IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2013-470-000223
[2013] NZHC 3379

UNDER	the Arbitration Act 1996
IN THE MATTER	of an appeal against an arbitration award
BETWEEN	FOODSTUFFS (WELLINGTON) CO-OPERATIVE SOCIETY LIMITED Appellant
AND	DAVID ANDREW HOLDEN and MARIE ALICE HOLDEN in their capacity as trustees of the D & M HOLDEN TRUST Respondent

Hearing: 21 August 2013

Appearances: R C Laurenson and D Butler for Appellant
I Williams for Respondents

Judgment: 16 December 2013

JUDGMENT OF WOOLFORD J

This judgment was delivered by me on Monday, 16 December 2013 at 1.30 pm pursuant to r 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors: R Laurenson, Wellington.
Shortland Chambers (I Williams) Auckland.

Introduction

[1] The appellant, Foodstuffs (Wellington) Co-operative Society Limited (Foodstuffs), is an industrial and provident co-operative society which operates under the New World, Pak'nSave, Write Price and Four Square banners. Foodstuffs lease premises in Marton from David Andrew Holden and Marie Alice Holden (Mr and Mrs Holden) in their capacity as trustees of the D & M Holden Trust (the Trust).

[2] A dispute has arisen between them about the terms of the lease. They took the dispute to arbitration. In an award dated 20 December 2012, the arbitrator, B J Paterson QC, found that Foodstuffs was in breach of the provision of the lease that obliged them to duly and punctually pay the rent. The rent is $154,451.16 (plus GST) per annum plus one per cent of the gross sales in excess of $5.2 million (exclusive of GST) per annum.

[3] Foodstuffs has paid the fixed annual rent. However, it no longer pays one per cent of gross sales in excess of $5.2 million per annum (the turnover rent) because it has had no sales since it closed down the supermarket business it ran from the premises in November 2010, when it opened a much larger New World supermarket across the road. The premises have remained vacant ever since. Foodstuffs will, however, continue to pay the fixed annual rent until the lease expires on 30 September 2014.

[4] The arbitrator found that Foodstuffs was also required to continue to pay the turnover rent. He determined that the measure of damages payable by Foodstuffs was to be assessed on a trend analysis basis adopted by an expert witness. The expert looked at the turnover trend of the supermarket business up until November 2010 and extrapolated the growth in business as if it was still operating from the premises. This was on the basis that Foodstuffs had an obligation to keep the supermarket business open or, in the alternative, sublease or assign the premises to another business with a turnover of at least $5.2 million per annum.

[5] Foodstuffs now appeals against the arbitrator's award on a question of law.

Lease

[6] There are four relevant provisions of the lease. Clause 1.2 sets out the annual rent. It was originally $91,000 plus GST (now $154,451.16 plus GST) plus one per cent of the gross sales in excess of $5.2 million (exclusive of GST) per annum. Clause 1.3 defines gross sales. Clause 2.9 prohibits a sublease or an assignment of the lease without the prior consent of the Trust. Such consent may be withheld without reason except in the case of an assignment of the whole of Foodstuffs' interest to a solvent and respectable assignee whose asset position and business history satisfies the Trust that they would be a suitable tenant.

[7] Most relevantly, clause 2.19 reads:

> 2.19 THE Lessee shall during the term hereof ensure that the demised premises are open for business and occupied during normal trading hours and that at all other times all exterior windows are fastened and outside doors locked AND during the term hereof will not use or permit to be used the demised premises or any part thereof for any purpose other than as premises for carrying on in an efficient and proper manner the businesses of a Supermarket or for any other use as may be a predominant use under the operative District Scheme for the zone within which the demised premises are situated and will not permit or suffer the use of the same or any part thereof for any other purpose...

[8] Three points can be noted at the outset:

(a) Although the fixed annual rent is $154,451.16 (plus GST) the market rent has been assessed by a valuer employed by Foodstuffs as $113,500 (plus GST). The lease is therefore different from other types of turnover rent arrangements where the lessee pays whichever is the higher of a base rent (usually between 70-80% of the market rent) and an amount calculated by reference to an agreed percentage of the lessee's turnover.

(b) There is no requirement in the lease for a minimum turnover, so that if Foodstuffs had continued to operate a supermarket business from the premises and the annual turnover had dropped below $5.2 million, no rent calculated on gross sales would have been payable. The Trust

therefore took the risk that turnover may drop below $5.2 million per annum.

