



**Supreme Court of New Zealand
Te Kōti Mana Nui**

5 JUNE 2020

MEDIA RELEASE – FOR IMMEDIATE PUBLICATION

127 HOBSON STREET LTD v HONEY BEES PRESCHOOL LTD

(SC 40/2019) [2020] NZSC 53

PRESS SUMMARY

This summary is provided to assist in the understanding of the Court’s judgment. It does not comprise part of the reasons for that judgment. The full judgment with reasons is the only authoritative document. The full text of the judgment and reasons can be found at Judicial Decisions of Public Interest www.courtsofnz.govt.nz

Background

Honey Bees Preschool Ltd (Honey Bees) is a childcare business located on the fifth floor of a central Auckland high rise. The landlord, 127 Hobson Street Ltd (127 Hobson), leased this premises to Honey Bees. Mr James, Honey Bees’ director, guaranteed the obligations under the lease. In a separate document to the Deed of Lease (known as the Collateral Deed), 127 Hobson and Mr Parbhu, 127 Hobson’s director, agreed to install a second lift in the building, providing additional access for Honey Bees’ business. The appellants, 127 Hobson and Mr Parbhu, also agreed that if the lift was not installed by a certain date, they would indemnify the respondents, Honey Bees and Mr James, for rent and outgoings under the lease until its expiry. The appellants failed to install the lift by the stipulated date.

The Courts below

The respondents issued proceedings in the High Court to enforce the indemnity. The appellants defended the claim on several grounds, including that the obligation to indemnify breached the common law rule against contractual penalties. This rule has the effect that contractual clauses providing consequences for breach that are penal are unenforceable.

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In the High Court, Justice Whata held that the obligation to indemnify did not breach the rule against penalties. He found for the respondents and ordered the appellants to indemnify the respondents for rent and outgoings up until the actual date of installation of the second lift.

The Court of Appeal dismissed the appellants' appeal to that Court.

The appellants were granted leave to appeal to the Supreme Court. The approved ground of appeal was whether the Court of Appeal was correct to dismiss the appellants' appeal to that Court and, in particular, whether the Court of Appeal was correct to conclude that the indemnity clause did not offend the rule against penalties. The main issues for determination were the content of the penalty rule in New Zealand and whether the obligation to indemnify in this case breached that rule.

The Supreme Court's decision

The Supreme Court has unanimously dismissed the appeal. The Court held the obligation to indemnify did not breach the rule against penalties.

The Court held that the correct test to be applied for a contractual penalty was as follows. A clause providing that a consequence for breach of a term of the contract will be an unenforceable penalty if the consequence is out of all proportion to the legitimate interests of the innocent party in performance of the primary obligation. A consequence will be out of all proportion if it can fairly be described as exorbitant when compared with those legitimate interests. The legitimate interests may extend beyond the direct loss caused by the breach. The parties may agree to consequences for breach which recognise the broader impact of non-performance of the obligation on the commercial interests the parties seek to achieve or protect through the contract.

The Court was satisfied the consequences were not out of all proportion to the legitimate interests of Honey Bees in performance of the obligation to install the lift. Honey Bees' legitimate interests included operating a business on the premises which was supported by two lifts and the protection of the future growth prospects of the business. The "all or nothing" nature of the obligation to install the second lift was relevant to the assessment of whether the consequence contracted for was out of proportion to Honey Bees' interest in performance. But the Court held, the consequences were not exorbitant in the overall circumstances, which included that 127 Hobson was given ample time to install the lift.

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