IN THE HIGH COURT OF THE COOK ISLANDS
HELD AT RAROTONGA
(LAND DIVISION)

APPLICATION NO: 264/12

IN THE MATTER	of Section 409B of the Cook Islands Act 1915 (as inserted by Section 2 of the Cook Islands Amendment Act 1978-79)
AND IN THE MATTER	of the land known as **CEMETERY RESERVE 206A1, AVARUA**
AND IN THE MATTER	of an application to Determine Market Rental by
BETWEEN	**REI TUAINEKORE JACK ENOKA** **Applicant**
AND	**AQUARIUS PACIFIC HOTELS (RAROTONGA) LTD** as Sub-Lessee **Respondent**

Hearing date: 4 and 5 October 2012
(Heard at Rarotonga)

Appearances: Mr T Moore for the Applicant
Mr Short for the Respondent

Decision: 23 January 2019

JUDGMENT OF JUSTICE P J SAVAGE

Introduction

[1] This is an application made pursuant to s 409B of the Cook Islands Act 1915 to determine market rental of the land known as Cemetery Reserve 206A1, Avarua ("the Land"). The Land is currently occupied by Aquarius Pacific Hotels (Rarotonga) Limited ("Aquarius") under a Deed of Sublease dated 1 May 2005.

Background

[2] The landowners leased the area of 3,300m^2 to the applicant, Rei Tuainekore Jack Enoka by deed of lease dated 30 March 2005. The applicant then subleased his interest in the Land to Aquarius under the Deed of Sublease ("the Deed") dated 1 May 2005.

[3] The Deed of Sublease is for 20 years, with two ten-year terms. The Deed sets out a rent review formula whereby Aquarius is required to pay an agreed "base rental" figure for each year, or 2.5% of gross income, whichever is greater. The "base rental" figures are set out in the Deed for each of the first five years. Rent is to be reviewed every five years.

[4] Rent reviews are to be settled by agreement between the sublessor and sublessee in the first instance. Failing agreement, rental is to be fixed by the High Court "based upon then current market rentals for comparable unimproved land of a similar value to the Land in its unimproved condition and upon the terms and conditions and provisions of this Deed but not to be less than the Rental payable for the preceding five years".

[5] The rent review due on 1 May 2010 remains outstanding and is the subject of this application.

Submissions for the Applicant

[6] Counsel for the applicant submits that the Court has the jurisdiction to fix market rental by any of the following methods:

a) "Based upon then current market rentals for comparable unimproved land of a similar value to the Land in its unimproved condition", as in accordance with the rent clause in the Deed of Lease;

b) "Upon the terms and conditions and provisions of this Deed"; or

c) "Notwithstanding anything in any lease" as per s 409B of the Cook Islands Act 1915.

[7] In terms of 'option a', counsel submits that the Lease and the circumstances surrounding it are so unusual that there are no comparable examples upon which to base rent. Counsel specifically identifies the fact that there was no up-front consideration paid when the Deed was granted, and there was a "special relationship" between the parties upon signing of the Lease.

[8] Counsel contends that leases entered into for commercial purposes in the Cook Islands generally include a form of goodwill or "up-front" payment, particularly when the sublessor is registered as a foreign enterprise with the Business Development Investment Board. In this case, the applicant accepted a 25% shareholding in Aquarius instead of an up-front payment when the Investment Board refused to approve a proposal for 100% foreign ownership of the company. Counsel further submits that, as a consequence of this shareholding, the original rentals were substantially reduced. It is said that this is common practice to charge less than market value where a lessor is also a shareholder in a company leasing the land, as the shareholder lessor also has the potential to collect profits from the use of the land.

[9] The Court discussed the effect of a "special relationship" between a lessor and lessee in *Island Hotels Limited v Landowners,* stating that:[1]

> Where there exists a special relationship between the parties, whether it be through kin, shareholding, partnership or otherwise, the rental payable under leases arranged by parties can hardly be described as "comparable rentals" with those payable under leases entered into in arms-length transactions.

