Society* [1997] 1 NZLR 391 ["*Melanesian Mission*"].

i) *Melanesian Mission*

[12] The Appellants submitted that the terms of the lease in the *Melanesian Mission* case closely resemble the Leases in question. In particular:

> "a) The absence of any express provision for a decrease in the rent.
>
> b) The use of the phrase 'based on current market rentals'.
>
> c) The express reference to a 'Dates for increase of Annual Rent'."

[13] The relevant clause in *Melanesian Mission* provided as follows:

> "3.1 The Lessee shall pay to the Lessor during the term of this Lease rent (hereinafter called 'Base Rent') at the rate specified in Item 9 of the First Schedule or where increased in accordance with the express provisions of this Lease at the increased rent."

[14] The Appellants submitted that the Court of Appeal should apply the same interpretative approach as the Privy Council in *Melanesian Mission*. The Privy Council's starting point was to examine the words used in the lease in order to see whether they were clear and unambiguous, and then, examine the document as a whole and in the context in which those words had been used. The Appellants contention is that, considered as a whole, the clear and unambiguous interpretation of the Leases is that they do not provide for a decrease in rent i.e., the Leases contain a ratchet clause.

ii) Errors of Interpretation

[15] The Appellants submitted that the Judge erred in several areas of interpretation. It is not necessary to set these out as the Court is already engaged in an interpretative analysis.

Respondent's Submissions

[16] The Respondent submitted this appeal should be dismissed and costs awarded in its favour. The Respondent said that the outcome of the High Court decision was correct, and in particular, was entirely consistent with:

> "i. The established principles of interpretation;
>
> ii. The commercial justice as between the parties; and
>
> iii. The self-evident proposition that if the lessee did not renew, the lessor could not expect, from the market, anything other than market rental."

Response to Appellants' Submissions

i) Melanesian Mission

[17] The Respondent submitted that the Appellants presented a "view of [*Melanesian Mission*] and its relevant facts that overstates its application. It is not, in fact 'closely analogous'" to this matter. The Respondent submitted three main points.

[18] First, *Melanesian Mission* did not turn on the interpretation of a clause dealing with the renewal of lease and the fixing of the rent on renewal. The Privy Council drew a distinction between a rent review during term (a lessor benefit) and a rent review on renewal (lessee benefit).

[19] Second, the *Melanesian Mission* lease's schedule contained material very different from that contained in the Schedule in the Apex Leases. Further, the Schedule in the Apex Leases was used for drafting conveniences, which, taken alone, would have no "independent, substantive, effect." In contrast, cl 3.1 of the *Melanesian Mission* lease was considered freestanding, clear and unambiguous.

[20] Finally, despite the Appellants' submissions, the phrase "based on market rentals" did not appear in the *Melanesian Mission* lease. Further, the Apex Lease eschewed the use of the word "increase" in preference for the term "vary", which is a term capable of connoting "decrease" as much as it does "increase".

Errors of Interpretation

[21] The Respondent replied to the Appellants' submissions on error of interpretation. However, as noted above, it does not assist to summarise the submissions on this section.

Other Grounds

[22] The Respondent relied on cl 36.1.6, which logically support the contention that the Apex Leases' marginal notes and headings should "not be taken to form any part of the context or to assist in the interpretation of the paragraphs."

Decision

[23] It is not necessary to traverse all the submissions made by the parties. The appeal involves the interpretation of the terms of the leases. The principles which apply to the construction of leases as stated by the Privy Council in the *Melanesian Mission* case are:

> "The approach which must be taken to the construction of a clause in a formal document of this kind is well settled. The intention of the parties is to be discovered from the words used in the document. Where ordinary words have been used they must be taken to have been used according to the ordinary meaning of these words. If their meaning is clear and unambiguous effect must be given to them because that is what the parties have taken to have agreed to by their contract. Various rules may be invoked to assist interpretation in the event that there is an ambiguity. But it is not the function of the Court, when construing

> a document, to search for an ambiguity. Nor should rules which exist to resolve ambiguities be invoked in order to create an ambiguity which, according to the ordinary meaning of the words, is not there. So the starting point is to examine the words used in order to see whether they are clear and unambiguous. It is of course legitimate to look at the document as a whole and to examine the context in which these words have been used, as the context may affect the meaning of the words. But unless the context shows that the ordinary meaning cannot be given to them or that there is an ambiguity, the ordinary meaning of the words which have been used in the document must prevail."

