

**COMING TO A CONSENSUS: *VECTOR GAS* AND THE ADMISSIBILITY  
OF PREVIOUS NEGOTIATIONS IN CONTRACT INTERPRETATION**

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*“There are times when an author is incompetent, and even intellectually and morally dishonest, if he fails to attack an often repeated statement of law...”*

Corbin “The Interpretation of Words and the Parol Evidence Rule” (1965) 50 Cornell LQ 161

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## INTRODUCTION

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Suppose A and B enter into an agreement for the supply of gas. The agreement is the result of negotiations executed through written correspondence. Following conclusion of the agreement, the contracting parties dispute the meaning of a clause regarding price. A contends price was exclusive of transmission costs whereas B contends price was inclusive of transmission costs. Fortunately the pre-contractual correspondence sheds light on the meaning to be accorded to the clause. One would think this solves the dispute. However, previous negotiations are traditionally not admissible to aid in the interpretation of the agreement.

This scenario arose in the recent New Zealand Supreme Court decision, *Vector Gas Limited v Bay of Plenty Energy Ltd*<sup>1</sup> and presented the Court with an opportunity to reconsider the rule excluding previous negotiations in a contract interpretation dispute. The rule can be stated as follows:<sup>2</sup>

The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear.

The House of Lords in *Chartbrook Ltd v Persimmon Homes Ltd*<sup>3</sup> had recently confirmed the existence of the rule in the England. Lord Hoffmann in an extensive albeit obiter statement upheld the rule on the basis of pragmatic considerations. It may have been thought New Zealand would follow the House of Lords. However, three years prior the Supreme Court had demonstrated a more liberal approach than England and ended the ban on the admissibility of subsequent conduct in a contract interpretation dispute.

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<sup>1</sup> [2010] NZSC 5.

<sup>2</sup> *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 913.

<sup>3</sup> [2009] 1 AC 1101.

Unfortunately, the Supreme Court offered no consensus on the issue of the admissibility of pre-contractual negotiations. The bench delivered five very diverse judgments, indicative of the wide diversity of opinion concerning the core principles of contract interpretation. In Part One this paper addresses the general principles of contract interpretation. Contract interpretation although one of the most practically important areas of commercial law tends to be the most intractable. This Part also outlines the establishment and rationale of the exclusionary rule and the exceptions that have developed. Part Two will analyse the Supreme Court's treatment of the exclusionary rule and its exceptions. Each judgment is evaluated to determine what consensus, if any, was reached regarding the admissibility of previous negotiations. In light of the decision the current state of the law will be considered to determine if previous negotiations are now taken to be admissible by lower courts and on what basis. The unfortunate conclusion is the existence of the rule is uncertain. The final part of this paper contends previous negotiations should be admissible, in principle and in practice, as relevant evidence in a contract interpretation dispute.

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## PART ONE: INTERPRETATION AND THE EXCLUSIONARY RULE

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### **1.1 Contract Interpretation Principles**

Dispute can occur when parties to an agreement have differing views on their legal rights and obligations. These differences must be settled through the process of interpretation.<sup>4</sup> However, the process is not straightforward and there are fundamental divisions amongst commentators, judges and practitioners regarding the governing principles and rules. Broadly, the purpose of interpretation is to ascertain the meaning of a document in accordance with the parties' intentions. The governing principles aim to operate under the central objective of contract law by giving effect to the reasonable expectations of honest men.<sup>5</sup>

Interpretation is to be achieved objectively; a feature deeply entrenched in the law of contract.<sup>6</sup> This approach is said to serve the needs of commerce, providing certainty and predictability.<sup>7</sup> The inquiry is into what a reasonable person, with all the background knowledge reasonably available to the parties at the time, would ascertain the document to mean.<sup>8</sup> Under a strict version of the theory the courts task is commonly understood to be the ascertainment of the parties "presumed intent" through the external standard of reasonableness.<sup>9</sup> The contracting parties are assumed to be reasonable men, devoid of their

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<sup>4</sup> The terms "interpretation" and "construction" are conventionally used interchangeably, but some consider construction to be a broader, distinct concept: Gerard McMeel "The Principles and Policies of Contractual Construction" in Andrew Burrows & Edwin Peel (eds) *Contract Terms* (Oxford University Press, Oxford, 2006) 27 at 32-33.

<sup>5</sup> Lord Steyn "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 LQR 433.

<sup>6</sup> David McLauchlan "Objectivity in Contract" (2005) 24 UQLJ 479 at 488 and Hugh Collins "Objectivity and Committed Contextualism in Interpretation" in Sarah Worthington (ed) *Commercial Law, Commercial Practice* (Hart Publishing, Oregon, 2003) 189 at 189-190.

<sup>7</sup> *Yoshimoto v Canterbury Golf International Ltd* [2001] 1 NZLR 523 at [60].

<sup>8</sup> *Investors Compensation Scheme*, above n2, at 912.

<sup>9</sup> There are some fundamental issues as to the precise meaning of objectivity and the consequences of an objective test in regards to the actual intent of the parties. See later discussion at 2.2.A.i and 3.1.



personal quirks.<sup>10</sup> The court embodies this impersonal author. As a consequence evidence of subjective intention is irrelevant to the inquiry.<sup>11</sup> Subjective intention can be defined as inner, uncommunicated or concealed intention in the parties' mind.

Traditionally contract ascribed to a conservative literal approach to interpretation, embodied in the plain meaning and parol evidence rules. The parol evidence rule limits interpretation exclusively to the four corners of the document where a contract is in writing. Extrinsic evidence is inadmissible to "add to, vary, or contradict" the contract.<sup>12</sup> The plain meaning rule prescribes that where the words of the contract are plain and unambiguous then extrinsic evidence is inadmissible to show the parties intended something different.<sup>13</sup> Many practitioners and judges ascribing to a literalist approach claim there should be strict adherence to these rules.<sup>14</sup> However, the rules have experienced demise in the last few decades with a shift away from literalist approaches adhering to the black letter of the contract.<sup>15</sup> Numerous exceptions<sup>16</sup> to the parol evidence rule have developed to such an extent some claim the rule is devoid of any substance.<sup>17</sup> A lack of ambiguity is also no longer

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<sup>10</sup> Lord Hoffmann "The Intolerable Wrestle with Words and Meanings" (1997) 114 S Afr Law Journal 656 at 661-662; Steyn, above n5 at 433-434 claims reasonableness postulates community values and the law will not protect unreasonable expectations.

<sup>11</sup> *McLaren v Waikato Regional Council* [1993] 1 NZLR 710 at 731.

<sup>12</sup> *Jacobs v Batavia and General Plantations Ltd* [1924] 1 Ch. 827; *Edwards v O'Connor* [1991] 2 NZLR 542; See also Burrows, Finn & Todd *Law of Contract in New Zealand* (3<sup>rd</sup> ed, Wellington, LexisNexis NZ, Ltd 2007) at 156; Kim Lewison *The Interpretation of Contracts* (4<sup>th</sup> ed, London, Sweet & Maxwell, 2007) at 85-86.

<sup>13</sup> *Benjamin Developments Ltd v Robert Jones (Pacific) Ltd* [1994] 3 NZLR 189 (CA).

<sup>14</sup> See Richard Calnan "Construction of Commercial Contracts, Construction & Interpretation: A Practitioners Perspective" in *Contract Terms*, above n4 at 19; Don Holborow "Contract Interpretation" [2004] NZLJ 272.

<sup>15</sup> See *Yoshimoto*, above n7, at [61]; Steyn, above n5, at 440.

<sup>16</sup> Established exceptions to the rule include allowing parol evidence to show a collateral agreement; custom or trade usage; where the agreement was not intended to be the entire contract; or to show a contract is not yet in force due to a unfulfilled condition precedent.

<sup>17</sup> McMeel "The Principles & Policies of Contractual Construction" above n4, at 45 proclaims "the parol evidence rule is dead". The UK Law Commission has concluded the rule no longer exists for all practical purposes. See *Law of Contract: The Parol Evidence Rule*, Report No 154, Cmnd 9700 (1986) at 2.7, 2.8, 2.45. Cf Robert Stevens "Objectivity, Mistake, and the Parol Evidence Rule" in *Contract Terms*, above n4, at 107 who prescribes the rule is still alive.

viewed as a barrier to the admission of extrinsic evidence.<sup>18</sup> Rather the plain meaning rule is relegated to the proposition that where words have their natural and ordinary meaning, this is a strong indication they were used in that sense. Courts will not easily accept linguistic mistakes.<sup>19</sup>

Much of the change can be attributed to the modern approach expounded in Lord Hoffmann's re-statement of contract interpretation principles in *Investors Compensation Scheme* ('ICS').<sup>20</sup> His oft-cited five principles sought to assimilate the interpretation of contractual language with the interpretation of everyday language. He observed a fundamental change in the law with the rise towards a contextual approach to interpretation.<sup>21</sup> Under a contextual approach language cannot be divorced from the context and the surrounding circumstances and "matrix of fact" will always be available to aid the court, subject to certain restrictions.<sup>22</sup> This approach is closely aligned with a purposive interpretation, which requires the court to examine meaning in light of the contract's purpose.<sup>23</sup> An interpretation that contradicts or

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<sup>18</sup> See *Pyne Gould Guinness Ltd v Montgomery Watson (NZ) Ltd* [2001] NZAR 789 at [29]; *Starrenburg v Morte Holdings Ltd* (2004) 21 NZTC 18,696 at [43]; *Ansely v Prospectus Nominees Unlimited* [2004] 2 NZLR 590 (CA) at [36].

<sup>19</sup> *Investors Compensation Scheme*, above n2, at 913.

<sup>20</sup> David Cabrelli "Interpretation of Contracts, Objectivity and the Elision of Consent Reached Through Concession and Compromise" (2010) U. of Edinburgh School of Law Working Paper No. 2010/06 at 3. Available at Social Science Research Network: <http://ssrn.com/abstract=1556335>. Cabrelli claims the decision established a presumptual shift, equivalent to a greater sub-conscious willingness to apply a contextual, rather than formal, literal analysis.

<sup>21</sup> The change is said to derive from *Prenn v Simmonds* [1971] 1 WLR 1381 and *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 3 All ER 570.

<sup>22</sup> For example, the context relied on must be known and reasonably available to both parties. See *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at [49]. Further restrictions are exclusions of subjective intent and previous negotiations.

<sup>23</sup> Ewan McKendrick "The Interpretation of Contracts, Lord Hoffmann's Re-statement" in *Commercial Law, Commercial Practice*, above n6, at 159 recognises *ICS* was more concerned with language than a purposive approach is, nonetheless courts and commentators tend to align the decision with this approach; Gerard McMeel "The Rise of Commercial Construction in Contract Law" (1998) LMCLQ 382; F Douglas, "Modern Approaches to the Construction and Interpretation of Contracts" (2009) 32 Aust Bar Review 158.

frustrates that purpose cannot be one held by a reasonable party.<sup>24</sup> The interpretation must also be one that yields to commercial commonsense.<sup>25</sup> The law does not require the court to give a meaning the parties did not intend. The New Zealand Court of Appeal adopted Lord Hoffmann's principles in *Boatpark v Hutchinson*.<sup>26</sup>

However, not all greeted Lord Hoffmann's re-statement with approval. His decision has attracted hostility for "upsetting the horses in the commercial paddock".<sup>27</sup> Essentially critics claim the principles expand the available matrix of fact and add to the high costs of litigation.<sup>28</sup> They claim this leads to uncertainty<sup>29</sup> and results in unfairness to third parties.<sup>30</sup> Critics also object to allowing surrounding evidence to alter natural meaning, effectively permitting the court to impose its own view on the contract.<sup>31</sup> They essentially believe in the inherent wisdom of the plain meaning and parol evidence rules.<sup>32</sup>

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<sup>24</sup> *Prenn*, above n21, at 1385; *Collins*, above n6, at 203, 205-206.

<sup>25</sup> *Investors Compensation Scheme*, above n2, at 913; *Antaios Cia Naviera SA v Salen Rederierna AB* [1984] 3 All ER 229 at 233.

<sup>26</sup> *Boatpark Ltd v Hutchinson & Findlay* [1999] 2 NZLR 74. The Court has been criticised for doing so without regard for its affirmation of the plain meaning rule a mere six years earlier in *Benjamin Developments*. See McLauchlan "The New Law of Contract Interpretation" (2000) 19 NZLJLR 147 at 148.

<sup>27</sup> See Steyn "The Intractable Problem of the Interpretation of Legal Texts" 25 Sydney Law Rev 25 at 9; Christopher Staughton "How Do the Courts Interpret Commercial Contracts?" (1999) 58 CLJ 303; *National Bank of Sharjah v Dellborg* [1997] EWCA Civ 2070 per Saville LJ. Also see discussion of the hostility in McKendrick, above n23; Lord Bingham "A New Thing Under the Sun? The Interpretation of Contracts and the *ICS* Decision" (2008) 12 Edinburgh L. Rev 374. Cf McLauchlan "The New Law of Contract Interpretation" above n26, at 164-65 who considers the decision to be conservative.

<sup>28</sup> Staughton, above n27, at 307; *National Bank of Sharjah*, above n27.

<sup>29</sup> Staughton, above n27, at 306-307; Calnan, above n14, at 18-20; Holborow, above n14, at 272.

<sup>30</sup> Alan Berg "Thrashing Through the Undergrowth" (2006) 122 LQR 354 at 359.

<sup>31</sup> *National Bank of Sharjah*, above n27; Calnan, above n14, at 18.

<sup>32</sup> McLauchlan "Interpretation and Rectification: Lord Hoffmann's Last Stand" [2009] 3 NZ Law Review 431 at 432.

## **1.2 Establishment of the Rule**

Before outlining the establishment of the rule excluding prior negotiations for the purpose of interpretation, it is necessary to consider the concept of prior negotiations. Prior negotiations can be defined broadly as any conduct or circumstances, which shed light on the agreement, prior to the formal contract.<sup>33</sup> The only prohibition is they must not solely constitute evidence of subjective intent. This paper takes the view a contract is a self-imposed voluntary obligation. A contract may be a formal, comprehensive written document, but also could be a more elusive agreement between parties.<sup>34</sup> There may not be one single moment when contractual responsibility comes into being and mutual intentions crystallise.<sup>35</sup> Rather the whole transaction should be examined in light of intention. The orthodox rules of offer and acceptance may be foregone for a more global approach to ascertaining agreement.<sup>36</sup>

The roots of the exclusionary rule can be traced to Lord Blackburn where he proclaimed “a court must look to the formal deed alone”.<sup>37</sup> He considered the purpose of a formal contract was to put an end to the disputes which would inevitably arise if one relied on the verbal negotiations of the parties. A century later Lord Wilberforce affirmed previous negotiations

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<sup>33</sup> For example, prior negotiations could include previous drafts, correspondence, letters, or file notes.

<sup>34</sup> Catherine Mitchell *Interpretation of Contracts, Current Controversies in Law* (Routledge-Cavendish, UK, 2007) at 12-14. Most modern scholars with an appreciation of social sciences regard agreement in this manner. They consider that to take the written agreement as the ultimate expression of the will of the parties may lead to variance with the realities of the agreement. If you reject the plain meaning rule in favor of a contextual approach, you are essentially rejecting the idea that contracts are just formal texts.

<sup>35</sup> Gerard McMeel “Prior Negotiations and Subsequent Conduct – The Next Step Forward for Contractual Interpretation” (2003) 119 LQR 272.

<sup>36</sup> *Boulder Consolidated Ltd v Tangere* [1980] 1 NZLR 560 (CA). See discussion of the approach in Burrows, Finn & Todd, above n12, at 35-36. Paterson, Robertson & Duke, *Principles of Contract Law* (3rd ed, Lawbook Co, Sydney, 2009) at 28-29 also recognise that the traditional doctrines of offer and acceptance may be unsuited to the some transactions as this classical formation is based on the idea of an identifiable moment of formation.

<sup>37</sup> *Inglis (A&J) v Buttery* (1878) 3 App Cas 552. *Blakely & Anderson v De Lambert* [1959] NZLR 356 adopted these principles in New Zealand.

were not admissible.<sup>38</sup> More recent affirmation can be found in *ICS*. Lord Hoffmann determined the matrix of fact included “absolutely anything which would have affected the way in which the language of the document would have been understood by the reasonable man”.<sup>39</sup> However, principle three excludes previous negotiations from the available matrix of fact.<sup>40</sup> The rule has been affirmed in New Zealand on countless occasions.<sup>41</sup>

### **1.3 Rationale of the Rule**

This section explores the rationale underlying the exclusionary rule, manifested in the pragmatic objections to abandoning the rule. Lord Hoffmann considered the exclusion was justified by “reasons of practical policy”.<sup>42</sup> He reasserted this in *Chartbrook* whereby he proclaimed previous negotiations were capable of raising practical questions different from those created by other forms of background.<sup>43</sup>

#### *i) Unhelpful*

Lord Wilberforce considered the reason for excluding evidence of previous negotiations was not one of technicality or convenience but simply because they are “unhelpful”.<sup>44</sup> The inherent nature of negotiations mean the parties’ positions are changing and divergent until

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<sup>38</sup> *Prenn*, above n21, at 1384-1385. The New Zealand Court of Appeal approved this decision in *Buckley & Young Ltd v Commissioner of IRD* [1978] 2 NZLR 485. The Court found there were sound reasons for refusing to admit evidence of negotiations.

<sup>39</sup> *Investors Compensation Scheme*, above n2, at 912. Following criticism of the breadth of this principle Lord Hoffmann clarified in *Bank of Credit and Commerce International SA*, above n22, at [39] that “absolutely anything” meant there is no conceptual limit as to what can be regarded as background, but this must be relevant material. McKendrick “Interpretation of Contracts and the Admissibility of Prior Negotiations” (2005) 17 SAclJ 248 at 252 considers this does little to reduce the width of the principle.

<sup>40</sup> *Investors Compensation Scheme*, above n2, at 913. See the text of the principle in the Introduction.

<sup>41</sup> See for example *Moreton & Craig v Montrose Ltd* ([1986] 2 NZLR 496; *Hawkers v Vickers* [1991] 1 NZLR 399; *Air New Zealand Ltd v Nippon Credit Bank Ltd* [1997] 1 NZLR 218 (CA); *Globe Holdings Ltd v Floratos* [1998] 3 NZLR 331.

<sup>42</sup> *Investors Compensation Scheme*, above n2, at 913.

<sup>43</sup> *Chartbrook*, above n3, at [38].

<sup>44</sup> *Prenn*, above n21, at 1384.

consensus is reached, which can often be at the very last minute. It is not easily discernible which statements merely reflect the parties' aspirations, or which exemplify provisional consensus and possibly what the contract 'actually' means.<sup>45</sup> Throughout the negotiations each party varies their position, making concessions, ultimately trying to gain the balance of the advantage in the final deal.<sup>46</sup> Evidence of what has gone before will therefore be of little value.<sup>47</sup> Parties will often adopt words that are unlikely to need examining, but which each hoped, in the event of dispute, would be interpreted in their favor.<sup>48</sup> If previous negotiations are admissible it is argued parties will be tempted to take advantage of circumstances that subsequently occur.<sup>49</sup> The purpose of the formal contract is to therefore end disputes inevitably arising if the matter were left to negotiations.<sup>50</sup>

ii) *Increased Time and Expense*

Time and expense is a practical objection operating at different levels of the contractual process. Firstly, it is contended if previous negotiations are admissible, fundamental change will result in the negotiating process. More time will need to be spent articulating positions and in pronouncing intentions. It is argued there is the risk of experienced negotiating parties making self-serving statements in the hope of influencing interpretation if dispute does arise.<sup>51</sup> More extensive file notes, and even minutes of negotiation meetings, may need to be

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<sup>45</sup> *Chartbrook*, above n3, at [38]; Mitchell, *Interpretation of Disputes*, above n34, at 82.