[10] A further factor which is said to make this case unusual is that, at the time the Deed was signed, there was a commercial laundry on the Land which included a number of buildings. There was no up-front payment for these improvements to the Land, which are said to be of a value of $170,000. While the Lease specifies that rent will be determined with reference to the unimproved value of the Land, counsel submits that the Court generally looks to the sum paid in up-front consideration at the time the Deed was signed when determining rent reviews. Where there is little or no up-front payment, the Court will generally apply a greater increase.

[11] In terms of 'option b', counsel submits that the "terms and conditions and provisions" of the Deed of Lease are not an appropriate basis on which to determine rent as the circumstances have significantly changed since signing. In February 2007, the applicant's 25% shareholding was "seized" by the Governing Director of Pacific Hotels Limited. It is said that this ended the "special relationship" between the parties, with the effect that greater rental should have taken affect from that date. Counsel says that the Court may take into consideration the circumstances and intentions of the parties at the time when they negotiated the terms, conditions and provisions of the Deed, as established by Justice Smith in the *Uruau* case.[2]

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[1] *Island Hotels Limited v Landowners* [2001], Application 63/1999.
[2] *Landowners v Cook Islands Investment Corporation* [2007] No. 523/2007.

[12] This leaves 'option c', whereby the Court may use s 409B to determine and fix rental "notwithstanding anything in any lease".[3] Counsel suggests that the starting point for the rent review should be $5,000 per month from 1 May 2010, with a 25% increase. Counsel refers to the case *Landowners v The Cook Islands Government Property Corporation*[4] where the Court held that an increase of 25% "would not be unfair" in a rent review where the initial rent was fair. In the present case, counsel suggests that a 40% increase would be fair and equitable to compensate for the fact that the initial rental rates were below market rental due to the applicant's acceptance of a 25% shareholding in the company.

[13] Counsel also asserts that the Court may take into account the actions and attitudes of the sublessee when fixing rental pursuant to s 409B. Counsel notes that it was the respondent's actions which unilaterally ended the "special relationship" between the parties and caused the applicant to lose his 25% shareholding without compensation. On the other hand, counsel notes that the applicant has provided significant support to the respondent by providing the initial asset base for the respondent's business, without any payment for this.

[14] Furthermore, counsel says that the respondent has failed to engage in attempts made by the applicant to negotiate an agreement on rental, which eventually led the applicant to file this application. This includes an offer made by the applicant, at the time the application was filed, to fix rental at $4,999.50 as at 1 May 2010. The respondent did not reply to this offer.

[15] Counsel also notes that the applicant was forced to issue multiple Notices of Forfeiture in respect of unpaid rent, the first being the largest sum of 8 months of unpaid rent amounting to $29,999.92, and subsequent notices for a further 4 months and 2 months of unpaid rent respectively.

[16] In terms of jurisdiction, counsel submits that there is nothing in s 409B which allows the Court to re-write the Deed in a way that would reduce the rent. Otherwise, it is said that the negotiation of contracts between parties would be rendered meaningless. The Court held in *Landowners v The Cook Islands Government Property Corporation* that, when faced with an initial agreement negotiated between parties as to rent, it should accept the agreement as having been fair at the time the parties negotiated it.[5] Counsel therefore submits that the Court must assume that the rent agreed to by the parties and set out in the Deed was fair, but may use s

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[3] Cook Islands Act 1915, s 409B.
[4] *Landowners v Cook Islands Investment Corporation* [2007] No. 523/2007.
[5] *Landowners v The Cook Islands Government Property Corporation* [2005] Application 392.05.

409B to increase the rent if there are material changes in the relationship between the parties which would justify an increase.

Submissions for the Respondent

[17] Counsel for the respondent contends that this is "a simple application for the review of the annual rent payable by Aquarius as required by the Deed of Sublease". Accordingly, the Court should only look to the evidence, or lack thereof, to support an increase of rent as is sought by the applicant. Rent as at 1 May 2010 must be based on comparable market rental, as set out in the Deed.