(c) The lease permitted Foodstuffs to carry on the business of a supermarket or any other business so long as the substituted business was a predominant use under the operative District Scheme. There was therefore no requirement that the business remain as a supermarket.

Arbitral award

[9] The arbitral award commences by stating that the fundamental issue in the arbitration is whether the Trust is entitled, under the terms of the lease, to additional rent based on gross sales. After noting the four relevant provisions of the lease and reviewing the submissions of the Trust and of Foodstuffs, the arbitrator commenced his discussion with a finding that Foodstuffs was in breach of cl 2.19 of the lease because it had not ensured that during the term of the lease the premises were open for business and occupied during normal trading hours. The Trust's right to the fixed annual rent was not in dispute but to succeed on its claim under cl 2.19, the arbitrator noted that the Trust needed to establish that on a proper construction of the lease, cl 2.19 obliged Foodstuffs not only to keep the premises open, but also to conduct a supermarket or equivalent business in them.

[10] The arbitrator then looked at the background to the lease as being relevant to its interpretation but in itself not determinative. He stated that persons familiar with supermarket business would have expected that while the supermarket operated from the premises, the rent would, at the end of the 12 year term, be in excess of the rent at the beginning of the term. Further, a reasonable person would have understood that the intention was to operate a supermarket from the premises as the building was supermarket specific and Foodstuffs had assisted with the finance for its construction. The arbitrator also noted that the sublease entered into by Foodstuffs with the operator of the supermarket was also supermarket specific in that it restricted the use of the premises to that of a Foodstuffs supermarket. The arbitrator therefore concluded that when the lease commenced, a reasonable person with

knowledge of these facts and applying business commonsense was likely, in his view, to have come to the conclusion that the obligation under cl 2.19 was to keep the premises open and operating as a supermarket. He also took into account the circumstances surrounding the acquisition of adjoining land in 1999 for the provision of further car parks for the supermarket.

[11] The arbitrator did note cl 2.19 provided that the premises may be used for a use which is "a predominant use under the operative District Scheme for the zone" and that another business, which was within the predominant use provision, may have had a turnover below $5.2 million per annum. He then stated that, presumably, if Foodstuffs had sought to alter the nature of the business it would have needed to terminate the sublease or, at least, vary the terms of it. In the arbitrator's opinion, if Foodstuffs had sought approval to a new sublease or a variation of it, the Trust could have refused consent if the new business would not have produced a turnover equivalent to that of a supermarket. The arbitrator then reiterated that, on his interpretation of cl 2.19, the Trust would have been able to withhold consent in the case of a business which was not that of a supermarket unless the turnover was comparable with a supermarket. He stated that turnover rental was an ingredient of the parties' bargain and that if a new sublessee's asset position and business history did not satisfy the Trust that such a rental would be received, the Trust could have refused to give their consent.

[12] The arbitrator noted that the other alternative would have been for Foodstuffs to have terminated the sublease by consent with the sublessee and to have commenced operation of another type of business from the premises. However if it had done this, it was the arbitrator's view that, on the correct construction of the lease, the Trust would have had a claim against Foodstuffs for loss of rent. The arbitrator noted that the lease did not require a minimum turnover. However, he did not see this as being inconsistent with the interpretation he gave to cl 2.19.

[13] Having found that Foodstuffs was in breach of cl 2.19 in not keeping the premises open as a supermarket during normal trading hours, the arbitrator then determined that Foodstuffs was therefore liable for additional rent based on turnover. The expert called by the Trust acknowledged that it was not possible to calculate

precisely what gross sales would have been achieved from the premises if they had remained open. His view was, however, that it was possible to provide a robust estimate of what the sales would have been from a well established and stable operation of a substantial and stable store type, such as a New World supermarket, which was operating in an established and stable local market. The arbitrator referred to two methods that the expert used to make his assessment. The first being a trend analysis and, the second, a model analysis. The arbitrator adopted the figures arising from the expert's trend analysis. Under the trend analysis, the estimate of turnover rent for the two and a half year period between 1 April 2010 and 13 November 2012 was $186,283.00.