[24] The starting point is the words used in the lease. If those words are clear and unambiguous within the context of the lease, they determine the meaning. In this case this Court is of the view that the issues can be determined by giving the ordinary and plain meaning to the words of the lease. It is not necessary to take into account the factual matrix.

[25] The leases do not provide for rent reviews within a term. The rent is only reviewed if the term is renewed. Thus in practice the provisions of clause 31.1 only have the effect to fix the rent under clause 32.1(a). Clause 31.1 could have been deleted and its terms incorporated in clause 32.1(a).

[26] The leases provide that whether the rent is determined by agreement or arbitration, the rent is "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". Clause 31.1 contains a specific formula for fixing the rent. That formula is the current market rentals for buildings of a similar nature excluding lessee's improvements. There is nothing in that formula which suggests or implies a ratchet clause unless it be the words "based upon".

[27] The Appellants say that the words "based upon" are important and rely upon the New Zealand Court of Appeal decision in *Metal Sales Limited v Ettema* (1995) 3 NZ ConvC 192. In that case the parties had by preliminary agreement agreed upon the rent but had provided that the lease to be entered into would include "provisions normally used in leases for similar properties by solicitors practising in Auckland". The issue was whether a ratchet clause was a provision normally used in leases. The Court held it was such a clause and that the provisions in the preliminary agreement that on a review "a rent was to be based on current market rentals" did not prevent a ratchet clause being included in the final lease. The effect of the provision was that the rentals were to be assessed on current market rentals but if they were lower than the existing rentals, the ratchet clause prevailed. Thus the case is authority for the proposition that if there is a ratchet clause and the rent is based on current market valuation, the ratchet clause will mean that the actual rental may be lower than the current market rental because of the operation of that clause. The case is not authority for the proposition that the insertion of the words "based upon" imply a ratchet clause.

[28] Clause 1.1 of the leases contemplates that on a rent review the rent may be "varied". Given its ordinary meaning a varied rent may be greater or less than the previous rent. If a ratchet clause operated the appropriate word would be "increased" and not "varied". This tells against a ratchet clause and the terminology is also relevant when considering the Melanesian Mission lease.

[29] The Appellants place reliance on the words "Dates for increase of annual rent" in the Schedule. The Schedule is clearly part of the lease. It is quite common to have operative provisions in a schedule. This Schedule however mainly includes definitions and elaborates on terms in the lease. As there is no other provision in the lease which can either expressly or impliedly be interpreted as containing a ratchet provision, it is necessary to interpret these words as being shorthand for an unwritten ratchet clause if the Appellants' contention is correct.

[30] We do not believe the words in the Schedule can be so interpreted. If the objective intent of the parties had been that the lease contained a ratchet clause, it would have been usual for the terms of that clause to have been expressly spelt out in the lease. As will be noted later, the Melanesian Mission lease provision was explicit. That the terms of a ratchet clause were not set out in the lease tells against the presence of such a clause. Secondly, the other provisions of the Schedule are of an explanatory nature and are not substantive provisions. Thirdly, clause 36.1.6 states the parties' agreement that 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. Lastly, even if the words are not strictly a marginal note, it is difficult to see that they import a ratchet clause into the lease. The words either have no contractual effect or alternatively, they are to clarify that if the rent is increased on a renewal either by agreement or arbitration, the increase is to take effect from the date of commencement of the renewed term but not at a later date when the market rent is agreed or affixed.

[31] In summary, when taken in context the plain meaning of the words in clauses 31.1 and 1.1 are that the rent is to be the current market rental at the time of the review. The insertion of "based upon", the side note in the Schedule and the provisions of clause 32.1(c) do not in this Court's view alter the clear meaning of the terms. There is no ratchet provision in the leases.

[32] It is necessary to deal with submissions made on behalf of the Appellants and not already referred to. The submissions based on the *Metal Sales* case have been referred to above.

