IN THE HIGH COURT OF NEW ZEALAND
PALMERSTON NORTH REGISTRY

CIV-2011-454-412

BETWEEN	ALADDINS MOTOR INN LIMITED Applicant
AND	BOWCORP HOLDINGS LIMITED Respondent

Hearing: 8 December 2011
(Heard at Palmerston North)

Counsel: M.R. Sherwood King - Counsel for Applicant
D. Sheppard - Counsel for Respondent

Judgment: 16 December 2011 at 4:15 PM

JUDGMENT OF ASSOCIATE JUDGE D.I. GENDALL

This judgment was delivered by Associate Judge Gendall on 16 December 2011 at 4.15 pm under r 11.5 of the High Court Rules.

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Introduction

[1] For determination are two applications brought by the applicant, Aladdins Motor Inn Limited against the respondent, Bowcorp Holdings Limited. The first is an application to set-aside a statutory demand issued by the respondent for rent and other charges alleged to be outstanding. The second is an application to appoint an arbitrator pursuant to a lease between the parties in order to resolve a dispute which had developed between them.

[2] With regard to the second application, that by the applicant to appoint an arbitrator, before me counsel advised that agreement had been reached to refer the matter to arbitration and to appoint Mr John Marshall QC as arbitrator. It is therefore unnecessary to consider this second application further.

[3] The first application to set-aside the statutory demand, is opposed by the respondent however. I now turn to consider that application.

Background

[4] For some time the applicant has leased motel premises on Main Street, Palmerston North from where it has ran its motel business. The respondent became the lessor of those premises when it purchased the freehold title on 28 April 2000. Under the lease of the motel, clause 1.1 contained the covenant to pay rent "free of any deductions". From 1 October 2010 onwards, monthly rental payments were set at $12,458.32 (GST incl). Clause 1.8(f) of the lease established a maintenance fund and provided that the lessee was also liable to make monthly payments of an annual amount equal to 5 per cent of the rent into an account for the maintenance of the premises.

[5] Importantly for the present application, the lease contained the following clause:

> ARBITRATION
>
> 3.9 (a) Should there be any dispute or disagreement between the parties hereto touching this lease or any provisions hereof or the interpretation of any of the clauses herein then every such dispute, argument or disagreement shall forthwith be referred to arbitration as in this clause provided. Every

> reference to arbitration contained in this lease shall be deemed to be a reference to the arbitration of a single arbitrator in case the parties can agree upon one and otherwise as to two (2) single arbitrators or to their umpire in case of a disagreement (one of the arbitrators to be appointed by each party in dispute) and in either case in accordance in all respect with the provisions in that behalf contained in the Arbitration Act 1908 or any statutory modification or re-enactment thereof for the time being in force.
>
> (b) 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.
>
> …

[6] Relations appear to have been reasonably amicable between the parties until about March 2010 when the applicant regularly fell behind on rent payments. It is said by the applicant that this was due to a decline in the patronage of the motel.

[7] The respondent says it attempted to resolve the initial rental arrears dispute by arbitration but this was frustrated at the time by the applicant. On 23 July 2010, the respondent wrote to the applicant requesting arbitration pursuant to clause 3.9 of the lease in order to resolve the issue of non-payment of rent. However, it seems the applicant did not appear at the arbitral hearing arranged and so the respondent abandoned that arbitration. The applicant subsequently brought rent up to date, and continued to meet rental payments regularly until April 2011. However, the applicant had failed to make maintenance payments which were due under the lease for November and December 2010 and these totalled $1,083.34. In addition, the applicant defaulted in making rental payments for April and May 2011 which totalled $18,916.44. On 13 June 2011, the respondent issued the present statutory demand for that amount plus interest and recovery of legal fees. The total amount demanded was $20,801.90.

[8] The applicant has apparently continued to refuse to pay rent and maintenance payments since April 2011. On 25 August 2011 the respondent issued a notice of intention to cancel the lease. On 5 October 2011, the respondent re-entered the motel premises and terminated the lease.

[9] On 12 October 2011 the applicant's solicitors wrote to the respondent's and noted the following:

1. The Lease in Clause 3.9 contains an arbitration clause. My client hereby requests, pursuant to paragraph 21 of the First Schedule to the Arbitration Act 1996, that the dispute between the parties be referred to arbitration.

2. The dispute concerns my client's claim to be entitled to an abatement of rent and to its counterclaim against your client for breaches of the Lessor's covenants under the Lease.