<sup>46</sup> Mitchell, *ibid.*

<sup>47</sup> Calnan, above n14, at 18; Staughton, above n27, at 306; Bingham, above n27, at 389 considers any detailed consideration of the exchanges will lead to excessive emphasis on what the parties wanted to agree and too little on their actual agreement.

<sup>48</sup> Hoffmann "The Intolerable Wrestle with Words and Meanings," above n10, at 668.

<sup>49</sup> Collins, above n6, at 195 considers the possibility of parties' asserting a different intention to that formed to take advantage of the dispute arisen; Catherine Mitchell "Contract Interpretation: Pragmatism, Principle and the Prior Negotiations Rule" (2010) 26 *Journal of Contract Law* 134 at 147 recognises there is a danger in parties deliberately generating interpretation disputes on the basis of what was said in negotiations.

<sup>50</sup> *A&J Inglis*, above n37, at 577.

<sup>51</sup> Lord Hoffmann in *Chartbrook*, above n 3 at [38]; *Chartbrook Ltd v Persimmon Homes Ltd* [2008] EWCA Civ 183 at [111] per Collins LJ; McKendrick "Interpretation of Contracts and the Admissibility of Prior Negotiations" above n39, at 264.

taken. These recordings, however, are unlikely to solve the inherent problem, as each party's notes will be embedded with their own interpretation of the negotiations. It is also suggested fundamental change will need to result in the drafting of documents, whereby aims, expectations, intentions, objections and understandings will need to be included.<sup>52</sup>

Time and expense is also claimed to affect the ability of a practitioner to advise on the meaning of a document. They will be required to regard all the pre-contractual material, which will often be voluminous.<sup>53</sup> This will result in more cost and time to the client and results in general inefficiency and inconvenience for the client and lawyer in practice.

Finally, the objection applies to litigation. Time, effort, and examination in the discovery process will increase with the growth in extrinsic evidence.<sup>54</sup> Both judges and practitioners will need to deal with large amounts of evidence, ultimately extending the length of hearing.<sup>55</sup> The court will no longer be able to construe a document simply by reading it against a background of undisputed facts.<sup>56</sup> For many practitioners who regarded *ICS* with hostility, this is a further burden which is unwelcomed.<sup>57</sup> It is also argued the number of interpretation disputes will increase with parties' having more scope for challenge. This in effect wastes time and expense on attempts to relieve parties from clearly contracted obligations and diverts useful economic activity into pointless litigation.<sup>58</sup>

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<sup>52</sup> This is the 'VOWEL' approach to drafting suggested by Dunedin practitioner Stuart Walker, Partner, Anderson Lloyd.

<sup>53</sup> Berg, above n30, at 360.

<sup>54</sup> J Spigelman, "From Text to Context: Contemporary Contractual Interpretation" (2007) 81 ALJ 322 at 344; Staughton, above n27 at 307.

<sup>55</sup> See Calnan, above n14, at 18, who is not optimistic that the courts can regulate themselves in respects of this increased evidence.

<sup>56</sup> Hoffmann, above n10, at 668. Further oral evidence and cross-examination will be required.

<sup>57</sup> David McLauchlan "Contract Interpretation: What is it About?" (2009) 31 Sydney Law Review 5 at 63-37 observes counsel in New Zealand appear to agree there needs to be an overhaul of civil procedure, regarding the discovery process and case management. Any proposals to extend the range of materials admissible are therefore not welcomed.

<sup>58</sup> Holborow, above n14, at 274.

iii) *Third Parties*

The effect on third parties is a significant practical objection to the admission of previous negotiations. In the contemporary commercial world third parties are often involved in transactions.<sup>59</sup> Interpretation, however, focuses on the parties to the contract, scarcely regarding third party interests. Critics claim the fiction that contracts are addressed to the original parties should be abandoned as in practice contracts are drafted so those with little knowledge of the background can use them.<sup>60</sup> Third parties take their position on the face of the contract and are not privy to negotiations or context, thus it is argued there is no logic in insisting interpretation should be in light of all the background. This is deemed to be unfair and furthermore increases the risk and costs for these parties if the clear words of the contract can be overridden with evidence of negotiations.<sup>61</sup> The exclusionary rule is said to protect their interests.<sup>62</sup>

iv) *Uncertainty*

Certainty is a desirable goal for commercial transactions and parties' should be able to enforce their promises with a high degree of predictability.<sup>63</sup> It is anticipated pre-contractual material will increase the scope for disagreement over the meaning of a contract.<sup>64</sup> Consequently, the outcome of litigation will be harder to predict, resulting in inability to advise at the preliminary stage. It will no longer be sufficient to provide the lawyer with the contract and summary of the commercial background.<sup>65</sup> More detailed correspondence will be

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<sup>59</sup> Spigelman, above n54, at 335. Third parties could include those assigned or acquiring the benefit of the contract, future parties and their advisors once primary advisors or management have moved on, financiers, guarantors and liquidators.

<sup>60</sup> Berg, above n30, at 359.

<sup>61</sup> *National Bank of Sharjah*, above n27; Holborow, above n14, at 274.

<sup>62</sup> See *Chartbrook Ltd v Persimmon Homes Ltd* [2007] 1 All ER (Comm) 1083 per Briggs J at [35-37].

<sup>63</sup> *Chartbrook*, above n3, at [35]; Calnan, above n14, at 18; Bingham, above n27, at 388; Spigelman, above n54, at 323.

<sup>64</sup> *Chartbrook*, above n3, at [37]. Lord Hoffmann considers the more one allows conventional meaning to be displaced by inferences drawn from the background, the less predictable the outcome is likely to be.

<sup>65</sup> Berg, above n30, at 358.



required. Furthermore, lawyers will need to qualify their advice with a caveat that unknown facts could supersede their advice.<sup>66</sup> Any uncertainty created at this stage is undesirable considering in practice the majority of cases will not reach court.<sup>67</sup> Such uncertainty and indecisiveness relates back to inefficiency objections.

v) *Objective Theory*

This is a theoretical objection rather than a practical consideration. It is maintained previous negotiations undermine the objective theory as they do not constitute objective facts as other surrounding circumstances do.<sup>68</sup> Negotiations are considered to be “drenched in subjectivity”,<sup>69</sup> and it is not easy to distinguish between subjective intent and objective evidence within negotiations.<sup>70</sup> Civil law, in contrast to the English theory of objectivity, regards the parties’ intentions as a subjective fact and therefore relevant to their subjective theory of contract.<sup>71</sup> Commentators warn against simply transposing rules based on one philosophy of contract onto another, as the practical consequences differ.<sup>72</sup> Previous negotiations, as a revelation of intention, are admissible for the purpose of interpretation in civil law. The common law, however, requires intent to be presumed as a matter of law, in regard to the reasonable observer, rather than an inquiry into the parties’ actual intent.

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<sup>66</sup> Holborow, above n14, at 274.

<sup>67</sup> Calnan, above n14, at 19.

<sup>68</sup> *Chartbrook*, above n3, at [38]; Bingham, above n27, at 389.

<sup>69</sup> *Chartbrook*, above n3, at [38] per Lord Hoffmann; Cf Cabrelli, above n20, at 14 who regards this as a rather blunt and simplistic approach.

<sup>70</sup> The exclusionary rules for previous negotiations and subjective intent are often declared together and some have acknowledged difficulty in discerning whether these are two different restrictions or more closely related. See Mitchell, *Interpretation of Contracts*, above n34, at 78; McMeel, ‘Prior Negotiations and Subsequent Conduct’ above n35 at 274. Cf *Chartbrook*, above n62, at [24] per Briggs J who considers although plainly linked, they are distinct.

<sup>71</sup> Catherine Valcke “On Comparing French and English Contract Law – Insights From Social Contract Theory” (2008) available at <http://ssrn.com/abstract=1328923>; Stefan Vogenour “Interpretation of Contracts: Concluding Observations” in *Contract Terms*, at 129-130.

<sup>72</sup> *Chartbrook*, above n3, at [39]. See Vogenour, above n71, at 135.

### **1.4 Boundaries of the Rule**

The rule is not one of absolute exclusion and evidence of negotiations may be admissible for other purposes. Lord Hoffmann admits the boundaries of the exclusionary rule are “in some respects unclear”.<sup>73</sup> This section will consider established exceptions to the rule.<sup>74</sup> The exception to establish objective background facts and the *Karen Oltmann* decision fall within interpretation, whereas rectification and estoppel by convention are indirect exceptions to the rule operating outside interpretation. Rectification and estoppel are considered to be “legitimate safety devices” which will in most cases prevent the exclusionary rule from causing injustice.<sup>75</sup>

#### *i) Objective Background Facts*

It is considered the rationale underlying the rule has no application where evidence of previous negotiations is admitted, not to provide a gloss on the terms, but rather to establish the parties’ knowledge of the circumstances with reference to which they used the words in the contract.<sup>76</sup> The inquiry is not into intention but into meaning as a guide to intention.<sup>77</sup> In order to ascertain the meaning of the language the court must be aware of the objective background circumstances. The circumstances include the commercial purpose of the contract, knowledge of the genesis of the transaction, the context and market in which the parties were operating.<sup>78</sup> These surrounding facts must be objectively ascertainable; known

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<sup>73</sup> *Investors Compensation Scheme*, above n2, at 913. He noted that it was not the occasion to explore them.

<sup>74</sup> There are also more particular exceptions to the rule but these do not relate to interpretation in general and thus will not be addressed in this paper. For example, negotiations are admissible in an action for misrepresentation; in order to determine whether a contract exists; or, in Australia, following *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, per Mason J, they are admissible to prove a refusal to include deleted terms.

<sup>75</sup> *Chartbrook*, above n3, at [47].

<sup>76</sup> *Bank of Scotland v Dunedin Property Investment Co Ltd* (1998) SC 657 at 665; *Prenn*, above n21, at 1384-1385.

<sup>77</sup> *Blakely*, above n37, at 367; *Eastmond v Bowis* [1962] NZLR 954 at 959.

<sup>78</sup> *Reardon Smith*, above n21, at 574.

by both parties, and must not constitute evidence of intention.<sup>79</sup> This exception also subsumes the subject-matter exception, whereby pre-contractual material is admissible to identify the subject-matter of the contract.<sup>80</sup>

## *ii) Rectification*

Rectification is an equitable remedy<sup>81</sup> applying where the terms recorded in a parties' agreement do not accurately represent the parties' agreed terms. The court can alter the document to correctly reflect and give effect to the parties' intentions.<sup>82</sup> The mistake can be one of fact, legal meaning or to the effect of terms, as long as it is one in the recording of the agreement, not during the negotiations.<sup>83</sup> Rectification can operate where the mistake is common or unilateral.<sup>84</sup> Rectification for common mistake requires a continuing common intention, outwardly manifested and evidenced with clear and convincing proof.<sup>85</sup> There must be a mistake in the recording of the agreement to the extent the parties' common intent is not adequately recorded. The requirements for unilateral mistake vary significantly as it operates where one party makes a mistake and the other party knows of this mistake, but does not communicate it. The mistake need not be in the recording of the agreement but could be during the negotiations. The action rests on the unconscionability of the non-mistaken party

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<sup>79</sup> *Eastmond*, above n77, 959-960.

<sup>80</sup> *Bank of NZ v Simpson* [1900] AC 182 (PC) at 187-189. The decision cites *MacDonald v Longbottom* (1859) 1 E&E 977 where evidence was admissible to prove that "your wool" meant not only wool produced by the plaintiff but also that produced on a neighboring farm; *Codelfa*, above n74, at 352.

<sup>81</sup> Preserved by the Contractual Mistakes Act 1977, s5(2)(b). The Contractual Mistakes Act 1977 does not apply to mistakes of interpretation, s6(2)(a).

<sup>82</sup> Burrows, Finn and Todd, above n12, at 291. Chetwin, Graw & Tiong, *Introduction to the Law of Contract in New Zealand* (3<sup>rd</sup> ed, Thomson Brookers, Wellington, 2006) at 246.

<sup>83</sup> Andrew Burrows "Construction and Rectification" in *Contract Terms*, above n4, at 85.

<sup>84</sup> There is some controversy regarding the availability of unilateral mistake in New Zealand after the Court of Appeal in *Tri-Star Customs & Forwarding Ltd v Denning* [1999] 1 NZLR 33 rejected a claim for unilateral mistake. The Court held unilateral mistake is inconsistent with the Contractual Mistakes Act 1977 as it renders s6(1)(a)(i) otiose. This reasoning however, has been questioned. See Chetwin, Graw & Tiong above n82, at 250-252; Burrows, Finn & Todd, above n12, at 294.

<sup>85</sup> *Westland Savings Bank Ltd v Hancock* [1987] 2 NZLR 21 at 9.

in allowing the mistaken party to insist the contract be upheld on the basis of their understanding.<sup>86</sup>

The inquiry differs from interpretation where the court construes what the document means. Under rectification, the meaning of the document is already ascertained but the parties' are permitted to depart from that meaning where it defeats actual intention.<sup>87</sup> Evidence of previous negotiations, as a revelation of intention, is logically available to prove the assertion that the recorded agreement does not reflect the parties' intention.<sup>88</sup> Rectification does not offend the objective theory as the contract is amended either in reference to another text, or common intention objectively ascertained.<sup>89</sup> However, it must be noted there is some overlap between interpretation and mistake. A mistake can be corrected through interpretation if it is clear on its face and clear what correction ought to be made.<sup>90</sup> The background can be considered for this purpose, but the exclusionary rule precludes previous negotiations.

### iii) *Estoppel by Convention*

Estoppel by convention is a form of common law estoppel<sup>91</sup> founded upon mutual assent to a particular state of affairs, the truth of which has been assumed by convention as the basis of

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<sup>86</sup> Burrows, above n83, at 88.

<sup>87</sup> Calnan, above n14, at 19.

<sup>88</sup> *Attorney General v Dreux Holdings Ltd* (1996) 7 TCLR 617 (CA); See McKendrick "Interpretation of Contracts and the Admissibility of Previous Negotiations" above n39, at 269.

<sup>89</sup> Hoffmann, above n10, at 667; *Chartbrook*, above n3, at [60-63]. The inquiry is not into inner minds but outward facts. Cf with Robert Stevens, above n17, at 101 who claims objectivity is qualified for mistake.

<sup>90</sup> *East v Pantiles (Plant Hire)* (1981) 263 EG 61 per Brightman LJ. In New Zealand see *Rattrays Wholesale Ltd v Meredyth-Young & A'Court Ltd* [1997] 2 NZLR 363 (HC) per Tipping J. This was recently confirmed in *Chartbrook*, above n3 at [25] where Lord Hoffmann considered there was no limit to the amount of red ink the court could use. Mitchell "Contract Interpretation: Pragmatism, Principle and the Prior Negotiations Rule" above n49, at 153 remarks it is unfortunate this is termed "correction of mistake" through interpretation as it implies the court has determined the parties could not have meant what they said. It is better to say the court recognised the terms were doubtful and could have been more clearly expressed in order to achieve their intended purposes.

<sup>91</sup> The common law estoppel could be estoppel by representation of a fact, promissory estoppel, or proprietary estoppel.

the parties' relationship.<sup>92</sup> Where the parties have acted upon the agreed assumption it would be unfair for one to resile from that assumption, thus the other is entitled to relief. The New Zealand Court of Appeal summarised the requirements in *National Westminster Finance*.<sup>93</sup> Tipping J determined the parties must proceed on the basis of an underlying assumption of fact or law. Each must, to the knowledge of the other, have expressly or implicitly<sup>94</sup> accepted the assumption as true for the purpose of the transaction. Each party is entitled to act in reliance upon the assumption. If one party would suffer detriment from the other being allowed to resile from the assumption, then it would be unconscionable to allow the other to do so and they will be estopped from denying the assertion.

Evidence of previous negotiations is admissible under estoppel as the inquiry goes to the correctness of underlying facts, rather than to the construction of terms.<sup>95</sup> The evidence is not used to determine meaning, but rather to establish it would be inconsistent to rely on the terms recorded. Reliance on previous negotiations is justified to demonstrate the parties' mutual assumption as to the interpretation to be given.<sup>96</sup> Estoppel does not offend against the objective theory as the contract is construed objectively and rather a party is prevented from enforcing certain rights on the grounds his previous words or conduct make it inequitable to do so.<sup>97</sup>

iv) *Private Dictionaries and Karen Oltmann*

The private dictionary principle prescribes parties can agree to an unconventional or special meaning, a meaning which words cannot linguistically bear, for the purpose of their

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<sup>92</sup> Feltham, Flochberg, Leech *Spencer Bower: Estoppel by Representation*, 4ed (Reed Elsevier UK Ltd, London, 2004) at 7, 180.

<sup>93</sup> *National Westminster Finance Ltd v The National Bank of NZ Ltd*, CA 159/92, 30 March 1993.

<sup>94</sup> The estoppel may operate by an express term of the contract, where the parties have expressly agreed they will take certain facts to be true, or more commonly parties may be precluded on the basis of a common assumption adopted as the factual basis of the contract. See Paterson, Robertson & Duke, above n36, at 170.

<sup>95</sup> *Air New Zealand Ltd*, above n41 at 234.

<sup>96</sup> Burrows, above n83, at 88.

<sup>97</sup> Hoffmann, above n10, at 667.

contract.<sup>98</sup> For example, they may agree that “buy” really means “sell”.<sup>99</sup> Evidence may be adduced to support the argument that the words of the contract should bear that intended unconventional meaning in accordance with the parties’ private code.<sup>100</sup>

An additional exception to the exclusionary rule may be said to arise from the decision of Kerr J in *Karen Oltmann*.<sup>101</sup> Kerr J admitted evidence of previous negotiations despite the ban in *Prenn*. The principle derived from the case is as follows:<sup>102</sup>

If a contract contains words which, in their context, are fairly capable of bearing more than one meaning, and if it is alleged that the parties in effect negotiated on an agreed basis that the words bore only one of two possible meanings, then it is permissible for the Court to examine extrinsic evidence relied upon to see whether the parties have in fact used the words in one sense only, so that they have in effect given their own dictionary meaning to the words as a result of their common intention.

The state of this exception is somewhat unclear as in effect the decision undermines the rationale of the rule.<sup>103</sup> There is widespread debate about whether the decision evidences the private dictionary principle. Some claim it is an illegitimate exception.<sup>104</sup> Others accept the

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<sup>98</sup> This is said to be akin to the principle by which a linguistic usage in a trade may be proved. See *Chartbrook*, above n3, at [45].

<sup>99</sup> For some reason the parties may wish to keep their dealings secret. See McLauchlan ‘Contract Interpretation: What is it About?’ above n57, at 18-20.

<sup>100</sup> *Chartbrook*, above n3, at [45].

<sup>101</sup> *Partenreederei M.S Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd’s Rep. 708. The facts involved an agreement whereby the charterer was given “the option to redeliver the vessel after 12 months trading, subject to giving three months notice”. There was dispute over “after” and whether this meant “on the expiry of 12 months” or “anytime after 12 months trading”.

<sup>102</sup> *Ibid* at 712.

<sup>103</sup> Steyn “The Intractable Problem of the Interpretation of Legal Texts” above n27, at 10; Steyn “Written Contracts: To What Extent May Evidence Control Language?” CLP 23 at 29; McLauchlan, “Contract Interpretation: What is it About?” above n57, at 16.

