The enforceability of arbitration clauses involving actions in rem: a critical analysis of the rationale in *Lawson v Gawith*

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Abstract

James Anson-Holland analyses the enforceability of arbitration clauses involving actions in rem. After helpfully setting out the distinctions between actions in rem and action in personam, Mr Anson-Holland delves into a case study of the High Court of New Zealand decision Lawson v Gawith [2017] NZHC 40. Arguing that this decision sets a flawed precedent, Mr Anson-Holland attempts to set the record straight by illustrating why, contrary to that decision, the renewal of a lease is an action in rem, and therefore, is simply not capable of being determined through arbitration.

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I Introduction

Must statutory applications for relief against a lessor's refusal to enter into a renewal of a lease be arbitrated when that lease has a mandatory arbitration clause? While a simple question, there is no clear answer. The High Court of New Zealand has released conflicting decisions in this matter: *Highgate on Broadway v Devine*[2] (***Highgate***) and *Lawson v Gawith*[3] (***Lawson***).

This article endeavours to provide an answer to the question above by critically analysing the rationale in *Lawson* that concluded a court has no jurisdiction to hear a statutory application for relief against cancellation of a lease where the parties to that lease are subject to an arbitration clause. Until the decision in *Lawson*, New Zealand legal practitioners could be confident in advising their clients to apply for relief in the High Court irrespective of the existence of an arbitration clause. This confidence was on the strength of a plain reading of the *Property Law Act 2007* (NZ) (**Property Law Act**) and the earlier decision in *Highgate*.

A significant part of this article is dedicated to considering the critical distinction between *Highgate* and *Lawson* – whether a statutory application for relief against a lessor's refusal to enter into a renewal is an action *in rem* or an action *in personam*. It is, therefore, useful to first provide an overview of actions *in rem* in contrast to actions *in personam* and their inherently fraught relationship with leases.[4] This article

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[2] *Highgate on Broadway v Devine* [2012] NZHC 2590.

[3] *Lawson v Gawith* [2017] NZHC 40.

[4] It must be acknowledged that any discussions involving actions *in rem* and actions *in personam* often leaves more questions than answers. The distinction between the two actions is a vexed issue in an inherently murky area of law. See for example George Fraser Jr "Actions in Rem" (1948) 34 Cornell L Rev 29. This article is confined to the subject matter, being renewal of leases and relief from cancellation.

will then move on to consider whether the renewal of a lease is an action *in personam* (in accordance with *Lawson*) or an action *in rem* (in accordance with *Highgate*). Having concluded that the renewal of a lease is an action *in rem*, this article will then discuss the reasons why actions *in rem* are simply not capable of being determined through arbitration. The above discussions are, of course, premised on an understanding of the facts and rationale of the very decision this article intends to critically analyse. To this end, a summary of *Lawson* is provided at the outset.

II Summary of *Lawson v Gawith*

The Lawsons leased land in Martinborough for the purposes of dairy farming. The lease was for a term of six years with two rights of renewal for six years each. In accordance with their rights under the lease, the Lawsons notified the lessor of their intention to utilise their second right of renewal. The lessor refused to renew. The Lawsons then applied for relief under ss 261–264 of the *Property Law Act*, which provides:[5]

> **261 Relief against lessor's refusal to enter into renewal or sell reversion to lessee**
>
> (a) This section applies to a lease if:
>
> (i) the lessor has covenanted in writing with the lessee that, -
>
> (1) on the expiry of the term of the lease, the lessor will extend the term of the lease, renew the lease, or enter into a new lease of all or part of the premises to the lessee; or
>
> (2) on the expiry of the term of the lease, or at some earlier time, the lessor will transfer or assign to the lessee all or part of the reversion expectant on the lease; and
>
> (ii) the obligation of the lessor referred to in paragraph (a) is conditional on –
>
> (1) the fulfilment of any condition or the performance of any covenant or agreement of the lessee; or
>
> (2) the lessee giving notice, within a specified time or in a specified manner, of the intention to exercise the right to require an extension or a renewal of the lease or the entering into of a new lease or the transfer or assignment of the reversion; and
>
> (iii) the lessee is in breach of the condition, covenant, or agreement, or has failed to give the notice within the specified time or in the specified manner; and
>
> (iv) the lessor has refused to extend or renew the lease, or enter into a new lease, or transfer or assign the reversion, as the case may be.
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> …