Discussion

[14] I am of the view, with respect, that the arbitrator's approach to the interpretation of the lease is flawed as a matter of law. At the outset, counsel for the Trust recognised that there was a difficulty when he submitted that there was a drafting error in cl 2.19, namely, an omission to add a provision to the permitted multiple uses provision that any alternative use was required to generate a turnover equivalent to that of a supermarket. He further submitted that the arbitrator, faced with a clear mistake on the face of the lease, was entitled to correct this mistake by reference to what he said was the parties' bargain. In the absence of an express provision, the arbitrator did this by stating that the Trust could withhold its consent to an assignment if it was not satisfied that such a turnover would be generated, on the basis that the Trust had to be satisfied of the proposed assignee's "asset position and business history". Similar considerations applied if Foodstuffs had terminated or varied the sublease and sought to alter the nature of the business it conducted from the premises.

[15] It is, however, clear that the turnover component of the rent was only ever going to be suitable for the supermarket business that operated from the premises. Mr Holden says that the $5.2 million threshold would not have been appropriate for any use other than a supermarket and, moreover, that the Trust would not have offered a tenant with an alternative use the one per cent turnover rate either. Mr Holden says that he relied on the understanding that was common between the

parties at the time, which was that the New World supermarket had captured the greater part of the Marton customer base and would only improve its turnover. He says:

> There was a clear expectation on both sides that the business would continue to trade from these premises at least until the end of the term and likely beyond.

[16] What happened was that the supermarket business outgrew the premises and although the Trust was prepared to commit further capital if improvements were required, the adjourning land necessary for expansion could not be obtained at a reasonable cost. Foodstuffs then chose to purchase land across the road and build a much larger supermarket. Mr Holden does not say what the parties' understanding or expectation was in those circumstances.

[17] In any event, the parties' subjective understanding or expectation is not the parties' bargain. The parties' bargain is contained in the lease. The lease is the agreement signed between the parties after legal advice. It is intended to impose binding legal obligations.

[18] The leading case in New Zealand on the principles of contractual interpretation is the Supreme Court decision in *Vector Gas v Bay of Plenty Energy.*[1] An ambiguity is not required to look at the contractual context. The contractual context will always be a necessary ingredient in ascertaining meaning.[2]

[19] At [19] – [24] of *Vector* Tipping J states:

> [19] The ultimate objective in a contract interpretation dispute is to establish the meaning the parties intended their words to bear. In order to be admissible, extrinsic evidence must be relevant to that question. The language used by the parties, appropriately interpreted, is the only source of their intended meaning. As a matter of policy, our law has always required interpretation issues to be addressed on an objective basis. The necessary inquiry therefore concerns 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. Evidence is not relevant if it does no more

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1 *Vector Gas v Bay of Plenty Energy* [2010] NZSC 5, [2010] 2 NZLR 444.
2 At [23].

than tend to prove what individual parties subjectively intended or understood their words to mean, or what their negotiating stance was at any particular time.

[20] Although subjective evidence would be relevant if a subjective approach were taken to interpretation issues, the common law has consistently eschewed that approach. The common law focuses strongly on the agreement in its final form as representing the ultimate consensus of the parties. Hence it is regarded as irrelevant how the parties reached that consensus. To inquire into that process would not be consistent with an objective inquiry into the meaning of a document which is generally designed to be the sole record of the final agreement. A party cannot be heard to say – never mind what I signed, this is what I really meant. ....

[21] ...But, despite its eschewing a subjective approach, the common law does not require the court, through the objective method, to ascribe to the parties an intention that a properly informed and reasonable person would not ascribe to them when aware of all the circumstances in which the contract was made.

[22] Nor does the objective approach require there to be an embargo on going outside the terms of the written instrument when the words in issue appear to have a plain and unambiguous meaning. This is because a meaning that may appear to the court to be plain and unambiguous, devoid of external context, may not ultimately, in context, be what a reasonable person aware of all the relevant circumstances would consider the parties intended their words to mean. An example of that situation is when plain words, read contextually, lead to a result which does not make sense, whether commercially or otherwise: a meaning that flouts business commonsense must yield to one that accords with business commonsense. The appropriate contextual meaning, if disputed, will, almost invariably, involve consideration of facts and circumstances not apparent solely from the written contract. While displacement of an apparently plain and unambiguous meaning may well be difficult as a matter of proof, an absolute rule precluding any attempt would not be consistent either with principle or with modern authority.

