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Principles of Contractual Interpretation – AKA Vector Gas, What Does it Mean?

1. Contractual interpretation is integral to resolution of many commercial / private disputes. The exercise of interpretation now unquestionably looks beyond the mere text of the contract to its context, in which an agreement must be placed. However, following the release of the Supreme Court's decision in **Vector Gas Ltd v Bay of Plenty Energy Ltd** [2010] NZSC 5, confusion remains over the exact principles to be applied in New Zealand.
2. Lord Hoffmann has been influential in shaping this important area since at least as early as **Investors Compensation Scheme Ltd v West Bromwich Building Society** [1998] 1 WLR 896 (HL) ("ICS"). In **Boat Park Limited v Hutchinson** [1999] 2 NZLR 74, our Court of Appeal adopted Lord Hoffmann's restatement and development of the law. That decision that has defined the standard approach in this country for more than a decade.
3. Recently, Lord Hoffmann's valedictory judgement, **Chartbrook Ltd v Persimmon Homes Ltd and Another** [2009] UKHL 38, reviewed and consolidated the approach applied under his stewardship. However, our Supreme Court has already taken a liberal approach in this area - **Wholesale Distributors Ltd v Gibbons Holdings Ltd** [2007] NZSC 37. With that background in mind, there has been real interest as to how the Supreme Court would approach the broader principles of interpretation in **Vector**.

Where Have We Been? An Appraisal

4. The practical effect of the **ICS** or **Boat Park** principles are as follows:
 - 4.1. the meaning and effect of a contract is that which the document conveys to a reasonable person having the background knowledge available to the parties at the time of the contract;
 - 4.2. no ambiguity is required to look beyond the contract, with the background being an essential element of the interpretive exercise;
 - 4.3. In practice, the background and commercial purpose of a contract have become important yardsticks in ascertaining meaning;
 - 4.4. Whilst background includes the widest array of relevant factors, it has excluded reference to previous negotiations for anything other than broadly ascertaining commercial purpose of the transaction;
 - 4.5. If consideration of background and commercial purpose means that the actual words used will flout business common sense, then the court may correct or amend mistaken language as part of the interpretation exercise.
5. Lord Hoffmann grounded his restatement in an extensive survey of the law, much of which already supported the threads he drew together. However, some certainly saw aspects of this judgment as progressive.

6. The first arguable development of the law in **ICS** was confirmation that substantial reference to the background did not require an initial ambiguity. A mark of the liberality of this can be seen from the New Zealand Privy Council appeal **Melanesian Mission Trust Board v AMP Society** [1997] 1 NZLR 391. Delivered just prior to **ICS**, this case required identification of an ambiguity before reference could be made to background material.
7. The second arguable development was incorporation of “correction of mistake” as an aspect of interpretation which could substantially rewrite critical areas of a contract. What might once have been considered under the separate doctrine of rectification is now an essential part of the interpretive analysis. Lord Hoffmann has confirmed in **Chartbrook** that this is the case no matter how far the literal words of the contract need to be amended to correct such mistake.
8. In **Gibbons**, our Supreme Court also found that subsequent conduct of the parties is admissible in interpreting the contract. Though there remains uncertainty whether this includes only conduct involving both parties or also extends to unilateral conduct, this indigenous jurisprudence is a step beyond the United Kingdom. Their approach has traditionally limited analysis to circumstances as at the date of the contract.
9. Whilst **Boat Park** and **Gibbons** will be familiar ground to most, there are still many in the commercial and legal worlds who think that a contract “means what it says that it means”. Whilst this will usually be the outcome of a well drafted contract, it certainly does not represent the way we go about the business of contractual interpretation.

The Vector Decision – What’s New?

10. As the Court was strongly influenced by the facts in **Vector**, a short outline is necessary. The parties had agreed a contract for the interim supply of gas until their principal dispute regarding ongoing supply could be determined. The issue was whether the interim price agreed did or did not include transmission costs.
11. The Supreme Court's view was ultimately that the contract did not properly capture the parties' agreement. The prior negotiations showed that a preliminary agreement (excluding transmission costs) had effectively been mis-recorded in the final contract (apparently including transmission costs).
12. The Court simply did not see Bay of Plenty Energy (“BoPE”) as having out-negotiated Vector, but rather considered that BoPE had either “snuck one by” Vector, or was trying to take advantage of a slip in recording. As a literal interpretation of the contract would grant a market discount approaching 30% to BoPE, the Court was motivated to achieve justice between the parties rather than adhere literally to the terms of the contract.
13. On its facts, **Vector** provided an ideal opportunity for our Supreme Court to definitively state New Zealand law. Somewhat unfortunately, individual approaches were taken by each of the five judges, leaving real confusion. What is clear is that the majority (Blanchard, Tipping, McGrath, Gault JJ) implicitly confirm that the **Boat Park / ICS** approach remains good law, at least subject to the following discussion of pre-contractual negotiation.
14. In the UK, **Chartbrook** very recently confirmed the traditional position, that reference to pre-contractual negotiations is impermissible for anything other than

broadly ascertaining the commercial purpose of the transaction. This is an exception to the general rule that interpretation takes place with the benefit of the background known to the parties. Some would say it is justified as much by convenience as by compelling legal principle.

