IN THE COURT OF APPEAL OF NEW ZEALAND

CA142/04

	BETWEEN	AVONDALE HOTEL NO.1 LIMITED First Appellant
	AND	PENINSULA MOTOR HOTEL LIMITED Second Appellant
	AND	PORTAGE LICENSING TRUST Respondent

Hearing: 10 August 2005

Court: Glazebrook, William Young and O'Regan JJ

Counsel: G J Kohler for First and Second Appellant
D R Bigio for Respondent

Judgment: 2 November 2005

JUDGMENT OF THE COURT

A The appeal is allowed.

B The declarations made in the High Court are amended by deleting the sentence "Avondale is liable for the replacement of CFFPME except for those that Portage has to replace under 4.2(a)".

C The appellant is awarded costs of $6,000 plus usual disbursements.

REASONS

(Given by O'Regan J)

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[1] This is an appeal against a decision of Venning J contained in an interim judgment dated 17 November 2003 and a subsequent judgment dated 12 February 2004. Initially the appeal encompassed the three key findings made by Venning J, but at the hearing of the appeal counsel for the appellants narrowed the scope of the appeal to one issue, and, in the light of that concession, a cross-appeal by the respondent was abandoned.

[2] The issue which we are required to determine is whether the first appellant, Avondale, has an obligation in its capacity as lessor of the Peninsula Hotel, Avondale (the hotel) to replace chattels, fixtures, fittings, plants, machinery and equipment (referred to by the parties as CFFPME: we will use the same abbreviation) for the hotel which it leases to the respondent (Portage). Avondale no longer contends that Portage is obliged to attend to the replacement of CFFPME. Rather, it contends that neither party has a legal obligation to do so.

[3] The leasing arrangements between Avondale and Portage are complex and somewhat convoluted, and it is necessary to traverse the factual background in some detail before turning to the legal issues involved.

Background

[4] Counsel were agreed that Venning J had accurately summarised the facts and the key documents in his judgment. Accordingly the summary of facts which follows is closely based on that which appears in the judgment under appeal.

[5] Portage is a licensing trust. It has statutory monopoly powers in respect of both on and off licences for the sale of liquor in an area of west Auckland which includes the Avondale area. Portage owned the hotel. The hotel was an underperforming asset. In 1991 Portage decided to sell the hotel.

[6] Avondale, a company operated by Mr and Mrs Crawford, agreed to buy the hotel. However, because of Portage's statutory monopoly for the sale of liquor in the area, the liquor licences still had to be held by Portage.

[7] In an attempt to overcome that difficulty, the parties made a series of agreements in September 1991. Portage sold the hotel to Avondale. Avondale and Portage entered into a deed of lease (the Lease) under which Portage took a lease back of the hotel from Avondale on special terms. Rental was nominal. In addition Portage entered a management agreement (the PMH Agreement) with the second appellant, Peninsula Motor Hotel Limited (PMH), another company owned and operated by the Crawfords under which Portage appointed PMH to manage the hotel on its behalf. Under the PMH Agreement, PMH effectively assumed Portage's responsibilities under the lease. The commercial effect of the arrangement was that the Crawfords, through PMH, retained the profits from running the hotel and accepted the lessee's obligation under the Lease to reinstate, refurbish and redecorate the hotel. There was a degree of circularity in the arrangements because one Crawford company, Avondale, was owner and lessor of the hotel, while another Crawford company, PMH, was responsible for the performance of the lessee's obligations. Portage had no real practical role at all, though its involvement was crucial from a liquor licensing point of view.

[8] However, shortly after the arrangement was put in place, Mr Crawford suffered ill-health and became unable to attend to the day to day management of the

hotel. A number of sub-management agreements were entered with third parties. The third parties assumed PMH's obligations under the PMH Agreement and retained a large portion of the profits of the business in return. The circularity was therefore no longer a feature of the arrangements. A Mr Fairbairn became involved as a submanager through his company, Avondale Peninsula Hotel Limited (APHL).

[9] The Liquor Licensing Authority (the Authority) expressed concern at the arrangements when the licences came up for renewal in June 1994. The Authority was concerned the effect of the various arrangements was that Portage had contracted out its statutory monopoly right to sell liquor. The parties' problems with the Authority continued during 1995, 1996 and 1997. A number of Authority decisions were taken on review/appeal to the High Court. Avondale and Portage also had some difficulties with Mr Fairbairn and APHL.

[10] In order to resolve the difficulties with Mr Fairbairn, and in an effort to address the Authority's concerns, the parties made new contractual arrangements in September 1997. On 18 September 1997 Avondale, Portage, PMH and APHL entered a Heads of Agreement pursuant to which they agreed to a variation of the Lease between Avondale and Portage and the appointment by Portage of APHL as manager of the hotel pursuant to a management agreement (the APHL Agreement). Drafts of these documents were attached to the Heads of Agreement. The parties also agreed that they would enter a Deed of Novation whereby the obligations of Portage under the Lease to reinstate, refurbish and redecorate the hotel were to be novated to APHL. At the time the Heads of Agreement was entered into, yet another application for renewal of the liquor licence for the hotel was before the Authority.

[11] Although the new arrangements were presented to the Authority, they were presented at a very late stage. The Authority did not take the new agreements into account. It declined the renewal application on 1 October 1997. The hotel was left without a licence to sell liquor.