[23] The proposition that a party may not refer to extrinsic evidence "to create an ambiguity" is at least potentially misleading. It does not mean context is irrelevant unless there is a patent ambiguity. Context is always a necessary ingredient in ascertaining meaning. You cannot claim to have identified the intended meaning without reference to context. Hence it is always permissible to go outside the written words for the purpose of identifying the context in which the contract was made and its objective purpose. While there are no necessary preconditions which must be satisfied before going outside the words of the contract, the exercise is and remains one of interpretation. Subject to the private dictionary and estoppel exceptions to be mentioned below, it is fundamental that words can never be *construed* as having a meaning they cannot reasonably bear. This is an important control on the raising of implausible interpretation arguments. Furthermore, the plainer the words, the more improbable it is that the parties intended them to be understood in any sense other than what they plainly say.

> [24] In some recent cases it has been suggested that contractual context should be referred to as a "cross-check". In practical terms this is likely to be what happens in most cases. Anyone reading a contractual document will naturally form at least a provisional view of what its words mean, simply by reading them. That view is, in a sense, then checked against the contractual context. This description of the process is valid, provided the initial view is provisional only and the reader is prepared to accept that the provisional meaning may be altered once context has been brought to account. The concept of cross-check is helpful in affirming the point made earlier that a meaning which appears plain and unambiguous on its face is always susceptible to being altered by context, albeit that outcome will usually be difficult of achievement. Those attempting the exercise unsuccessfully may well have to pay for the additional costs caused by their attempt.

[20] In the present case, the parties differed as to whether a trigger was required to look outside the terms of the contract. I am of the view that looking at the commercial context is always permissible,[3] but admitting specific pre-contractual negotiations is normally only available in circumstances of mistake, ambiguity or special meaning.[4]

[21] Applying Tipping J's approach in *Vector Gas*, I do not consider that the words in cl 2.19 "other than as premises for carrying on in an efficient and proper manner the businesses of a supermarket or for any other use as may be a predominant use under the operative District Scheme for the zone within which the demised premises are situated" can be read down to mean that only a supermarket or another business with a turnover of at least $5.2 million per annum can lease the premises. The starting point is the plain words of the lease. The plain words indicate to me that a supermarket or other business that is permitted under the District Scheme can operate on the premises. There is plainly no turnover requirement.

[22] I am of the view, as affirmed by Tipping J in *Vector Gas*,[5] that the plainer the words are, the more improbable it is that parties intended them to be understood in any sense other than what they plainly say. The words clearly say that a supermarket or other business that is permitted under the District Scheme can operate on the premises. I agree with Tipping J when he states that it is fundamental that words can

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3 *Vector Gas v Bay of Plenty Energy*, above n 1, at [23]. See also *Ansley v Prospectus Nominees Unlimited* [2004] 2 NZLR 590 (CA) at [36].

4 *Vector Gas v Bay of Plenty Energy*, above n 1, at [33].

5 At [23].

never be construed as having a meaning that they cannot reasonably bear. Clause 2.19 cannot reasonably be construed as meaning "only a supermarket or equivalent business with a turnover of at least $5.2 million per annum can lease the premises".

[23] The authors of Burrows, Finn and Todd state:[6]

> One thing remains clear however. Even after examining the matrix of fact it may be found that it is incapable of changing the clear meaning the words bore at first sight. If that is the case, the clear meaning must prevail. Unless it is clear that there has been a mistake in the language the extrinsic facts cannot make the words mean something they are incapable of meaning.

[24] Likewise, the New Zealand Court of Appeal has noted that courts must be very cautious if one of the constructions contended for, will require a substantial rewriting of the contract. They state:[7]

> While the *Investors Compensation* approach permits the Court to read words as having an effect different from their literal meaning, or even on occasion to conclude that the wrong words were used and must be given no effect, the Court must be very cautious indeed in applying that approach where the effect is substantially to rewrite the contract. The more reconstruction is required, the more difficult it is to displace what Lord Hoffmann... called "the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents".

[25] To consider that this contract mandated that only a supermarket or another business with a turnover of at least $5.2 million per annum could operate on the premises, would, in my view, constitute a substantial rewriting of cl 2.19.

[26] Lord Hoffman noted in *Investors Compensation Scheme Ltd v West Bromwich Building Society* that:[8]

> if one would conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to parties an intention which they plainly could not have had

[27] This is not a case where one would consider, when reading the contract, or looking at the background, that something must have gone wrong with the language.

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6 John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (Lexis Nexis New Zealand, Wellington, 2012) at 197.

7 *Starrenburg v Mortre Holdings Ltd* (2004) 21 NZTC 18,696 (CA) at [44].

8 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 913.