In response to the lessee's application, the lessor applied to have the application struck out based on an arbitration clause in the lease. That arbitration clause read:

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[5] It is important to note that it is not entirely clear whether the Lawsons gave notice of their intention out of time or were in breach of a condition, covenant, or agreement (see requirement in s 261(1)(c) of the *Property Law Act 2007* (NZ). However, the application was made in reliance of ss 261-266 of the *Property Law Act 2007* (NZ), which implies that the requirements of s 261(1)(c) were met.

12.3 Arbitration

(a) If any dispute or difference shall arise between the parties as to:

(i) the meaning or application of any part of this Lease; or

(ii) any other matter in connection with or which may have an effect on this Lease

the dispute or difference ("the Issue") shall be referred to the award of a single arbitrator to be agreed upon between the Lessor and the Lessee.

The predominant question for determination was simple: is the court's jurisdiction excluded by the arbitration agreement? Clark J held in the affirmative. Her Honour's reasoning can be summarised as follows:

a. The relief application is a dispute for the purposes of the arbitration clause contained in the lease.[6]
b. Section 10 of the *Arbitration Act 1996* (NZ) (***Arbitration Act***) provides a presumption in favour of arbitration notwithstanding any general jurisdiction provisions (such as the *Property Law Act* provisions) that confer power on the courts generally.[7]
c. The '[r]enewal of a lease is a quintessentially private law matter capable of determination inter partes' and cannot be considered an action *in rem*.[8] However, even if a renewal was considered an action *in rem*, the Arbitration Act would not render a dispute in land not arbitrable. Clark J based this view on the exclusion of a provision previously in the *Arbitration Act 1908* (NZ) that excluded contractual disputes relating to land or any interest in land from arbitration.[9]

The decision had the unfortunate effect of leaving the Lawsons without recourse. This is because not only did the Court deny the application from relief based on jurisdiction, but the Lawsons also failed to commence an arbitration within the timeframes required under the *Property Law Act*.

III Discussion

A An overview of actions *in rem* and actions *in personam*

In the civil jurisdiction of the law there are predominately two general classes of action and judgments: *in personam* and *in rem*. A judgment *in personam* is said to affect the interests of the parties to the proceeding. That is, a judgment *in personam* can only bind (and be enforceable) on the parties to the proceeding. A judgment *in rem* by comparison is less straight forward. At face value *in rem* means 'against a thing' and refers to the power of a court over real and personal property (i.e. land). In contrast to an action *in personam,* an action *in rem* binds every interested party, even if they are not party to the proceeding. That is because an action *in rem* is declaratory about the status of a thing.

It must be said that these rather simplistic and distinct definitions are somewhat contrived in the sense that it would seem nearly all actions *in rem* are utilised for the purposes of compelling an individual to confront an action *in personam*. This is perhaps no better illustrated than through the conflicting relationship between contractual and proprietary rights that arises from a lease. For example, an action

[6] *Lawson v Gawith* [2017] NZHC 40 at [19].
[7] *Lawson v Gawith* [2017] NZHC 40 at [25].
[8] *Lawson v Gawith* [2017] NZHC 40 at [28].
[9] *Lawson v Gawith* [2017] NZHC 40 at [32].

for breaching a lease, while proprietary in nature, has the intended effect of altering the contractual nature between the parties. Herein lies an issue that has vexed the common law courts for some time. The Privy Council sought to clarify this issue in *Glenwood Lumber Co Ltd v Phillips* when Lord Davey held:[10]

> *If the effect of the instrument is to give the holder an exclusive right of occupation of the land, though subject to certain reservations or to a restriction of the purposes for which it may be used, it is in law a demise of land itself.*