<sup>104</sup> See Lord Hoffmann in *Chartbrook*, above n3, at [45-46]. He considered the principle does not evidence the private dictionary meaning as there was no unconventional usage of “after”. See also Berg, above n30, at 355, 360 who considers it is not a true exception to the exclusionary rule, but instead evidence of a collateral or side

validity of the principle but face difficulty in trying to analyse the decision in more orthodox terms. The New Zealand Court of Appeal in *Air New Zealand Ltd* endorsed the decision noting it had “the ring of estoppel by convention”.<sup>105</sup> Other commentators have suggested the principle should be re-evaluated as rectification.<sup>106</sup> This is despite Kerr J’s view that rectification is not available where the principle applied as the choice of words would not result from any mistake, but rather would reflect the meaning both parties intended.<sup>107</sup> McLauchlan on the other hand considers the principle to be in accordance with commonsense.<sup>108</sup> He further contends the exception should not be confined to situations of ambiguity, nor should it be limited to actual common intent but also where one party has reasonably led the other to believe that they had accepted the meaning.<sup>109</sup>

### **1.5. Conclusion**

This part has aimed to introduce the governing principles of contract interpretation, highlighting the shift to a contextual approach. The exclusionary rule established long before the shift in emphasis, has survived against the tide due to the policy considerations underpinning the rationale of the rule. However, the rule is not one of absolute exclusion, and

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agreement to meaning. Cf McLauchlan, “Contract Interpretation: What is it About?” above n57, at 17 who has attacked this reasoning as artificial.

<sup>105</sup> *Air New Zealand Ltd*, above n41, at 223-224. While prepared to accept the decision as good law, the Court found the evidence was equivocal and did not establish express assent. See also McKendrick “Interpretation of Contracts and the Admissibility of Pre-Contractual Negotiations” above n39, at 271 who notes the principle “appears to resemble estoppel by convention”.

<sup>106</sup> See *Chartbrook*, above n62, at [41-42] per Lord Briggs; *Burrows*, above n83, at 95; and *Lewison*, above n12, at 76.

<sup>107</sup> *Karen Oltmann*, above n101, at 712. See also Lord Nicholls “My Kingdom for a Horse: The Meaning of Words” (2005) 121 LQR 578 at 586, and McLauchlan, “Contract Interpretation: What is it about?” above n57, at 21-23 who considers there was no mistake in intention.

<sup>108</sup> McLauchlan “Common Assumptions and Contract Interpretation” (1997) 113 LQR 237 at 240-241. On his view it would be wrong for pre-contractual negotiations to be inadmissible when they evidence actual common intention of the parties.

<sup>109</sup> *Ibid*, at 243-245; McKendrick ‘Interpretation of Contracts & the Admissibility of Previous Negotiations’ above n39, at 271 also criticises the principle on these grounds and considers the decision should represent a wide principle whereby negotiations are admissible whenever such evidence proves to be reliable and helpful.

exceptions have developed throughout. The next part considers the *Vector* decision and its application of interpretation principles and the exclusionary rule.



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## PART TWO: THE *VECTOR* DECISION

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This part is divided into three sections. Section one outlines the background to the *Vector* proceedings. Section two analyses the five Supreme Court judgments in relation to substantive themes drawn from the decision. Finally, this part will consider the status of the law post-*Vector* and whether previous negotiations are now admissible, in light of recent lower court decisions.

### **2.1 Background to *Vector***

In 1995 Vector Gas and Bay of Plenty Energy ('BoPE') entered an agreement regarding the supply of gas to BoPE for an eleven-year period. Vector terminated the agreement early in 2004. BoPE subsequently challenged the validity of this termination. The parties began negotiating the possibility of a replacement agreement. Vector proposed to continue to supply gas at \$6.50 per GJ, exclusive of transmission costs.<sup>110</sup> BoPE subsequently rejected this offer, due to the "severity in price discrepancy", and proposed they negotiate an interim agreement until the validity of the agreement was determined.<sup>111</sup> This was to act as a substitute for BoPE obtaining an interim injunction with an undertaking to pay damages in the event the proceedings were unsuccessful. In the proposal BoPE summarised the parties' positions noting Vector had gas to supply at \$6.50 per GJ. Vector replied by offering to continue to supply gas on the terms of the 1995 agreement, provided that BoPE undertook to pay "the difference between the price in the 1995 Agreement and \$6.50 per GJ" in the event that BoPE's proceedings were unsuccessful.<sup>112</sup> BoPE subsequently accepted this proposal on 15<sup>th</sup> October 2004. Unfortunately, neither party specified whether price was inclusive or exclusive of transmission costs. Five days later Vector sought an amended undertaking for a price

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<sup>110</sup> *Bay of Plenty Electricity Ltd v Vector Gas Ltd* HC Wellington CIV-2004-485-2287, 3 August 2007 at [116]. This occurred on September 24<sup>th</sup> 2004.

<sup>111</sup> *Ibid.* This letter was dated October 5<sup>th</sup> 2004.

<sup>112</sup> *Ibid.* October 8<sup>th</sup> 2004.

exclusive of costs.<sup>113</sup> BoPE refused to give this, so Vector counterclaimed for an order in the High Court.

In order to fully understand the dispute the following factors must be known. Price under the 1995 agreement was inclusive of transmission costs. Market price at the time of the interim agreement was \$6.68 per GJ, exclusive of transmission costs. If \$6.50 were inclusive of costs, Vector would be losing approximately \$3 million. Furthermore, it was accepted by both that if Vector had elected to rely on BoPE's undertaking upon applying for an interim injunction then it would have expected to recover the full price of gas at market price, inclusive of transmission costs.<sup>114</sup>

Vector argued references to '\$6.50 per GJ' in letters subsequent from their first proposal became shorthand reference for price only.<sup>115</sup> Counsel argued it was necessary to consider the relevant factual matrix, being the context of the proceedings, the market price of gas, and the prior correspondence. It submitted the correspondence was admissible under the objective background fact exception and the private dictionary principle.<sup>116</sup> The submissions ultimately asserted that BoPE's interpretation flouted commercial commonsense.<sup>117</sup> BoPE argued the appropriate place to start in determination of the dispute was the agreement reached on 15<sup>th</sup> October.<sup>118</sup> However, if it were open to the Court to consider the negotiations it maintained there was no consensus that price was to be exclusive of transmission costs.<sup>119</sup> Rather the basis of pricing changed with their rejection of the replacement agreement and proposal of

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<sup>113</sup> *Bay of Plenty Electricity Ltd*, above n110, at [117].

<sup>114</sup> As discussed in *Vector Gas Limited v Bay of Plenty Energy Ltd* [2010] NZSC 5 at [110] per Wilson J, under Rule 7.54, High Court Rules BoPE would have had to sign an undertaking that they would compensate "for any damage sustained through the injunction".

<sup>115</sup> Supreme Court Transcript, SC 65/2008, 23 June 2009 at 9. Counsel for Vector submitted '\$6.50 per GJ' was shorthand reference for '\$6.50 per GJ, plus transmission at cost'.

<sup>116</sup> Cf with BoPE who submitted that any consideration of the earlier correspondence was inevitably a consideration of subjective intentions. See Supreme Court Transcript, at 64.

<sup>117</sup> *Ibid*, at 45-47.

<sup>118</sup> *Ibid*, at 65-67.

<sup>119</sup> *Ibid*, at 62.

the interim agreement.<sup>120</sup> They further submitted their interpretation did not flout business commonsense as the agreement worked perfectly well; rather Vector had made a bad bargain.<sup>121</sup>

BoPE was subsequently unsuccessful at trial. The High Court found in favour of Vector on both the issue of termination, and interpretation of the interim agreement. Harrison J thought it was unlikely Vector would agree to an arrangement whereby BoPE was in a better position than if it had given an undertaking in court.<sup>122</sup> He was satisfied a clear distinction had been drawn from the outset and at all relevant times the parties were referring to a price exclusive of costs. In subsequent references BoPE did not challenge or break down the figure to indicate otherwise.<sup>123</sup>

The Court of Appeal differed and found in favour of BoPE. They considered Vector's proposal on 8th October, to continue to supply gas in the interim, was a new and distinct offer and thus there was no need to look earlier in the chain.<sup>124</sup> The Court concluded it was plain the letter was inclusive of cost.<sup>125</sup> They considered that even if prior negotiations were relevant there was difficulty in Vector's shorthand reference argument due a clear rejection from BoPE in response to the replacement agreement.<sup>126</sup> They observed that, at most, a mistake seemed to have occurred but rectification had not been pleaded.<sup>127</sup>

The Supreme Court unanimously overturned the Court of Appeal's decision and came to the conclusion that price was exclusive of transmission costs. This, however, is where any

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<sup>120</sup> This involved an assertion that a reference to \$6.50 per GJ on the first page of the letter was inclusive of costs, but a subsequent reference to \$6.50 per GJ was exclusive of costs. See Supreme Court Transcript, above n115, at 73-75.

<sup>121</sup> Ibid, at 98-99.

<sup>122</sup> *Bay of Plenty Energy Limited*, above n110, at [128-131]. He was persuaded both parties were aware of the market price, which was to be determined in isolation as transmission costs varied with location.

<sup>123</sup> Ibid, at [130].

<sup>124</sup> *Bay of Plenty Electricity Ltd v Vector Gas Ltd* [2008] NZCA 338 at [91]

<sup>125</sup> Ibid, at [92].

<sup>126</sup> Ibid, at [96].

<sup>127</sup> Ibid, at [97].

overall consensus in the judgment ends. Each member of the bench delivered a separate judgment that differs in approach to contract interpretation and to the admissibility of prior negotiations. In brief, Blanchard J determined the issue through interpretation on a ‘commercially sensible’ basis, without the use of previous negotiations. He then admitted previous negotiations under the subject-matter exception to reinforce his interpretation. Tipping J decided the outcome as an issue of interpretation, which included use of the relevant previous negotiations. In the alternative he characterised the decision as estoppel by convention. McGrath J upheld the ban on previous negotiations and decided the case based on estoppel. Wilson J determined previous negotiations are admissible in the available matrix of fact where there is ambiguity; or where the decision flouts commercial commonsense; or where estoppel applies. He decided the case on the basis of commercial commonsense, or alternatively estoppel. Gault J, in the shortest judgment of the bench, agreed with the reasons of Blanchard J and simply determined the dispute with reference to the correspondence, and without reference to contract interpretation principles.

## **2.2 Analysis of Vector**

### **A. Principles of Interpretation**

#### *i) Objective Theory and the Role of Intent*

Each judgment in *Vector* took care to ensure the objective approach was maintained. Whether previous negotiations are admissible or not, each Judge was staunch in asserting that subjective intent<sup>128</sup> is irrelevant evidence in contract interpretation.<sup>129</sup> It does, however, become apparent from the judgment that there are issues as to the precise meaning of objectivity and the consequences of applying an objective test.<sup>130</sup> There is wide consensus as

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<sup>128</sup> The inner or uncommunicated intent of the parties. See discussion in Part 1 at 1.1.

<sup>129</sup> See Blanchard J at [14], Tipping J at [28], and McGrath J at [76]. However, Wilson J comments at [129] “whether the test is objective or subjective, assistance can be derived from evidence of previous negotiations”. It is likely the reference to ‘subjective’ is not a suggestion that subjective intent is relevant to our jurisprudence, but rather a reference to the subjective approach taken in civil law jurisdictions to which his Honour was comparing the common law.

<sup>130</sup> Jeremy Johnson “Contract: Missed Opportunity?” [2010] NZLJ 50 at 52-53; Thomas J in *v Wholesale Distributors Ltd v Gibbons Holdings Ltd* [2008] 1 NZLR 277 (SC) at [90] recognises often these distinctions are

to what objective contractual intention is not.<sup>131</sup> It is not concealed intention in inner minds, which this paper terms subjective intent. There is, however, disagreement as to whether outward objective manifestations of actual intent constitute subjective intent.<sup>132</sup> On a strict detached objective approach the interpreter is primarily concerned with the objective meaning of the words recorded in the final agreement. The court presumes intention by ascertaining the meaning that the document would convey to a reasonable person with all the background knowledge of the parties.<sup>133</sup> Actual intent, even where objectively ascertainable, is irrelevant. Previous negotiations as a revelation of actual intent therefore constitute inadmissible ‘subjective’ intent.<sup>134</sup> A more expansive theory of objectivity focuses on objectively ascertaining the parties’ intention. The inquiry is into what a reasonable and informed person *in the position of the parties* would consider the parties intended the words of their contract to mean.<sup>135</sup> Actual mutual intent can be accommodated under this objective approach where it is outwardly expressed, and does not constitute subjective inner intention. It follows from this that objective evidence of mutual intent within the negotiations is admissible.

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not appreciated by those discussing the objective theory. See McMeel ‘The Rise of Commercial Construction in Contract Law’ above n23, at 386 and his discussion of Lord Steyn’s differing articulations of the objective approach in his judgments.

<sup>131</sup> Valcke, above n71, at 10-11.

<sup>132</sup> This paper takes the stance actual mutual intent can be accommodated if it is objectively ascertainable. For example, where actual intent is manifested outwardly in a draft agreement, or correspondence between the parties. See later discussion in 3.1

<sup>133</sup> *Investors Compensation Scheme*, above n2, at 912-913. Reaffirmed in *Chartbrook*, above n3, and quoted by *Vector*, above n1, at [61] per McGrath J. See McLauchlan ‘New Law of Contract Interpretation’ above n26, at 165 who provides a discussion on the *ICS* decision as representing the strict theory.

<sup>134</sup> *McLaren*, above n11, at 731; *Stevens*, above n17, at 102; *Collins*, above n6, at 189; *Hoffmann*, above n10, at 661-665.

<sup>135</sup> See McLauchlan “Objectivity in Contract” above n6, at 494. At 492 McLauchlan argues it would be a contradiction if a reasonable person in the position of the parties did not give language the meaning the parties intended.

Tipping J demonstrated an approach that was concerned to establish the parties' actual intent, objectively ascertained.<sup>136</sup> His Honour started with the premise that the ultimate objective in contract interpretation is to establish the meaning the parties intended their words to bear.<sup>137</sup> This is in accordance with the approach taken by the Supreme Court in other decisions whereby the parties' objective intent was found to act as a reliable guide to meaning.<sup>138</sup> His Honour considered previous negotiations were relevant in determining actual intent, and admitting them as evidence would not offend the objective theory as subjective intentions are inadmissible.<sup>139</sup>

Wilson J's judgment is, to some extent, contradictory. His approach reflected strict objectivity by placing prominence on the literal meaning of the words to presume the parties' intent.<sup>140</sup> Despite this, his Honour was content to admit evidence of previous negotiations. The difficulty is compounded where he claimed previous negotiations could be used to "presume the parties' intent".<sup>141</sup> With respect to Wilson J the use of previous negotiations will facilitate discerning the parties' actual intent, as opposed to presumed intent, consistent with the more expansive objective theory. His judgment does, however, recognise that subjective intention constitutes undeclared intent, what was thought instead of said, which must be excluded.<sup>142</sup>

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<sup>136</sup> Note that Blanchard J does not directly address the objective theory in his judgment, but like Tipping J does seem to support the more expansive approach whereby the reasonable person must be in the position of the parties. See *Vector*, above n1, at [7][10].

<sup>137</sup> *Ibid*, at [19]. "the necessary inquiry therefore concerns what a reasonable and properly informed third party would consider the parties intended the words of their contract to mean".

<sup>138</sup> See *Gibbons*, above n130, where the Court held subsequent conduct was a reliable guide to the parties' actual objective intention. See more specifically the comments of Tipping J at [63] and Thomas J at [79] [95] [97]. See also *Totara Investments Limited v Crismac Limited and Ulster Limited* [2010] NZSC 36 at [31] where the Court held contract interpretation of boilerplate provisions must not lead to distortion of the objective intention of the parties.

<sup>139</sup> *Vector*, above n1, at [19][20][27]. Lord Hoffmann himself in *Chartbrook*, above n3, at [33] has recognised admitting previous negotiations may not be inconsistent with the objective theory.

<sup>140</sup> See *Vector*, above n1, at [119] "words should be given their ordinary meaning because parties are presumed to have intended the words to be given that meaning".

<sup>141</sup> *Ibid*, at [129].

<sup>142</sup> *Ibid*, at [122].

McGrath J's judgment represents the stricter objective approach. His Honour claimed 'intention' plays no real part in contract interpretation, and that any move to an approach similar to that advocated by McLauchlan<sup>143</sup> will bring intentions to the forefront of interpretation, placing the objective theory at risk.<sup>144</sup> He claimed the closest *ICS* came to relying on intention was to make clear the court was not required to attribute to the parties an intention they plainly did not have.<sup>145</sup> With the greatest of respect to McGrath J this seems contrary to principle. Surely requiring of the court that it does not arm parties with an intention contrary to what they actually intended is in effect being concerned with actual objective intention. In other words, McGrath J must surely accept that the parties' intention as to the meaning of words is indeed relevant to contractual interpretation. McGrath J seems to have misinterpreted the arguments of McLauchlan and others advocating for the admissibility of previous negotiations as encompassing subjective intent. However, they do not advocate, using the words of McGrath J, that 'inner intention, rather than overt contextual factors'<sup>146</sup> be examined.

*ii) Plain Meaning and Extrinsic Evidence*

*Vector* acknowledged that the parties' language was to be the source of meaning and that the court will not easily displace a plain meaning.<sup>147</sup> Nevertheless, the decision affirmed the shift away from a strict adherence to the plain meaning rule. It was considered permissible, by the majority, to consult extrinsic evidence even where the contract is plain and unambiguous.<sup>148</sup>

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<sup>143</sup> McLauchlan advocates the aim of contract interpretation should be to find the parties' actual mutual intention to the extent it can be objectively discerned. See for example, McLauchlan "Objectivity in Contract" above n6; "Contract Interpretation: What is it About?" above n57; "The New Law of Contract Interpretation" above n26.

<sup>144</sup> *Vector*, above n1, at [76].

<sup>145</sup> *Ibid.*

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.* See Blanchard J at [11]; McGrath J at [61]; Tipping J at [22].

<sup>148</sup> *Ibid.* See Blanchard J at [4]; Tipping J at [22-23]; McGrath J at [66].

In particular, McGrath J traced the common law shift in interpretation, emphasising the need to place contractual language in context to ascertain meaning.<sup>149</sup>

Wilson J was the only judge to consider that ambiguity was required to refer to extrinsic material. In fact his Honour's approach essentially affirmed the plain meaning rule, albeit in a more liberal sense than the orthodox literalist approach.<sup>150</sup> Wilson J provided a somewhat novel approach to interpretation.<sup>151</sup> He prescribed that words should be given their ordinary meaning as parties are presumed to have intended those words.<sup>152</sup> He posed three exceptions to this principle. Extrinsic evidence can be considered when ascertaining meaning where there is ambiguity; the words in their ordinary meaning make no commercial sense; or under estoppel.<sup>153</sup> This approach can be criticised as being inconsistent with the trend away from the plain meaning rule and as having two significant problems. Firstly, it is argued words do not have fixed, settled meanings independent of those who use them, thus context is required to determine meaning.<sup>154</sup> Secondly, as evidenced in *Vector*, judges will often disagree as to whether words are ambiguous or plain.<sup>155</sup>

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<sup>149</sup> *Vector*, above n1, at [57-67].

<sup>150</sup> Wilson J is more liberal in the scope of extrinsic evidence that can be admitted when an ambiguity does occur as he considers previous negotiations are admissible.

<sup>151</sup> Although he claims this is a 'difference more apparent than real'. See his discussion at [127-128] and McLauchlan's criticism in "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" (2010) 16 NZBLQ 229 at 262-263.

<sup>152</sup> *Vector*, above n1, at [119].