[12] Portage reapplied for a liquor licence, this time directly relying on the new arrangements. The parties executed the Variation of Lease on 13 February 1998 and a copy of the APHL Agreement about the same time. The Authority issued an

interim decision on 13 March 1998 in which it indicated it would grant a licence if a number of matters of concern regarding the documentation were addressed. Further correspondence between the solicitors followed. The parties then executed a further and amended copy of the APHL Agreement and a Deed of Novation on 3 April 1998. The Authority granted the liquor licence.

[13] Unfortunately, the difficulties for the hotel continued. Further issues arose between Portage and Mr Fairbairn. Portage became concerned that Mr Fairbairn was not properly accounting for the profits of the hotel. Proceedings were issued. The issues between Portage, APHL and Mr Fairbairn were settled. In accordance with a settlement agreement made on 4 February 1999, Mr Fairbairn vacated the premises and APHL's role as manager ceased. On 9 February 1999, Portage formally communicated advice of that to Avondale.

[14] From that time, Portage has remained in effective possession of the hotel as lessee. It has appointed a salaried manager to undertake the day to day running of the hotel.

[15] Both Avondale and Portage accepted that the physical condition of the hotel is unsatisfactory at present and significant refurbishment and redecoration work was required, but could not agree on the responsibility for payment for such work. Further, Portage had paid for the replacement of certain chattels, fixtures and fittings which it considered should have been paid for by Avondale.

[16] From October 2001 Portage withheld half of the rental paying the balance into its solicitor's trust account.

[17] This led to the present proceedings. In the High Court, Avondale sought a declaration as to Portage's liability for reinstatement, redecoration and refurbishment and judgment for the outstanding rental. Portage counterclaimed for a declaration that there was an implied term in the lease that Avondale would replace CFFPME.

[18] In the High Court, counsel agreed that for the purposes of these proceedings, the reinstatement, refurbishment and redecoration obligations under the Lease were

those obligations contained in cls 4.1 (b), 4.1 (f), 4.2 (b), 4.2 (c), 8.4 (b), 8.4 (c) and 9.3 of the lease and as identified in paragraph 1.1 of the Deed of Novation.

Documentation

[19] There are a number of documents relevant to the issues before the Court. Of those entered into in 1991, the key documents are the Lease and the PMH Agreement, the features of which where:

(a) Lease:

- Portage took a lease of the "premises", which were defined as the hotel and the land it stands on, as well as fixtures, fittings, plant, machinery, equipment, services, utilities and amenities in the hotel owned by Avondale (but not chattels). The permitted use was for a motor hotel, restaurant and conference centre.

- The term was one year with 24 rights of renewal at the option of Avondale as lessor. This was apparently to accommodate the possibility that Portage's statutory monopoly would come to an end.

- The rental was a nominal sum of $3,000 per annum plus GST.

- Portage had an obligation under cl 4.1(a) to replace broken glass and defective electrical fittings, but no other obligation to replace defective or worn out CFFPME.

- Portage assumed responsibility for reinstatement, refurbishment and redecoration obligations.

- The Lease recorded a management agreement was to be made between Portage and PMH.

(b) PMH Agreement:

- Portage appointed PMH as manager of the business of the hotel.

- Specific provisions in the PMH Agreement mirrored Portage's obligations as lessee in relation to certain reinstatement, redecoration and refurbishment provisions in the Lease. In addition, cl 3.7, a catch-all clause, imposed an obligation on PMH to observe and perform all obligations of the lessee under the Lease (save for the payment of rent) "as if it were the lessee ...". Clause 3.7 was stated to be paramount.

- PMH was to retain as a fee, the balance of all money received from the operation of the business after the payment of liquor licence applications, outgoings, creditors, obligations under the PMH Agreement (including lessee's obligations under the Lease) and $6,000 plus GST by way of administration charge payable to Portage.

[20] Under the documentation put in place following Mr Crawford's inability to manage the hotel due to ill health, the sub-managers assumed PMH's obligations under the PMH Agreement (including the obligation to meet Portage's obligations under the Lease) in exchange for a share of the profits. APHL became the sub-manager as a result of various assignments by other sub-managers and therefore became responsible for the discharge of these obligations.

[21] The later documents (completed in 1997-1998) which are particularly relevant are the Heads of Agreement completed on 18 September 1997, the Deed of Variation of Lease made on 13 February 1998, the APHL Agreement of 3 April 1998 and the Deed of Novation completed on the same day. Their key points are summarised in the paragraphs which follow.

Heads of Agreement

[22] The parties to the Heads of Agreement were Avondale, Portage, PMH and APHL. Avondale and Portage agreed to a variation of the Lease. Portage and APHL agreed that APHL would be appointed manager.

[23] The Heads of Agreement contained the following relevant provisions:

> 6.1 Each term of this agreement is essential as is the timely performance of every obligation contemplated by it. Any breach of the terms of this agreement or failure to perform any obligation in a timely fashion will entitle the party or parties not in breach or not required to perform to cancel this agreement.
>
> ...
>
> 7(a) The chattels provided by [Avondale] and their replacements are and remain the property of [Avondale], but the additional measurable non-replacement items (eg the big screen, the music system and the computer system) are the property and belong to APHL.
>
> …
>
> 10. The parties shall enter into a Deed of Novation (in the form agreed by the parties within 14 days or, failing agreement, determined under cl 5.8) whereby the obligations of [Portage] under the Portage Lease regarding its obligations to reinstate and refurbish the Hotel shall be novated to APHL.
>
> 11. On the Lease termination date, APHL shall take a Lease which shall run until 31 March 2010.
>
> 12. The provisions of this agreement as they are set out in cls 1 to 11 hereof shall run until 31 March 2000 or until the termination of the Lease (whichever is the later) ("Lease termination date").

