



MARTIN TAYLOR, BARRISTER (B.A., L.L.B.)

LEVEL 7 SYBASE HOUSE, 101 LAMBTON QUAY - PO BOX 5241, WELLINGTON 6145
PH +64 4 471 4274 - MB +64 27 448 0841 - FAX +64 4 473 1105
EMAIL: MARTIN.TAYLOR@CUBACHAMBERS.COM

Contractual Interpretation – Certainty Versus Correctness After Vector Gas

Introduction

1. In NZ Lawyer issue 134 I wrote approvingly of the approach to contractual interpretation taken in **Vector Gas Ltd v Bay of Plenty Energy Ltd** [2010] NZSC 5, [insert link to article]. My central thesis was that

The [Court's] 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.

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.

2. In a response published in issue 138 Chris Hall, general counsel for the unsuccessful party, Bay of Plenty Energy, responded raising the concern that the Court's new approach:

... poses a serious risk and uncertainty to the orderly conduct of business and that as a development it is quite unwelcome.

3. Amongst other matters, Mr Hall refers to the availability of specific remedies such as rectification and the law of mistake. He implies that these provide sufficient safeguards, making the **Vector Gas** approach unnecessary and/or at risk of arbitrary application and outcome.
4. Mr Hall is in a small way restating criticisms that have been levelled at the modern approach to contractual interpretation in the rich academic debate that has taken place ever since **Investors Compensation Scheme Ltd v West Bromwich Building Society** [1998] 1 WLR 896 (HL). Undoubtedly, many practitioners have a view on the relative merits of the different approaches.
5. Mr Hall supports the “contractual certainty” lobby - the courts should give effect to the plain meaning of the words of the contract. **Vector Gas** is the realisation of a more nuanced approach to properly giving effect to the intentions of the parties. This recognises that slavish adherence to the assumed plain meaning of a contract's may pervert that goal – contracts, like all other human endeavour, are susceptible to error or sub-optimal expression.
6. As noted in my earlier article, **Vector Gas** is largely an adoption of principles already expressed in **Investors Compensation** and previously adopted in this country. **Vector Gas** largely extends our understanding of how these tools may be used, rather than developing a new approach:

- 6.1. "correction of mistake" is not limited to mere drafting errors - such correction may occur as part of the interpretive exercise even if it has a significant impact on what would otherwise be the "plain reading" outcome of the contract;
- 6.2. the case promotes a permissive though not fully resolved approach allowing detailed consideration of background materials impinging on the fringes of, if not including, the course of negotiations.
7. **Vector Gas** genuinely develops the law of estoppel by convention, making this a fundamental aspect of the law of contract. Where there is an agreement between the parties as to meaning of a term used in the contract, the parties will be estopped from denying that particular meaning. Full reference may be made to the course of negotiations for this purpose. This question is either part of or closely allied to the process of interpretation.
8. It must however be emphasised that this modern approach to contractual interpretation is not the be all and end all of contractual remedies. The law of mistake and the doctrine of rectification will both continue to play an important role in regulating contractual issues. It is therefore convenient to review the scope and role of these two areas of law.

Mistake

9. Contractual mistakes are now governed almost entirely by the Contractual Mistakes Act 1977. That act is a code in relation to mistakes, save for the preservation of the "non est factum" plea, the doctrine of rectification, misrepresentation and other actions related to undue influence, fraud, illegality and frustration.
10. Importantly for our purposes, relief cannot be provided under the Contractual Mistakes Act for "mistakes of interpretation" - section 6(2). This is noted in **Vector Gas** itself. Other requirements are that:
 - 10.1. there is either a mutual mistake, or mistake of one party which was known to the other;
 - 10.2. the mistake was influential in the mistaken party entering into the contract;
 - 10.3. this resulted in a substantial inequality of bargain between the parties;
 - 10.4. the mistaken party has actually turned their mind to the relevant matter, failing which there is no mistake at all; and
 - 10.5. there is no contractual obligation for the mistaken party to assume the risk of mistake - in effect the act is subject to contracting out.
11. This is an important protection for mistakes of fact. However, the courts are vigilant to ensure the proper characterisation of mistakes, and to exclude matters of interpretation, even if they can also be characterised as mistakes of fact. See for example **Motor Trade Finance Ltd v Bentinck St Ltd** HC Dunedin, CIV 2009-412-000893, 1 July 2010 at [55]. The defendant's misunderstanding of the extent of obligations undertaken in a financing agreement was argued to be a mistake of fact. The Court however found that these were detailed in the contract, and were therefore matters of interpretation.

Rectification

12. Rectification is an equitable doctrine which allows the courts to correct the terms of a contract which does not correctly record the mutual intention or actual bargain of the parties. However a presumption exists that a document signed by the parties expresses their intentions. Therefore substantial proof must be tendered to the court that the bargain struck by the parties was different to that finally recorded in their written agreement. The civil standard of balance of probabilities continues to apply, but the courts will require very cogent evidence before upholding a bargain different to that recorded.
13. In this regard, there is much commonality between rectification and the extended scope given to contextual interpretation and correction of mistake by cases such as **Vector Gas**. Tipping J at [33] of **Vector** points out that drafting or linguistic errors are primarily the subject of rectification, but can be remedied by way of interpretation where there is clarity as to what was intended.
14. The question of whether a unilateral mistake can be the subject of rectification is a question of some contention. Professor McLaughlan discusses this in "The 'Drastic' Remedy of Rectification for Unilateral Mistake" (2008) 124 LQR 608-640. His conclusion is that rectification of a unilateral mistake is permissible where one party knows of the other's mistake and seeks to take advantage of it in bad faith. Lord Hoffmann agrees in **Chartbrook** though perhaps on a different basis.
15. In New Zealand the comments of the Court of Appeal in **Tri-Star Customs and Forwarding Limited v Denning** [1999] 1 NZLR 33 also appear to prevent rectification of unilateral mistake in New Zealand. This reasoning has been questioned.