<sup>153</sup> Wilson J at [126] also recognises extrinsic evidence is available in an action for rectification, which lies outside interpretation.

<sup>154</sup> See McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 258-259; Hoffmann, above n10, at 658; Steyn "The Intractable Problem of the Interpretation of Legal Texts," above n27, at 6-7; Nicholls, above n107, at 578-579.

<sup>155</sup> See *Yoshimoto*, above n7, at [66]. In *Vector* Blanchard J at [4] and Tipping J at [40] considered "\$6.50 per GJ" to be ambiguous. McGrath J at [56] considered the phrase to be plain, but considered the background to determine if it shed light on meaning. Wilson J at [135] considered the phrase to be plain.



Some commentators<sup>156</sup> maintain *Vector* illustrates a court rewriting a plain and unambiguous meaning as four judgments indicated that the plain words of the contract supported BoPE's interpretation.<sup>157</sup> McGrath J's judgment in particular supports this claim as his Honour agreed with the Court of Appeal that the meaning of agreement was plainly in favor of BoPE's interpretation.<sup>158</sup> Hall argues that this alone should have resolved the interpretation. Instead the Court substituted their view which subsequently risks certainty and confidence in the clear words of the contract being upheld by the court. This argument, however, is essentially challenging the shift away from the plain meaning rule. In response it can be argued plain meaning is not the ultimate inquiry of contract interpretation, except to the extent it evidences the parties' intended meaning. Furthermore, as discussed there will always be disagreement as to what constitutes a plain meaning, thus the use of extrinsic evidence is valid in determining the parties' intended meaning. The judgments in *Vector* considered, on different grounds, that the plain meaning did not in this instance reflect the parties' intended meaning.

### B. Admissibility of Previous Negotiations

The judgments of Tipping, McGrath and Wilson JJ are the only three to explicitly discuss the exclusionary rule and whether it should be upheld. Tipping and Wilson JJ end the ban on previous negotiations, whereas McGrath J holds steadfast. Blanchard J does not use negotiations in his interpretation inquiry and implicitly upholds the rule by recognising it is not one of absolute exclusion, relying on the subject-matter exception.<sup>159</sup> His Honour left the matter open for another day. Gault J agreed with the reasons of Blanchard J. He further stated

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<sup>156</sup> Chris Hall "Vector Gas – An Unwelcome Decision" *NZLawyer* (Issue 138, 11 June 2010) at 23. Hall was General Counsel for BoPE; Lisa Tat "A Timely Reminder of the Importance of Careful Drafting" (Bell Gully Commercial Quarterly, 2010) <[www.bellgully.com/newsletters/18corporate/commercial\\_1.asp](http://www.bellgully.com/newsletters/18corporate/commercial_1.asp)>.

<sup>157</sup> See Blanchard at [4-5] "\$6.50 by itself..is perhaps more likely to be a price inclusive of supply...at first sight appears to resolve the point in favor of BoPE"; Tipping J at [40] "the reference to the interim agreement suggests the sum included delivery costs"; Wilson J at [135] "on the ordinary and unambiguous meaning of the words...price..was therefore inclusive of transmission costs".

<sup>158</sup> *Vector*, above n1, at [56].

<sup>159</sup> *Ibid*, at [13].

no reference to the principles of contract interpretation is required and determined the dispute simply by ascertaining objectively what the parties agreed to in their correspondence.<sup>160</sup>

Tipping and Wilson JJ provide some sound and logical reasoning for abandoning the exclusionary rule.<sup>161</sup> Both emphasised the relevance of pre-contractual correspondence in ascertaining the parties' intent.<sup>162</sup> Tipping J, in particular, considered the touchstone of admissibility to be relevance.<sup>163</sup> Negotiations are relevant if they constitute evidence of circumstances and conduct which shed objective light on the meaning both parties intended.<sup>164</sup> Furthermore, both firmly assert subjective evidence is irrelevant and inconsistent with the objective approach.<sup>165</sup> The two judgments also support the principles articulated by the Supreme Court in *Wholesale Distributors v Gibbons Holdings*<sup>166</sup> and consider there can be no logical distinction between pre-contractual negotiations and post-contract conduct.<sup>167</sup> If evidence of subsequent conduct is admissible to aid interpretation, as it provides a reliable

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<sup>160</sup> *Vector*, above n1, at [151]. He considered the case to be one where the parties had formulated the arrangement progressively with a view to accepting obligations once all terms were agreed upon, similar to an oral contract. The letter of 5<sup>th</sup> October from BoPE was not a rejection but rather built on Vector's proposal.

<sup>161</sup> It must be noted, that although Wilson J determined previous negotiations were admissible, this is still conditional on one of his three exceptions applying. Rather than abandoning the rule completely he has widened the available matrix of fact in situations where it is permissible to consider the surrounding circumstances.

<sup>162</sup> *Vector*, above n1. Wilson J at [122] states that they might illuminate what the parties were intending to achieve.

<sup>163</sup> *Ibid*, at [29]. Tipping J uses Evidence Act 2006, s7 to reinforce this view. S7(1) provides all relevant evidence is admissible in a proceeding. S7(3) determines evidence is relevant if it has a tendency to prove or disprove anything that is of consequence to the determination of the proceeding.

<sup>164</sup> *Ibid*, at [27].

<sup>165</sup> *Ibid*. Tipping J at [27-29]; Wilson J at [122].

<sup>166</sup> Above n130 and n138. The facts concerned the interpretation of a deed of assignment of a sub-lease. The original sub-lease specified the term was to expire on 30<sup>th</sup> October 2002, with a new lease to be granted expiring 31<sup>st</sup> October 2010. The deed of assignment specified it would expire 'on the remainder of the lease.' The issue concerned whether this should be interpreted to be 30<sup>th</sup> October 2002, or the 31<sup>st</sup> October 2010. Gibbons submitted there was relevant subsequent conduct which supported their interpretation. Four of the five members of the bench determined subsequent conduct could be relevant evidence to the interpretation of a contract. However, not all members found the subsequent conduct in this instance was helpful.

<sup>167</sup> *Vector*, above n1. Wilson J at [122]; Tipping J at [31]. Tipping J was a member of the Supreme Court bench in *Gibbons*.

guide to the parties' actual intent, then there seems to be no sensible basis for excluding evidence of prior negotiations, which can also provide a reliable guide to intent.<sup>168</sup> Both Tipping and Wilson JJ were not convinced by pragmatic considerations justifying the rule.<sup>169</sup> Unfortunately, Tipping J does not adequately address the objections to overturning the rule. He merely stated he was not satisfied with any pragmatic considerations.<sup>170</sup> Wilson J elaborates further and asserts they should not act as a barrier in interpretation when they do not act as a bar in rectification.<sup>171</sup> He also determined that third parties freely choose to involve themselves in the contract and must accept that in interpretation the court is entitled to the evidence of prior negotiations.<sup>172</sup>

With the greatest of respect to Tipping J, two questionable footnotes have been suggested to weaken his judgment.<sup>173</sup> Tipping J properly determined previous negotiations are admissible if the evidence is capable of shedding objective light on meaning. Unfortunately, he claimed this is consistent with *Chartbrook* in accordance with Lord Hoffmann's statement that admitting prior negotiations, which may throw light upon meaning, is not inconsistent with the objective theory of law.<sup>174</sup> However, Lord Hoffmann clearly considered there was no convincing justification for abandoning the exclusionary rule and the force of his judgment upholds the rule. Tipping J also comments he was unsure whether Lord Hoffmann regarded pragmatic considerations as justifying the exclusion of subjective intention, and in addition, evidence demonstrating objective intention.<sup>175</sup> He suggested that if it were only the former then that evidence would be inadmissible on grounds of irrelevance anyway. With the utmost respect to Tipping J it does seem clear that Lord Hoffmann was excluding more than just

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<sup>168</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 265; McLauchlan "Interpretation and Rectification: Lord Hoffmann's Last Stand" above n32 at 453; Johnson, above n130, at 51.

<sup>169</sup> *Vector*, above n1, at Wilson J at [129]; Tipping J at [29].

<sup>170</sup> *Ibid*, at [29]. Perhaps more discussion on this would have given his judgment more force.

<sup>171</sup> *Ibid*, at [129].

<sup>172</sup> *Ibid*.

<sup>173</sup> See McLauchlan "Contract Interpretation in the Supreme Court - Easy Case, Hard Law?" above n151, at 245-247.

<sup>174</sup> *Vector*, above n1, at FN 29; *Chartbrook*, above n3, at [33] per Lord Hoffmann.

<sup>175</sup> *Vector*, above n1 at FN 30.

subjective intention as his Lordship recognised admissibility was usually based on relevance, but the exclusionary rule is an exception whereby relevant evidence is inadmissible on pragmatic grounds.<sup>176</sup>

Wilson J's abandonment of the exclusionary rule is to some extent undermined by his actual reliance on the pre-contractual correspondence. His Honour first determined prior negotiations were admissible when outlining the ambiguity exception, but did not decide on this ground. He did, however, provide further discussion on the admissibility of previous negotiations after outlining all three exceptions.<sup>177</sup> It can be assumed at that point he was regarding previous negotiations to be admissible for the purpose of each exception, including commercial commonsense.<sup>178</sup> His Honour found BoPE's interpretation lacked commercial commonsense, but again he did not rely on the negotiations in this conclusion. Instead Wilson J examined the negotiations under estoppel, where they are already admissible. Despite this, it is contended the force of his argument is still present as he clearly proposed abandoning the rule.<sup>179</sup> To the contrary Tipping J examined the negotiations in his interpretation.<sup>180</sup> Unfortunately this reliance is also slightly undermined as he concluded, in one paragraph, that the case could also be analysed as estoppel.<sup>181</sup> McLauchlan remarks there

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<sup>176</sup> See McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 245-246.

<sup>177</sup> *Vector*, above n1, at [129].

<sup>178</sup> As established in 1.4.iii negotiations are already admissible for the purpose of estoppel. The fact His Honour did not specifically mention the admissibility of negotiations whilst discussing the commercial commonsense exception would not be problematic in admitting negotiations under that exception as he clearly proposed abandoning the rule at [122].

<sup>179</sup> Wilson J at [122] stated it is "time to remove the bar in this country imposed by *Prenn*".

<sup>180</sup> *Ibid*, at [40 - 45]. His Honour found that accepting BoPE's argument would involve accepting a subtle distinction that reference to \$6.50 on the first page of the 8<sup>th</sup> October letter, where the parties' positions are recorded, is price exclusive yet their proposal on the second page is price inclusive. He considered it was clear the parties had reached an agreement during the negotiations as to what '\$6.50 per GJ' should mean for the purpose of their agreement. Through an examination of the correspondence Tipping J observed BoPE did not dispute or challenge the figure and that if their interpretation was accepted it would not be "quantifying the loss" fully as stated.

<sup>181</sup> *Ibid*, at [48].

was no need to invoke the safety net of estoppel when his Honour did not accept the existence of the exclusionary rule in the first place.<sup>182</sup>

McGrath J was persuaded by recent affirmation in *Chartbrook* that prior negotiations are inadmissible as evidence of the parties' intention, but admissible for the purpose of rectification, estoppel or in establishing the background facts known to the parties.<sup>183</sup> McGrath J adhered to the objections<sup>184</sup> against abandoning the exclusionary rule and was satisfied these pragmatic considerations justify the rule notwithstanding that reliable evidence contributing to the parties' intended meaning may be excluded.<sup>185</sup> He recognised the arguments of McLauchlan<sup>186</sup> but concluded that the force of these was lessened by *Chartbrook's* reaffirmation and the "legitimate safety devices", estoppel and rectification.<sup>187</sup> He concluded it was better to "march in step with settled approaches overseas in this important field of commerce".<sup>188</sup>

With the greatest of respect to McGrath J, dismissing arguments for abandoning the exclusionary rule due to recent confirmation of the rule in the House of Lords and Australia<sup>189</sup> is not a sufficient justification.<sup>190</sup> New Zealand law is developing in a different direction from

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<sup>182</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 250-251. He argues there is no need for estoppel because the accepted meaning *is* the true meaning. See further discussion at 3.2.iv.a.

<sup>183</sup> *Vector*, above n1, at [67].

<sup>184</sup> *Ibid*, at [71]. McGrath J raises delay, expense, increased uncertainty, and risk and inconvenience to third parties.

<sup>185</sup> *Ibid*, at [75].

<sup>186</sup> McLauchlan "Contract Interpretation: What is it About?" above n57. McLauchlan argues evidence of negotiations can be accommodated within an objective approach and thus previous negotiations where they demonstrate objective mutual intention should be admissible.

<sup>187</sup> *Vector*, above n1, at [73].

<sup>188</sup> *Ibid*, at [78].

<sup>189</sup> *Codelfa*, above n74.

<sup>190</sup> McGrath J's reasoning is similar to that identified by Mitchell as a reason why the rule was upheld in *Chartbrook*. See "Contract Interpretation: Pragmatism, Principle & the Prior Negotiations Rule" above n49 at 143. Mitchell recognises an underlying reason in Lord Hoffmann's judgment was a reluctance to depart from a long and consistent line of authority. His Lordship did not consider there was a power to depart from precedent

those jurisdictions, one more inclined to allow any evidence relevant to the objective meaning of the contract and the parties' actual intent. This is evidenced by the liberal approach taken by the Supreme Court in *Gibbons*.<sup>191</sup> McLauchlan has also criticised McGrath J's use of *Chartbrook*. He contends Lord Hoffmann did not in fact decide the exclusionary rule *was* justified by pragmatic considerations, but rather said it *may* be.<sup>192</sup> Lord Hoffmann concluded that there was no clearly established case for departing from a long established rule and that the ultimate determination lay not with a judicial body. He considered an empirical study was required to determine whether pragmatic disadvantages of admissibility outweighed the advantages of admissibility.<sup>193</sup>

### C. Exceptions to the Rule

#### *i) Subject-matter exception*

Blanchard J, in disagreement with McGrath J, considered the subject-matter exception applied and thus used evidence of previous negotiations, to merely reinforce his interpretation.<sup>194</sup> His Honour furthermore, took a liberal view and effectively expanded the scope of the exception. Blanchard J considered there could not sensibly be degrees of subject-matter, thus the court could regard communications that shed light on the commercial purpose and further what ground the contract was to cover, subject to the caveat that subjective intent is admissible.<sup>195</sup> Applying this to the facts he considered one could not sensibly refer to negotiations to ascertain the subject-matter of the agreement was the supply of gas, without ascertaining whether the price of gas was inclusive of supply costs. To the contrary, McGrath J considered the contract's subject-matter was clearly identifiable as the

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as the rule was not impeding the proper development of the law, nor leads to results that are unjust or contrary to public policy under the *Practice Statement (Judicial Precedent)*. See *Chartbrook*, above n3 at [41].

<sup>191</sup> *Gibbons*, above n130. Edward Scorgie & Tim Smith, "Tips from the Top on Commercial Interpretation" (Chapmann Tripp 26 February 2010) <[www.chapmantripp.com/Pages/Publication.aspx?ItemID](http://www.chapmantripp.com/Pages/Publication.aspx?ItemID)>.

<sup>192</sup> *Vector*, above n1, at [75]. McGrath J states the House of Lords considered the rule *was* justified on pragmatic grounds.

<sup>193</sup> *Chartbrook*, above n3, at [41]. Lord Rodger agreed at [70].

<sup>194</sup> *Vector*, above n 1, at [13].

<sup>195</sup> *Ibid*, at [14].

supply of gas.<sup>196</sup> Blanchard J left open how far the courts should go for another day. With respect it is arguable this exception can go no further.<sup>197</sup> If it was open to Blanchard J to determine price under this exception, then it seems any important contractual terms might too constitute the “ground the contract was to cover”.<sup>198</sup> McLauchlan argues this is an example whereby a judge has purported to adhere to the exclusionary rule, but in reality has invoked an exception to find proof of the parties’ intention.<sup>199</sup>

## *ii) Estoppel by Convention*

McGrath, Tipping and Wilson JJ all considered estoppel by convention could give appropriate relief to Vector.<sup>200</sup> A common understanding, that \$6.50 was exclusive of transmission costs, could be found from BoPE’s letter on the 5<sup>th</sup> October. Any further references were the parties continuing to negotiate on their common assumption.<sup>201</sup> It was therefore found to be unconscionable to allow BoPE to depart from this common assumption. Estoppel was not pleaded in the proceedings but the Court determined it would not prejudice BoPE to permit the action at this stage.<sup>202</sup> It was considered estoppel had inherently been pleaded through the contention that the parties had agreed to their own dictionary meaning.<sup>203</sup>

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<sup>196</sup> *Vector*, above n1, at [83].

<sup>197</sup> The next step would be to admit evidence of subjective intent, which clearly is not contended for by anyone. McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law?” above n151, at 239-240.

<sup>198</sup> *Ibid*, at 239-240.

<sup>199</sup> *Ibid*, at 240-241. He also considers *Bank of Scotland v Dunedin Property Invest Co Ltd* 1998 SC 657 to be another example. See later discussion at 3.4.A.

<sup>200</sup> It must be noted Tipping and Wilson JJ decided on this ground in the alternative.

<sup>201</sup> *Vector*, above n1. See McGrath J at [95-97]; Wilson J at [142].

<sup>202</sup> As discussed later at 2.2.C.iv this is contrary to what the Court thought about the pleading of rectification. McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law?” above n151 at 266 has criticised this difference as the finding of estoppel by convention in this case has the same effect as granting rectification.

<sup>203</sup> See McGrath J at [85]. Tipping J at [25] considered the private dictionary principle to be a linguistic example of estoppel by convention. At [48] he considered it need not be specifically pleaded, as there was no element of surprise which would prejudice BoPE. Wilson J at [124] stated “estoppel by convention effectively subsumes the “private dictionary” principle. At [130] he questioned whether estoppel must be pleaded when it is advanced in response to the proposition that the words in the contract carry their ordinary meaning. At [140] he

As previously discussed Tipping and Wilson JJ undermine their determinations on the admissibility of previous negotiation through the alternative use of estoppel. However, McGrath J used estoppel in the orthodox sense to admit previous negotiations. This orthodoxy, however, can be directly challenged. If one accepts previous negotiations are admissible not only under estoppel and rectification, but also to prove the existence of the subject-matter or background facts known to both parties, then it is arguable the exclusionary rule is stripped of any real substance.<sup>204</sup> In practice previous negotiations are likely to be admissible on some established basis. Furthermore, once the evidence is before the court then in practice it may be difficult for a judge to divorce their pure interpretation from the evidence in the negotiations.<sup>205</sup>

To the contrary, Martin Taylor proposes that following *Vector* estoppel has taken on a new importance as a tool whereby the court will uphold an agreement to the meaning of a contractual term.<sup>206</sup> He suggests this injection of equity is a development to be welcomed. However, McLauchlan has suggested a ‘more principled approach’ than reliance on estoppel.<sup>207</sup> If it can be proven parties have negotiated under a common assumption as to the meaning of a contractual term, then that meaning *is* the meaning of the term. Accordingly, if actual meaning can be ascertained there is no need to invoke estoppel to prevent a party denying that meaning.<sup>208</sup> Ascertaining this meaning can be facilitated through the use of previous negotiations thus they should be admissible when undertaking interpretation.

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determined that BoPE was not prejudiced by the estoppel as Vector had raised it under the private dictionary principle.

<sup>204</sup> McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law?” above n151, at 257.

<sup>205</sup> This lack of transparency is essentially what McLauchlan has claimed in relation to Blanchard J’s reasoning. See McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law?” above n151, at 240-241.