[24] The Heads of Agreement attached draft copies of the proposed Variation of Lease and APHL Agreement. As it transpired, APHL never took a lease of the hotel.

Variation of Lease

[25] The Variation of Lease was executed by Avondale and Portage on 13 February 1998, some months after the Heads of Agreement. It was not exactly the same as the version appended to the Heads of Agreement, the parties having agreed to changes in the meantime. The particularly relevant provisions of it were:

- The rental payable under the Lease was increased from $3,000 plus GST per annum to a weekly sum of $8,653.85 plus GST ($450,000 plus GST per annum) together with a variable weekly amount calculated on turnover.

- The term was changed from one year (with 24 rights of renewal) to a term ending of 31 March 1998, with ten rights of renewal (to a final expiry date of 31 March 2009).

- A provision which defined chattels and CFFPME for the first time. Confusingly, the term "chattels" was said to have the same meaning as CFFPME so the term "chattels" meant CFFPME as well as meaning one component of CFFPME. The recitals defined "Hotel" as including the land, buildings and CFFPME (including chattels) and said that the Hotel as defined was leased to Portage under the Lease. This was not consistent with the Lease, which did not refer to chattels, but was taken by the Judge as indicating chattels were included in the "premises" subject to the Lease.

- A provision recording that the Lease would immediately terminate on the issue of liquor licences permitting the sale of liquor from the premises to the public by any party other than Portage.

- A provision (cl 8) which inserted a new cl 21 into the Lease that suspended the lessee's obligations of reinstatement, redecoration and refurbishment while Portage was lessee:

> For as long as [Portage] is the Lessee under the Lease, the Lessee's obligations of reinstatement, redecoration and refurbishment in the lease shall be suspended to the intent that [Portage] shall have no liability for any reinstatement, redecoration or refurbishment of the premises.

APHL Agreement

[26] The APHL Agreement contained the following provisions:

6. The Principal [Portage] shall:

…

6.4 meet from its own bank account all costs for the Business including but not by way of limitation the costs of all purchases, wages, salaries, repairs, replacements, maintenance, licence obligations in accordance with the Lease ...

7. The Manager (APHL) shall:

…

7.9 be responsible for arranging for the repairs and maintenance of the Hotel and the repairs maintenance and replacement of any CFFPME as necessary.

[27] A recital at the beginning of the document said Portage leased CFFPME contained in and around the hotel from Avondale. The parties acknowledged the CFFPME remained property of Avondale (cl 10). The APHL Agreement provided for Portage to pay APHL an annual management fee of $80,000 plus GST together with a performance related bonus.

The Deed of Novation

[28] The Deed of Novation recited that the parties had agreed:

> on the later of 31 March 2000 or the termination of the [Portage] Lease ("Effective Date"), APHL shall take a lease from [Avondale] which shall run until 31 March 2010 on the terms set out in cl 13 of the Heads of Agreement.

[29] The operative provisions of the Deed of Novation provided:

1. Novation

1.1 With effect on and from the Effective Date APHL shall be liable (as lessee and not as manager) for all Portage's reinstatement, refurbishment and redecoration obligations under the [Portage] Lease being Portage's obligations under the following cls of the [Portage] Lease: cls 4.1(b), 4.1(f), 4.2(b), 4.2(c), 8.4(b), 8.4(c) and 9.3.

1.2 For the avoidance of doubt it is recorded that nothing in this deed requires APHL to be liable for Portage's maintenance and cleaning obligations during the term of the [Portage] Lease under the following clauses of the [Portage] Lease: cls 4.1(a), 4.1(c), 4.1(e), 4.2(a), 5.1, 5.2 and 8.4(a).

…

2. Release of Portage

2.1 With effect on and from the Effective Date, [Avondale] releases Portage from all its reinstatement, refurbishment and redecoration obligations under the [Portage] lease including all its obligations under the above clauses of the [Portage] lease and from all actions, claims or proceedings that [Avondale] may have against Portage under or in respect of the above clauses of the [Portage] Lease. Portage shall not be released from any breach of its obligations prior to the Effective Date.

3. Repairs and Maintenance

3.1 From the date of this deed until the Effective Date Portage agrees with APHL that it will continue to implement for the Premises a repairs and maintenance policy which will ensure that all normal repairs and maintenance are undertaken in a timely fashion and that the historical approach to expenditure on such matters will be maintained as will the current appearance and standard of the Premises.

[30] As the Lease has not terminated, the Effective Date referred to in the Deed of Novation did not occur. The beneficiary of Portage's covenant in cl 3.1 was APHL as the prospective new tenant, not Avondale as lessor.

Background facts

[31] Venning J noted that there was an apparent ambiguity in the documentation, so that relevant background facts within the mutual contemplation of the parties would be relevant to the construction of the bargain made by the parties: *Potter v Potter* [2003] 3 NZLR 145 at [34]. He was fortified in that conclusion by the fact that the cl 14 of the Heads of Agreement provided that the agreements which were to be entered into in accordance with the Heads of Agreement were to be prepared in accordance with the Heads of Agreement and the earlier correspondence between the lawyers acting for Portage, Avondale and APHL which was identified in it. This meant that the negotiations recorded in that correspondence were also relevant.