Despite this clear statement of principle at the beginning of the twentieth century, there have been continued attempts to disavow the proprietary nature of a lease and revert back to the contractual genesis from which leasehold agreements began.[11] While a lease may never be purely proprietary in nature or wholly deny its contractual underpinning, the law must require a clear distinction of actions into separate *in personam* and *in rem* categories. This is particularly evident following the decision in *Lawson* and the concerning repercussions that may stem from mis-categorisation. Given the wide use of rights of renewal in leases, the almost standard use of alternative dispute resolution or arbitration clauses, and individuals' uncanny ability to prevaricate and neglect proscribed lease procedure, two important and interrelated questions arise: first, whether rights of renewal are rights *in rem*; and second, if so, whether rights *in rem* are arbitrable.

B Nature of rights of renewal

It is settled law that, unless there are clear words to the contrary, a right of renewal grants a new lease.[12] The principle is clearly set out in *Halsbury's Laws of England* as follows:[13]

> *Where a lease contains an option to renew the lease the exercise of the option ordinarily involves the creation of a new lease, and as regards the new lease there is no privity of contract between the landlord and the original tenant under the old lease which contains the options to renew; but the right given to a tenant may be simply to extend the term, in which case privity of contract endures between the original parties, even during the extended term.*

It can therefore be said that when a lease, properly construed, contains a right to renew then that is a right to receive an entirely new estate in land.[14] The importance and effect of the creation of an estate in land cannot be overstated. An estate in land carries certain exclusive rights and obligations that will not only bind the parties to the lease but also the rest of the world at large: the right to exclusive possession; quite enjoyment; and non-derogation from grant are a few examples.

It is accepted that leases have a somewhat unusual 'duality of character' to the extent that the contractual (and thus *in personam*) rights sit awkwardly behind the proprietary (and thus *in rem*) rights.[15] The High Court of Australia in *Willmott Growers Group Inc v Willmott Forests Ltd* accepted this duality and acknowledged the contractual and proprietary rights as being 'one and the same' to the extent '[t]he continuity of the leasehold estate or interest conveyed by the lease depends on the continuity of the

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[10] *Glenwood Lumber Co Ltd v Phillips* [1904] AC 405 (PC) at 408.
[11] At first leases were simply regarded as personal contracts (rights *in personam*) binding only on the parties. It was not until the fifteenth century that leases became protected (or even recognised) as property rights (rights *in rem*) that granted an estate in land. See generally RE Megarry and HWR Wade *The Law of Real Property* (4th ed, Stevens & Sons Limited, London, 1975) at 43-48 and 613-617.
[12] See generally *W E Wagener Ltd v Photo Engravers Ltd* [1984] 1 NZLR 412 (CA); *Powell v Tinline Properties Ltd* [2002] 1 NZLR 568 (HC); and *Otehei Bay Holdings Ltd v Fullers Bay of Islands Ltd* [2011] NZLR 449 (CA).
[13] *Halsbury's Laws of England* (4th ed reissue, 2006) vol 27(1) *Landlord and Tenant* at [556].
[14] Elizabeth Toomey et al (ed) *New Zealand Land Law* (3rd ed, Thomson Reuters, Wellington, 2017) at 8.1.
[15] *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 (HCA) at 51 (per Deane J).

lease'.[16] But that is not to say that all issues resulting from contracts concerning property can be litigated as actions *in rem*. Simply put, rights in property that are created by contract will only be determined as an action *in rem* if the decree affects that property. The renewal of a lease must inevitably fall within this category as an action *in rem*.

C Whether rights *in rem* are arbitrable

The question of whether rights *in rem* are arbitrable necessarily builds from the discussion above. If a right of renewal gives rise to an estate in land, that right has the ability to bind parties that have an interest in the estate but are not otherwise associated with the lease instrument from which the right of renewal arises. This becomes problematic if that lease instrument contains a requirement to arbitrate.

