**IN THE COURT OF APPEAL OF NEW ZEALAND**

**CA16/2012**
**[2012] NZCA 532**

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| BETWEEN | ALADDIN'S MOTOR INN LIMITED<br>Appellant |
| AND | BOWCORP HOLDINGS LIMITED<br>Respondent |

Hearing: 29 August 2012

Court: Ellen France, Harrison and Stevens JJ

Counsel: M R Sherwood King for Appellant
D I Sheppard for Respondent

Judgment: 14 November 2012 at 11 am

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**JUDGMENT OF THE COURT**

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**A The appeal is allowed in part.**

**B The statutory demand stands but the costs order in the High Court is quashed. An order that the appellant pay the respondent costs of $23,951.05 is substituted.**

**C The appellant shall pay the respondent costs on the appeal calculated on the basis set out in [48] of the reasons plus usual disbursements.**

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**REASONS OF THE COURT**

(Given by Ellen France J)

## Introduction

[1] Aladdin's Motor Inn Ltd, the appellant, leased motel premises on Main Street, Palmerston North. The lease of the premises continued for some time and the appellant ran its motel business from there. Bowcorp Holdings Ltd, the respondent, became the lessor of the premises when it purchased the freehold title on 28 April 2000.

[2] The lease provides that the lessee, Aladdins, shall pay the rent "free of any deductions". The lease also requires additional monthly maintenance payments. From about March 2010, Aladdins fell behind on rent payments. While payments were later brought up to date, Aladdins defaulted again later. On 13 June 2011, the lessor (Bowcorp) issued a statutory demand for the amount outstanding plus interest and recovery of legal fees. The total amount demanded was $20,801.90. Ultimately, in early October 2011, Bowcorp re-entered the motel premises and terminated the lease. Aladdins then requested the parties go to arbitration as provided for in the lease. The matter is proceeding to arbitration. The lease states that a reference to arbitration does not suspend rental due pending the result of the arbitration.

[3] Aladdins applied to have the statutory demand set aside, primarily on the basis it has a counterclaim or set-off against Bowcorp based on an alleged failure to repair the premises.

[4] Associate Judge Gendall dismissed the application to set aside the statutory demand. Further, the Associate Judge ordered Aladdins to pay Bowcorp's reasonable costs.[1] The costs approved by the Registrar were $29,474.99. Aladdins appeals against both decisions.

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[1] *Aladdins Motor Inn Ltd v Bowcorp Holdings Ltd* HC Palmerston North CIV-2011-454-412, 16 December 2011.

**Factual background**

[5] The motel premises were built in 1996–1997. In early 1997, a lease was entered into between Rayami Developments Ltd as lessor and Raymond Hickey and Michael Green as lessees.

[6] Aladdins was incorporated on 2 May 1997 and in June that year, Aladdins bought the lease, as lessee. The premises were unfinished.

[7] Over the period of March/April 2000, during pre-purchase negotiations, Bowcorp raised issues about the property with Rayami. Some of those issues were matters Aladdins had raised about the premises.

[8] Bowcorp bought the property at the end of April 2000 and became the lessor.

[9] Aladdins defaulted on its obligations to make the rental payments due under the lease in March 2010. Attempts to arbitrate matters were made in mid-2010. It appears that Aladdins did not appear at the arbitral hearing.

[10] Aladdins brought the rent up to date but failed then to make the maintenance payments due for November and December 2010. Aladdins defaulted in the rental payments for April and May 2011. That left a total amount outstanding of $18,916.44. Bowcorp issued a statutory demand for that amount, together with interest and recovery of legal fees.

[11] Aladdins did not make any payment of rent and maintenance from April 2011. On 25 August 2011 Bowcorp issued a notice of intention to cancel the lease. On 5 October 2011, Bowcorp re-entered and terminated the lease.

[12] The parties' disputes were referred to arbitration on 12 October 2011.

[13] Aladdins says that since the time it took over the motel, defects in the premises were apparent. Essentially, Aladdins says the building is a "leaky" one with a range of problems arising from poor workmanship and the lack of

weathertightness. Aladdins filed evidence in the High Court outlining these problems. There was also evidence before the High Court about the parties' unsuccessful attempts to sort out a process to rectify the problems. Aladdins says the defects have had a significant impact on its business.

**The terms of the lease**

[14] Clause 1.1 is a covenant to pay rent. The clause provides as follows:

> The Lessee shall duly and punctually pay each and every month to the Lessor … the rent herein mentioned at the times and in the manner herein provided free of any deductions.