[32] Accordingly, Venning J identified background facts which were relevant to his task of construing the documents. In summary, these background facts were:

(a) Prior to the completion of the Heads of Agreement there had been stand off between the Crawfords (Avondale), Mr Fairbairn (APHL) and Portage. The parties' solicitors had exchanged a number of letters regarding the relationship;

(b) Under the arrangements in place before the completion of the Heads of Agreement, Portage did not receive the profits from running the hotel business: the manager (which was then APHL) did. As a quid pro quo, the manager (APHL) had the obligation to refurbish and redecorate. The issue of reinstatement had never arisen;

(c) Portage was anxious to ensure it did not reassume the obligation for refurbishment, reinstatement and redecoration. Portage made its position clear in the correspondence leading up to the Heads of Agreement, Management Agreement and Variation of Lease documentation which was incorporated into the Heads of Agreement by cl 14. It was clear from this correspondence that Portage had resisted attempts by the Crawford interests and the Fairburn interests to persuade it to accept responsibility for reinstatement and refurbishment;

(d) The parties expected that, within a relatively short period (two or three years), Portage's statutory monopoly regarding the sale of liquor in the Avondale area would cease;

(e) All parties' interests were threatened by the Authority's reluctance to grant a renewal of licence;

(f) After the Heads of Agreement was made, but before the Deed of Novation was prepared, the Authority issued a decision on 1 October 1997, in which it refused to grant a renewal of the liquor licence. Portage reapplied for a liquor licence, relying on the Heads of Agreement and related documents. In an interim decision of 13 March 1998, the Authority indicated that it would grant liquor

licences if it could be satisfied on six matters of concern. On receipt of that decision Portage solicitors wrote to the solicitors for APHL and Avondale on 16 March 1998, identifying the six matters raised by the Authority. The Deed of Novation that followed was completed against that background.

Settlement Agreement

[33] Although it is not directly relevant, we also note the Settlement Agreement between Portage, APHL and Mr Fairburn dated 4 February 1999. Under this agreement, the APHL Agreement was terminated and APHL's chattels and equipment used in the conduct of the hotel business vested in Portage. These chattels were valued by the parties at $50,000.

High Court judgment

[34] The High Court proceedings encompassed a number of issues which were not the subject of the appeal.

[35] The first issue was whether Portage, as lessee, was liable for the reinstatement, refurbishment and redecoration obligations under the Lease (that is the obligations under the clauses mentioned in cl 1.1 of the Deed of Novation, quoted at [29] above). Venning J found that cl 21 of the Lease (as inserted by cl 8 of the Variation of Lease which is reproduced at [25] above), under which Portage's obligations of reinstatement, redecoration and refurbishment in the Lease were suspended for as long as Portage was lessee, continued to apply. He rejected a number of arguments to the contrary based on the particular provisions of other documents relied upon by Avondale. He also found that Portage was not estopped from relying on cl 21 by a letter it had written to Avondale at the time it took over management responsibility for the hotel from APHL.

[36] Having found that Portage was not liable for reinstatement, refurbishment and redecoration under the Lease, Venning J was then required to consider whether

Avondale was liable or neither party was liable. Venning J found there was no provision in the Lease which imposed such liability on Avondale, and no basis to imply such a term. He also rejected an argument that a failure by Avondale to refurbish and redecorate the hotel could amount to a derogation from the grant of the Lease. Effectively, therefore, neither party has an obligation to comply with the provisions in the Lease relating to reinstatement, refurbishment and redecoration.

[37] Venning J then addressed the question which is the principal issue before this Court, that is whether Avondale was liable to replace CFFPME as and when they require replacement as a result of reasonable wear and tear through their reasonable use by Portage as lessee. Each party claimed that the other was responsible.

[38] Venning J accepted that there was no basis for implication of a term requiring Avondale to replace CFFPME. He said that if Avondale had such an obligation, this was because of the existing provisions of the Lease rather than because of an implied term. He noted that cl 4.2(a) was the only provision of the Lease which dealt with the lessee's obligation to replace CFFPME, but that clause dealt only with glass breakages and breakages and defects to lights, power points and other electrical items. He noted that cl 6.4 of the PMH Agreement required Portage to meet the costs of among other things, repairs, replacements, maintenance in accordance with the Lease. But he said this could not have extended the obligations of Portage under the Lease, which were limited to the cl 4.2(a) obligation.

[39] Venning J concluded that if any CFFPME other than that referred to in cl 4.2(a) required replacement, then the obligation to do so fell on Avondale as owner and lessor rather than Portage as lessee. He said this was supported by the practical commercial position for two reasons. The first was that the chattels, fixtures and fittings were the property of Avondale, so Avondale was entitled to depreciate them. The second was that, when the rental was fixed, the rental included an allowance for the value of the chattels, fixtures and fittings employed in the business.

[40] Finally, Venning J considered the issue of set-off. He determined that a lessee was entitled to set-off rental due under a lease against a claim which the lessee

had against the lessor, unless that was expressly excluded by the terms of the lease: *Grant v NZMC Limited* [1989] 1 NZLR 8. He noted that the Lease in its original form did exclude the right of set-off but that the relevant clause had been amended by the Variation of Lease which did not have such an exclusion. Accordingly he found that Portage was entitled to set-off against rental the cost of replacements of CFFPME for which it had paid.