The starting point is the High Court of New Zealand decision *Raukura v Moana Fisheries Ltd v The Ship "Irina Zharkikh"*[17] (***Raukura***), which concerned an investigation by the Ministry of Fisheries into certain fishing offences said to be committed by two vessels charted by the plaintiff. As a result of the investigation the Ministry sought to arrest the vessels. The question arose whether the ships owners where entitled to an automatic stay of the *in rem* proceeding on the basis of an agreement to arbitrate. It was held that there would be no stay of proceedings. This was on the basis that an arbitrator does not have an *in rem* jurisdiction. Young J (as he then was) stated his reasoning as follows:[18]

> *The reason is simple: judgments in rem in respect of these vessels would bind parties who are, themselves, not subject to the arbitration agreement. An arbitral tribunal does not have the power to bind parties who are not subject to the arbitration agreement.*

His Honour did not stop there. Expanding on the reasoning above, it was thought that a finding that an action *in rem* was not justiciable by arbitration was also based on one or more of the following reasons:

a. Section 10 of the Arbitration Act prevents an arbitrator from making an award *in rem* as it should be construed to legislative provisions that apply between the parties.

b. Pursuant to article 8(1) of the first schedule to the Arbitration Act, an arbitration agreement is 'inoperative, or incapable of being performed' in respect of a statutory claim *in rem*.

c. The word 'dispute' in an arbitration agreement must be confined to a dispute that is capable of resolution by arbitration and the existence of an *in rem* claim is no such dispute.

The proposition in *Raukura* that an arbitrator does not have *in rem* jurisdiction is not without further support. The High Court of New Zealand in *Theatrelight Electronic Control & Audio Systems Ltd v Zheng* (***Theatrelight***) also dealt with the possibility of an arbitrable award dealing with actions *in rem*.[19] Heath J cited Mr DAR Williams QC of the *Laws of New Zealand, Arbitration* as accurately stating the law in New Zealand. Mr Williams simply commented that '… matters relating to a change is status, or an action in rem, may not be referred to arbitration'.[20] After all, it should be well known that consent is an essential pre-condition to an agreement to arbitrate.[21] In line with this, s 10 of the *Arbitration Act* has

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[16] *Willmott Growers Group Inc v Willmott Forests Ltd (receivers and managers appointed) (in liq)* [2013] HCA 51 at [67].
[17] *Raukura v Moana Fisheries Ltd v The Ship "Irina Zharkikh"* [2001] 1 NZLR 801 (HC).
[18] *Raukura v Moana Fisheries Ltd v The Ship "Irina Zharkikh"* [2001] 1 NZLR 801 (HC) at [45].
[19] *Theatrelight Electronic Control & Audio Systems Ltd v Zheng* High Court, Auckland, 5/12/2005, CIV-2002-404-1934.
[20] *Theatrelight Electronic Control & Audio Systems Ltd v Zheng* High Court, Auckland, 5/12/2005, CIV-2002-404-1934 at [22] citing Mr DAR Williams QC *Laws of New Zealand* Arbitration (online ed) at [5].
[21] See G Born *International Commercial Arbitration* (2nd ed, Kluwer, The Netherlands, 2014) at 256-259 cited in *Williams & Kawharu on Arbitration* (2nd ed, LexisNexis, Wellington, 2017) at 1.1.5.

been interpreted to provide that if a dispute involves the interests of third parties (i.e. a party who has not consented to the arbitration) public policy may demand that an arbitration agreement is of no effect.[22] A number of examples help to illustrate the potential debacle that would follow an attempt to bind non-parties to an arbitration involving rights of renewal under a lease agreement:

a. Sublessee. A lessee may have granted an interest in land to a subtenant that is subject to a separate lease agreement. A sublessee enjoys an estate in land quite separate from any relationship between the head lessor and the head lessee. However, if the head lease is cancelled, all interests deriving from that head lease will come to an end, including a sublease. Therefore, an arbitrator's decision to cancel a head lease agreement would also have the effect of removing a non-party's estate in land. This unacceptable result is exacerbated further if a subtenant (assuming for a moment that no arbitration clause exists in the sublease) applies to court for relief under s 258 of the *Property Law Act* (right of sublessee to apply for relief on cancellation of superior lease). This would have the potential to create a situation where an arbitrator and court have ruled inconsistently on separate lease agreements that relate to the same land.