[15] In addition, cl 1.8(f) of the lease established a maintenance fund. Under this clause, Aladdins was also liable to make monthly payments towards an annual amount equal to five per cent of the annual rent into an account for the maintenance of the premises.

[16] Clause 3.5 deals with the situation when the "rent reserved" is in arrears and unpaid for 14 days, whether it has been lawfully demanded or not. In those circumstances, cl 3.5 states that the lessor is entitled to determine the lease, re-enter and repossess the premises. The lessor can take these steps:

> … without any process of law whatsoever and without releasing the Lessee from liability for and without prejudice to the [Lessor's remedies for any antecedent breach of covenant] … .

[17] Clause 3.9(a) makes provision for disputes to be referred to arbitration and for the composition of the arbitral tribunal. Clause 3.9(b) deals with the effect of a referral to arbitration and states:

> No reference to arbitration shall be deemed to suspend rental or other payments due under this lease and all payments otherwise due shall be made pending the result of such arbitration.

**The decision of the Associate Judge**

[18] Applying this Court's decisions in *Grant v NZMC Ltd* and *Browns Real Estate Ltd v Grand Lakes Properties Ltd*,[2] the Associate Judge acknowledged that the parties may contractually exclude set-off. As the Court confirmed in *Browns Real Estate Ltd*, such a provision precludes a party from setting aside a statutory demand in reliance on a counterclaim, set-off or cross-demand.

[19] The Associate Judge took the view that cl 3.9(b) was not as clearly worded in this respect as the clause considered by this Court in *Browns*, which expressly required payment of rent free of set-off. However, the Associate Judge said, the contract did not have to expressly state that set-off was excluded. Ultimately, he concluded that the intent of cl 3.9 was clear.

[20] Associate Judge Gendall summarised his conclusion as follows:[3]

> [29] … [d]isputes are to be settled by way of arbitration. Where matters are submitted to arbitration, *payment* of rent must continue. This significantly is not merely the lessor's right to claim rent later. In *Club Civic Ltd* the Master appears to have adopted an interpretation to an equivalent clause to our cl 3.9(b) that the word "suspension" equates to the word "due" and both refer to the fact that the lessee is still liable for overdue rent, but does not have to pay in the sense that legal or equitable set-off may be claimed. However, such an interpretation in my view clearly renders clause 3.9(b) redundant. Of course, the pay now, argue later approach is not without limitation. The Court of Appeal in *Industrial Group Ltd v Bakker* declined to apply *Browns Real Estate Ltd* in light of a counterclaim for deceit. And Associate Judge Bell, in *Simply Logistics Ltd*, declined to apply *Browns Real Estate Ltd* where there was a claim of misappropriation of property. However, those aspects are absent here. I consider that the present case is one of a normal run of cases as contemplated by the Court in *Browns Real Estate Ltd*.

[21] Accordingly, the Associate Judge was satisfied that Aladdins could not claim an equitable set-off, cross claim or counterclaim against rent or payments otherwise due under the lease pending the determination of the dispute by arbitration. That conclusion effectively disposed of the application to set aside the statutory demand. The Associate Judge dismissed the application. The Associate Judge did not

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2 *Grant v New Zealand Motor Corporation Ltd* [1989] 1 NZLR 8 (CA) and *Browns Real Estate Ltd v Grand Lakes Properties Ltd* [2010] NZCA 425, (2010) 20 PRNZ 141.

3 Citations omitted.

consider the respondent's second concern that Aladdins in any event had not properly established the existence of a set-off.

**The relevant principles**

[22] Section 290 of the Companies Act 1993 provides that the court may set aside a statutory demand. Sub-section 290(4) states that a court may grant an application to set aside if satisfied:

> (a) there is a substantial dispute whether or not the debt is owing or is due; or
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> (b) the company appears to have a counterclaim, set-off, or cross-demand and the amount specified in the demand less the amount of the counterclaim, set-off, or cross-demand is less than the prescribed amount; or
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> (c) the demand ought to be set aside on other grounds.

In its notice to set aside, Aladdins relied on s 290(4)(b) and (c).

[23] No issue is taken with Associate Judge Gendall's summary of the principles applicable to an application to set aside. The Associate Judge set out this excerpt from *Brookers Insolvency Law and Practice*:[4]

> (a) The applicant must show that there is arguably a genuine and substantial dispute as to the existence of the debt. The task for the Court is not to resolve the dispute but to determine whether there is a substantial dispute that the debt is due. The mere assertion that there is a genuine substantial dispute is not sufficient: … .
>
> (b) The mere assertion that a dispute exists is not sufficient. Material, short of proof, is required to support the claim that the debt is disputed.
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> (c) If such material is available, the dispute should normally be resolved other than by means of proceedings in the Companies Court.
>
> (d) An applicant must establish that any counterclaim or cross demand is reasonably arguable in all the circumstances. The obligation is not to prove the actual claim. Such an obligation would amount to the dispute itself being tried on the application.