[18] Comparison with similar unimproved lands suggests that the rental which the applicant receives from Aquarius is far in excess of other comparable leases, and possibly the highest in the Cook Islands. It was suggested that Aquarius currently pays more than five to six times the rent of the neighbouring properties leased to the Vaile's and Rarotonga Rentals Limited. As evidence for this proposition, counsel produced an affidavit from registered valuer, John McElhinney, which states that the $3,749 per month currently paid by Aquarius is much more than what has been paid for similar leases in the Cook Islands in the past. In further evidence, counsel provided an email from Mr Eggleton of the Frame Group in support of the proposition that the 2.5% gross income formula would produce a "fairer rent" going forward. Mr Eggleton referred to two comparative properties of Rendezvous Villas and Aroa Beachside Inn which pay rent of 2% and 3% of accommodation revenue respectively.

[19] Counsel disputes the applicant's view of the "seizure" of his 25% shareholding in the company. Counsel argues that the respondent gifted the 25% shareholding to the applicant in good faith with an expectation that he would actively support the hotel venture. The applicant would consequently gain significant benefit from the company's success. The respondent decided to remove the applicant's shareholding after he failed, on a number of occasions, to meet his obligations under the Deed. This includes failing to guarantee clean title of the whole area leased to the respondent, which consequently required the respondent to go to Court to resolve a boundary dispute.

[20] Counsel claims that the respondent made multiple attempts between 2007 and 2012 to contact the applicant to resolve these issues, but the applicant failed to respond. The respondent was therefore surprised when served with demands for increased rent and Notices of Forfeiture from the applicant for unpaid rent.

[21] Counsel notes that Aquarius is already struggling financially to meet the current high rent. The original rent was based on "optimistic projections and estimates" of the success of the hotel industry prior to the global recession, but the economic climate has significantly changed following the recession. It was expected that 2.5% of the company's income would soon exceed the original rent figures set out in the Deed but, in reality, the annual turnover is only about half the amount of rent currently charged to Aquarius. Accordingly, counsel submits that the economic projections upon which the "base rental" figures were agreed are no longer sustainable in the current economic climate.

[22] Counsel notes that counsel for the applicant introduced s 409B into these proceedings, thereby inviting the Court to consider it. Counsel submits that, if the Court is of a mind to apply s 409B in these circumstances, it should use the section to reduce the rental paid by Aquarius in light of both the current economic reality and the problems experienced by the respondent as a result of the applicant's failure to meet his obligations as lessor.

[23] It is said that s 409B of the Cook Islands Act 1915 has provided the Court, as a court of equity, with the ability to intervene in the interests of fairness to address what counsel considers an "imbalance" in the high rent currently paid by the respondent for the use of the Land. Counsel argues that the wording of that section, "notwithstanding anything in the lease", allows the Court to set aside any provision in a Deed of Lease when determining rent. Counsel therefore suggests that the Court remove the words "whichever is greater" from the Deed's rent review formula, thereby leaving 2.5% of gross income as the single option for rent review.

[24] Counsel proposed an alternative "prudent lessee test" as discussed in *Wellington City v National Bank of New Zealand Properties Ltd* and *Granadilla Ltd v Berben*, whereby the Court could determine what rental would be fair for the land in question by considering what the hypothetical "prudent lessee" would pay for the premises upon the terms and conditions of the lease, and upon the basis of an open market.[6] Counsel submits that the Court could apply the same approach in this case.

[25] Counsel notes that counsel for the applicant was unable to provide examples of any lease that had comparably high rental to that currently being paid by Aquarius. It is said that the applicant's argument to increase rent has therefore not been justified.

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[6] *Wellington City v National Bank of New Zealand Properties Limited* [1970] NZLR 660; *Granadilla Ltd v Berben* (1999) 4 NZ ConvC 192,963 (CA).

