Woolworths Limited
v.
Merost Pty Limited & Anor

(In the Supreme Court of New South Wales, Commercial Division, 8 June 1988, Giles J.)

Rent Review: Annual market rental value, premium long term lease. Issue of whether a valuer fixing a rent for purposes of determining annual market rental value of premises should include a premium over and above the market rent which could be expected to be paid for a lease of premises comparable to the demised premises which lease made provision for regular rent reviews.
Held: Words "annual rent" interpreted as a yearly figure rather than as a one-year term and that the valuer was correct in considering the term of the lease, without a further review (20 years), and reflecting a premium in his assessment.

Giles J: By lease dated 31 August 1966 the plaintiff leased from the Colonial Mutual Life Assurance Society Limited premises at Engadine for the term from 1 September 1966 to 31 August 2006 "at the yearly rent payable and calculated as provided in Clause 2(a) hereof ...". The defendants are assignees of the Colonial Mutual Life Assurance Society Limited. I shall refer to the plaintiff as the lessee and to the defendants collectively as the lessor.

By clause 2(a) of the lease the lessee covenanted with the lessor to pay "an annual rental" calculated and payable as follows:

> "I. FIRSTLY an annual rent of $31,740.00 per annum during the period from the commencement of the term of this lease to the thirty-first day of August 1986 payable in advance by regular and consecutive quarterly instalments of $7,935.00 each on the first day of the months of March, June, September and December in each year during the said period and at that rate for less than a quarter the first of such instalments or a prorportionate part thereof to become payable on the first day of September 1966 calculated to the thirtieth day of November 1966.
>
> II. SECONDLY an annual rent during the residue of the term of this lease commencing on the first day of September 1986 of such an amount (not being less than the rental hereinbefore referred to) as shall be agreed between the lessor and the lessee in writing to be the annual market rental value of the demised premises at such last mentioned date or in the event of the parties failing to reach agreement prior to the said date an annual rent being the annual market rental value of the demised premises as determined at the joint cost of the parties by a qualified valuer to be appointed by the President or other principal officer for the time being of the Commonwealth Institute of Valuers (or should such institute then have ceased to exist of such body or association as then serves substantially the same objects as such institute). AND such annual rent as agreed or determined as aforesaid shall be payable in advance by regular and consecutive quarterly instalments in the same manner and on the same days as the rent firstly above reserved."

There being no agreement upon the annual rent for the period commencing 1 September 1986, Mr D.B. King was appointed to make the determination for which this provision calls. I shall refer to him as the valuer. By a written report dated 21 July 1987 the valuer determined "the annual market rental value of the premises ... for a term of twenty (20) years from 1st September, 1986" at $375,000 per annum.

In these proceedings the lessee seeks a declaration that it is not bound by that determination.

In paragraph II of the points of claim the lessee asserted:

> "In fixing the rent referred to in the preceding paragraph, the valuer determined that such rent should include a premium over and above the market rent which could be expected to be paid for a lease of premises comparable to the demised premises which lease made provision for regular rent reviews."

This paragraph was admitted by the lessor. It was intended to reflect the relevant aspect of the determination, the lessee contending that the valuer was not entitled to determine the annual rent by the inclusion of the premium referred to.

The determination is a document of 21 pages broken up into four parts, plus two appendices.

It is plain that the valuer received submissions from valuers representing the lessor and the lessee, and in Part 3 there are noted aspects of these submissions together with the comments of the valuer thereon. One of the submissions recorded is that of the lessor that in determining the rent of the premises for the purposes of a review for the residue term of 20 years regard must be had to the duration of the period for which the rent is to be determined, a submission with which the valuer notes his concurrence. Another of the submissions recorded is that of the lessee described as a "detailed submission with enclosures including a rental calculation method involving an arbitrary basis of assessing a premium 'for the fact there are no rent reviews for 20 years', and adding this to an amount representing the current market rent assuming 'a normal review period'".