It is entirely conceivable that within their contract the parties allowed for other businesses consistent with the District Scheme to operate on the premises as a contingency. There is no evidence from the contractual context that this was an intention the parties plainly could not have had. It is also not a case where business commonsense would dictate that the lease must be interpreted to allow only a supermarket or another business with a turnover of at least $5.2 million per annum to operate on the premises. It is business commonsense that if a supermarket could no longer be housed on the premises, a suitably large scale store, correctly zoned but with a different profit margin and turnover, may also be a suitable lessee for the premises.

[28] In my view, the arbitrator, with respect, placed too much weight on the fact that when Foodstuffs signed the lease, the business operated as a supermarket, the sublease was supermarket specific and that expansion of car parking in 1999 was for the purpose of facilitating use as a supermarket. These are certainly factors which make up the context of the contract. However, in my view, they are not factors which mean that a reasonable person would consider that cl 2.19 only allows for a supermarket or another business having a turnover of at least $5.2 million per annum to be operated on the premises. As a matter of proof, this context is not evidence that the parties actually intended their words at cl 2.19 to mean "only a supermarket or another business with a turnover of at least $5.2 million per annum can lease the premises".

[29] The context indicates that at the time the lease was signed, the premises were certainly operating as a supermarket, but that cl 2.19 left open the possibility that some other business could legitimately operate on the premises. The context surrounding the making of the contract does not suggest that the parties did not intend the words to have their plain meaning. There is, in my view, no evidence which suggests there was an objectively apparent consensus between the parties that cl 2.19 was to mean a supermarket or another business with a turnover of at least $5.2 million per annum only could operate.

[30] Furthermore, I am also of the view that the fact the sublease was for a supermarket does not mean that cl 2.19 cannot be interpreted on its plain words. Of

course the sublease was for a supermarket, as that was the business operating on the premises at the time. This does not negate the fact that the primary lease allowed for another business to operate on the premises if it met zoning requirements. Hypothetically, if another business had operated on the site, then the sublease would have specifically named that alternate business and that would not have nullified the interpretation of the primary contract as allowing for either a supermarket or another appropriately zoned business to operate. Extra car parking was bought for a supermarket, but again this does not displace the plain and unambiguous meaning. There is also no pre or post-contractual evidence that the parties intended cl 2.19 to only mean a supermarket or another business with a turnover of at least $5.2 million per annum could operate. There are no e-mails or correspondence between the parties to this effect.

[31] Moreover, there is no requirement in the lease for a minimum turnover. The arbitrator himself stated at [54] that "Mr and Mrs Holden took the risk that the turnover of the supermarket may drop below $5.2 million in subsequent years". If the arbitrator accepts that the Trust took that risk, it is inconsistent then to conclude that both parties intended cl 2.19 to allow only a supermarket or another business with a turnover of at least $5.2 million per annum to operate on the premises.

[32] As noted above, counsel for the Trust submits that the drafting of cl 2.19 is a mistake. However, this is not a claim in rectification. It is a claim in contractual interpretation. The House of Lords in *Chartbrook Ltd v Persimmon Homes Ltd*[9] states that in order for there to be a mistake two conditions must be satisfied. There must be a clear mistake on the face of the instrument and it must be clear what correction should be made to cure the mistake. I am of the view that this is not a case of clear mistake on the face of the lease that can be rectified. The lease makes perfect sense with cl 2.19 written as it is.

[33] In order for pre-contractual negotiations to be admitted they must shine an objective light on the meaning to be ascribed to the words of the contract as intended

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9 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1001 (HL).

by the parties.[10] The business context of the supermarket does not suggest that the contract could not still have intended to allow for another business to operate if the supermarket could no longer operate. Furthermore, the submission by counsel for the Trust may shine light on the Trust's subjective intention that only a supermarket should operate from the premises, but the Trust did not elaborate on how both parties objectively intended cl 2.19 to be interpreted.

[34] In my view, Foodstuffs is only liable to pay the fixed annual rent to the Trust. The Trust is not able to receive damages equivalent to one per cent of the turnover in excess of $5.2 million as this was never guaranteed under the contract. The appeal is accordingly allowed and the arbitrator's award quashed.

[35] Foodstuffs are entitled to costs on a 2B basis.

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Woolford J

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[10] *Vector Gas v Bay of Plenty Energy,* above n 1, at [14], [19] and [22]. Similarly post-contractual negotiations must shine an objective light see *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277..