COURT DECISIONS

"HOLMANS" CASE

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LEASE — MARKET RENT

In the Matter of the Rules of the Supreme Court of Queensland and In The Matter of a Lease from the Colonial Mutual Life Assurance Society Limited to H.W. Tasal Services Pty Ltd (as Service Trust for Holmans Solicitors) and In The Matter of a further Lease between the Colonial Mutual Life Assurance Society Limited and H.W. Tasal Services Pty Ltd (as Service Trust for Holmans Solicitors)

(In the Supreme Court of Queensland, 16 June 1992, Dowsett J.)

Dowsett J: The Colonial Mutual Life Assurance Society Limited (the respondent) is the registered proprietor of certain land at 300 Queen Street, Brisbane, on which are erected commercial premises. H.W. Tasal Services Pty Ltd is the registered lessee of certain parts of those premises pursuant to two registered leases.

The second appendix to each lease provides:

Notwithstanding anything to the contrary elsewhere herein contained or implied the rental payable hereunder shall be reviewed at the date of the expiration of each successive period stated in Item 6 of the Fourth Appendix hereto in accordance with the following provisions:

1. On or within three months before or at any time after the expiration of each successive period stated in Item 6 of the Fourth Appendix hereto during the said term, computed from the date of commencement of this lease, but not later than the following rent adjustment date as hereinafter defined, the Lessor may give notice to the Lessee that it considers that the annual market rental value of the demised premises exclusive of the cost of cleaning has increased to an amount stated in the notice and that it requires the annual rental payable hereunder to be increased to the amount so stated as from the date of commencement of the next succeeding period stated in Item 6 of the Fourth Appendix hereto (if the said notice is given before the rent adjustment date) or the current period stated in Item 6 of the Fourth Appendix hereto (if the said notice is given on or after the rent adjustment date) (such date of commencement being herein called in each instance "the rent adjustment date"). If the Lessee, having been given such a notice, does not, within 21 days after the date of service thereof as provided in paragraph 2(a) of this Appendix, object in writing to the alteration to the rental required thereby, such alteration shall take effect and the annual rental payable hereunder shall increase to the amount specified in the notice as from the rent adjustment date.

2. If the Lessee considers in any case that the annual market rental specified by the Lessor by notice pursuant to paragraph (1) of this Appendix is not the current annual market rental value of the demised premises for the relevant period the following provisions shall apply:

(a) The Lessee may, by notice in writing to the Lessor within 21 days after service pursuant to paragraph (1) of this Appendix of the notice specifying the same, require the rent to be determined by two valuers (being members of the Australian Institute of Valuers practising in the Central Business District of Brisbane), one to be selected by each party, and the said valuers shall jointly determine the current annual market rental value of the demised premises for the relevant period. If the said valuers are unable to agree upon the current annual market rental value of the demised premises then the question shall be referred for determination to a third valuer, similarly qualified, to be appointed by the President for the time being of the Division of the Australian Institute of Valuers in the State of Queensland at the request of either of the said valuers. All of the said valuers shall act as experts and not as arbitrators and their decision(s) shall be final and binding on the Lessor and the Lessee PROVIDED HOWEVER that such determined rent shall not in any case be less than the rental payable hereunder immediately prior to the relevant rent adjustment date PROVIDED FURTHER THAT if the Lessee shall not appoint a valuer as aforesaid within 14 days after notice to him in writing by the Lessor requiring him to do so then the alteration referred to in clause 1 of this Second Appendix shall take effect and the annual rental payable hereunder shall increase to the amount specified in the notice given pursuant to that clause as from the relevant rent adjustment date.

(b) The current annual market rental value of the demised premises as determined in accordance with sub-paragraph (a) of this paragraph (2) shall, subject to sub-paragraph (d) of this paragraph (2), become the annual rent payable by the Lessee in lieu of the annual rent by the Lessee as aforesaid with effect from the relevant rent adjustment date.

(c) All costs of the determination of the rental shall, unless the current annual market rental of the demised premises determined under sub-paragraph (a) of this paragraph (2) is equal to or greater than the rental initially specified by the Lessor in terms of paragraph (1) of this Appendix (in which event all costs of the determination of the rent shall be borne by the Lessee), be borne equally by the Lessor and the Lessee.