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[4] *Brookers Insolvency Law and Practice* (online looseleaf ed, Brookers) at [CA 290.02(1)], cited at [14], citation omitted.

(e) It is not usually possible to resolve disputed questions of fact on affidavit evidence alone, particularly when issues of credibility arise.

**Application to this case**

[24] The contest between the parties is clear cut and is apparent from our summary of the key submissions that follows.

*The competing contentions*

[25] Aladdins says the Associate Judge was wrong to focus on cl 3.9(b). Rather, cl 1.1 is the applicable provision. That clause does not preclude the ability to set-off. Further, Mr Sherwood King for Aladdins submits, even if cl 3.9(b) is relevant it does not assist because the clause deals only with an ongoing obligation to pay rent. Where, as here, the lease has been terminated rent is no longer "due". Finally, even though Mr Sherwood King accepts cl 3.9(a) remains effective despite termination of the lease, he submits that cl 3.9(b) does not.

[26] The respondent takes the position that cl 3.9(b) is the relevant clause and the Associate Judge was correct to conclude the clause had the effect of precluding set-off. Mr Sheppard for the respondent says that the arbitration clause survived termination of the lease.

*Discussion*

[27] We agree, as Mr Sheppard accepts, that if cl 1.1 was the only relevant provision then this case would be on all fours with *Grant v New Zealand Motor Corporation Ltd*. In *Grant* this Court was considering a covenant to pay rent which used the following words:[5] "[Rent is payable] free and clear of exchange or any deduction whatsoever". This Court did not consider the word "deduction" was sufficiently clear to exclude a set-off. Somers J said the word "deduction" did not "in its natural sense embrace a set-off".[6]

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5 *Grant v New Zealand Motor Corporation Ltd*, above n 2, at 13.
6 At 13.

[28] However where, as here, the matter has gone to arbitration cl 3.9(b) must come into play. For the reasons we explain shortly, we consider that the effect of cl 3.9(b) equates to the relevant clause in *Browns Real Estate Ltd*. The wording in issue in *Browns Real Estate Ltd* required payment of rent "without demand from the Lessor and free of any deduction, withholding, set-off or reduction on any account".[7] The Court considered there were strong grounds for the view the applicants' claim was barred, that is, that set-off was excluded.

[29] We interpolate here that we obtained further submissions from the parties as to whether cl 3.9 continued to operate, given that the parties did not refer the matter to arbitration until after the lease had been terminated.[8] On this point, we accept the submissions for the respondent. As Mr Sheppard notes, the rules applicable to the arbitration are set out in sch 1 of the Arbitration Act 1996.[9]

[30] The effect of art 16(1), chapter 4 of sch 1 of the Act is that cl 3.9 survived termination of the lease. The pertinent part of that article states:

> … an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract.

[31] As Mr Sheppard also submits, art 16(1) reflects the common law position, namely, that a clause in a contract referring disputes to arbitration remained binding even where the contract containing the arbitration clause had been repudiated or cancelled.[10] The appellant contends that cl 3.9(b) is not "independent" as anticipated by art 16(1). We do not see any basis for treating cl 3.9(b) differently from cl 3.9(a) in this respect.

[32] As Tipping J said in *Vector Gas Ltd v Bay of Plenty Energy Ltd*, the "ultimate objective in a contract interpretation dispute is to establish the meaning the parties intended their words to bear".[11] The relevant features here are the combination of cls 1.1, 3.5 and 3.9 which together establish the obligation to pay and the ability to

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7 *Browns Real Estate Ltd v Grand Lakes Properties Ltd*, above n 2, at [5].
8 Minutes of 29 August 2012 and 14 November 2012 refer.
9 Arbitration Act 1996, s 6(1)(a).
10 *Heyman v Darwins Ltd* [1942] AC 356 (HL); *Mills v SIMU Mutual Insurance Association* [1970] NZLR 602 (CA); and *Heli-Flight New Zealand Ltd v Massey University* HC Auckland CIV-2005-404-4855, 30 November 2005 at [11]–[12].
11 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [19].

take action to enforce the obligation, and make it plain that the reference to arbitration does not affect those obligations. To adopt language used by counsel at our hearing, the "pay now, argue later" approach was intended and adopted.