Obligation to replace CFFPME

[41] It is clear that the argument in the High Court proceeded on the basis that either Portage or Avondale was responsible for replacement of CFFPME (other than broken glass and electrical items which were covered by cl 4.2(a)). But in this Court Avondale did not suggest that the obligation fell on Portage. Rather, it suggested that the Lease and other relevant documentation simply did not provide for either party to undertake this obligation and that it therefore fell into a "black hole". The "black hole" contention gave rise to a further issue, which had not been dealt with in submissions. That was, if there was a "black hole", who owned replacement CFFPME which was paid for by Portage? Counsel were agreed that it was necessary for us to deal with that issue if we were to uphold the appeal and determine that Avondale was not required to replace CFFPME. We therefore gave counsel time to file supplementary submissions on that issue, and we deal with it later in this judgment.

Avondale's arguments

[42] Counsel for Avondale, Mr Kohler put forward seven points which he said demonstrated that the High Court Judge was wrong to find that Avondale was obliged to replace CFFPME, other than that for which Portage was responsible under cl 4.2(a). We will deal with each of them in turn.

1. Inconsistency

[43] Mr Kohler said that the Judge's finding in relation to replacement of CFFPME was inconsistent with his finding in relation to reinstatement, redecoration and refurbishment (noted at [35] above). He said the Judge had found that the obligations of the lessee to reinstate refurbish and redecorate were suspended for so long as Portage was the lessee, but also rejected the claim that Avondale was obliged to redecorate and refurbish the premises. Mr Kohler said that premises was defined in a way which included CFFPME. He said if neither party had an obligation to reinstate, redecorate and refurbish the premises (including CFFPME), then it could not be said that Avondale had an obligation to replace CFFPME.

[44] We do not accept that submission. The issue before us is replacement of CFFPME, which is clearly distinguished in the documentation from reinstatement, redecoration and refurbishment. As noted at [18] above, the parties agreed that the reinstatement, refurbishment and redecoration obligations were those contained in specific clauses in the Lease. The Judge's determination of responsibility for those obligations deals with a different issue from the replacement obligation. In those circumstances consistency is not required.

2. Implied term

[45] Mr Kohler said that the Judge had defined the issue in relation to replacement as "is there an implied term in the lease that Avondale will replace chattels, fixtures and fittings?" He said the Judge correctly concluded that there was no proper basis for the implication of a term and had said that if Avondale had an obligation to replace the CFFPME then this arose under the existing provisions of the Lease. But he said the Judge had not identified which provision of the Lease imposed this obligation on Avondale. He said this meant that the Judge had effectively ruled out the implication of a term and then done precisely that.

[46] Counsel for Portage, Mr Bigio said that the Judge's conclusion did not rely on the implication of a term in the sense described in *BP Refinery (Westernport) Pty*

Ltd v Shire of Hastings (1977) 16 ALR 363 at 376. Rather, he said the Judge's approach was consistent with that of this Court in *Vickery v Waitaki International Limited* [1992] 2 NZLR 58. He said in the present case the lessor's obligation to replace CFFPME could be deduced by implication or interpretation from the express terms of the Lease.

[47] Mr Bigio relied on two express terms. They were:

(a) Clause 4.2(a), which imposed an obligation on the lessee to make good any glass breakages and breakages, defects or damage to electrical items. This obligation extended to replacement of items which were damaged beyond repair or worn out. He asked the rhetorical question, why would this clause be needed if the obligation to replace all CFFPME fell on the lessee? But answering that question only leads to a conclusion that the lessee is not obliged to replace CFFPME other than other cl 4.2(a). It begs the question as to whether there is any contractual implication on the lessor to do so.

(b) The broad definition of "premises" in cl 1.1 of the Lease, which the Judge found, and counsel agreed, included CFFPME. He said this meant that Avondale as lessor was leasing not only the hotel premises but also the CFFPME to Portage, and if it did not replace CFFPME as it wore out, it would not be providing for lease what it agreed to provide under the terms of the Lease. Thus he said it could be implied that there must be an obligation on the part of the lessor to replace CFFPME as it wore out.

[48] We see the contention that the express terms of the lease are such that a necessary implication is the imposition on the lessor of an obligation to replace CFFPME as the key issue, and we will discuss it in further detail later.

3. Inconsistency with earlier passages

[49] Mr Kohler said that the Judge's finding was inconsistent with [75] and [76] of his judgment. In [75], the Judge noted cl 7.6 of the Lease, which provides that the lessor gives no warranty or representation that the premises are, or will remain, suitable or adequate for use by the lessee. The Judge concluded in [76] that, in the light of that provision and the general rule that a landlord is not obliged to repair much less refurbish and redecorate, the lessor has no obligations in relation to refurbishment and redecoration. He said that the Judge's conclusion in relation to replacement of CFFPME was inconsistent with that finding.

[50] We reject that contention, on the same basis as we rejected Mr Kohler's first contention. Refurbish and redecoration are quite distinct from replacement, and the Judge's conclusion on the former does not need to be consistent with his conclusion on the latter.

4. Inconsistency with contractual documentation

[51] Mr Kohler said the Judge's conclusion was inconsistent with the Lease and with specific provisions in the PMH Agreement, the sub-management agreement with APHL and the Heads of Agreement.