<sup>206</sup> Martin Taylor “Vector Gas – What Does it Mean?” *NZLawyer* (Issue 134, 16 April 2010) at 16-17.

<sup>207</sup> This is a ‘more principled approach’ than estoppel by convention which McGrath J considered at [74] to be a “principled supplementary approach in contract interpretation”.

<sup>208</sup> McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law?” above n151, at 248.



iii) *Karen Oltmann and Private Dictionaries*

Tipping J is the only judge to have addressed *Karen Oltmann*<sup>209</sup>. Firstly, his Honour classified the private dictionary principle as a linguistic example of estoppel by convention. The parties are bound by their agreement to use a special linguistic meaning for the purpose of their contract, which neither can later disavow.<sup>210</sup> He determines this private code is to be determined objectively. His Honour, like Lord Hoffmann, is not satisfied the *Karen Oltmann* decision is one of private dictionary meaning as there was no unconventional usage of the word ‘after’.<sup>211</sup> He considered that it was an example of an estoppel by convention where the parties had negotiated on a common assumption that words will have one of two meanings.<sup>212</sup>

McLauchlan has criticised this reasoning, as hiding under the pretense that it is consistent with *Chartbrook*.<sup>213</sup> Lord Hoffmann did consider *Karen Oltmann* to be an illegitimate exception. However, he acknowledged the possibility of rectification or estoppel, if specifically pleaded, as both were remedies contending the agreement did not have the meaning the parties were seeking.<sup>214</sup> To the contrary, Tipping J explained the decision as one where the parties had reached an agreement to meaning, which they were bound by.<sup>215</sup> On this basis *Karen Oltmann* is not required as an exception to the exclusionary rule as the meaning the parties are bound by is the parties’ actual meaning. There is also no need to distinguish the private dictionary principle as on Tipping J’s analysis evidence of previous

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<sup>209</sup> *Karen Oltmann*, above n101.

<sup>210</sup> *Vector*, above n1, at [25-26].

<sup>211</sup> *Ibid*, at [36]. See Lord Hoffmann in *Chartbrook*, above n3, at [45-46].

<sup>212</sup> *Ibid*, at [34-36].

<sup>213</sup> This is because Tipping J claimed the decision does not evidence the private dictionary principle in accordance with Lord Hoffmann.

<sup>214</sup> *Charbrook*, above n3, at [47]. See McLauchlan “Interpretation and Rectification: Lord Hoffmann’s Last Stand” above n32, at 446-451; “Contract Interpretation in the Supreme Court – Easy Case, Hard Law” above n151, at 248-249 for a criticism of the Lord Hoffmann’s reasoning.

<sup>215</sup> *Vector*, above n1, at [36].

negotiations are always admissible in interpretation, if objectively determined.<sup>216</sup> Previous negotiations can be given where there are two unconventional or conventional meanings. This renders Tipping J's discussion of the case otiose.<sup>217</sup>

#### *iv) Rectification*

Rectification must be specifically pleaded and clearly established.<sup>218</sup> The Court collectively agreed it would be unfair for rectification to be pleaded at the later stage of the proceedings.<sup>219</sup> However, many consider the facts of this case were right for rectification.<sup>220</sup> It is claimed this is evidenced by Vector's final piece of correspondence where it asked for an amendment.<sup>221</sup> Critics contend the Court rewrote the contract to reflect a reasonable agreement without concern that a clear remedy, rectification, was the appropriate solution. In doing so, the requirements and safeguards of that doctrine have been circumvented through the use of interpretation.<sup>222</sup>

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<sup>216</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law" above n 151, at 250. McLauchlan also argues there is no point distinguishing the principle if Tipping J does not adhere to the plain meaning rule.

<sup>217</sup> This ties back to his use of estoppel which was unnecessary and undermines his decision. With respect it perhaps would have been better to use *Karen Oltmann* to show the relevance previous negotiations may have in determining the parties' actual shared meaning in a contract interpretation dispute.

<sup>218</sup> *Vector*, above n1, at [130]. *Chartbrook*, above n3, at [47] per Lord Hoffmann.

<sup>219</sup> *Ibid*, see [9], [84], [132].

<sup>220</sup> See Wilson J at [131]; Court of Appeal in *Bay of Plenty Energy Ltd*, above n124, at [97]; BoPE submissions in Supreme Court Transcript, above n115, at 61, 113; Hall, above n156 at 23; Martin Taylor "Certainty versus Correctness after Vector Gas" NZLawyer Extra (Edition 7, NZLawyer Online, 30 July 2010) <[www.nzlawyermagazine.co.nz/NZLawyerextraarchive/Bulletin7/extra7F3/extra7F3print/tabid/2500/Default.aspx](http://www.nzlawyermagazine.co.nz/NZLawyerextraarchive/Bulletin7/extra7F3/extra7F3print/tabid/2500/Default.aspx)>. It was thought by Wilson J that rectification wasn't pleaded as a result of compromised objectivity of the counsel representing Vector, see [149].

<sup>221</sup> Hall, above n156, at 23. It would certainly be open to argument from BoPE that the mistake was not common. On this basis, unilateral rectification would be the only remedy available, but as at 1.4.ii the state of this action in New Zealand is unclear. However, as Tipping, McGrath and Wilson JJ's judgments all considered the parties were negotiating under a common intention that price was inclusive, it is likely objective common intent necessary for common mistake could be found.

<sup>222</sup> Hall, above n156, at 23. These requirements relate to delay, third parties and the need for clear and convincing proof.

In response Taylor asserts there is still a significant burden necessary before a court will displace the formal document through interpretation.<sup>223</sup> The Court took care to reaffirm that “linguistic mistakes will not easily be accepted”.<sup>224</sup> Taylor further suggests *Vector* has not expanded the range of circumstances in which a remedy is available for inadequate record of a bargain as, if pleaded, rectification was likely to grant relief anyhow.<sup>225</sup> This leads one into discussion regarding the overlapping processes of interpretation and rectification. Wilson J recognised that rectification is not a question of interpretation, but may in fact obviate a question of interpretation that might arise.<sup>226</sup> Tipping J recognised that clear drafting errors will primarily be subject to rectification, but where an error is clear, and intention from both parties is equally clear, then this mistake can be remedied through interpretation, taking context into account.<sup>227</sup> In *Chartbrook* Lord Hoffmann considered the exclusionary rule to hinder the available ‘context’ in an interpretation issue. The consequence of this is to disadvantage correction of mistakes through interpretation, as compared to rectification. Tipping J’s ‘context’ does include previous negotiations thus on his analysis the approach under rectification and interpretation is amalgamated.

#### D. Commercial Commonsense

It can fairly be stated that at the core of *Vector* the Court was unanimously convinced the interpretation advanced by BoPE defied commonsense.<sup>228</sup> Blanchard J decided the

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<sup>223</sup> Taylor “Certainty versus Correctness after *Vector Gas*” above n220.

<sup>224</sup> See *Vector*, above n1, at [61] [128]. McGrath J said at [66] “there must be a strong case to persuade the Court something has gone wrong with the agreement”. Taylor asserts *Vector* also requires some established justification be satisfied, i.e. estoppel or commercial commonsense, before the court will intervene through interpretation.

<sup>225</sup> Taylor “Certainty versus Correctness after *Vector Gas*” above n 220.

<sup>226</sup> *Vector*, above n1, at [126]. The opposite could be contended, interpretation could obviate rectification which would otherwise arise.

<sup>227</sup> *Ibid*, at [33]. However, this seems to be contrary to the decision he cites in footnote 35, *Rattrays Wholesale Ltd* above n90, where Tipping J at 13 states there is no power to go beyond the document at issue.

<sup>228</sup> See McGrath J at [8-9]; Tipping J at [46]; McGrath J at [82]; Wilson J at [137]; and Gault J at [151]. Chapman Tripp, above n191.

background proceedings indicated the only ‘commercially sensible’ conclusion which was ‘\$6.50 per GJ’ was exclusive of transmission costs, otherwise the agreement was extremely unfavorable for Vector considering the recovery they have could received in court.<sup>229</sup> Tipping J also considered it was unlikely Vector would be willing to enter into the agreement on this less favourable basis.<sup>230</sup> McGrath J recognised the courts are not required to attribute to the parties an intention they could not have intended, especially where it flouts business commonsense.<sup>231</sup> Wilson J considered it defied commercial commonsense for Vector to have entered the agreement when they could have received market price and transmission costs under BoPE’s undertaking.<sup>232</sup>

As discussed some commentators argue the Court rewrote the plain meaning of the contract to facilitate a more fair and reasonable bargain.<sup>233</sup> This is despite Lord Hoffmann’s caution that a contract appearing unduly favorable to one party is not sufficient reason for supposing it means otherwise.<sup>234</sup> Wilson J considered that where a decision defies commercial sense, then it constitutes more than a bad bargain. The distinction between what merely amounts to a bad bargain and what defies commercial sense is fine.<sup>235</sup> *Vector* illustrates this point with disagreement between the lower Courts and Supreme Court on this issue. McLauchlan argues the facts of *Vector* were possibly not comparable to cases where genuine commercial absurdity was found<sup>236</sup> and as a result Blanchard J, who decided on this ground alone, has

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<sup>229</sup> *Vector*, above n1, at [9].

<sup>230</sup> *Ibid*, at [39].

<sup>231</sup> *Ibid*, at [82].

<sup>232</sup> *Ibid*, at [137].

<sup>233</sup> See Tat, above n156; Hall, above n221, at 23; Taylor, “Vector Gas – What Does it Mean?” above n206 at 16 recognises the Court might have been motivated to achieve justice rather than adhere to the literal terms.

<sup>234</sup> *Chartbrook*, above n3, at [20]. Blanchard J recognises this at [9].

<sup>235</sup> For example, in application to *Vector*, did BoPE out-negotiate Vector, or were they trying to take advantage of a recording error?

<sup>236</sup> McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law?” above n151, at 236. See for example, *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749. In that decision a notice to terminate a lease on “12 January” actually meant “13 January” as a reasonable person in the position of the landlord with knowledge of the contract would have understood this. *Investors Compensation Scheme* and *Chartbrook* are also cited as examples where genuine commercial absurdities were found.

come very close to remedying a bad bargain under the guise of interpretation.<sup>237</sup> He proposes that if one could not consider the parties' prior correspondence when undertaking interpretation then it is unlikely one would infer something had gone wrong with the language.<sup>238</sup>

Whether or not the agreement was commercially sensible, consideration of the use of this ground is necessary. It must be noted commercial commonsense was not used as a ground in itself, other than by Blanchard J. In fact the other members of the bench did not decide on commercial sense alone, but supplemented this reasoning with other grounds. Tipping J only used it to reinforce his interpretation. McGrath and Wilson JJ considered the ground but decided on estoppel in the alternative. Furthermore, the bench did not use commercial commonsense as an abstract reason in itself.<sup>239</sup> The absurdity was used to discern the intent of the contracting parties.<sup>240</sup> This is in accord with the aim of interpretation, to discern the parties' intent, actual or objective.

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<sup>237</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 236. McLauchlan further warns of the danger of this approach for future parties at 235.

<sup>238</sup> Ibid. Blanchard J claimed to have reached his decision without previous negotiations, which merely reinforce his interpretation. McLauchlan argues at 240 that this is an example of a judge adhering to the exclusionary rule but in practice invoking the evidence. However, it must be noted Wilson J's application of commercial commonsense is reached without consideration of the negotiations, although on his approach, they were admissible if he did want to regard them. McGrath J also does not use the previous negotiations when considering the commercial sense of the transaction, and only considers them in depth under estoppel.

<sup>239</sup> Cf McLauchlan who criticises Wilson J's exception for commercial commonsense. Wilson J explains a commercial absurdity as there being 'no possible commercial justification for the results of giving the words of the contract their ordinary meaning.' McLauchlan claims this is a stricter inquiry than considering whether a reasonable person would intend the meaning. The test Wilson J poses is one whereby absence of commonsense is in itself enough to displace the meaning of the document. See McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 263-264.

<sup>240</sup> *Vector*, above n1. See Blanchard J at [10] who claims "no party acting rationally would in these circumstances have agreed to give up transmission costs"; Tipping J at [45]: "a reasonable and properly informed reader would undoubtedly have understood BoPE to be agreeing to pay \$6.50 plus transmission costs"; McGrath J at [82] "For [Vector] to have agreed to those terms would flout business commonsense...strong indication something went wrong with the language"; Wilson at [139] "in order to give commercial sense to their contract, the parties must have intended price be exclusive of transmission costs".

### **2.3 The State of the Law Following *Vector***

After considering the complexity and diversity of *Vector* it is important to determine whether a collective majority can be found regarding the admissibility of previous negotiations, or the ground decided on. Unfortunately, after the analysis it becomes apparent there is no clear majority to either. Most commenting on *Vector* observe that the issue has not been resolved and rather the Court has confused the state of law.<sup>241</sup> The five separate judgments present a view that is far from uniform. Both Tipping and Wilson JJ explicitly abandoned the exclusionary rule,<sup>242</sup> contrary to the one explicit upholding of the rule from McGrath J. It then seems the balance lies with Blanchard J, with the support of Gault J. Johnson argues Blanchard's liberal subject-matter exception combined with his reference to a clear limiting principle on the use of pre-contractual negotiations, the exclusion of subjective intent, demonstrates partial agreement with Tipping J.<sup>243</sup> However, it is more arguable the judgment of Blanchard J implicitly affirmed the existence of the rule through his Honour's use of the subject-matter exception. Nonetheless, a clear majority for upholding the rule cannot be found either as Blanchard J employed a liberal version of the subject-matter exception, leaving little substance in the rule. Furthermore, his Honour left the question open for another day. It is more tenable there is now strong authority that previous negotiations have relevance in contract interpretation and are likely to be admissible.<sup>244</sup> On which grounds, however, is unclear. The liberal approach taken by the Court and the use of negotiations in every

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<sup>241</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 265; David Goddard 'Contract Law Update' *Commercial Law Intensive* (NZLS, Wellington, May 2010) 1 at 6; Taylor "Vector Gas – What Does it Mean?" above n206, at 16.

<sup>242</sup> It must be borne in mind that under Wilson's judgment the admissibility of previous negotiations are still subject to one of his exceptions applying.

<sup>243</sup> Johnson, above n130, at 52.

<sup>244</sup> Goddard, above n241, at 7-8; Johnson, above n130, at 52. Not all commentators agree with this analysis. See Brent O'Callahan "Transactions – Contract Interpretation" [2010] NZLJ 137 who argues *Vector* left the law unchanged as the facts of the case did not require any development in the law to resolve the issues. He claims practitioners can keep playing by the same rules. Although he does not rule out that this may change if a case comes before the Supreme Court where the admission of such material would produce a different result than the more traditional approach. See also Brent O'Callahan "Transactions – Contract Interpretation- Previous Negotiations" [2010] NZLJ 69 at 70.

judgment is indicative of the fact it seems likely full reference to negotiations will become standard.<sup>245</sup>

Even though no consensus can be found on the admissibility of previous negotiations the importance of commercial commonsense in interpretation cannot be denied following *Vector*. Although the majority did not decide on this ground alone, it was a common theme running throughout the judgment. It could also be argued a majority ruling can be found under estoppel by convention.<sup>246</sup> Commentators have recognised the importance and relevance of estoppel in contract interpretation following the decision.<sup>247</sup> However, this majority is slightly dubious, considering both Tipping and Wilson JJ decided on estoppel in the alternative.

As helpful as the comments and predictions are in determining the law post-*Vector*, it is pertinent to consider how the lower courts have analysed the decision and approached contract interpretation. McLauchlan predicts courts will act with puzzlement and exasperation at the state of disarray.<sup>248</sup> One High Court decision has explicitly recognised an analysis in the light of *Vector* is not straightforward.<sup>249</sup> Deeper analysis shows inherent confusion in some judgments, especially regarding the objective theory. Tipping J's objective analysis is cited alongside McGrath J's and *ICS*, which as discussed, fundamentally differ.<sup>250</sup>

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<sup>245</sup> Taylor "Vector Gas – What Does it Mean?" above n206, at 17; Goddard, above n241, at 8.

<sup>246</sup> McLauchlan, "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 266 recognises it has majority support through Wilson, Tipping and McGrath JJ.

<sup>247</sup> Taylor "Vector Gas – What Does it mean?" above n206, at 16-7; Chris Browne & Kate Morrison "Use of Evidence of Prior Negotiations in Contract Interpretation" (2010) <[www.wilsonharle.com/use-of-evidence-of-prior-negotiations-in-contract-interpretation](http://www.wilsonharle.com/use-of-evidence-of-prior-negotiations-in-contract-interpretation)>.

<sup>248</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151 at 265.

<sup>249</sup> *Blackler v Tiger Lilly Productions Ltd* HC Wellington CIV-2009-485-1599, 23 March 2010 at [46]. The judge avoided a contract interpretation analysis by concluding there was no contract which had come into force.

<sup>250</sup> See *Blackler*, above n249, at [43]; *Lumley General Insurance (NZ) Ltd v Body Corporate No 205963* [2010] NZCA 316 at [29] where the Court stated the objective was to ascertain 'presumed mutual intent' and cited Tipping J for this proposition; See also *Dominion Finance Group Ltd (in rec and in liq) v Dyson Smythe & Gladwell* (2010) 24 NZTC 24,330 (HC) at [31-32]; *KC Securities Ltd v Belgrave Finance Ltd (in rec)* CA115/10, 8 September 2010 at [30-31].

It appears no cases have attempted to analyse what ground *Vector* was decided on. Nevertheless, some direction from the decisions can be gained.<sup>251</sup>

Many cases use *Vector* in an orthodox manner. Some judgments use the decision to affirm the decline in the plain meaning rule and the importance of a contextual approach in interpretation.<sup>252</sup> Others affirm the use of commercial commonsense in contract interpretation.<sup>253</sup> Many of the cases cite Tipping J's objective approach<sup>254</sup> as the appropriate approach to contract interpretation.<sup>255</sup> Notwithstanding many of those judgments are likely to have cited Tipping J without regard for the distinction with respect to the strict objective approach, the authority is present and their affirmations give strength to Tipping J's judgment.<sup>256</sup> These decisions provide further evidence of New Zealand courts being more concerned to ascertain actual intent over presumed.

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<sup>251</sup> This is contrary to the view of Goddard who considers *Vector* provided no useful guidance to lower courts but rather lays out a smorgasbord of possible approaches. See Goddard, above n241, at 7.

<sup>252</sup> See *ANZ National Bank Ltd v Tower Insurance Ltd* [2010] NZCA 267 at [88]; *Camelot Partnerships Ltd v BOP Business Consultants Ltd* HC Tauranga CIV-2009-470-1052, 29 June 2010 at [53]; *Chang v Lumley General Insurance (NZ) Ltd* HC Auckland CIV-2009-404-7820, 23 August 2010 at [36-36]; *Henderson v Henderson* HC Auckland CIV-2009-404-5557, 26 April 2010 at [30-31]; *I-Health Ltd v iSoft NZ Ltd* HC Auckland CIV-2006-404-7881, 8 September 2010 at [23]; *Little v IAG New Zealand Ltd* HC Auckland CIV-2010-404-729, 26 August at [25].

<sup>253</sup> See *Todd Pohokura Ltd v Shell Exploration NZ Ltd and Anor* HC Wellington CIV-2006-485- 1600, 13 July 2010 at [111-112]; *Chang*, above n252, at [36]; *I-Health*, above n252, at [31]; *Lumley*, above n250, at [41]; *KC Securities*, above n250, at [38]. The court distinguished the facts from *Vector* as the background there demonstrated KC Securities failed to negotiate better terms, and thus it was not commercially absurd in the sense it was in *Vector*.