Part 4 of the determination deals with the basis of

determination and the determination itself and includes the statement:

"In my deliberations I have been conscious of the facts that my determination has to be made at a sum which:

a) will not adversely affect the viability of the lessee's business and cause it to perhaps operate at a loss for an unreasonable length of time; albeit that we are all no doubt aware of examples of supermarkets of all persuasions which sometimes operate at a loss — particularly in the early years of trading of a new store.

b) will reflect a premium rental over and above market rent for a 'normal' review period and conditions, but which also take cognizance of the fact that circumstances might arise prior to the end of the twenty year review period which could result in offer and acceptance of a surrender of the lease to the mutual benefit of both lessor and lessee. Assessment of an inadequate premium rental would disadvantage the lessor in the long term whereas assessment of an excessive premium rental could disadvantage the lessee in the event of an early surrender of the lease."

In *Legal & General Life of Australia Ltd* v. *A. Hudson Pty Ltd* (1985) 1 NSWLR 314, the lessee also sought a declaration that the determination of a rental value was not binding upon it. McHugh JA distinguished (at 331) between a mistake involving departure from the question referred to the valuer and a mistake as to the process of valuation. After a review of the authorities upon when a mistake would invalidate a valuation, his Honour said (at 335-6):

"In my opinion the question whether a valuation is binding upon the parties depends in the first instance upon the terms of the contract, express or implied. This was pointed out by Sir David Cairns in the Court of Appeal in *Baber* v *Kenwood Manufacturing Co Ltd* (at 181). A valuation obtained by fraud or collusion can usually be disregarded even in an action at law. For in a case of fraud or collusion the correct conclusion to be drawn will almost certainly be that there has been no luation in accordance with the terms of the contract. ,s Sir David Cairns pointed out, it is easy to imply a term that a valuation must be made honestly and impartially. It will be difficult, and usually impossible, however, to imply a term that a valuation can be set aside on the ground of the valuer's mistake or because the valuation is unreasonable. The terms of the contract usually provide, as the lease in the present case does, that the decision of the valuer is 'final and binding on the parties'. By referring the decision to a valuer, the parties agree to accept his honest and impartial decision as to the appropriate amount of the valuation. They rely on his skill and judgment and agree to be bound by his decision. It is now settled that an action for damages for negligence will lie against a valuer to whom the parties have referred the question of valuation if one of them suffers loss as a result of his negligent valuation: *Sutcliffe* v *Thackrah* (1974) AC 727; *Arenson* v. *Arenson* (1977) AC 405. But as between the parties to the main agreement the valuation can stand even though it was made negligently. While mistake or error on the part of the valuer is not by itself sufficient to invalidate the decision or the certificate of valuation, nevertheless, the mistake may be of a kind which shows that the valuation is not in accordance with the contract. A mistake concerning the identity of the premises to be valued could seldom if ever, comply with the terms of the agreement between the parties. But a valuation which is the result of the mistaken application of the principles of valuation may still be made in accordance with the terms of the agreement. In each case the critical question must always be: was the valuation made in accordance with the terms of a contract? If it is, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value. Nor is it relevant that the valuer has taken into consideration matters which he should not have taken into account or has failed to take into account matters which he should have taken into account. The question is not whether there is an error in the discretionary judgment of the valuer. It is whether the valuation complies with the terms of the contract."

Mahoney JA in the same case was of the view that the valuer had not made a mistake of the kind alleged against him, and found it unnecessary to express a view on whether, had there been a mistake, it would have rendered the determination ineffective. Priestley JA asked whether the lessee had shown that the valuation "did not comply with the agreement in the lease" (at 324) and was not satisfied that it had. On appeal to the Privy Council (*A. Hudson Pty Ltd* v *Legal & General Life of Australia Ltd* (1986) 61 ALJR 280) their Lordships found no mistake in the valuation and did not consider the kinds of mistake which might justify interference by the court with the valuation of an expert.