[52] The essence of Mr Kohler's argument was that, when the Lease and PMH Agreement were first entered into, it was clear that Avondale did not have an obligation to replace CFFPME. Rather, that obligation fell on the Crawfords' other company, PMH, which covenanted with Portage in cl 5.4. of the PMH Agreement that it would:

> Keep, maintain and repair the exterior and interior of the Hotel including replacing all worn out fixtures, fittings, floor coverings, doors, sink wastes, lavatories, drains, water and electrical taps, outlet fittings, switches, plugs, light bulbs and points in at least the same condition as they are at the commencement of this agreement…

[53] Mr Kohler asked rhetorically why PMH's manager needed to undertake that obligation to Portage, if Avondale was already under an obligation to do so in its capacity as lessor.

[54] When PMH appointed a sub-manager, it included a back-to-back provision in the sub-management agreement requiring the sub-manager to undertake the obligation under cl 5.4. By virtue of various assignments that obligation eventually fell on APHL. After the 1998 restructuring of the contractual arrangements, the APHL Agreement included a provision which required that APHL "be responsible for arranging for the repairs and maintenance of the Hotel and the repairs maintenance and replacement of any CFFPME as necessary". A later clause prohibited APHL from incurring expenditure of a capital nature without Portage's approval, but then said that "expenditure of a capital nature did not include replacement and repair of CFFPME required to the operation of the business". Mr Kohler said that this indicated that APHL was expected to replace CFFPME and would be using money which was otherwise payable to Portage for that purpose. He said that it could be deduced from this that it was Portage's obligation to replace CFFPME.

[55] We do not find any of these arguments convincing. All they show is that, as between Portage and its manager APHL, the responsibility for replacement of a number of specified types of CFFPME fell on APHL. But Avondale was not a party to these documents, and they do not establish that Portage accepted an obligation vis-à-vis Avondale that it would pay for the replacement of CFFPME. In our view the terms of the APHL Agreements do not assist with the interpretation of the Lease. They can be construed consistently with the position taken by Avondale, but equally they can be construed consistently with the position taken by Portage.

[56] Mr Kohler also relied on cl 6.4 of the APHL Agreement, which said that Portage would meet from its own bank account all costs of the hotel business including, among others, "repairs, replacements, maintenance" in accordance with the Lease. But we agree with the High Court Judge, and with Mr Bigio's submission to the effect that this can provide no assistance in interpreting the Lease, because it requires Portage to do no more than the Lease requires it to do. If Portage's

obligations under the Lease are limited to replacing broken glass and broken or worn out electrical items, then cl 6.4 simply requires it to make payments for that purpose.

5. Parties' expenditure

[57] Mr Kohler said that Portage had replaced CFFPME and paid for it, and that this indicated it had an obligation to do so. We reject that submission: Portage has consistently claimed that it was entitled to reimbursement of sums spent on the replacement of CFFPME and claimed that Avondale had an obligation to reimburse it. Its conduct is not inconsistent with the stance it takes in this appeal.

6. Practical commercial position

[58] As noted at [39] above, Venning J said that the interpretation imposing an obligation on Avondale to replace CFFPME was supported by the practical commercial position. He said this was so because the chattels, fixtures and fittings were the property of Avondale and Avondale was entitled to depreciate them, and because the calculation of rental had included an allowance for the value of chattels, fixtures and fittings employed in the business.

[59] Mr Kohler said that the Judge had been wrong in reaching that conclusion. He said there was no accounting evidence as to what had or could have happened in the parties' books of account, and no evidence relating to depreciation. And he said that the expert determination of rental which had made an allowance for CFFPME had not been acted upon because the parties had agreed to a global rental figure with a CPI adjustment which did not explicitly include an allowance for chattels.

[60] We do not think that Venning J gave great weight to these factors and nor would we. We do not have before us evidence as to whether Avondale could or did depreciate CFFPME, and, if so, on what basis. Venning J appeared to assume that Avondale would own replacement CFFPME, as, indeed, it would if it paid for it as Venning J said it was obliged to do. But in our view the argument becomes circular, and does not assist with the construction of the Lease. Similarly, the allowance for

rent is not a significant factor. As a matter of logic, the calculation of rental must have made an allowance for CFFPME owned by Avondale which was leased to Portage, whether this was explicitly identified by the parties or not. But it does not necessarily follow from that that Avondale is obliged to replace CFFPME as it wears out. That is one possible construction, and it would be a logical outcome if the Lease provided for that to occur. But, when the Lease is silent on the issue, it cannot be a determining factor.

7. What would have been said/provided for

[61] Mr Kohler said that if such an unusual, important and fundamental obligation had been intended, the Lease would have said so clearly and there would have been further machinery provisions to cater for its observance. Mr Bigio accepted that the documentation was not a model of clarity, but said that the exigencies under which many of the documents had been drafted (against the background of difficulties with the Authority) meant that matters had not been as carefully articulated as might have been the case. But he said that this did not affect the argument that it was a proper implication from the express terms of the Lease that the lessor would replace CFFPME which became worn out.

[62] We do not see this point as significant: it is one of many matters which may need to be considered in determining whether a term should be implied, but it is by no means decisive.