Law

[26] Section 409B of the Cook Islands Act 1915 provides the Court's power to determine and fix current market rental:

> **409B Land Rental Arbitration**
> Notwithstanding anything in any lease, contract or other document conferring rights in any person to land or an interest in land the Land Court may upon application by any interested party and upon sufficient cause being shown, hear, determine and fix the capital value of any land or interest in land or the current market rental of any land or interest in land.

Discussion

[27] It has been well-established that the Court will not lightly interfere with contracts freely negotiated by fully-informed parties. The Court's reluctance has been discussed in a number of cases, including *Lineen* where Justice Grice held that "parties are entitled to have the provisions of the Lease they have negotiated varied only to the minimum extent possible. Therefore only where necessary should the original lease provisions be altered".[7]

[28] I dealt with similar arguments in a 2015 decision relating to *Are Tamanu Villas* in a s 409B application to fix rental under a lease. Counsel had argued that the Court could use s 409B to "overlook or alter" the terms of a lease and apply a valuation method other than that stipulated in the lease. I repeat my conclusion below as it applies equally to the arguments made before me in this case:

> ...I do not accept that [s 409B] contemplates the Court meddling in the commercial transactions that the parties have entered into with their eyes open... As I read the section this confers a jurisdiction on the Court exercisable, notwithstanding any ouster or fetter on the Court which could arise, perhaps per medium of an arbitration clause or possibly where a method of valuation was impossible to achieve or calculate. But in most cases the Court will honour the contract.
>
> The second point to be made is that I do not have any sufficient evidence as would support the suggestion of economic devastation caused by this interpretation of this particular contract. It would take much stronger wording than this to convince me that

[7] *Lineen v MacQuarrie – Vaitamanga Holdings Limited* (2008) CKLC 47, App 3/2008, 26 September 2008 at [47].

> the Court has the jurisdiction in an ordinary run of the mill case such as this, to in effect, amend a lease.

[29] The applicant seeks an order of the Court pursuant to 'option c' referred to in paragraph [6] of this judgment. Such an order would use s 409B to increase the rental paid by Aquarius by taking into account the ending of the "special relationship" between the parties and other factors such as the parties' conduct.

[30] I do not accept that s 409B gives me jurisdiction to re-write the contract and I do not accept that the interplay between the parties as to shareholding is at all relevant to my task to fix current market rental. The exercise to be undertaken is to be objective and other contractual arrangements between the parties cannot alter the market. Neither do I accept that I can use s 409B to reduce the rental, as is sought by the respondent, in the face of a contractual arrangement where the parties have agreed that this should not happen.

[31] I note that neither party provided adequate evidence from which I could fix rent on the basis of comparative market rentals. Counsel for the respondent relied on Mr McElhinney's affidavit to suggest that the $3,749 per month currently paid by Aquarius is far in excess of what has been paid for similar leases in the Cook Islands in the past. Mr Eggleton's email was provided in support of the proposition that the 2.5% gross income formula would produce a "fairer rent" going forward. Mr Eggleton stated that even 2.5% of gross income is "on the higher side of property rentals" and any increase in rent would be untenable for the respondent business.

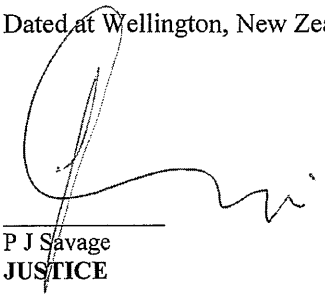
[32] The applicant called no evidence to support his argument for increased rent. The evidence provided by the respondent is the only evidence I have. Mr McElhinney was cross-examined on his affidavit but, I must say, with no effect. The only other information I have is that which was received in evidence from Mr Eggleton. In light of the lack of evidence, there is no basis upon which I could increase the rental.

[33] This is an elderly file which became lost and forgotten. I am not sure what the explanation for this is, but I am somewhat relieved that the result of this case is that no-one has been prejudiced by the delay, for rent has continued to be paid, I believe, at the appropriate rate and over the appropriate period.

Decision

[34] The application is dismissed.

Dated at Wellington, New Zealand this 23rd day of January 2019.



P J Savage
JUSTICE