The lessee submitted that the determination was not made in accordance with clause 2(a)II of the lease because in incorporating the premium the valuer was not assessing the annual market rental value of the premises as at 1 September 1986. (Although the words "as at 1 September 1986" appearing in that clause qualify only the annual market rental value to be agreed, there must also be read into the annual market rental value to be determined a like qualifying phrase.) In support of this submission it was said that:

(a)the valuer, by incorporating the premium, was altering the bargain of the parties, they having agreed upon a lease with one rent review only after 20 years and the valuer giving to the lessor the additional benefit of the equivalent of a lease with a number of successive rent reviews during the second 20 years;

(b)the function of a rent review clause such as that under consideration is to adjust the base rent for inflation to the date of review, not to incorporate a premium for anticipated inflation for which the parties have deliberately chosen not to provide;

(c)the lease being a commercial lease, the parties are not to be taken as having intended to permit the valuer to indulge in what was said to be speculation in attempting, for the purpose of arriving at a premium, to predict rates of inflation for 20 years.

The first step must be to establish what the lease requires to be valued. Clause 2(a)II says it is the annual market rental value of the demised premises. But that cannot be enough to identify that for which the contract embodied in the lease calls, since rent may vary according to the length of theterm and other conditions of the lease. The valuer must have to determine the annual market rental value of the premises if let on the conditions of the lease and, in my view, for the term of 20 years from 1 September 1986

This was recognised by Beach J in *Capel Services Ltd v Legal & General Assurance Society Ltd* (unreported, 23 October 1984). The lease there in question provided for a renewed term at such rental as

> "...shall be agreed upon by the landlord and the tenant and failing agreement as to the fair open market value two months before the expiration of the said term such fair open market value shall be determined by two valuers .... "

For the lessee it was contended that the rental should be determined as for a lease of the premises upon present day normal and usual commercial terms without regard to the fact that the renewal of the lease was for a term of 15 years without provision for rental review. For the lessor it was contended that what was required was a determination of the fair open market value of the rental of the premises as for a lease of the premises upon the terms contained in the lease including the term that the renewal of lease was for 15 years without provision of rental review. Beach J said:

> "It would seem to me that what the parties have really sought to do in this case is to raise two quite separate and distinct matters for determination by the court. In the first place they ask the court to determine whether or not the valuer or valuers appointed by the parties should have regard to the fact that the renewal of the lease is for a term of 15 years when determining the rental to be paid by Capel in respect of the subject premises. In the second place they ask the court to determine whether or not it is valid for the valuer, or valuers, to have regard to future inflation when arriving at that determination.
>
> The conclusion I have arrived at, in so far as the first aspect of the matter is concerned, is that in determining the fair open market value of the rental of the subject premises it is the duty of the valuer, or valuers, to have regard to the fact that the lease of the premises is for a term of 15 years. If I may be permitted to adapt the words of Sim J in *re Lund's Lease* 'How can a rental be the fair open market value of the premises if it is fixed without any regard to the duration and conditions of the tenancy?'
>
> If one was auctioning the lease of the premises, I have little doubt that the first question prospective buyers would ask is 'What is the term of the lease?' Clearly that would be an important consideration in determining the market value of the lease.
>
> To attempt to fix the fair open market value of the rental of the premises without regard to the term of the lease would be to ignore a factor which must have a significant bearing on the rental a prospective lessee would be prepared to pay for the premises.
>
> I have little doubt that if the owner of city premises offered to let a floor of his building for a term of one year only, with no provision for renewal, he would not obtain as high a rental for that floor as he would if he was prepared to let it for, say, three years with an option for a further period of three years. A lease of a floor in a city building for one year only would be a far less attractive proposition to the businessman who wished to set up his business in the city, than a lease of that same floor for a period of three years with an option for a further period of three years.
> At the other end of the scale, however, a lease for a period of 15 or even 20 years may, in some respects, be less attractive than a lease for a shorter period of time with options for renewal, in that in the former case the lessee is tied to the premises and may encounter difficulties in the future if, for economic reasons, he wishes to expand or contract his business operations. Again, if I may adapt the words of the Court of Appeal in *re Brechin and Drapery Importing Co Ltd*, it would seem to me that clear words would be required to support the construction that the fair open market value of the rental of the premises should be determined without reference to the duration of the tenancy. There are no such words in clause 4(ii)(a) of the lease and accordingly I am of the opinion that the fact that the lease is for a term of 15 years is a matter which must be taken into account by the valuers in determining the appropriate rental."