<sup>254</sup> Embodied in *Vector*, above n1, at [19].

<sup>255</sup> *Todd* above n253, at [110]; *Chang*, above n252, at [36]; *D A Constable Syndicate 386 v Auckland District Law Society Inc* [2010] 3 NZLR 23 at [23]; *Dominion Finance*, above n250, at [32]; *Henderson*, above n252, at [30]; *I Health*, above n 252, at [22]; *Porteous v Chief Executive of The Department of Building and Housing* (2010) 9 NZELC 93,520 (EMC) at [59]; *Mathews v CP Realty (PN) Ltd* HC Palmerston North CIV-2010-454-276, 15 September 2010 at [28].

<sup>256</sup> They are also unlikely to appreciate the possible consequences for the admissibility of previous negotiations flowing from the differing objective approaches.



What are more controversial are the decisions of the lower courts regarding the admissibility of previous negotiations. Like the *Vector* decision, the approaches are varied. *Henderson v Henderson* quotes the judgment of McGrath J<sup>257</sup> whereby he confirms the application of the exclusionary rule in New Zealand.<sup>258</sup> The context of this quote aimed to demonstrate that evidence of common intention was available for rectification and estoppel claims. In *Fairview Park v Harrison Grierson Consultants*<sup>259</sup> Associate Judge Faire recognised the breadth of the factual inquiry in interpretation is less than in rectification due to the exclusionary rule. The Judge did not consider that the breadth of the inquiry under interpretation had changed after *Vector*.<sup>260</sup> However, Court of Appeal authority in *Cockburn v CS Development* considers otherwise.<sup>261</sup> Counsel submitted on the authority of *Vector* that the Court should consider the negotiations to assist in interpretation.<sup>262</sup> The Court recognised *Vector* took differing approaches to admissibility and went on to state that despite those differences, evidence of negotiations would be helpful if it shed light on objective commercial purpose,<sup>263</sup> or objective meaning.<sup>264</sup> The Court cited approval of Tipping J's analysis of the distinction between negotiations which constitute relevant objective evidence, which is admissible, and evidence of subjective intent which is not. The Court considered the negotiations and found on the facts there was no objective evidence to support the meaning claimed.<sup>265</sup> Asher J in *I-Health Ltd v I-Soft NZ Ltd*<sup>266</sup> has provided the most extensive

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<sup>257</sup> *Vector*, above n1 at [67].

<sup>258</sup> *Henderson*, above n 252, at [45].

<sup>259</sup> *Fairview Park Ltd v Harrison Grierson Consultants Ltd* (No 2) HC Auckland CIV-2006-404-6588, 4 May 2010.

<sup>260</sup> *Ibid*, at [19]. In essence he considered the exclusionary rule is still good law.

<sup>261</sup> *Cockburn v C S Development No 2 Ltd* [2010] NZCA 373 (CA) at [74].

<sup>262</sup> The facts concerned a dispute about the GST implications of an agreement for sale of a property. Cockburn contended the property was sold as a going concern and therefore zero-rated for GST purposes. The Court was asked to consider evidence of the previous negotiations. They found that when inadmissible subjective evidence was stripped from the negotiations, little assistance could be derived.

<sup>263</sup> *Cockburn*, above n261, at [74]. This is in accordance with objective background fact exception. They quote approval of Blanchard J's liberal subject-matter exception.

<sup>264</sup> This is directly contrary to the proposition that evidence of previous negotiations cannot be considered to provide a gloss on meaning. This proposition was cited with reference to Tipping J in *Vector* at [27].

<sup>265</sup> *Cockburn*, above n261, at [74-79].

examination of *Vector*. He considered Tipping, Blanchard and Wilson JJ declined to follow *Chartbrook*.<sup>267</sup> In accordance with the judgment of Tipping J he admitted previous negotiations on the basis that when construed objectively they could be relevant to establish background facts, known to both parties, and furthermore to cast light on meaning.<sup>268</sup> He acknowledged subjective intent was inadmissible. Asher J undertook a clear and logical analysis whereby he examined the relevant previous drafts and emails to firstly determine objective background facts, and then to discern the extent to which they shed light on the parties' intended meaning. He carefully excluded subjective material where it asserted internal exchanges of individual thought.<sup>269</sup>

## **2.4 Conclusion**

It is apparent *Vector* has resulted in confusion amongst commentators, judges and practitioners. There seems to be some authority following *Vector* which counsel could rely on to admit evidence of previous negotiations, but there is no clear statement in favour of abandoning the exclusionary rule. It seems that at this stage previous negotiations could be admissible on the authority of Tipping and Wilson JJ's judgment with the support of *Cockburn* and *I-Health*. If this approach is not utilised then evidence of previous negotiations is still likely to be admissible in contract interpretation under the established exceptions. For the lawyer advising, it would be pertinent to review pre-contractual material to determine the extent these shed light on meaning.<sup>270</sup>

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<sup>266</sup> *I-Health*, above n 252. The facts concerned the sale of I-Health to I-Soft, with the purchase price being a percentage of future turnover. I-Soft breached the agreement by failing to use all reasonable endeavors to promote and sell the product. The issue regarded the interpretation of a limited liability clause and whether it operated to limit I-Soft's liability for breach of the best endeavors clause. Asher J determined the clause did limit I-Soft's liability.

<sup>267</sup> *Ibid*, at [37]. He determined Blanchard J's liberal version of the subject-matter exception went further than the principles in *Chartbrook*.

<sup>268</sup> *Ibid*, at [40-41].

<sup>269</sup> *Ibid*, at [52].

<sup>270</sup> Goddard, above n 241, at 8. He furthermore states any documents relating pre-contractual negotiations should be discovered and reviewed in every interpretation dispute.

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### PART THREE: THE ADMISSIBILITY OF PREVIOUS NEGOTIATIONS

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In the words of Lord Steyn, the reason for a rule is important and the rule ought to apply where the reason requires it. If the rule appears not to fulfill its purpose it is potentially defective and is at liberty for review.<sup>271</sup> This part aims to demonstrate that the rule precluding the admissibility of previous negotiations in contract interpretation is defective in principle and in practice. Firstly, this part promotes conceptual clarity in contract law. The misunderstanding surrounding the objective approach will be discussed and it will be demonstrated previous negotiations are capable of being accommodated within the objective theory. Abandoning the rule will also result in more coherent contract principles. Secondly, this part criticises the rule in practice. The relevance and utility of prior negotiations will be emphasised and the pragmatic considerations used to justify the exclusion will be counterbalanced to demonstrate they are inadequate reasons for retaining the rule. Finally this part will consider further justifications and advantages in abandoning the exclusionary rule, being transparency and harmonisation with international instruments. In essence this part advocates for a liberal contextual approach where there are no artificial limits on evidence.<sup>272</sup> Previous negotiations should be admissible on account of their relevance in ascertaining the background facts known to both parties and in shedding light on the meaning intended by the parties. They will be relevant to meaning where they are objective and demonstrate actual mutual intent, or where one party has led the other to reasonably believe they accepted a certain meaning. Subjective, inner, intention is not admissible on any account. In accepting these propositions it is important not to lose sight of the fundamental premise that we will not easily accept mistakes in a formal contract.<sup>273</sup> However, where context is required in interpretation, the surrounding circumstances should not be artificially restricted by the exclusionary rule.

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<sup>271</sup> Steyn “Contract Law: Fulfilling the Reasonable Expectations of Honest Men” above n5, at 433.

<sup>272</sup> As opposed to a traditional literal approach focused solely on the meaning of words, or the qualified contextual approach embodied in *Investors Compensation Scheme*. See discussion from McLauchlan in “Contract Interpretation, Contract Formation & Subsequent Conduct” (2006) 25 UQLJ 77 at 90-94; McLauchlan “Contract Interpretation in the Supreme Court – Easy Case, Hard Law” above n151, at 258-259.

<sup>273</sup> *Chartbrook*, above n3, at [14-15]; *Vector*, above n1, at [61][128]; *Yoshimoto*, above n7, at [75].

### **3.1 The Exclusionary Rule and the Misunderstanding Regarding the Objective Theory**

As previously canvassed<sup>274</sup> there is a difference of opinion regarding the precise meaning of objectivity. This operates at the core of the division between judges, practitioners and academics as to the admissibility of prior negotiations. To recap, a strict theory of objectivity is concerned with ascertaining the meaning the document conveys to the reasonable person. This entails an impersonal construction, whereby the parties are stripped of their personalities and assumed to be reasonable men.<sup>275</sup> This external standard is used to presume the parties' intent. Effectively, the court is discerning the intention the parties *should* have had, as a reasonable person would have had this intention. Actual intent, even where objectively manifested, represents the parties' inadmissible subjective intent. Previous negotiations as a revelation of actual intent are therefore irrelevant to the inquiry.<sup>276</sup> They can only be received to the limited extent they shed light on the contract's purpose and background. Lewison claims the traditional formulation of interpretation, framed in reference to the parties' intention, gave rise to the erroneous thought that the inquiry was to ascertain the intention of the actual parties. He claims this is not the approach taken by English law, which despite references to intention, has always been presumed intention.<sup>277</sup> The theory of presumed intent seems to have been approved in countless statements, and perhaps seems beyond challenge. Judges have come to presume intent without questioning the process.<sup>278</sup>

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<sup>274</sup> See 2.2.A.i.

<sup>275</sup> Hoffmann "Intolerable Wrestle with Words and Meaning" above n10, at 661-662; Steyn, above n5, at 433.

<sup>276</sup> Nicholls above n107 at 582; Collins, above n6, at 197; McLauchlan "New Law of Contract Interpretation" above n26, at 165; See also Vogenauer, above n71, at 128.

<sup>277</sup> Lewison, above n12, at 21-22. He claims this was re-emphasised in *ICS*. Lewison quotes the following passage from *Reardon-Smith* in support of this proposition: "when one speaks of the intention of the parties, one speaks objectively - they cannot themselves give evidence directly of their intention – what must be ascertained is what is to be taken as the intention which reasonable people would have had if placed in the situation of the parties." With respect to Lewison, this quote actually supports the expansive theory of objectivity as the reasonable person is not strictly detached but in the position of the parties.

<sup>278</sup> *Gibbons*, above n130, at [96] per Thomas J; Valcke, above n71, at 11 recognises the English courts have refrained from clarifying the objective theory and describes the concept as "inherently unstable." As discussed, the confusion in approach is evidenced in Wilson J's judgment in *Vector* and some of the lower court decisions

To the contrary, Thomas J claims formalism has caused the object of giving effect to intentions to be confused.<sup>279</sup> Mere rhetorical weight should not be given to statements regarding the ascertainment of intent, nor should the doctrine be elevated to a universal rule whereby it is always necessary to presume intent.<sup>280</sup> Rather the parties' actual mutual intent should be ascertained where possible with the strict objective test applying in the absence of actual intention.<sup>281</sup> The inquiry no longer focuses on discerning what the parties *should* have intended in reference to what a reasonable person would have intended. Instead, the reasonable person is placed as far as possible in the position of the contracting parties.<sup>282</sup> The inquiry asks what did they *actually* intend, discerned under an objective framework. Actual intention as to meaning must be mutual or where one party led the other to reasonably believe they had accepted a particular meaning.<sup>283</sup> This is an approach said to uphold the reasonable expectations of the contracting parties.<sup>284</sup>

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post-*Vector*. This confusion results from a distinction that is often not appreciated when articulating the objective theory.

<sup>279</sup> *Gibbons*, above n130, at [95]. In *Yoshimoto*, above n7, at [37] he found the objective of ascertaining actual intent was a cardinal principle, enshrined in ancient authority.

<sup>280</sup> Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 153; McLauchlan "New Law of Contract Interpretation," above n26, at 166.

<sup>281</sup> McLauchlan "A Contract Contradiction" (1999) 30 VUWLR 175 at 177.

<sup>282</sup> Counsel for Persimmon Homes invited the House of Lords to relax the rule on the ground the rule was illogical and prevented the court from putting themselves in the positions of the parties' and ascertaining their true intent. See *Chartbrook*, above n3, at [30]

<sup>283</sup> McLauchlan, "Contract Interpretation: What is it About?" above n57, at 13.

<sup>284</sup> *Yoshimoto*, above n7, at [71]; McLauchlan "New Law of Contract Interpretation" above n26, at 166; Sebastian Grammond, "Reasonable Expectations and the Interpretation of Contracts Across Legal Traditions" Social Science Research Network <<http://ssrn.com/abstract=1474266>> at 10. Cf Holborow, above n14, at 273 who thinks a conservative approach is required for contract law to enable the efficient conduct of business and the parties' reasonable expectations. Parties would be surprised if they realised their words could be overturned by the meaning of the contract. Stephen Smith "The Reasonable Expectations of the Parties: An Unhelpful Concept" (2009) Social Science Research Network. <<http://ssrn.com/abstract=1349995>> provides an interesting discussion on the different conceptions of a "reasonable expectation" and the limited role it plays in interpretation. He claims it is more useful as a slogan than a practical concept.

In most instances actual and presumed intent will correspond, however, we cannot always be sure.<sup>285</sup> Consequently, where actual intent is discernible, a court should do so over presuming intent.<sup>286</sup> A meaning should not be imposed on parties which may not accord with their actual intention.<sup>287</sup> Ascertaining actual intent, however, is not possible in every case. Frequently the parties will not have contemplated the situation that has arisen. It would be an impossible task and furthermore artificial to attribute intention where it was clearly not formed. Meaning in this instance can only be resolved through presumed intention.<sup>288</sup>

The decision in *Codelfa*<sup>289</sup> evidences a situation where actual intent prevails. If parties refuse to include a provision in their agreement then evidence of this refusal should be, and is, admissible. The court should not undertake the objective exercise to the extent they might attribute a meaning that the parties were united in rejecting. There is the risk this could occur if the inquiry is framed from the detached reasonable observer. This decision is claimed to destroy the rationale for the exclusionary rule.<sup>290</sup> If evidence of a common rejection was admissible to determine actual meaning then evidence establishing the parties were united in accepting a meaning should too be admissible.<sup>291</sup> Lord Hoffmann's discussion regarding a conversation between Alice and Humpty provides a further example.<sup>292</sup> Humpty informs Alice that "glory" means "a nice knock-down argument" contrary to its ordinary meaning. Lord Hoffmann states Alice, as a reasonable person who has been expressly told,<sup>293</sup> will now have no problem in understanding what "glory" means. McLauchlan argues this reveals Lord Hoffmann is in fact not a strict objectivist. The reasonable person is in fact placed in the

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<sup>285</sup> *Gibbons*, above n130, at [63]; Hoffmann, "Intolerable Wrestle with Meaning and Words" above n10, at 661.

<sup>286</sup> *Ibid*, at [97] per Thomas J.

<sup>287</sup> *Yoshimoto*, above n7, [37]; *Gibbons*, above n130, at [63] per Tipping J; McLauchlan, "Common Assumptions and Contract Interpretation" above n108, at 241.

<sup>288</sup> *Attorney General v Dreux*, above n88, at 632; *Yoshimoto*, above n7, at [37]; McLauchlan "Contract Interpretation: What is it about?" above n57, at 10; "Objectivity in Contract" above n6, at 488.

<sup>289</sup> Above n74.

<sup>290</sup> Nicholls, above n107, at 584 claims this decision "lets the cat out of the bag"; McLauchlan "A Contract Contradiction" above n281, at 187.

<sup>291</sup> McLauchlan "A Contract Contradiction" above n281, at 187.

<sup>292</sup> *Investors Compensation Scheme*, above n2, at 914.

<sup>293</sup> Or if she could infer this from the surrounding circumstances.

position of the parties, aware of their shared communications and understandings.<sup>294</sup> The objective meaning of “glory” is a “nice knock-down argument” in accordance with their actual intent.<sup>295</sup>

Those advocating previous negotiations should be admissible are resolute in asserting subjective intention is inadmissible.<sup>296</sup> As discussed, subjective intention represents one party’s uncommunicated, inner intent. It is not suggested a party should be allowed to deliver an unsubstantiated version, with the benefit of hindsight, as to what they meant.<sup>297</sup> Claims of previous negotiations and declarations of subjective intent as one in the same, no longer hold true. Admissible evidence of negotiations is not “drenched in subjectivity”.<sup>298</sup> On the approach advocated for, it is illogical to exclude previous negotiations to the extent they constitute objective evidence of intention.<sup>299</sup>

Once accepted it is legitimate for a court to give effect to actual intention, then objections to the admissibility of previous negotiations on the basis of an inconsistency with the objective theory become null. To exclude the evidence would in fact be perverse. The judge armed with previous negotiations will be better equipped to ascertain actual intention, as the most

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<sup>294</sup> McLauchlan “Contract Interpretation: What is it About?” above n57, at 39; “Objectivity in Contract” above n6, at 493-494. He reveals a fundamental inconsistency with this proposition is that is that the evidence of shared understandings is excluded by Lord Hoffmann’s ban on previous negotiations.

<sup>295</sup> Alice is bound not because we are concerned with their subjective intentions, but because a reasonable person in Alice’s position, armed with her knowledge, would have understood this to be the meaning.

<sup>296</sup> See *Yoshimoto*, above n7, at [49][74]; Tipping, above n1, at [19]; McKendrick “Interpretation of Contracts & the Admissibility of Previous Negotiations” above n39, at 265; McLauchlan, “Contract Interpretation: What is it About?” above n57, at 13; McMeel, “Prior Negotiations and Subsequent Conduct” above n35, at 274; Mitchell “Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule” above n49, at 146.

<sup>297</sup> *Yoshimoto*, above n7, at [74]; McLauchlan “New Law of Contract Interpretation” above n26, at 170. This differs from the civil system whereby any evidence of what the parties actually intended, explicitly or implicitly, is legally significant, even if it has not been shared with the other. See Valcke, above n71, at 5.

<sup>298</sup> Cabrelli, above n20, at 14. He claims Lord Hoffmann’s rather blunt and simplistic analysis breaks down at the margins.

<sup>299</sup> McKendrick “Interpretation of Contracts & the Admissibility of Previous Negotiations” above n39, at 264-65 recognises the exclusionary rule in its present form goes further than just excluding declarations of subjective intent and encompasses objective evidence of mutual intent.

pertinent background is no longer artificially excluded.<sup>300</sup> In accordance with the move away from the plain meaning rule, abandoning the exclusionary rule is another step in ascertaining actual intent.<sup>301</sup> This shift is evidenced by Supreme Court decisions<sup>302</sup> and Tipping J's analysis in *Vector*. An undermining of the presumed intent approach is also reflected in *Codelfa* and *Karen Oltmann*.<sup>303</sup> More recently this trend is evidenced by post-*Vector* decisions.<sup>304</sup>

It could be argued the confusion is embedded in an inconsistency between underlying contract theories and the objective approach. Classical will theory framed contract law principles in reference to inner will and intention.<sup>305</sup> This paper adheres to promissory theories which later subsumed classical will theory. Contracts are essentially still considered to be self-imposed voluntary obligations but the concept of inner wills was removed.<sup>306</sup> Under these theories interpretation is concerned with the ascertainment of intention.<sup>307</sup> However, this fundamentally conflicts with the objective theory and the search for apparent intention.<sup>308</sup> This creates perennial uncertainty, reflected in the debate regarding previous negotiations. If interpretation is to be achieved on a strict objective approach then previous negotiations are inadmissible to the extent they reveal intention. However, if interpretation is framed in reference to discerning intention, then previous negotiations should be admissible. Smith's solution to this inconsistency supports the approach advocated for. Subjective intention is not

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<sup>300</sup> Nicholls, above n107, at 580-583; McLauchlan "A Contract Contradiction" above n281, at 183; Collins, above n6, at 197, cites Roy Goode who claims "often the negotiations culminating in the contract is the best guide to the intention of the parties".