15. The clearest lesson from **Vector** is the potential importance of estoppel by convention, an approach acknowledged by Tipping, McGrath and Wilson JJ. Fundamentally, where there is an agreement between the parties as to meaning of a term used in the contract, or agreement on the approach to be taken to an aspect of the contract, the courts will uphold that agreement, through estoppel or otherwise.
16. An estoppel analysis allows full reliance on the course of negotiations. Whilst **Vector** was particularly suitable for an estoppel approach, it is now a powerful tool where available on the facts. The Court appears to differ whether this is an integral aspect of the interpretation exercise, or a closely aligned supplementary doctrine. This is of little relevance in practice, as the two will be closely linked in argument. The majority also appear to indicate that it is not necessary to plead an estoppel, though it will certainly be good practice to do so.
17. Absent a suitable basis for estoppel, the Court provides mixed support for general reference to pre-contractual negotiation. Without providing an authoritative majority position, **Vector** appears to take a more liberal approach than accepted in **Chartbrook**.
18. Tipping and (providing there is an ambiguity or absurdity) Wilson JJ are in favour of full resort of pre-contractual negotiations for the purposes of interpretation. Their focus is on use of objective evidence to get at the intent of the parties, either for properly interpreting or for correcting the words used in the contract. McGrath J is against this, adopting the **Chartbrook** approach and limiting use of negotiations to understanding of the background only.
19. Blanchard J acknowledges at least a very liberal “subject matter exception”, allowing reference to negotiations to learn about the detailed subject of the contract. Beyond this he leaves open the question of whether more extensive reference to pre contractual negotiations is appropriate. Gault J adopts this position.

Practical Application

20. In light of this generally liberal approach, it appears that full reference to negotiations will eventually become a standard approach to interpretation. However that day has not yet arrived. Confirmation of this will require a case on point to reach at least the Court of Appeal and preferably the Supreme Court in due course.
21. For the moment, it is now good law to refer to negotiations to identify the detailed subject matter of a contract. Beyond this, one may justify reference to negotiations through either estoppel or (if available) rectification, where reference to negotiations is also acceptable.
22. It is likely that the full course of negotiations, together with all relevant evidence of subsequent conduct, will be placed before the courts by one or both sides under varying guises. This is really no different to the current practice in many cases,

and support for this practice, in appropriate cases, can be drawn from at least Tipping J.

23. What must not be lost sight of is the need to maintain the contract at the heart of the analysis. The words of the contract interpreted in accordance with conventional usage are the default position, deviation from which should require substantial proof. As was stated in **ICS**:

We do not easily accept that people have made linguistic mistakes, particularly in formal documents.

24. In the absence of an obvious ambiguity requiring interpretation, good reason will be required to successfully challenge the meaning of an apparently plain contract. Conduct amounting to estoppel, or an apparent meaning which flouts common sense, would certainly reach this threshold. In this regard, Wilson J's preliminary categories where reference to extrinsic material is permissible, whether or not adopted in such terms (refer **Vector** paragraphs [120] – [124]), may provide a useful test for whether an argument has merit.
25. It remains incumbent on counsel to assess both the relevance and weight of any material tendered in support of alternative interpretation arguments. Evidence of subjective intent will never be an acceptable aid to interpretation, and must be put to one side. Tipping J at [24] raises the prospect of increased costs as a penalty for fruitless attempts at displacing plain meaning.

Conclusion

26. It is disappointing that **Vector** does not provide a majority judgement. As our final Court, the delivery of individual views needs to be balanced against the need to clearly state the law. Judicial agreement at a detailed level is essential for the guidance of lower courts and practitioners, and it is hoped that this will be forthcoming.
27. From a more conceptual perspective, **Vector** and recent developments may raise the need to reconceive the underlying approach taken to interpretation. Tipping J at [19] states the traditional position:

The language used by the parties, appropriately interpreted, is the only source of the intended meaning.

28. However, the Courts have increasingly given expression to the parties' intent, even at the expense of the contractual document. Hence we see that:
- 28.1. ambiguity is not necessary before reference is had to extrinsic material;
and
- 28.2. correction of mistaken expression is a legitimate aspect of interpretation, no matter how far the literal words of the contract need to be amended to correct such mistake.
29. The characterisation of this as simply the "informed interpretation" of contractual language itself strains words to breaking point. The certainty of the words of a contract may be respected, but only if they are consistent with an objective assessment of the parties' intentions, no plain contrary intention exists, and the outcome is not commercially absurd.

30. The focus appears in practice to have moved to ascertaining and giving effect to the bargain achieved between the parties, whether or not it is properly recorded. The Courts will resist unequal outcomes which have been achieved by mis-recording or sleight of language, rather than transparent negotiation.
31. The central use of an equitable principle, estoppel by convention, provides a window to the new philosophy of contractual interpretation. One could do worse than suggest that the Courts now truly seek to inject equity into the interpretation of contracts. On balance, this is a development to be welcomed.

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