In the present case I cannot see any words in clause 2(a)II of the lease (or elsewhere in the lease) whereby the annual market rental value is to be determined without reference to the length of the term. I do not see any relevant difference between "fair open market value of the rental" and "annual market rental value": the word "annual" seems to me to connote the expression of the market rental value as a yearly figure rather than the expression of a market rental value for a one year term, and contemplates a term extending beyond a year. In this regard the word "annual" qualifying the word "rent" in clause 2(a) is clearly used in the sense of a yearly figure rather than for a one year term and I see no reason to give it different meaning when qualifying "market rental value".

The phrase "at such last mentioned date" does not require that the length of the term be ignored, doing no more than direct the valuer to make his determination on the assumption of a prospective lessor and lessee striking a bargain on 1 September 1986. Since the determination may not be made for some time after 1 September 1986, factors relevant to the determination but arising after 1 September 1986 are to be ignored (except, no doubt, to the extent to which they would have been foreseen as at 1 September 1986).

Re Lund's Lease (1926) NZLR 541 and *re Brechin Drapery Importing Co Ltd* (1928) NZLR 241, both refered to by Beach J, concerned the regard to be had in determining rent under a rent review clause to the terms and conditions of the lease. In both it was held that regard had to be had to the duration and conditions of the tenancy.

In *re Lund's Lease* the lease required the valuer to exclude from consideration improvements on the land "and estimate the then annual value of the land only". It was contended for the lessor that the rental payable for the last period of 10 years was the fair annual value for the land only at the commencement of the period of 10 years, apart altogether from the fact that there were 10 years of the lease left. That argument was rejected, it being said that the valuer had to ascertain what a prudent lessee would give as ground rent for a lease for the specified term and subject to the specified conditions.

In *re Brechin Drapery Importing Co Ltd*, the trial judge had considered that the requirement that the determination be of "the fair and reasonable rent of the said premises calculated on the basis of the unimproved values of the said lands" meant that no regard should be had to the duration and conditions of the tenancy, but it was held on appeal that those words only meant that improvements should be disregarded. It was said (at 248) that:

> " ... the duty of the arbitrators or umpire is to ascertain what a prudent lessee would give as a ground rent for

a lease of the land for the term of 14 years without any buildings or improvements thereon, and subject to the obligations imposed on the lessee, including the obligation of remaining the tenant thereof for two further periods of 14 years, and the obligations of leaving on the land any buildings and improvements erected by the lessee".

In the present case the valuer had to arrive at the annual market rental value for the premises for a term of 20 years without rent review. As a matter of principle, a prospective lessor for such a term could well look to receive a rent which would reflect anticipated inflation. Over the 20 year term many matters could operate to affect the lessor and the lessee: some are referred to by Beach J, and others which can be instanced are the effect of development in the area and possible dilapidation of the premises or their becoming "dated" for use as a retail outlet. Some of these matters will operate adversely to the lessor, others adversley to the lessee, and each may take them into account in deciding what rent he wishes to receive, or is prepared to pay, as annual rent over a 20 year term.

Referring, as the valuer did in the statement from Part 4 of the determination which I have set out above, to a premium rental is to my mind no more than a way of referring to a way of accommodating one of such matters. A lessor for a 20 year term with rent reviews may anticipate receiving rental of periodically increasing annual amounts, with a given total over the 20 years. A lessor for a 20 year term without rent reviews may anticipate receiving a like total amount over the 20 years, but because it must be received by equal annual amounts the initial (and constant) annual amount will be greater than the initial annual amount where there are rent reviews. As the statement makes clear, this is only one matter of which the valuer was conscious: he was also conscious of, at least, the impact of consensual surrender of the lease prior to the expiry of the 20 years. That, no doubt, is why the valuer said that the determination should "reflect" a premium rental rather than (as paragraph II of the points of claim says) "include a premium". It is also why the comparison which the valuer makes is with market rent for a "normal" review period and conditions (i.e. for a period of one to five years: see p. 15 of the determination) and not a lease for a term of 20 years with regular rent reviews (as paragraph 11 of the points of claim seems to say). In these respects I am of the view that paragraph 11 of the points of claim does not accurately reflect the determination, and I consider that notwithstanding its admission by the lessor I should proceed by reference to the determination itself.