[10] The applicant now alleges that the premises require repair by the respondent and consequently it is entitled to a retrospectively operating abatement in rent from the date the respondent became lessor, 28 April 2000. The applicant also alleges it has a counterclaim against the respondent due to the alleged failure to repair the premises, although the applicant has not quantified this counterclaim. The respondent denies these allegations.

[11] On all of this, the applicant claims essentially that there are, and have been, substantial defects in the premises for a considerable period of time, and these date back to before the respondent took over the freehold title and became the lessor. Mr Waugh, a director of the applicant, details these in his affidavit in support of this application. He goes on to claim that those defects have had a significant impact on the applicant's business. Mr Waugh alleges that any compensation for these matters owed by the respondent to the applicant would far exceed the amount claimed by the respondent in its statutory demand. In support of the present application, the applicant also produces affidavits sworn by Mr Joyce, a building surveyor and Mr Moule, a specialist fire engineer. Both of those affidavits express concern at the then current state of the motel premises, allege that the building is a "leaky building", in the weathertight homes sense, and also that it has issues reaching the required fire rating.

[12] The parties have now agreed to submit matters to arbitration. The issue remains as to whether payment of the rent and other payments owing must be made notwithstanding that submission.

Counsels' Submissions and My Decision

[13] The applicant brings the present application pursuant to s 290(4)(a) which provides that the court may grant an application to set aside a statutory demand if it

is satisfied that there is a substantial dispute whether or not the debt is owing or is due. The applicant's solvency is not seriously disputed.

[14] The principles relating to s 290(4)(a) are well settled. The authors of *Brookers Insolvency Law and Practice* (online looseleaf ed, Brookers) provide the following succinct summary at [CA290.02]; adopted in *North Harbour Equine Hospital Limited v Little* HC Auckland CIV-2006-404-7585, 19 February 2007 at [17]; *Carpet Plus 2003 Ltd v A Team Flooring Specialist Ltd* HC Auckland CIV-2008-404-4725, 19 January 2009 at [4] and *Trinity Hills Retreat Ltd v Kroehl* HC Nelson CIV-2010-442-101, 12 August 2010 at [5]:

> The general principles applicable to applications under s 290(4) are now well established. These principles, which can be discerned from cases such as *United Homes (1988) Ltd v Workman* [2001] 3 NZLR 447; (2001) 9 NZCLC 262,605 (CA); *Fletcher Homes Ltd v Ellis* 23/7/99, Master Faire, HC Auckland M471IM99; *Forge Holdings Ltd v Kearney Finance (NZ) Ltd* 20/6/95, Tipping J, HC Christchurch M149/95; *Queen City Residential Ltd v Patterson Co-Partners Architects Ltd (No 2)* (1995) 7 NZCLC 260,936; Rennie v Prospect Resources Ltd 3/11/95, Tipping J, HC Greymouth M14/95; *Crown Transport Services Ltd v Waipa District Council* 2/7/08, Associate Judge Faire, HC Hamilton CIV-2007-419-1711; and *Taxi Trucks Ltd v Nicholson* [1989] 2 NZLR 297; (1989) 1 PRNZ 390 (CA), are as follows:
>
> (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: *Queen City Residential Ltd v Patterson Co-Partners Architects Ltd* (No 2) (1995) 7 NZCLC 260,936 (HC).
>
> (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.
>
> (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.
>
> (e) It is not usually possible to resolve disputed questions of fact on affidavit evidence alone, particularly when issues of credibility arise.

[15] An initial point arises here. In an earlier judgment of mine, *Northern Crest Investments Ltd v Robt Jones Holdings Ltd* HC Wellington CIV-2010-485-2673, 11 March 2009, I set aside in part a statutory demand issued for payment of rent under a

lease which was owed for rental periods after the termination of the lease on the basis that this was properly a claim for damages and so the rent in question was not a "debt due" until judgment was obtained. That case can be distinguished from the present situation however. Here the rental arrears claimed arise from the period up to formal termination of the lease and not beyond that date so they are proper debts due under the contract: *Miller v Mattin* (1993) NZ ConvC 191,714 (CA).

[16] The issues for consideration on this application are:

> (i) Does clause 3.9(b) of the lease between the parties operate to hold a lessee liable to pay rent notwithstanding the claim and a general dispute has been submitted to arbitration; and
>
> (ii) If the answer to (i) above is no, has the applicant here shown that it has a counter-claim or set-off greater than the prescribed amount.