<sup>301</sup> *Yoshimoto*, above n7, at [71]. The plain meaning rule essentially presumed the plain meaning to be the parties' intention, rather than ascertaining actual intent.

<sup>302</sup> *Gibbons*, above n130; *Totara*, above n138.

<sup>303</sup> See later discussion at 3.2.iv.c.

<sup>304</sup> Discussed at 2.3. See n255.

<sup>305</sup> Paterson, Robertson & Duke, above n36, at 5-7.

<sup>306</sup> *Ibid*, at 9-12. Stephen Smith, *Contract Theory*, (Oxford University Press, New York, 2004) at 56-59. If classical will theory was adhered to as governing contract principles, then the claim advocated in this paper that subjective inner intention is inadmissible on all accounts would be inconsistent with the theory.

<sup>307</sup> Cabrelli, above n20, at 1.

<sup>308</sup> Collins, above n6, at 189.



relevant to interpretation and on that basis classical will theory will always be inconsistent with the objective theory.<sup>309</sup> However, under the promissory version of contract, meaning is public and objective, as opposed to inner will.<sup>310</sup> Actual intent can therefore be accommodated to the extent it is expressed objectively. Mitchell furthermore argues contracts should be ascertained according to intent, not just as a matter of contractual theory, but also as a matter of legal entitlement derived from voluntary assumed obligations.<sup>311</sup>

### **3.2. Establishing Coherency**

The exclusionary rule and surrounding legal principles are conceptually unsound. Maintaining the rule on the basis of policy has come at a cost for coherency.<sup>312</sup> This section will consider the exclusionary rule and incoherency in relation to contract formation, the contextual approach to interpretation and the admissibility of subsequent conduct. Finally, this section will consider the unsound exceptions to the rule and the effect abandonment of the exclusionary rule would have on the doctrines of rectification and estoppel.

#### *i) Contract Formation*

Contract formation also mandates an objective approach.<sup>313</sup> However, here the objective approach is more concerned to give effect to actual intentions through the requirement of an intention to create legal relations and doctrines such non est factum.<sup>314</sup> In deciding whether parties should be held to their bargain a court is required to engage with relevant material, including objective evidence of previous negotiations. There is no sensible reason why interpretation should differ from the formation process. Why should a party be permitted to

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<sup>309</sup> Smith, *Contract Theory*, above n306 at 272-273.

<sup>310</sup> Ibid, at 272-274.

<sup>311</sup> Mitchell “Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule” above n49, at 154.

<sup>312</sup> McLauchlan “New Law of Contract Interpretation” above n26, at 175; Cf Spigelman, above n54, at 332 who considers coherency is unquestionably desirable, but not the only value in contract law. He claims there is no incoherency in having a general rule, subject to exceptions, where there are good policy reasons. He argues the common law does not have the same fascination with consistency as civil law systems do.

<sup>313</sup> *Smith v Hughes* (1871) LR 6 QB 597 per Blackburn J.

<sup>314</sup> Smith, above n306, at 173-176.

contradict an apparently complete contract, but not the apparent meaning of the contract?<sup>315</sup> Furthermore, if the issue of formation is not upheld in court, then it is possible an interpretation claim might be brought in the alternative. The court must then discount the evidence when undertaking interpretation, resulting in “unnecessary intellectual gymnastics.”<sup>316</sup> This is illustrated in *Edwards v O’Connor* where the New Zealand Court of Appeal relied on pre-contractual material to conclude the agreement in writing constituted the whole contract.<sup>317</sup> However, in accordance with the parol evidence rule, on the issue of construction the Court concluded evidence manifesting intention was not admissible and went on to apply the strict objective theory.<sup>318</sup>

## ii) *Contextual Approach*

In light of the contextual approach taken to interpretation, it is difficult to rationalise the exclusion of previous negotiations from ‘absolutely anything’ in the admissible matrix of fact. The exclusionary rule was founded in an era, very remote from the contextual approach now taken, where interpretation focused solely on the document.<sup>319</sup> Yet the rule was re-stated in *ICS*, inherently conflicting with the rest of the ‘commonsense’ principles formulated.<sup>320</sup> The most pertinent background should not be excluded from the admissible context, as a reasonable person in the position of the parties gains an incomplete picture and is less able to discern the parties’ intended meaning.<sup>321</sup> Furthermore, previous negotiations would facilitate discerning what is commercially sensible and what is merely a bad bargain.<sup>322</sup>

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<sup>315</sup> McLauchlan “Objectivity in Contract” above n6, at 496; “A Contract Contradiction” above n281, at 182.

<sup>316</sup> McMeel “Prior Negotiations and Subsequent Conduct” above n35, at 286-287.

<sup>317</sup> [1991] 2 NZLR 542. The trial judge Smellie J had found the agreement was partly written and partly oral. The facts concerned a contract regarding the sale of a fishing business. The issue was whether fishing quota passed with the sale. The evidence excluded by the court clearly evidenced an intention that it was meant to.

<sup>318</sup> *Ibid*, at 548-550.

<sup>319</sup> McKendrick “Interpretation of Contracts & the Admissibility of Previous Negotiations,” above n39, 273-274.

<sup>320</sup> A Kramer “Common Sense Principles of Contract Interpretation” (2003) 23 (2) OJLS 173 at 180.

<sup>321</sup> McLauchlan “Contract Interpretation: What is it About?” above n57, at 32; Richard Buxton “‘Construction’ and Rectification After Chartbrook” (2010) 69(2) CLJ 253 at 259.

<sup>322</sup> Cabrelli, above n20, at recognises the court may be able to determine the agreement was a bad bargain due to concessions given during the negotiations. See discussion at 2.2.D regarding McLauchlan’s claim that

iii) *Subsequent Conduct*

Subsequent conduct, until recently, was also excluded in interpretation disputes. It was considered “one and the same principle which excluded evidence during the negotiations, or subsequent to the contract.”<sup>323</sup> As discussed, the Supreme Court in *Gibbons* lifted the ban on subsequent conduct.<sup>324</sup> This rejection calls for reconsideration of the ban for previous negotiations. Subsequent conduct is now admissible on the basis it provides a reliable guide in establishing the commercial purpose, background and furthermore where it sheds light on the mutual intention of the parties.<sup>325</sup> Much of the reluctance in admitting subsequent conduct was an inability to distinguish between the task of giving effect to mutual intention and the misguided exercise of ascertaining subjective intent. It is now established the latter is an illegitimate exercise and that evidence must be objectively ascertainable in order to elucidate meaning.<sup>326</sup> There can be no sensible reason for continuing to exclude previous negotiations when they will be used on the same basis as subsequent conduct and could possibly provide an even more reliable guide to meaning.<sup>327</sup> If the exclusions derived from the same principle, then logically, previous negotiations should no longer be subject to exclusion, just as subsequent conduct is not.

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Blanchard J in *Vector* inadvertently used the prior correspondence to determine the agreement was not ‘commercially sensible’.

<sup>323</sup> *L Shuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 at 261; Steyn “The Intractable Problem of the Interpretation of Legal Texts” above n27, at 10 states the exclusion on both pre-contractual and post-contractual conduct was described as the “two sacred cows” of English Law.

<sup>324</sup> *Gibbons*, above n130. There is still some confusion regarding the requirement of mutual conduct. Tipping and Anderson JJ found mutual conduct was needed, in disagreement with Thomas J. In *Vector* Wilson J at [122] considered mutuality was not a requirement but a consideration in weight. Tipping J at [30] also considered his relevance approach was a more simpler and clearer articulation than in *Gibbons*.

<sup>325</sup> McLauchlan “Interpretation & Rectification” above n32, at 453; “Contract Formation, Contract Interpretation, and Subsequent Conduct” above n272, at 84.

<sup>326</sup> *Gibbons*, above n130, at [114] per Thomas J.

<sup>327</sup> As discussed, this reasoning was prominent in the judgments of Tipping and Wilson JJ in abandoning the rule. See *Vector*, above n1, at [31] per Tipping J; at [129] per Wilson J.

iv) *Exceptions to the Rule*

The exceptions to the exclusionary rule also demonstrate incoherency. Formalism and compartmentalisation are being used to overcome a defective and unjust rule.<sup>328</sup> The exceptions cause many fine distinctions to be drawn and really serve to demonstrate the rule is wrong in principle. The exceptions for rectification, estoppel, private dictionaries and *Karen Oltmann* are primarily concerned with giving effect to the parties' actual mutual intentions. There is no need for these exceptions where the primary purpose of interpretation is to ascertain actual mutual intention. Rather if previous negotiations are admissible, these exceptions will, to a large extent, be accommodated within interpretation. This section aims to highlight the difficulties with the exceptions.

a) *Objective Background Facts*

This exception involves the difficult process of distinguishing evidence in previous negotiations to the extent they shed light on objective background facts or the subject-matter of the contract, and disregarding the evidence for the light it might shed on meaning. This involves a very thin line that is hard to draw in practice.<sup>329</sup> Furthermore, in light of the liberal analysis Blanchard J accords to the subject-matter, this exception in essence can be used to shed light on meaning, contributing to a lack of transparency in judicial reasoning.<sup>330</sup> If the exclusionary rule was abandoned previous negotiations could be used to facilitate an understanding, not only of the objective background, but also the meaning intended by the parties.<sup>331</sup>

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<sup>328</sup> McLauchlan "Contract Interpretation in the Supreme Court" above n151, at 257.

<sup>329</sup> McKendrick "Interpretation of Contracts & the Admissibility of Contracts" above n39, at 273; Mitchell "Contract Interpretation: Pragmatism, Principle and the Prior Negotiation Rule" above n49, at 152; McLauchlan "Interpretation and Rectification" above n32, at 443.

<sup>330</sup> See later discussion at 3.4.A.

<sup>331</sup> Tipping and Wilson JJ in *Vector* demonstrate this approach. See also *Cockburn*, above n261; *I-Health*, above n252; *Brownsons Holdings (1999) Ltd v The Plaza Pakuranga Ltd* High Court Auckland CIV 2004-404-2113, 30 May 2006.

## b) Estoppel and Private Dictionaries

After *Vector* the prominence of estoppel is evident. However, estoppel proves to be an artificial and unnecessarily cumbersome means of holding a party to their intention.<sup>332</sup> Unconscionability must be established and it is difficult to see why this should act as an obstacle in ascertaining the parties' actual intentions.<sup>333</sup> If previous negotiations are admissible to confirm the parties were negotiating on the basis of a common understanding that a term had a particular meaning, then that meaning *is* the meaning of the term. This will be so, whether the meaning was a private code or conventional. Both are to be determined on an objective basis. This is a more principled and coherent approach, where there is no need to invoke the "legitimate safety device" of estoppel.

## c) *Karen Oltmann*

The decision in *Karen Oltmann*, despite numerous attempts to analyse it in orthodox terms, clearly evidences an exception devised in order to escape the exclusionary rule.<sup>334</sup> The decision demonstrates how previous negotiations can be helpful and relevant in establishing a shared meaning. Using previous negotiations to ascertain common assumptions to meaning should not, however, be precluded by a requirement of ambiguity.<sup>335</sup> *Karen Oltmann* illustrates a Court willing to ascertain actual intent, over presumed intent, where it exists.

## d) Rectification

Rectification and the overlap with interpretation, demonstrate the most incoherent aspect of the exclusionary rule. Interpretation has overtaken much of rectification's role through the modern contextual approach, causing the two to live in uneasy parallel.<sup>336</sup> The contextual

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<sup>332</sup> McLauchlan "Contract Interpretation in the Supreme Court" above n151, at 248-249.

<sup>333</sup> Ibid, at 249.

<sup>334</sup> Collins, above n6, at 197, recognises the decision was most likely a route to get around the restriction.

<sup>335</sup> McLauchlan 'Common Assumptions and Contract Interpretation' above n108, at 243.

<sup>336</sup> Buxton, above n321, at 253; Burrows, above n83, at 90; McMeel "Principles and Policies of Contractual Construction" above n4, at 35.

approach allows greater freedom to rectify the contract under the guise of interpretation, as if concluded from the context that the parties used the wrong words, the court is not required to attribute an intention they could not have had.<sup>337</sup> The neat line between interpretation and rectification as a corrective tool collapses.<sup>338</sup> *ICS* itself evidences this trend, whereby Lord Hoffmann was able to extract the contractual terms from their brackets.<sup>339</sup> Practitioners express alarm at this approach, which allows the court to make certain assumptions about the parties' intentions without the clear evidence required in rectification.<sup>340</sup>

When undertaking interpretation the court is disadvantaged by the exclusionary rule. In this framework, where the relationship with rectification is so close, it is therefore sensible to allow evidence of previous negotiations under interpretation to facilitate finding actual mutual intent.<sup>341</sup> This would not offend against the objective theory. Previous negotiations are admitted under rectification on the objective basis advocated for in this paper.<sup>342</sup> Continuing

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<sup>337</sup> McKendrick "Interpretation of Contracts & the Admissibility of Prior Negotiations" above n39, at 270. Buxton, above n321, at 267-8 provides a specific discussion on the revolutionary nature of principle five of *Investors Compensation Scheme*. It allows the court to substitute for the meaning of the document an intention that was not manifested in the agreement. This reflects the ability of the court to correct clear mistakes through interpretation as discussed at 1.4.ii and 2.2.C.iv.

<sup>338</sup> Cabrelli, above, n20 at 10.

<sup>339</sup> Lord Hoffmann, at 914, concluded the phrase excluding "[a]ny claim (whether sounding in rescission for undue influence or otherwise)" was actually used by the parties to mean "[a]ny claim sounding in rescission (whether for undue influence or otherwise)". In reaching this conclusion Lord Hoffmann acknowledged he had not given the words their natural and ordinary meaning but justified his decision on the ground the parties had not used the words in their natural and ordinary sense. Lord Lloyd, at 904, dissented. He stated that he knew of "no principle of construction" which enabled a court "to take words from within the brackets, where they are clearly intended to underline the width of "any claim" and place them outside the brackets where they have the exact opposite effect"" In his opinion, the majority had crossed the line between purposive interpretation, which is legitimate, and creative interpretation, which is not.

<sup>340</sup> Calnan, above n14, at 19.

<sup>341</sup> McKendrick 'The Interpretation of Contracts and the Admissibility of Previous Negotiations' above n39, at 270.

<sup>342</sup> Under rectification one is searching for actual intention, to the extent it is objectively ascertainable. See Burrows, above n83, at 95.

common intention is an objective fact, not a subjective one.<sup>343</sup> This in fact reveals a fundamental inconsistency. Previous negotiations are not available in interpretation due to their ‘subjective’ nature, yet they are admissible under rectification to establish an objective prior consensus.<sup>344</sup> The ascertainment of actual objective intent under rectification is fundamentally what interpretation should be seeking to achieve, but which has become misguided with strict objectivity. Rectification developed to bridge the gap between the strict objective test and the aim of ascertaining the parties’ intentions.<sup>345</sup> Civil systems, which ascertain actual, albeit inner, intent through interpretation know no doctrine of rectification.<sup>346</sup>

If accepted that previous negotiations are admissible, much of rectification for common mistake will be subsumed by interpretation.<sup>347</sup> If actual objective meaning can be ascertained in interpretation, there will be no need to resort to rectification to accord meaning with actual intention. Take for example, where two parties agree to the sale of ordinary horsebeans, but stipulate in the contract “feveroles,” due to a mistaken belief they were ordinary horsebeans. There is no need to rectify the contract, as objective common intention can be found as to meaning. However, the doctrine will not be rendered completely redundant. There will still be room for rectification where parties may have mistakenly omitted a whole clause.<sup>348</sup>

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<sup>343</sup> Lord Hoffmann emphasises the need for the prior consensus to be objective. *Chartbrook*, above n3, at [59-65]. See also Cabrelli, above n20, at 10.

<sup>344</sup> Buxton, above n321, at 260.

<sup>345</sup> Valcke, above n71, at 13; Hoffmann “Intolerable Wrestle with Meaning and Words” above n10, at 667.

<sup>346</sup> Steyn “Written Contracts: To What Extent May Evidence Control Language” above n103 at 27; Vogenour, above n71, at 124; Valcke, above n71, at 5. There is no need for a corrective measure to bring contractual intention into line with actual party intention.

<sup>347</sup> Burrows, above n83, at 94-97. The extent to which unilateral mistake is swallowed up, if it does exist as an action, depends on whether it is accepted that common intention can be established where one party has reasonably led the other to believe they are accepting their meaning. It might still play a role, however, due to the unconscionability element of the action, which is not a requirement in interpretation.

<sup>348</sup> Nicholls, above n107, at 586; Burrows, above n83, at 96. Although Burrows admits this will be relatively rare.

### **3.3 The Utility and Relevance of Previous Negotiations**

It is conceded previous negotiations may frequently be unhelpful in identifying meaning. For example, they will not be helpful or relevant, where the parties did not anticipate the events that occurred, nor where they demonstrate a meaning intended by one party only.<sup>349</sup> However, the claim that the parties' positions are constantly changing and therefore negotiations are never helpful is no more than a generalisation.<sup>350</sup> To the contrary, it is possible prior negotiations may provide cogent evidence shedding light on the interpretation to be accorded to the agreement. A judge should not have to speculate where evidence is available which might afford valuable insight.<sup>351</sup> Previous negotiations may, for example, demonstrate that changes occurred concerning the nature and structure of the transaction, and the reasons for such changes may be relevant to the interpretation to be given.<sup>352</sup> Not only might previous negotiations establish essential objective background facts, but they may also reveal that the parties had made clear the meaning they intended by their language.<sup>353</sup> Or they may offer a different shade of meaning sufficient to negate an ambiguity and show a particular meaning.<sup>354</sup> In *Chartbrook* Lord Hoffmann endorsed the rationale in *Prenn* that negotiations were "unhelpful". This however, sits uncomfortably with his rectification finding that an objective consensus was reached during the negotiations, months before the conclusion of the contract.<sup>355</sup> This indicates actual objective consensus *can* be found in evidence of negotiations and that the parties' positions are not constantly changing and divergent as claimed.

As discussed earlier, it is claimed the formal contract puts an end to future disputes as the last word of the parties' therefore evidence of what has come before is irrelevant.<sup>356</sup> However, in

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<sup>349</sup> *Gibbons*, above n130, at [52] per Tipping J.

<sup>350</sup> *Yoshimoto*, above n7, at [77].

<sup>351</sup> *Nicholls*, above n107, at 581.

<sup>352</sup> McLauchlan "Contract Interpretation: What is it About?" above n57, at 32.

<sup>353</sup> *Nicholls*, above n107, at 583; Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 149.

<sup>354</sup> Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 157. What may seem ambiguous to the reader may not actually be to the parties.

<sup>355</sup> *Chartbrook*, above n3, at [66]; McLauchlan "Interpretation and Rectification" above n32, at 444-445.