It follows that as a matter of principle the valuer did not depart from the terms of the contract in arriving at his determination. Whether or not he was right in his appreciation of the need for, or amount of, the "premium rental" which his determination should reflect is another question, but one with which the court is not concerned. If he was not right, he made a mistake in the process of valuation only, to use the language of McHugh JA in *Legal & General Life of Australia Ltd* v *A. Hudson Pty Ltd.* Beach J in *Capel Services Ltd* dealt with the second question which he had identified in like manner:

"I turn then to the second matter which seems to me to be in issue between the parties, namely whether or not the valuer or valuers should have regard to future inflation when making this determination.
In my view this is a matter upon which the court should not express an opinion. I say that for this reason. By clause 4(ii)(a) of the lease the parties have bestowed upon the valuer or valuers the obligation of determining the fair open market value of the rental of the premises. In such circumstances it is not appropriate for this court to delineate the matters which the valuer or valuers should take into account. To do so would be to trespass on the valuer's or valuers' territory."

It is necessary, however, to refer to two decisions cited by the lessee.

In *Lear* v *Blizzard* (1983) 3 All ER 662 an option to renew provided for a term "at a rent to be agreed between the parties hereto or in default of agreement at a rent to be determined by a single arbitrator... " One of the questions which Tudor Evans J was called upon to answer was

"(d) whether, having regard to the fact that a twenty-one year lease without further rent reviews during the currency of the term was provided for by clause 3(2) of the lease, a premium to take into account anticipated inflation during the currency of the term should be built into the new rent and, if so, whether it should be assessed at the level of the premium applicable in 1961 which should then be converted into a premium and applied to the current rental value or whether the percentage should be assessed by reference to the current market conditions at the date of renewal."

His Lordship answered this question by stating that a premium was not to be added to take into account anticipated inflation during the currency of the new term. He recorded the argument of counsel for the lessor that a premium should be applied to take account of the fact that in the new lease for 21 years there was no provision for a rent review, that being necessary to protect the lessor from inflation over the period of the new lease, and the argument of counsel for the lessee that that would in effect be permitting the building in of provision for rent review into a lease to provide a guarantee of future inflation of an amount which, in the nature of events, could only be pure speculation. He referred to *National Westminster Bank Ltd* v *BSC Footwear Ltd* (1980) 42 P & CR 90, where it was held that a power to determine "the then prevailing market rent" did not include a power to direct that it should be periodically reviewed, and said of the lessor.

"They are seeking to introduce the effect of a rent review clause into a lease which makes no such provision. It seems to me that the concluding observations of Templeman LJ about the impossiblity of taking back what the predecessors in title have given away are apposite here. Moveover, I think that there is great force in the contention of counsel for the tenant that the whole process of making a calculation and building in a percentage for the effect of inflation on rents is entirely speculative both as to the continuation of inflation and as to the rates which might prevail from time to time."

The observations of Templeman LJ (with which O'Connor and Lawton LJJ agreed) *National Westminster Bank Ltd* v *BSC Footwear Ltd* to which his Lordship referred were set out by him (at 672) in the following terms:

"In my judgment, the arbitrator has no power to introduce any variations between the original lease and the renewed lease. The arbitrator must determine the rent, and only the rent, and for this purpose he must deter-

mine the prevailing market rent ... The result of that declaration [by the judge at first instance] is to confer on the arbitrator a discretion to decline to determine the rent payable under the renewed lease for 21 years, but only to determine the rent for a period of three or five years, or some other period which he is free to choose, having heard indeterminate evidence; and then he has power to direct that subsequent rent for subsequent parts of the term of 21 years shall be determined by such persons, at such intervals and by such machinery, as the arbitrator may think fit to draft and award. What is said is that if the arbitrator fixes the rent at the beginning of 21 years for the whole period, then the landlord is in danger of not getting the fruits of inflation which he might otherwise get if there were rent review clauses. But what the landlords' predecessors in title gave away these landlords cannot now take back."