[17] I now turn to consider the first issue. As the Court of Appeal recognised in *Grant v NZMC Ltd* [1989] 1 NZLR 8 (CA) at 13 and in *Browns Real Estate Ltd v Grand Lakes Properties Ltd* [2010] NZCA 425, (2010) 20 PRNZ 141, parties in a situation such as the present may contractually exclude set-off. Mr Sherwood King, for the applicant, submitted that a literal construction of clause 3.9(b) here would lead to an unreasonable result and, in line with this Court's judgment in *Benjamin Dev Ltd v Robt Jones Ltd* [1994] 3 NZLR 189 (HC) at 203, should not be adopted. That is because, to find a lessee liable to pay rent arrears while a claim before an arbitrator is afoot, could mean that the lessee is liable to pay rent which is ultimately found not to be due for what are manifestly defective motel premises.

[18] Mr Sherwood King also referred me to this Court's decision in *Club Civic Ltd v Command Nominees Ltd* [1991] 1 NZ ConvC 180,816 (HC). In that case the clause at issue provided for the lessee:

> TO PAY to the Lessor without demand the rentals hereinbefore reserved in advance at the times and in the manner aforesaid free from any deduction whatsoever by automatic payment transfer to such bank account in New Zealand as the Lessors may from time to time nominate and direct.

[19] Master Hansen, placed considerable reliance on the Court of Appeal's decision in *Grant*. In that case, the lease provided that rent was to be paid as the lessor may direct:

> free and clear of exchange or any deduction whatsoever.

[20] At 13, the Court of Appeal said:

> We do not think the work "deduction" is clear enough to hold that it was agreed that a set-off of the kind claimed by Mr and Mrs Grant could not be made. The word "deduction" does not in its natural sense embrace a set-off.

[21] Master Hansen said that the differences between the clause at issue in his case and that at issue in *Grant* were so small as to be indistinguishable. Counsel, however, also relied on a further clause contained in the lease. Clause 2(c) provided:

> IN CASE of any difference or dispute arising as to any clause matter or thing herein contained or implied or as to the construction hereof or arising in any way in respect of this Deed of Lease such difference or dispute shall be referred to the arbitration of two (2) independent persons as arbitrators one to be chose by the Lessor and the other to be chose by the Lessee and an umpire to be chosen by the two (2) arbitrators before entering upon the consideration of the matters submitted and every such reference shall be deemed a submission to arbitration within the meaning of the Arbitration Act 1908 and its amendments and shall be conducted and take effect accordingly except only so far as the provisions of the said Act are hereby expressly modified. No reference to arbitration shall be deemed to suspend rental or other payments shall be made pending the result of such arbitration.

[22] The Master said that this clause does not have the effect of avoiding set-off. His Honour said, at 95-108:

> Its meaning is that where there is reference to arbitration, that, of itself, is not a ground to suspend rental payments. However, the prime obligation to pay rent is laid down by cl 1(a), and that clause does not, in my view, either expressly, or by implication, exclude the right to allege equitable set off. The last sentence of 2(c) does not, in my view, by clear implication negative the right set off, which clearly survives the terms of cl 1(a). Accordingly, I am satisfied that the defendants are entitled to allege equitable set off, as it is not expressly, or by clear implication, excluded by the contractual terms.

[23] In response, Mr Sheppard for the respondent relied on the Court of Appeal's recent decision in *Browns Real Estate Ltd v Grand Lakes Properties Ltd* [2010] NZCA 425, (2010) 20 PRNZ 141. In that case the clause at issue, clause 3.1, provided:

> **Payment**: The Lessee shall in each year during the Term, pay the Rent and any other money required to be paid by the Lessee pursuant to this Lease, to the Lessor without demand from the Lessor and free of any deduction, withholding, set-off or reduction on any account.

[24] At [14] the Court said:

> In our view, by raising the counterclaim in response to the statutory demand, Browns is seeking to justify the non-payment of the rent. In so doing, Browns are in breach of clause 3.1 which prohibits withholding of rent (and any other payments due under the lease) on any account.

[25] The Court then turned to consider the effect of clause 3.1 on an application to set aside a statutory demand. The Court said at [17]: (footnotes omitted)

> In our view a contractual no set-off provision of the type at issue in this case would normally result in the court's discretion being exercised against an applicant if the sole grounds for an application to set aside a statutory demand was the existence of a set-off, counterclaim or cross-demand which a party had expressly agreed could not be raised. We consider that commercial parties should be required to honour the bargain they have made, absent other grounds that tell against the recognition of a statutory demand.