Overall evaluation

[63] The lack of clarity in documentation makes it extremely difficult to identify exactly what the intention of the parties was in relation to the replacement obligation. The Lease seems to have been drafted on the assumption that there would be a change in the licensing laws within a short period of time, so that it would be a short term arrangement only. But even making allowance for that, the fact that the Lease originally had 24 rights of renewal, and now can be renewed out to 31 March 2009

should have caused the parties to address what would happen if items of CFFPME needed to be replaced. The Lease simply fails to address the issue.

[64] There appear to be three possible outcomes, namely:

(a) Avondale is required to replace CFFPME: it bears the cost, but receives rent which, at least notionally, provides a return on the replacement CFFPME which it supplies;

(b) Portage is required to replace CFFPME and pay for it, and when it does so the CFFPME becomes part of the "premises" and therefore owned by Avondale. This places Portage in the position of having to meet the capital cost of replacements CFFPME and pay rental which reflects the value of the CFFPME which it has purchased;

(c) Neither party is required to replace CFFPME: there is what Mr Kohler called a "black hole".

[65] If there is a black hole, the practical outcome would appear to be that Portage would have to replace CFFPME and pay for it, to ensure its hotel business can continue to carry on. That would then give rise to another issue: which party would own the replacement CFFPME?

[66] The first two possibilities set out above impose obligations on either Avondale ((a) above) or Portage ((b) above) which are not expressly provided for in the Lease. So it would be necessary to imply a term in the Lease in order to provide for either of those possibilities. The High Court Judge found that Portage's only obligation under the Lease to replace CFFPME was that expressed in cl 4.2(a), relating to glass and electrical fittings. Mr Kohler did not contest that finding, which limits the available options to (a) and (c) above.

[67] We agree that the High Court Judge was right to say that, on a proper construction of the document Portage's obligation to replace CFFPME is limited to the obligations set out in cl 4.2(a). But it does not necessarily lead to the conclusion

that it is implicit that Avondale is required to replace CFFPME because the possibility that neither party has that obligation remains open. We also note that the obligation to repair is subject to a fair wear and tear exception which means that it could not be said that Portage as tenant has an obligation to replace CFFPME, but it is clear from *Keasey v Thompson* [1947] NZLR 392 and *Collins v Winter* [1924] NZLR 449 that the mere fact that fair wear and tear is excepted from the tenant's covenant to repair did not impose an obligation on the landlord to make good damage caused by fair wear and tear. By analogy, that supports the argument that Avondale does not necessarily have an obligation to replace CFFPME in the present case.

[68] Venning J rejected the proposition that a term requiring Avondale to replace CFFPME could be implied on the basis outlined in the *BP (Westernport)* case, and neither party took issue with that conclusion in this Court. We agree with the High Court Judge that the five-point test set out in *BP (Westernport)* at 376 is not met on the facts of this case.

[69] That means that if a term is to be implied into the lease, it would need to be on the basis that it was implicit in the terms of the Lease that Avondale was obliged to replace CFFPME. The test for imposing an obligation on the basis that it is implicit in the agreement is that set out in the decision of this Court in *Vickery v Waitaki International Limited.* In that case Cooke P referred to the implicit obligation as being "taken for granted" (at 64) while Richardson J referred to the implicit obligation as being "a matter of the true construction of the express terms of the contract" (at 65). Gault J said that the unexpressed obligation was "implicit in the language of the contract" (at 67).

[70] If the parties had addressed their minds to this issue when the Lease was being negotiated (or when it was renegotiated in 1997-98), they would have made provision for the replacement of CFFPME as that became necessary, as must inevitably happen when a lease continues for a period that is longer than the expected life of many types of chattel. There is logic in the contention that, where CFFPME comprises part of what is being leased by a landlord, the landlord should bear the cost. But we do not think that it can be said that an obligation on Avondale

to replace CFFPME, no matter how logical that might be, can properly be said to be implicit in the express terms of the Lease, applying the test in *Vickery*. The fact that a proposition makes commercial sense does not, of itself, lead to the conclusion that a requirement to bring about that commercial outcome must be implicit in what the parties agreed. That is especially so when the parties have recorded their commercial agreements in considerable detail and revisited and renegotiated them more than once.

[71] That leads to the conclusion that neither party to the Lease has an obligation to replace CFFPME, i.e. the "black hole" option. Unsatisfactory though that outcome may be from the point of view of Portage, we believe that the circumstances are such that the parties must be held to the detailed (but deficient) terms to which they agreed when the Lease was signed, and which they did not change when the Lease was varied in 1997-1998.

[72] The practical outcome of that finding is that Portage will need to replace essential CFFPME in order to allow it to continue to run the hotel business. Given that the rental payable by Portage must reflect the value of the CFFPME originally owned by Avondale, that is an unattractive outcome from its point of view.

Ownership of CFFPME replacements

[73] That leads us to consider the issue which then arises, namely who owns items of CFFPME which are replaced by, and paid for by, Portage. We received submissions from both parties on this issue after the hearing.

[74] On behalf of Portage, Mr Bigio put forward another argument supporting the contention that Avondale was obliged to replace CFFPME. He argued that the Court should draw an analogy with cl 15 of the Lease, which requires the landlord to reinstate premises if they are destroyed, for example by fire. He also drew our attention to cl 15.1(c) which provides for an abatement of rental while premises are wholly or partially destroyed, during the period that repairing and reinstatement takes place.

[75] Clause 15 deals with a specific situation and, in our view, there is no basis to apply it to an individual item of CFFPME or to CFFPME generally. We do not think the analogy suggested by Mr Bigio is helpful.