What Templeman LJ said was in a different context to the present, and there can be no quarrel with the decision in *National Westminster Bank Ltd v BSC Footwear Ltd.* But it does not follow from a refusal to give "the fruits of inflation" by provision for rent review that it is impermissible to reflect in the assessment of the prevailing market rent the then perception of the market as to possible inflation and its effect on rents. The former would provide a more or less accurate means of keeping up with inflation (depending on the formula adopted); the latter might or might not achieve the same end result, dependent as it would be upon the correctness of the perception of the market. I do not read the judgment of Templeman LJ as excluding whatever allowance be proper in the assessment of the prevailing market rental for anticipated inflation, and his Lordship (at 95-6) described the task of the arbitrator as "to reconsider the figure '£1250' in the original lease and to insert the figure which he thinks proper, having regard to market rents".

When in *Lear v Blizzard*, Tudor Evans J found assistance in the observations of Templeman LJ, it seems to me, with respect, that he failed to take account of the matter I have set out in the preceding paragraph. It may be that his Lordship was distracted by the way the argument for the lessor was put, in terms of a premium or percentage uplift over "market value" (671); that way of putting the argument starts with a market value and adds a premium, when in the view that I take the correct position is that the market value may itself reflect a premium.

The other consideration affecting his Lordship, being the speculative proccess of "making a calculation and building in a percentage for the effects of inflation on rents", I refer to below in dealing specifically with the lessee's arguments. Having carefully reconsidered my own view I am respectfully unable to agree with his Lordship's decision on this point.

I note that in *Capel Services Ltd v Legal & General Assurance Society Ltd* Beach J refers at length to *Lear v Blizzard* without express comment thereon. While his Honour observed that the assessment of inflationary trends in the future could be nothing more than speculation and that "there is no reason for thinking it is [a task] within the capacity of the real estate valuers", as appears from the passages which I have earlier set out, he declined to trespass on the valuer's territory by saying whether or not he should have regard to future inflation in making his determination. I find in this tacit disagreement with the decision in *Lear v Blizzard.*

Page 286

I return then to the lessee's submissions. I have already set out my view of the effect of the direction to assess the annual market rental value of the premises as at 1 September 1986. I refer to the arguments by the same lettered paragraphs by which I earlier identified them.

(a) I do not think that reflecting a premium alters the bargain of the parties, as for the reasons given in considering *National Westminster Bank Ltd v BSC Footwear Ltd* and *Lear v Blizzard* it does not amount to rewriting the lease to provide for rent reviews but does no more than give effect to the existing agreement of the parties upon annual market rental value.

(b) I am unable to accept that the function of a rent review clause is necessarily limited in the manner submitted by the lessee. Its function depends primarily upon its terms, but I see no reason why it should not enable regard to be had to anticipated future inflation, to the extent that that is part of fixing a market rent. To say that the present parties deliberately chose not to provide for anticipated future inflation begs the question. I see nothing in the agreement for lease which I admitted subject to objection which assists (or hinders) the lessee's submission.

(c) In support of the submission that the prediction of inflation was speculative the lessee referred to *Todorovic v Waller* (1981) 151 CLR 502. The same point was made in *Lear v Blizzard* and in *Capel Services Ltd v Legal & General Assurance Ltd.* However, the parties entrusted to the valuer the determination of the annual market rental value, including whatever prediction of inflation (or, more correctly, assessment of the market's perception of the effect on rents of future inflation) might be involved therein. Whatever difficulty there may be in that task does not mean that it was not open to the valuer to undertake it.

For the foregoing reasons I do not think that the valuer departed from the terms of the contract embodied in the lease in arriving at his determination. The summons should be dismissed with costs.