(d) If the annual market rental value of the demised premises determined in accordance with the provisions of sub-paragraph (a) hereof is the same as or is less than the annual rental payable by the Lessee immediately prior to the relevant rent adjustment date; there shall be no change in the amount of the annual rental payable by the lessee for the next period of years stated in Item 6 of the Fourth Appendix hereto.

This clause is common to both leases; however, there are certain variations in the particulars set out in the

Fourth Appendix to each lease which I should record. The relevant particulars are as follows:

First Lease

Term 6 years
Date of commencement 1.5.87
Date of termination 30.4.93
Initial annual rental $55,640
Rent review period (clause 1 Second Appendix) 2 years

Second Lease

Term 5 years 8 months
Date of commencement 1.9.87
Date of termination 30.4.93
Initial annual rental $49,140
Rent review period (clause 1 Second Appendix) 1.9.87 - 30.4.89, 1.5.89 - 30.4.91, 1.5.91 - 30.4.93

Pursuant to each lease the respondent was entitled to notify a new rental with effect from 1 May 1991. This was done. In each case the applicant declined to accept the rent proposed by the respondent and therefore the procedure prescribed by paragraph 2 of the Second Appendix was invoked. That procedure requires the appointment by each party of a valuer, which valuers are to determine jointly the current annual market rental value of the demised premises. For present purposes, the period for which the rent is to be fixed is the period from 1 May 1991 to 30 April 1993. In the event that the valuers fail to agree, the matter is to be referred for determination to a third valuer appointed by the President of the Institute of Valuers (Queensland Division). All valuers are to act as experts and not as arbitrators. The rent may not, in any case, be less than that prevailing in the period immediately prior to the adjustment. The parties have appointed valuers pursuant to paragraph 2.

The parties (and the valuers) differ as to the proper approach to the task in hand. The difference concerns the common practice of offering incentives to prospective tenants of commercial premises. The tenant or some person associated with the tenant often receives a significant benefit from the landlord in consideration of the tenant entering into the lease. Put broadly, the respondent asserts that in performing the rent-fixing exercise contemplated by the leases in the present case, the valuers should not have regard to rental transactions involving incentive payments. The applicant asserts that the proper course is to have regard to all rental transactions relating to comparable premises.

At first blush, the dispute appears to depend upon the acceptance or rejection of the evidence of one or other of the valuers. Were this the exercise, I would not undertake it. **First**, it would be inappropriate to do so because it would not resolve the matter in dispute between the parties. No valuation has yet been effected and therefore it would be premature to interfere at this stage to correct an apprehended error (as it is alleged), leaving to the valuers the possibility of erring further before they arrive at their decision. More significantly, the parties have agreed that the rent be fixed by the valuers acting as such. In other words, the rent is to be determined by nominated third parties, their duty being to fix the current annual market rental value in each case. The court will not intervene in such a process.

However, the applicant urges that it seeks construction of the expression **"current annual market rental value"**. I will limit my involvement in this matter to that question of construction.

The nature of such a valuation exercise appears from the decision of the High Court in ***Spencer v. The Commonwealth of Australia*** **(1907) 5 CLR 418. In particular, in the judgment of Griffith CJ at page 431, this most** helpful exposition appears:

> In the case of chattels it is often, though not always, easy to ascertain the value. In order that any article may have an exchange value, there must be presupposed a person willing to give the article in exchange for money and another willing to give money in exchange for the article. When there is a large or considerable number of articles of the same kind which are the subject of daily or frequent sale and purchase, the value of the articles is taken to be their current price. Thus, in the *Sale of Goods Act*, the measure of damages for wrongful refusal to deliver goods is to be ascertained with reference to "the market or current price of the goods". The foundation of this doctrine is that a man desiring to sell such articles can readily find a purchaser at a price which is fairly certain, and conversely that a man desiring to buy can find a seller at about the same price. But these considerations are not necessarily equally applicable to land. There is, no doubt, much land in many places the value of which per acre is as definitely fixed as the price of wheat or sugar but in the case of a new port, in a new State, where the area of land is limited, and each piece differs in many of its characteristics from the rest, it is impossible to apply any such rule. Bearing in mind that value implies the existence of a willing buyer as well as of a willing seller, some modification of the rule must be made in order to make it applicable to the case of a piece of land which has a unique value. It may be that the land is fit for many purposes, and will in all probability be soon required for some of them, but there may be no one actually willing at the moment to buy it at any price. Still it does not follow that the land has no value. In my judgment the test of value of land is to be determined, not by inquiring what price a man desiring to sell could actually have obtained for it on a given day, ie, whether there was in fact on that day a willing buyer, but by inquiring "what would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?" It is, no doubt, very difficult to answer such a question, and any answer must be to some extent conjectural. The necessary mental process is to put yourself as far as possible in the position of persons conversant with the subject at the relevant time, and from that point of view to ascertain what, according to the then current opinion of land values, a purchaser would have had to offer for the land to induce such a willing vendor to sell it, or, in other words, to inquire at what point a desirous purchaser and a not unwilling vendor would come together.

Isaacs J (as he then was) said at page 441:

> To arrive at the value of the land at that date, we have, as I conceive, to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser, willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land, and cognisant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then present demand for land, and the likelihood, as then appearing to persons best capable of forming an opinion, of a rise or fall for what reason soever in the amount which one would otherwise be willing to fix as the value of the property.
> In *The Queen* v. *Brown*, Cockburn CJ said: "A jury, whether the dispute be as to the value of land required to be taken by the company, or as to the compensation for damages by severance, in assessing the amount to which the landowner is entitled, have (sic) to consider the real value of the land, and

may take into account not only the present purpose to which the land is applied, but also any other beneficial purpose to which in the course of events at no remote period it may be applied, just as an owner might do if he were bargaining with a purchaser in the market. That is the mode in which the land would be valued." Having mentally placed itself in the position of the bargaining parties as on the critical date ... the question for the tribunal is: What is the point at which the parties would meet? What is the sum that one would be willing to give and the other to take?

The present valuation exercise is being performed in the context of a mid-term review rather than at the beginning of a term. It might therefore be said that neither the lessor nor the lessee is in the classic position of the willing, but not overly anxious, vendor or purchaser. Each is bound to the terms of the leases. This point, put in a number of different ways, is really at the heart of the respondent's submissions. In effect, the submission is that because the parties do not have the option of walking away from each other, rentals negotiated between parties who had such an option should not be considered.

To state the proposition in this way is really to identify its fallacy. The parties have bound themselves, leaving one term in each lease to be fixed by the third party valuers. They have agreed to pay and accept rent fixed in accordance with the mandate given to those valuers. That mandate is to fix the current annual market rental value of the premises. The mandate assumes the existence of market, and that is precisely the concept discussed by Griffith CJ in *Spencer* (supra). Although these parties may not be able to walk away from the transaction should there be no agreement between them as to rent, they have nonetheless bound themselves to a rental fixed by reference to the market where parties can do so.

Notwithstanding this initial impression, it is appropriate that I address the arguments advanced on both sides as to the appropriate construction of the term "current annual market rental value". I should also consider some of the cases.

In *Edmund Barton Chambers (Level 44) Co-operative Ltd v. Mutual Life and Citizens Assurance Co Ltd* (1986) 6 NSWLR 322, the New South Wales Court of Appeal considered a reference to arbitration to fix the "current market rent" of certain premises. A case was stated for the Court of Appeal by the arbitrator and Glass JA (Hope JA concurring) was of the view that:

> The dry question of law isolated by the stated case may be paraphrased as asking whether in determining the "current market rent" of premises subject to a rent review clause the rent review rentals of comparable premises constitute relevant evidence.