[76] Mr Bigio sought when he filed his supplementary submission to amend the grounds of cross-appeal to include a ground which said that if neither party was responsible for the replacement of CFFPME and Portage elected to replace any items CFFPME, then there should be an abatement of rent as the level of CFFPME provided by Avondale diminishes. Mr Kohler strongly objected to this extra ground of appeal being admitted, noting that leave would be required under the Court of Appeal (Civil) Rules 2005, but had not been sought. He said any such application for leave would be opposed. We do not think there is any proper basis to allow for the addition of extra grounds of cross-appeal after the hearing of the appeal and cross-appeal has concluded, in a context where submissions were sought by the Court on one specific issue only. In any event, we see no proper basis on which an abatement of rental provision could be implied into the Lease either on the basis set out in *BP (Westernport)* or on the basis set out in *Vickery*.

[77] On the question of ownership, Mr Bigio referred us to the decision of the High Court in *Short v Kirkpatrick* [1982] 2 NZLR 358 for the proposition that chattels brought onto the land by a tenant remain the property of the tenant. If they are affixed to the land and become fixtures, they may be tenant's fixtures depending on the terms of the relevant lease. In the present case cl 8.4(a) provides that partitions, fixtures, fittings and furnishings placed or installed in the premises by the lessee (Portage) are to be the property of the lessee and the lessee is then responsible for their maintenance and insurance. So there is no real issue about ownership of items of CFFPME replaced by Portage which come within the categories in cl 8.4(a). Clause 8.4(b) allows the Lessee to remove items covered by cl 8.4(a) at the end of the Lease, subject to an obligation to make good damage caused by the removal.

[78] The obligation to make good damage caused by the removal of tenant's fixtures, fittings and furniture has been suspended, so will not apply to Portage. That leads to the rather unsatisfactory position that, at the end of the Lease, Portage will be entitled to remove fixtures, fittings and furniture which it has supplied in

replacement of the CFFPME originally provided by Avondale, without any obligation to make good any damage caused. It will also mean that the premises received back by Avondale may not be capable of being operated as a hotel if essential fixtures, fittings and furniture owned by Portage have been removed. That is obviously not a satisfactory outcome for either party, but it is, of course, one which they can resolve sensibly by negotiation if they are minded to do so. Of course, the reality is that unless there is a change in the licensing laws applying in the Avondale area, Portage will be Avondale's only possible tenant for the hotel anyway.

[79] We now turn to the ownership of chattels which do not fall within cl 8.4(a): i.e are not furnishings, and do not become fixtures or fittings. Mr Kohler relied on cl 7(a) of the Heads of Agreement (quoted at [23] above) which refers to chattels provided by Avondale and their replacements remaining the property of Avondale but non-replacement items being the property of APHL. That argument is, of course, a two edged sword because it supports Portage's argument that Avondale is responsible for replacing the chattels it provided initially. In any event, cl 7(a) dealt with the position which was to apply between Avondale and APHL, on the assumption that Portage had no ongoing interest. We do not think it is determinative of the position now applying between Avondale and Portage. If it had been intended to provide that the lessee under the Lease was obliged to replace chattels but effectively gift them to Avondale as landlord, it is likely that an arrangement with such an unusual outcome would have been expressed in clear terms.

[80] In our view the corollary of the finding that neither side has an obligation to replace CFFPME is that when chattels originally provided by Avondale wear out and are discarded, Portage has the choice of continuing to operate the hotel without them (if that is feasible) or buying a replacement chattel itself which, having been purchased voluntarily by Portage (i.e. not because Portage had any contractual obligation to do so), would in the normal course of events belong to Portage. In the absence of any provision in the Lease requiring a different outcome, we think that this is the position which now obtains between Avondale and Portage.

[81] We do not think there is any cause for Avondale to complain about that outcome. Indeed, Avondale is in the fortunate position that the rental payments continue to be payable by Portage notwithstanding a diminution in the content and value of the "premises" being demised pursuant to the Lease by Avondale.

Set-off

[82] Our conclusion on the essential issue in the appeal means that we do not need to decide the set-off point. However it appears clear to us that the High Court Judge was right in his decision given the absence of any provision in the payments clause in the Lease (as varied) limiting the normal right of contractual set-off. In our view the decision of this Court in *Grant v NZMC Limited* clearly applies.

Fair wear and tear

[83] Mr Kohler said that he had not completely abandoned the ground of appeal relating to the obligation to reinstate, redecorate and refurbish. He asked us to determine that the finding that Portage has no obligation to reinstate, redecorate and refurbish does not mean that it can allow the premises to deteriorate through fair wear and tear to an extent that they are no longer in "good and tenantable repair". Mr Bigio objected to this, on the basis that the withdrawal of the point of appeal (which led to the cross-appeal being withdrawn by Portage) left the Court with no jurisdiction to consider this point. We accept Mr Bigio's submission: the Court cannot be asked to give an opinion on the meaning of a High Court ruling in circumstances where there is no appeal before the Court against that High Court ruling.

Result

[84] We allow Avondale's appeal and amend the declaration made by Venning J at [102] (2) of his judgment by deleting the sentence: "Avondale is liable for the replacement of CFFPME except for those that Portage has to replace under 4.2(a)".

Costs

[85] Avondale has succeeded on the point of appeal which it pursued in this Court and is therefore entitled to costs, which we fix at $6,000, plus usual disbursements.

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