[26] Accordingly, Mr Sheppard maintained that, in light of the Court of Appeal's decision in *Browns Real Estate Ltd*, this Court's decision in *Club Civic Ltd* should not be followed. He submitted two key points in support. First, he suggested that to follow *Club Civic Ltd* would undermine the efficacy of the contract between the parties and secondly, that these are experienced commercial parties who have negotiated at arm's length and so should be held to their bargain.

[27] As it is clear that one may contract out of an ability to set-off, the matter as I see it, is strictly speaking, an issue of contractual interpretation. Not only that, but as Associate Judge Bell considered in *Simply Logistics Ltd v Real Foods Ltd* HC Auckland CIV-2011-404-3497, 11 September 2011 at [52], the question remains:

> the enquiry that I have to make is whether there are particular circumstances in this case that require me not to exercise the discretion in the way indicated by the Court of Appeal [in *Browns Real Estate Ltd*].

[28] In the present case, I accept that clause 3.9(b) is not as clearly worded as the clause considered by the Court in *Browns Real Estate Ltd*. Nevertheless, in order to exclude a party's right to set-off in my view the clause in question does not need to expressly state that set-off is excluded. Indeed, in *Grant* the Court of Appeal affirmed the statement of Lord Salmon in *Modern Engineering (Bristol) Ltd v*

Gilbert-Ash (Northern) Ltd [1974] AC 689 at 712 where his Lordship said that a "clear implication" is sufficient.

[29] As a decision of the Court of Appeal, I am bound by *Browns Real Estate Ltd* and the approach taken there. Having said that, I need also to note here that I respectfully differ with the decision of the learned Master in *Club Civic Ltd*. There, His Honour was persuaded by the fact that the lessee's obligation to pay rent arose from clause 1(a) in that lease under which there was no right to set-off. However, I consider that the wording of clause 3.9 in the present case is clear. Disputes 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 clause 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* [2011] NZCA 142, (2011) 2011) 20 PRNZ 413 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 the normal run of cases as contemplated by the Court in *Browns Real Estate Ltd*.

[30] The general approach to the proper interpretation of a contract was recently summarised by Tipping J in the Supreme Court in *Vector Gas Ltd v Bay of Plenty Energy Limited* [2010] NZSC 5, [2010] 2 NZLR 444 at [19] as concerning: (emphasis added)

> what a reasonable and properly informed third party would consider the parties intended the words of their contract to mean. The court embodies that person. To be properly informed the court must be aware of *the commercial or other context* in which the contract was made and of all the facts and circumstances known to and likely to be operating on the parties' minds.

[31] The present case involves a long-standing motel and lease where two commercial parties have bargained at arm's length. The commercial reality as I see it is that the lessor sought to protect its income stream pending any dispute. In those circumstances, clause 3.9(b) should not be read down to deny the respondent as lessor its rights. As the Court of Appeal said in *Browns Real Estate Ltd* at [16]:

> Just as in the CCA context, the efficacy of a no set-off contractual provision would be undermined if statutory demands could be set aside on the basis of a set-off, counterclaim or cross-demand a commercial party had by contract expressly agreed could not be raised.

[32] In those circumstances, I am satisfied that the applicant cannot claim an equitable set-off, cross claim or counterclaim here against rent or payments otherwise due under the lease pending the determination of the dispute by arbitration.

[33] That being my conclusion with respect to the first issue noted at [16] above, that effectively disposes of the present application which must be dismissed. I need not turn to consider the respondent's second concern that the applicant in any event has not properly established the existence of a set-off.

Conclusion

[34] For the reasons set out above, the applicant's application to set-aside the statutory demand is dismissed. I order the applicant to pay the amount demanded in the statutory demand being $20,801.90 to the respondent within 5 working days of this judgment. In default of payment, the respondent may bring an application to place the applicant into liquidation.

[35] As to the issue of costs, the respondent seeks costs here on a solicitor client basis. On this, counsel referred me to clause 3.16(b) of the lease which provides:

> The Lessee will 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, remedies and powers under this lease.

[36] Under r 14.6(4)(e) of the High Court Rules the court may order solicitor client costs where the party claiming costs is entitled to indemnity costs under a

contract or deed. Of course, all rules as to costs are at the discretion of the court: r 14.1. I am satisfied in this case however that the clause in the lease noted above entitles the respondent to full solicitor client costs on the present application, it being incidental to the enforcement of the respondent's rights as lessor. I therefore order the applicant to pay the reasonable costs of the respondent on a solicitor client basis incidental to this application, as certified by the Registrar, together with disbursements (if any) as approved by the Registrar.

'Associate Judge D.I. Gendall'