Analysis

16. Mistake per se is little help on interpretation issues in New Zealand, due to the Contractual Mistakes Act. Rectification remains an important tool, but equally has evidential difficulties around the required proof of a common mistake. On substantial points of interpretation, opposing parties will inevitably assert their clear intention to agree the bargain that favours them.
17. In spite of this, many observers agree that **Vector Gas** was a proper case for rectification if it had been pleaded. It is therefore difficult to see that **Vector** has in substance extended the range of circumstances in which a remedy is available in regard to contracts which inadequately record the parties' bargain.
18. Further, the approach taken to interpretation is no more generous than the significant burden which the doctrine of rectification places on the plaintiff before they are able to displace a written agreement. The need for real rigour before correcting a mistake by way of interpretation forms one of the "first principles" in the **Investors Compensation** case:

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

19. Such sentiments are littered through **Vector Gas**. Any prospect of a bargain now being rewritten on the basis merely of effecting a more "reasonable contract" simply does not exist. The courts will require something in the nature of a commercial absurdity or an estoppel before they intervene.

20. Some may be concerned that this "commercial absurdity" approach may allow the court to impose its own commercial assessment over the top of a contract. There is again some validity in this point. However, the balancing between commercial certainty and giving effect to the intentions of the parties (which is ultimately what the contract is intended to record) will always require such compromise. Equally, such analysis is an implicit part of most rectification actions. Assessment of the commercial common sense of a transaction will frequently be part of determining whether there is "substantial evidence" that the bargain between the parties was other than recorded, and should be rectified.
21. Viewed in theory, there may be a valid objection to the overlapping process of interpretation and rectification. Where a remedy clearly exists by way of rectification, is it really appropriate to extend "correction of mistake" to such extremes? Perhaps not. However, in practice there is often no bright line delimiting interpretation issues as against remedy issues:
- 21.1. Language which one person may say is perfectly plain, leading to a conclusive but adverse interpretation, can be seen as ambiguous by another. In such case a remedy might equally lie in interpretation or rectification. The House of Lords case of **Chartbrook Ltd v Persimmon Homes Ltd and Another** [2009] UKHL 38 is an example where the interpretation of a part of an agreement in isolation seemed unambiguous, but in the context of the broader contract was shown to be ambiguous as being inconsistent with the language and other terms of that document;
- 21.2. The estoppel by convention relied on by the Supreme Court is most often directed at a point of interpretation. The language of the final document may use a code or special or private meaning. Absent its context, this may lead to a "plain meaning" quite different to that which is apparent by use of the parties' convention. This cannot be ignored in the process of interpretation, only to be revived as a matter of rectification.
22. Finally, **Vector Gas** has gone some way to homogenising the approach of interpretation and rectification to admissibility of background materials and evidence of negotiation. It allows a more extensive assessment of background material, particularly where estoppel by convention can be raised.
23. Wily litigators have for many years pleaded rectification in addition to causes of action based on pure interpretation. This recognises that reference to negotiations, available as admissible evidence in rectification but not interpretation, does bear on the interpretive exercise. Parties have practically wanted to ensure the court has a full understanding of the context in which the language of a contract occurs.
24. This artifice does not need to be preserved and the closing of the gap is desirable. In fact, the absence of full reference to negotiations puts the process of interpretation at a disadvantage to that of rectification until the rules of admissibility for interpretation purposes are further developed.

Conclusion

25. **Vector Gas** should not be seen as a cause for concern. The plain meaning approach to interpretation has long been superseded. The courts have chosen a position which balances the function of commercial contracts in giving "certainty" with the pragmatic acceptance that the drafting and expression of bargains within

a contract contains no special magic. It is as open to interpretation and mistake as other aspects of life.

26. In any case, the Contractual Mistakes Act for factual mistakes and the doctrine of rectification for mis-recording of agreements have long been available. These other avenues have already given parties the ability to go behind the contract where a disjunct exists between the bargain agreed and its contractual expression. Any claim that certainty by way of literal contractual meaning existed prior to **Vector Gas** is vastly overstated.
27. The real lesson from **Vector** is not that the Courts will second guess a commercial bargain. Relief is not based on redressing the apparent commercial absurdity or unfairness of the bargain itself. Rather, there will typically be a need to point to both:
 - 27.1. underlying facts indicating a different agreement than that recorded, and/or other contextual indications of a significant error within the document; and
 - 27.2. a patent commercial absurdity arising from the literal meaning which is otherwise sought.
28. The Court has properly indicated that relief will be granted where one party seeks to rely on a slip or error or anomaly in the language of a contract to achieve a disproportionately beneficial bargain. This is because the result of such error is that the contract differs from that agreed to by the parties.
29. The common sense and commercial merit of such approach is plain. There is no convincing case that this should be divorced from the business of interpretation itself.

ENDS