[33] The Appellants submit that the facts are very similar to those of the *Melanesian Mission* case. They say there are two distinctive features:

i. The use of the words "dates for increase of annual rent"; and

ii. The absence of any provision providing for a reduction in rent".

[34] We accept that there is no provision allowing for a decrease in the rent. In the circumstances we see this as a neutral provision. We do not accept that the phrase "dates for increase of annual rent" as it appears in the Schedule of the leases is similar to the provision in the *Melanesian Mission* case. In that case there was a substantive provision in the Schedule. The clause in the Schedule in the *Melanesian Mission* case was a substantive provision requiring the lessee to pay during the term of the lease the base rent "or where increased in accordance with the express provisions of the lease at the increased rent". In other words, there was a specific contractual provision to pay the rent set out in the lease for any increased rent. The lessee only had two alternatives, pay the rent in the lease or the increased rent. This is a vastly different position from the provision in the relevant leases.

[35] The Court sees no force in the submission that clause 32.1(a) of the leases which says that a rent under review should be fixed in accordance with clause 31, ties the rent to the Schedule which includes the words "increase of annual rent". Clause 31 gives the date on which the rent is to be reviewed and is relevant for that purpose but as indicated does not in the Court's view import into the lease a ratchet clause.

[36] It was for these reasons that the Court gave judgment dismissing the appeal and awarding costs to the respondent.

Reservation on Principles of Contractual Interpretation

[37] In paragraph 12 of the Judgment below there was reference to the principles of contractual interpretation in relation to leases and reference was made to the *Melanesian Mission* case.[2]

[38] Since the decision of the Privy Council in *Melanesian Mission* there has been development in the law of contractual interpretation in England. Foremost among these developments is the well-known speech of Lord Hoffman in *Investors Compensation Scheme v West Bromwich Building Society*[3] which has been described as a modern restatement of the English law as to contractual interpretation. This is not the occasion to examine the judgment in *Investors Compensation Scheme* or consider whether it should be adopted as part of the law of the Cook Islands. That is for another day. In the meantime, it is noted that *Investors Compensation Scheme* has been subjected to some criticism by the Bar and Bench in England and Lord Hoffman has been obliged to modify some elements of his restatement.[4]

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[2] It is not the case that there are any special principles of contractual interpretation which govern leases alone and the citation from *Wellington Racing Club v Harnet & Wedder Limited* (High Court, Wellington Registry, AP243/96, 9 June 1997, Ellis, McGechan JJ), referred to by His Honour, confirms that leases are commercial instruments and the general rules of contractual construction apply to them.

[3] *Investors Compensation Scheme v West Bromwich Building Society* (1998) 1 WLR 896

[4] As to guidance from New Zealand on contractual interpretation this is unlikely at the moment since the law in this area is in a state of some confusion as the result of the New Zealand Supreme Court decision in *Vector Gas v Bay of Plenty Energy Limited* [2010] NZSC 5 (2010) 2 NZLR 4. As to this case, Chief Justice Elias of the New

[39] It is sufficient to say that, at least for the present, the proper approach to the interpretation of contracts in the Cook Islands should remain the traditional approach set out in *Melanesian Mission*, which was reproduced above at [23].

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David Williams P

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Barker JA

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Paterson JA

Zealand Supreme Court said in an address given at the Banking & Financial Services Law Association Conference on Monday 11 August 2014 that:

> "The New Zealand Supreme Court has not thought to have acquitted itself particularly well in its principal foray into this field in *Vector Gas v Bay of Plenty Energy Limited*. That was not a case I sat on, a fact for which I am grateful. It has not only been described as the worst in the Court's first ten years but the reasoning of each of the Judges have been subject to withering criticism by Professor McLachlan [David McLachlan Contract Interpretation in the Supreme Court – Easy Case, Hard Law? (2010) 16 NZBLQ 229.

As to Australia, the basic authority remains *Codelfa Construction Pty Ltd v. Slate Rail Authority* (NSW) (1982) 149 CLR 337, which is in line with *Melanesian Mission* and has never been overruled: see J Spigelman "Contractual Interpretation: A comparative perspective" (2011) 85 ALJ 412.