b. New tenant. Perhaps, prior to a lessee's application for relief against the failure of the lessor to renew, the lessor enters into a separate agreement to lease with an unrelated third party. It must be obvious that an arbitrator does not have the jurisdiction to bind the unrelated third party. If an arbitrator decided to grant the original lessee's application for relief, such a decision would also need to effectively dispose of the lease agreement with the unrelated third party – something an arbitrator simply cannot do. It is only a court, under s 264(3) of the *Property Law Act*), which should have the ability to grant relief to a prejudicially affected third party.[23]

It is immediately apparent that the rationale behind *Raukura* and *Theatrelight* is directly at odds with the rationale behind *Lawson*. The fatal flaw in the *Lawson* rationale must be the view that the renewal of a lease is always a 'private law matter capable of determination inter partes'.[24] It is accepted that there are narrow circumstances in which the renewal of a lease may be considered *in personam*. For example, an equitable action by way of specific performance that requires a lessor to renew a lease is an inherently private law matter capable of being determined through arbitration. This is because an action for specific performance is not determining an estate in land. Rather the action is determining parties' obligations in accordance with an existing lease (i.e. an existing estate in land). However, an application for statutory relief under ss 261-264 of the *Property Law Act* against a lessor's refusal to renew is different. The statutory relief is only available if the lessee is in breach of the lease or has failed to give notice within a specific time or manner. The Court of Appeal of New Zealand in *Vince Bevan Ltd v Findgard Nominee Ltd* confirmed this when it held the nature and effect of the statutory application for relief from refusal by a lessor to enter into a renewal was to relieve a lessee 'who had failed to observe all the covenants of the lease and, accordingly, was not entitled to an order for specific performance in a suit at equity'.[25] In other words, the lessee is devoid of any contractual right of recourse against the lessor. This is because the lease has come to a valid end and the only way to grant a new lease (i.e. a new estate in land) is through an application for statutory relief. In short, specific performance enforces a contractual right and statutory relief under ss 261- 264 of the *Property Law Act* grants relief in the absence of a contractual right. This fundamental distinction was not considered in *Lawson*.

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[22] *Williams & Kawharu on Arbitration* (2nd ed, LexisNexis, Wellington, 2017) at 7.2.1.
[23] It is also worth noting that similar arguments can be made for cross leases (although they are likely bound by similar leases), mortgagees, and receivers.
[24] *Lawson v Gawith* [2017] NZHC 40 at [28].
[25] *Vince Bevan Ltd v Findgard Nominees Ltd* [1973] 2 NZLR 290 (CA) at 299. While the decision relates to the relief provisions in ss 120 and 121 of the Property Law Act 1952 (NZ), the sections are to the same effect regarding the preconditions for relief. The one inconsequential difference is that, under s 120 of the 1952 Act, applications could only be made by the lessee. The 2007 Act extends the applicants to include certain interested parties (mortgagees, joint tenants etc.) (see s 261(2)).

IV Drawing the threads

The potential precedent the *Lawson* decision creates in New Zealand is concerning. The decision represents what this article has shown to be a flawed understanding of an action *in rem* in contrast to an action *in personam* as they relate to rights of renewal in a lease. In the event the *Lawson* rationale is adopted in subsequent decisions, there could be severe (and unexpected) repercussions for not just those individuals and entities that are party to a lease with an arbitration clause, but also for those who have an interest in land as a result of a lease with an arbitration clause. The answer to the question posed at the outset of this article must be answered in the negative. Statutory applications for relief against a lessor's refusal to enter into a renewal of a lease simply cannot be arbitrated at law. This is consistent with the line of authority that the decision in *Highgate* has followed and represents a correct treatment of an action *in rem*. The position is in need of clarification.