Glass JA continued:

> The authorities show that in determining the sale price which would have been acceptable to the hypothetical vendor and purchaser as a pure register of market forces, it is permissible to have regard to sales in which one or other party is influenced by non-market considerations provided allowance is made for that fact... The test of the hypothetical sale or letting is not fully described as a process in which each party is free to withdraw from the negotiations. The hypothesis requires the assumption to be made that although each is free to withdraw a bargain nevertheless results. The rentals struck between a lessor and an incoming tenant are said by the appellant to give full expression to market forces and to constitute the only material relevant to the current market rent. However, a lessor seeking to fill a new building may be under a host of constraints which force the rentals it will take below current market levels. Nevertheless these constitute acceptable evidence to which adjustments will be made in applying the criterion of the rental which would be agreed in a hypothetical letting responsive to pure market forces. In principle, therefore, rent review rentals constitute material relevant to the determination of current market rent. In the process of evaluating such material the distortions due to non-market forces will necessitate some adjustment.

This is the converse of the situation with which I am concerned. Here it is submitted by the respondent that *only* rent review rentals of comparable premises constitute relevant evidence for the purpose of fixing the current annual market rentals. Although *Barton* (supra) establishes that such transactions are relevant for that purpose, it is inherent in the judgment that other transactions are also relevant. A similar approach was taken by Ryan J in *IBM Australia Ltd* v. *MEPC Australia Limited* (1991) 1 QldR 201.

It is submitted for the respondent that a significant feature of the case is that the process by which the valuers are to arrive at the appropriate rental is not prescribed by the lease but rather left at large. This is, in one sense, correct in that no detailed procedure for valuation is prescribed. Nonetheless the valuers have been directed to fix the current annual market rental value of the demised premises for the relevant period. In this sense they have been given a quite precise direction as to the way in which the rent is to be fixed. These proceedings are designed to construe that direction.

The respondent also submits, correctly, that where the parties leave a term to be fixed by a third party in this way, they must be taken to have agreed to accept the determination reached in accordance with the mandate to the third party, regardless of whether it be right or wrong. It is also submitted that the courts will not intrude into the method of valuation adopted by valuers so appointed as third parties. As a statement of principle, this is also correct. However, this does not lead to the conclusion that declaratory relief should not be given in the present case. There is a clear dispute between the parties as to the meaning of a key term in each lease. Therefore there is a probable justiciable issue for determination by the court. One would expect the valuers to accept as correct any construction of the clause by the court, but that is not to say that the court is interfering in the valuation process.

A further submission made on behalf of the respondent is that if transactions involving incentives are considered, such rentals will require adjustment to reflect the value of the incentives, but no process of this kind is prescribed in the lease. It is submitted that it follows from this that it was not intended by the parties that transactions requiring such discounting be used in the exercise. This implies an unusual and unnatural restriction upon the valuation process clearly contemplated by the lease. In any valuation exercise, it is necessary to take into account the fact that so-called "comparable" transactions are almost invariably not precisely comparable. There is always a degree of adjustment to reflect variations in circumstances. This same process is appropriate to cope with the presence of inducements in some leasing transactions. There is no substance in this argument.

I am also referred to the decision of the Full Court in Re *ANZ Executors and Trustees Co Ltd* (unreported OS 214/1991; Full Court, 8 November 1991) where Cooper J (Williams J concurring) discussed the relative value of such incentives to lessor and lessee, indicating that "one off" payments may not necessarily indicate a rateable inflation of the rental value of the premises. This is almost axiomatic, but it is relevant only to the discounting exercise to which I have referred above.

In conclusion, the view initially expressed above is correct, namely that the parties have agreed that the new rental should be the current annual market rental. Once it is accepted that it is the market rental which is to be fixed by the valuation process, the substance of the respondent's argument disappears. It is the rent which could be obtained in the marketplace for the premises upon terms similar to those of these leases, assuming willing but not overly anxious potential landlord and tenant, and assuming that such parties will reach eventual agreement. In determining this value, it is obviously necessary to look at other premises of similar quality and in similar locations and the terms upon which they are available in the marketplace. This inevitably involves a consideration of any incentives, with appropriate adjustments.

As to the precise form of the declaration, I would propose as follows:

> That "the current annual market rental value of the demised premises for the relevant period" referred to in the said leases means the market rental able to be obtained for such premises in the marketplace, on terms substantially similar to those of the leases in question, the market including (but not exclusively) the market for premises not currently occupied.

I will receive further submissions as to the precise form of the declaration and as to costs.