[33] On analysis of cl 3.9(b), we agree with Mr Sheppard that it can be seen as having two parts. The first part, which provides that "no reference to arbitration shall be deemed to suspend rental or other payments due", makes it clear that a reference to arbitration is not to be treated as suspending rental or other payments. That is the context in which the word "deemed" is used. The second part of the clause makes it clear that all payments otherwise due shall be made in the interim, that is, until the arbitration is concluded.

[34] The clause has the effect that the landlord has the assurance of an income stream even when a dispute goes to arbitration. In other words, the clause can be seen as an agreement as to how the respective risks are to be allocated.[12] It is hard to see what purpose the clause has if it is not interpreted in this way.

[35] The argument that the second part of the clause deals only with ongoing obligations has some semantic attraction. However, it would not make sense to treat the clause as only applying to payments falling due after the arbitration was commenced. Otherwise, in a case such as this where the non-payment of rental is very much a part of the dispute leading to the decision to go to arbitration, the rental payments already due would remain, effectively, suspended.

[36] For these reasons, we consider the Associate Judge was right. The effect of cl 3.9(b) is to preclude a set-off once the parties have referred the matter to arbitration.

[37] No good reason is advanced to suggest the Associate Judge was wrong not to exercise the residual discretion under s 290(4)(c) of the Companies Act and set aside the statutory demand. Mr Sherwood King did raise the possibility that s 290(4)(a) applied, namely, that there was a substantial dispute whether the debt was owing or

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[12] See the discussion in *Bountiful Holdings Ltd v University of Auckland* [2012] NZHC 1076 at [20].

is due. However, on analysis, the claim now sought to be advanced under this head is a counterclaim or set-off. The argument essentially is that there is a claim against the lessor and so rent is not due because of the lessor's breaches. This potential basis for setting aside the statutory demand accordingly fails for the reasons already given.

**Appeal against costs in the High Court**

[38] The Associate Judge ordered the appellant to pay the respondent "reasonable costs … on a solicitor client basis incidental to [the] application, as certified by the Registrar, together with [approved] disbursements …".[13]

[39] The Associate Judge's order reflected cl 3.16(b) of the lease. That clause requires the lessee to pay "all reasonable legal costs (as between solicitor and client)" of the lessor "of and incidental to the enforcement or attempted enforcement" of the lessor's rights under the lease.

[40] It is common ground that the costs were approved by the Registrar without the respondent having any opportunity to consider the schedule of costs. It appears counsel for the respondent had not anticipated the speed with which the Registrar would deal with the matter.

[41] Mr Sherwood King is critical of this process. He also says the costs are not reasonable given the nature of the claim. The reality is, he points out, that the costs following a hearing of no more than two hours were 30 per cent higher than the total amount claimed.

[42] Mr Sheppard says the costs were reasonable, particularly as the appellant's non-compliance with timetabling directions gave rise to additional costs.

[43] The parties did attempt after the hearing to resolve this issue. However, it was not ultimately possible to do so. It may be that if these issues had been canvassed between counsel prior to the sealing of the judgment, the matter could have been resolved without the need for this Court's intervention.

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[13] At [36].

[44] Mr Sheppard accepted that the clause in the lease only allowed the respondent to claim reasonable costs in relation to the enforcement of the lessor's rights. Given this, the costs award is a large one given the amount and nature of the issue. Further, it is unclear whether some of the matters referred to in the schedule relate to the enforcement of the lessor's rights. For these reasons, we consider the costs are not reasonable even on a solicitor client basis.

[45] In the normal course of events, we would remit the question of costs back to the High Court. However, the respondent has advised that it would be content with costs in the amount of $23,951.05 (without conceding the reasonableness of the total charge). That figure is reasonable given the appellant's costs were in the order of $18,000. The appellant's non-compliance with timetabling directions in the High Court would account for some differentiation between the two sets of costs.

[46] Accordingly, the costs order in the High Court is quashed. An order that the appellant pay the respondent costs of $23,951.05 is substituted.

**Result**

[47] For these reasons, the appeal is allowed in part. The statutory demand stands but the costs order in the High Court is replaced as we have indicated above.

[48] There is no reason why the respondent, having succeeded, should not receive reasonable costs on a solicitor client basis as contemplated by the lease. We accept Mr Sheppard's suggested calculation, that is, to award costs for a standard appeal on a band A basis. That figure is then to be multiplied by 1.5. In addition, the respondent should have usual disbursements.

Solicitors:
MacKay & Gilkison, Wellington for Appellant
Fitzherbert Rowe, Palmerston North for Respondent