<sup>356</sup> *A&J Inglis*, above n37, at 577.



practice many parties do not view the contract in this discrete manner.<sup>357</sup> In their view ‘negotiations’ cannot often be easily distinguished from the ‘contract’.<sup>358</sup> This may especially be true where parties have used a variety of instruments, such as letters, draft contracts and agreements to agree, in the process of recording their agreement. The law at present therefore excludes the most pertinent and relevant background, providing an incomplete picture to the interpreter.<sup>359</sup>

It is apparent the “unhelpful” objection is not wholly convincing. Rather, it is contended previous negotiations should be admitted on the basis of Tipping J’s judgment in *Vector*.<sup>360</sup> That is, admissibility on the basis of relevance, an approach supported by the Evidence Act.<sup>361</sup> Negotiations will be relevant where they establish the circumstances in which the contract was entered into and any objective consensus as to meaning.<sup>362</sup> It makes little sense to have a rule of exclusion when it is only possible to conclude previous negotiations are

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<sup>357</sup> It must be noted that if previous negotiations are admissible then one possible consequence could be a decline in the importance and need for the formal contract, furthermore possibly leading to an increase in incomplete contracts. However, the scope of this possibility is outside the reach of this paper. In brief, this possibility would not affect the arguments of the paper. This paper takes the view that contractual relations and intent may not be solely found in the formal deed. It can further be argued there will still be a need for the formal contract as the starting point of the interpretation inquiry is the language used by the parties. Context is used in a facilitative role.

<sup>358</sup> Mitchell, “Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule” above n49, at 147-148; Mitchell claims empirical evidence demonstrates the parties rarely view the contract as the last word on their obligations. Contracts will always be surrounded by their expectations and informal understandings. Mitchell “Contracts and Contract Law: Challenging the Distinction Between the ‘Real’ and ‘Paper’ Deal” 29(4) OJLS 675 expands further on the bridge between the formal contract and artificial world created by contract law on the one hand and the real world of the parties and how they understand the agreement on the other. The paper argues legal reasoning will be improved if we place more emphasis on the ‘real deal.’

<sup>359</sup> McLauchlan “New Law of Contract Interpretation” above n26, at 170.

<sup>360</sup> This analysis is considered to be more principled than the judgment of Wilson J. As already discussed, the admissibility of previous negotiations under Wilson J’s judgment is subject to the three exceptions he provides.

<sup>361</sup> This is similar to the argument made by counsel for Persimmon in *Chartbrook* who submitted the rule should only apply in cases where the previous negotiations are actually irrelevant, and if they do assist in meaning they should be admitted. See *Chartbrook*, above n3, at [32].

<sup>362</sup> *Vector*, above n1, at [27].

irrelevant or unhelpful by firstly regarding the evidence.<sup>363</sup> Simon France J demonstrates a process similar to Tipping J's approach in *Brownsons Holdings v The Plaza Pakuranga*<sup>364</sup>. He examined the pre-contractual material to determine what evidence was relevant and admissible, and what constituted evidence of subjective intent.<sup>365</sup> If evidence is produced which is unreliable or equivocal, then this is suggested not to be a matter of admissibility but rather for the weight to be attached to the evidence.<sup>366</sup> The court should approach such evidence with caution.<sup>367</sup> Furthermore if evidence is led which is superfluous, irrelevant and unnecessarily prolongs the hearing, then this is a matter where the court should deploy their power to award costs.<sup>368</sup>

Numerous examples can be found where evidence was reliable and helpful in resolution of interpretation. For example, in *Yoshimoto* the extrinsic evidence left no doubt in Thomas J's mind that the plain meaning was contrary to the parties' actual intention.<sup>369</sup> He considered the evidence to be reliable as the drafts did not form part of the bargaining process, but instead

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<sup>363</sup> McKendrick "Interpretation of Contracts & the Admissibility of Previous Negotiations" above n39, at 265.

<sup>364</sup> Above n331.

<sup>365</sup> Ibid, at [17-27]. He excludes pre-contractual material where it did not establish any relevant common knowledge and subjective intent that went to proving the meaning of the agreement.

<sup>366</sup> Nicholls, above n107, at 585; McKendrick "Interpretation of Contracts & the Admissibility of Previous Negotiations" above n39, at 265; Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 136; McLauchlan "New Law of Contract Interpretation" above n26, at 172.

<sup>367</sup> *Yoshimoto*, above n7, at [49].

<sup>368</sup> *Vector*, above n1, at [24] per Tipping J; *Brownsons*, above n 331 at [13]. Cf Scorgie & Smith, above n191, doubt whether costs will be a realistic disincentive to the 'kitchen sink' approach.

<sup>369</sup> *Yoshimoto*, above n7. The facts concerned the price payable under an agreement to buy shares in a company whose principal activity was the development of land into a golf course. In addition to the base price, a further payment of NZ\$1m would become payable if Canterbury Golf obtained "all necessary consents to the development within 12 months of the date of this agreement". Canterbury Golf failed to obtain one consent until five months after the expiry of the 12 month period. It denied that it was liable to make the payment. Thomas J let in evidence of previous negotiations, despite the exclusionary rule, as hard evidence of what the parties had in mind to assist in interpreting the meaning of "necessary consents."

were consequential changes seeking to give effect to the bargain reached.<sup>370</sup> In the Court of Appeal in *Chartbrook*,<sup>371</sup> Lawrence Collins J felt bound to accept the rule, but stated that if the evidence were admissible, it would determine the construction as there was strong evidence supporting Persimmon's interpretation. Lady Hale, in the House of Lords, also conceded she could not have reached her decision on interpretation had she not been made aware of the agreement which the parties had reached on this aspect during the negotiations.<sup>372</sup>

If the court is deprived of reliable evidence, which may otherwise be helpful, then the court is, to that extent, less able to accurately ascertain meaning in accordance with the parties' intentions.<sup>373</sup> This is a less than satisfactory state of affairs and is prone to cause injustice where credible and reliable evidence is excluded.<sup>374</sup> The justice of a correct interpretation, one that accords with actual objective intention where possible, surely outweighs any costs that might occur.<sup>375</sup> This aptly leads into discussion regarding the pragmatic considerations.

### **3.4 Counteracting the Pragmatic Considerations**

It is not enough to merely address the conceptual arguments supporting the admissibility of previous negotiations. Nor is it enough to demonstrate they can constitute relevant and reliable evidence. Lord Hoffmann himself recognised that *prima facie* evidence of previous

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<sup>370</sup> Ibid, at [70]. Thomas J's decision was, as predicted by himself, overturned by the Privy Council in *Yoshimoto v Canterbury Golf International Ltd* [2004] 1 NZLR 1 (PC). At [25] Lord Hoffmann declared this was not a suitable occasion for re-examining the law, as they considered on the facts, the evidence was unhelpful.

<sup>371</sup> *Chartbrook*, above n51, at [131]. The facts concerned a contract to develop property owned by Chartbrook. The interpretation concerned a complex formula concerning the price payable. See a summary of the facts in McLauchlan "Interpretation and Rectification" above n32, at 434-435.

<sup>372</sup> *Chartbrook*, above n3, at [99].

<sup>373</sup> Nicholls, above n107, at 586.

<sup>374</sup> McMeel "Prior Negotiations and Subsequent Conduct" above n35, at 294; Burrows, above n83, at 82.

<sup>375</sup> Cf Lord Hoffmann in *Chartbrook*, above n3, at [41] who claims a system which allows this to happen is justified in the more general interest of economy and predictability in obtaining advice and adjudicating disputes.

negotiations may be relevant and that inadmissibility is usually based on irrelevance.<sup>376</sup> However, he considered, on balance that pragmatic considerations weighed in favor of exclusion.<sup>377</sup> This section intends to counteract and weaken the force of the pragmatic considerations, essentially arguing they are factors which support the need for caution in the admissibility of previous negotiations, but they are not wholly convincing nor do they support the retention of the exclusionary rule in light of the arguments for admissibility.

*i) Time and Expense*

Judges are invited to read voluminous pre-contractual correspondence when determining other contractual issues, such as the formation of a contract or misrepresentation. It can be questioned why time and expense acts as an objection in interpretation. Why should the court not have to undergo this exercise where the evidence is reliable and relevant? Huge costs are already incurred in the parties attending court.<sup>378</sup> Any extra delay as a result of the ‘voluminous’ evidence produced could be controlled by the judiciary through their case management powers.<sup>379</sup> This same objection was expressed in relation to the contextual approach following *ICS*. Many have recognised that fears of being overwhelmed by masses of evidence have not resulted.<sup>380</sup> Any suggestion that previous negotiations differ from other background as they result in large amounts of material, many of which is subjective, is

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<sup>376</sup> *Chartbrook*, above n3 at [33].

<sup>377</sup> *Ibid* at [41]. Mitchell “Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule” above n49, at 142 recognises it is not clear that Lord Hoffmann himself endorsed the policy as good reason for retaining the rule. Rather he recognised the policy considerations as arguments to weigh in balance when considering whether to overturn the rule. In the end he was not required to reach a final decision and was able to remain equivocal, although it is safe to assume he supports them on some level.

<sup>378</sup> McLauchlan “Contract Interpretation: What is it About?” above n57, at 37 claims costs might in fact be reduced with fewer disputes over what is admissible.

<sup>379</sup> See Part 7, High Court Rules in the Judicature Amendment Act 1908, sch 2. Suggested by Nicholls, above n107, at 587; McKendrick “Interpretation of Contracts & the Admissibility of Previous Negotiations” above n39, at 266; McMeel “The Principles and Policies of Contractual Construction” above n4, at 46.

<sup>380</sup> *Chartbrook*, above n3, at [38]; Bingham, above n284, at 387-388; McMeel “The Principles and Policies of Contractual Construction” above n4, at 46.

unconvincing.<sup>381</sup> As discussed, only evidence of objective mutual intent is admissible and should be admitted on the basis of relevance.<sup>382</sup>

The most persuasive claim against this objection, is that in reality the evidence will be submitted in support of estoppel or rectification.<sup>383</sup> Little time or cost is therefore avoided by the exclusionary rule. Furthermore, *Vector* demonstrates that estoppel need not be formally pleaded and if in essence the action applies the courts will employ it. If rectification or estoppel is not, it is still likely evidence of the negotiations will be considered under the objective background exception. This is even more so, with Blanchard J's liberal version of the subject-matter. It is these trends that have led Thomas J to acknowledge he can recall few contractual disputes in New Zealand where evidence of pre-contractual negotiations have not been before the court.<sup>384</sup>

The objection is perhaps most pertinent in relation to increased time and expense in the practitioner's ability to advise. However, in the majority of cases, meaning is unlikely to be disputed as in most cases the legal advisor will have carefully spelt out the parties' core interests in the document.<sup>385</sup> Furthermore, claims of inconvenience in attending the background material are inconsistent with the contextual approach taken to interpretation. It must be accepted previous negotiations constitute a vital part of that background which is regarded as essential in interpretation. The objections raised by practitioners are overstated

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<sup>381</sup> See Bingham, above n284, at 389-90; *Chartbrook*, above n3, at [38] per Lord Hoffmann.

<sup>382</sup> *I-Health*, above n252, at [42] per Asher J, employs this approach to admissibility. He does so conscious of the fear of judges being asked to wade through endless exchanges of drafts. However, he considers the touchstone of relevance, when firmly applied, should ensure that this task can be kept within reasonable bounds.

<sup>383</sup> *Yoshimoto*, above n7, at [80]; McLauchlan, "Contract Interpretation: What is it about?" above n57, at 37; Buxton, above n321, at 253 claims all but the most negligent of counsel will have pleaded rectification in the alternative.

<sup>384</sup> *Yoshimoto*, above n7, at [80];

<sup>385</sup> *Gibbons*, above n130, at [120]. This is especially so, if as considered, more time will be spent in the negotiating and drafting process to ensure this. Maybe more time spent at the start will be beneficial later on. McLauchlan 'Contract Interpretation: What is it About?' above n57, at 12 recognises it is all too easy to attach significance to the difficult cases reaching court. This ignores the reality, that most issues of interpretation can be advised on solely by reading the words of the contract in context.

and would herald a return to literalism.<sup>386</sup> In the end, primacy must be accorded to the discovery and implementation of actual intent.

Finally, the objection claims that negotiations will become protracted with more care and skill required in establishing and recording the parties' positions. More time spent at this stage of the process can be argued to have a beneficial effect and will perhaps result in clearer articulations of intention and less dispute later on.<sup>387</sup> The claim of parties making self-serving statements during the negotiations is unlikely as the parties' minds are likely to be on other facets of the business relationship.<sup>388</sup>

ii) *Third Parties*

Potential prejudice to third parties is prima facie a compelling objection. However, if the task of interpretation is to ascertain the contracting parties' intention, then this process should not be constricted by concern for third parties. They should not be entitled to hold the parties privy to a contract to a meaning they did not intend.<sup>389</sup> It is permissible to take account of other contextual matters, which may not necessarily be known by third parties. It does not logically follow that third parties would be anymore vulnerable if previous negotiations were admissible<sup>390</sup> as this evidence is objective and would not include subjective intent.<sup>391</sup> Wilson J

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<sup>386</sup> *Gibbons*, above n130, at [119-120] per Thomas J.

<sup>387</sup> It seems some New Zealand law firms have taken this lesson of clear drafting from *Vector*. See Buddle Findlay "A New Interpretation – Using Evidence of Prior Negotiations in Interpreting Contracts" (Legal Update, March 2010) <[www.buddlefindlay.com/article/2010/02/26/legal-update-on-commercial-and-banking-law-february-2010](http://www.buddlefindlay.com/article/2010/02/26/legal-update-on-commercial-and-banking-law-february-2010)>.

<sup>388</sup> Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 148.

<sup>389</sup> *Yoshimoto*, above n7, at [81]; *Gibbons*, above n130, at [121-122] per Thomas J; McKendrick, "Interpretation of Contracts & the Admissibility of Previous Negotiations" above n39, at 268; McLauchlan "Contract Interpretation: What is it About?" above n57, at 42.

<sup>390</sup> McLauchlan "Contract Interpretation: What is it About?" above n57, at 42.

<sup>391</sup> This is similar to the approach taken in civil law regarding contracts which are specifically designed to evoke involvement and reliance on third parties. Such contracts require a more objective standard of interpretation, whereby the parties' subjective intentions are disregarded. See discussion in Claus Wilhelm Canaris & Hans

correctly suggests third parties freely choose to involve themselves and must accept the court is privy to this background material.<sup>392</sup> McLauchlan further claims he is yet to see a specific example in practice where negotiations would adversely affect third parties in a way that could not be avoided by the application of another doctrine.<sup>393</sup>

### iii) *Uncertainty*

Certainty is an overriding goal in contract and commercial law. However, contract interpretation is the most intractable of all commercial disputes. They are notoriously difficult to predict as judges often disagree on fundamental questions such as what is the plain meaning or what constitutes commonsense.<sup>394</sup> The admission of previous negotiations is therefore unlikely to contribute to the already uncertain outcome in an interpretation dispute. The claim that it will be impossible to advise clients at a preliminary level is wholly unconvincing, as in the majority of cases advice can be given based on the context of the contract.<sup>395</sup> It must be remembered we will not easily accept linguistic mistake. Furthermore, it is argued to the contrary, that admitting previous negotiations may increase certainty surrounding interpretation. No longer artificially excluding relevant and pertinent background will facilitate finding the parties' actual intent. The exclusion perhaps generates uncertainty by enabling one party to advance a case for a meaning which he knows was not intended and which would otherwise be untenable considering the evidence.<sup>396</sup> At present the rule and its boundaries are uncertain in themselves.<sup>397</sup> Mitchell contends it would be more certain to

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Grigoleit *Interpretation of Contracts* (2010) Social Science Research Network <<http://ssrn.com/abstract=1536169>>.

<sup>392</sup> *Vector*, above n1, at [129].

<sup>393</sup> McLauchlan, "Contract Interpretation: What is it About?" above n57, at 39. For example, where a third party, to the actual or constructive knowledge of the parties, reasonably expects to take the contract at face value and acts in reliance, their legitimate concerns can be met through estoppel. See also Burrows, above n83 at 97.

<sup>394</sup> McLauchlan "New Law of Contract Interpretation" above n26, at 175; McLauchlan "A Contract Contradiction" above n281, at 189. This is illustrated by the differing opinions in *Vector*.

<sup>395</sup> McLauchlan "Contract Interpretation: What is it About?" above n57, at 12. He claims too much emphasis is put on the difficult, rare, cases which reach court.

<sup>396</sup> Nicholls, above n107, at 587.

<sup>397</sup> As recognised by Lord Hoffmann in *Investors Compensation Scheme*, above n2, at 912.

abandon the exclusionary rule and allow parties the freedom to provide for such exclusion in their contracts.<sup>398</sup>

iv) *Principle versus Policy*

What I have aimed to demonstrate is that the pragmatic objections can be counteracted and do not outweigh the arguments for abandoning the exclusionary rule. However, that debate reflects a deeper consideration as to whether contract law should be concerned with adhering to principle or policy. Policy advances community goals and standards, and looks beyond the individual ruling to what is desirable in the future. It requires an assessment of what consequences are beneficial economically, politically and socially in the community.<sup>399</sup> Principle, on the other hand, protects individual or group rights and advances standards to be observed as a requirement of justice or fairness. Principles express values internal to the legal system. They rationalise rules and aim to contribute to coherency.<sup>400</sup>

Those pertaining to pragmatic considerations indicate a preference for policy to govern contract law. For example, Spigelman J claims justice does not attain to the individual and the expectation is the law will provide neutral principles, whereby judges will not decide the appropriate outcome on a case-by-case analysis.<sup>401</sup> The practical considerations canvassed, despite the misgivings discerned, therefore wholly justify the exclusion of the rule. If policy outweighs principled criteria in determining interpretation, then this suggests contract law is more concerned with channeling future disputes than resolving interpretation in accordance with the terms the parties agreed upon.<sup>402</sup> Conversely, this paper has expressed a concern with ensuring actual objective intent in the individual case is ascertained. It is argued therefore that principles are the legal criteria that should govern interpretation. Clear and coherent rules should prevail over the pursuit of policies. A case is fundamentally an argument between two

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<sup>398</sup> Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 135.

<sup>399</sup> Ibid, at 140-141. These definitions derive from R Dworkin *Taking Rights Seriously*, (Duckworth, London, 1978) and N MacCormick *Legal Reasoning and Legal Theory* (Oxford University Press, Oxford, 1994).

<sup>400</sup> Ibid.

<sup>401</sup> Spigelman, above n54, at 333.

<sup>402</sup> Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 135.



parties, whereby the role of the judge is adjudication. It is therefore the wrong forum for an assessment of collective welfare from an unelected judiciary.<sup>403</sup> Policy considerations in the face of countervailing principles are not strong and should be considered secondary to the right to individual justice.

### **3.4 Further Arguments for Admissibility**

This section aims to detail two further arguments and advantages supporting the admissibility of previous negotiations.

#### **A. Transparency**

The exclusionary rule at present undermines transparency in the judicial system.<sup>404</sup> Skepticism can be expressed at the court's ability to find a meaning, which seems difficult to objectively justify, yet happens to accord with the pre-contractual evidence which has been overtly excluded for the purpose of interpretation.<sup>405</sup> It is thought to be common practice for counsel to include a rectification claim as a means of producing previous negotiations before the court.<sup>406</sup> The aim, or hope, either consciously or subconsciously, is to influence the judge on their interpretation, even though no express reliance is placed on the evidence.<sup>407</sup> If an alternative claim of rectification, or estoppel, is not brought, the evidence is still likely to be produced to establish objective background facts. It is argued the law should not encourage this subterfuge and admitting previous negotiations for the purpose of interpretation would restore some intellectual honesty to interpretation.<sup>408</sup> The continuance of this practice suggests an unsatisfactory state of law. It is often claimed *Bank of Scotland v Dunedin*

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<sup>403</sup> Mitchell "Contract Interpretation: Pragmatism, Principle, and Prior Negotiations Rule" above n49, at 140-141.

<sup>404</sup> Spigelman, above n54, at 332 contends the law should not be dictated by this fashionable concept.

<sup>405</sup> *Yoshimoto*, above n7, at [66] per Thomas J.

<sup>406</sup> This practice is considered to be legitimate if the rectification claim is genuine and arguable.

<sup>407</sup> Nicholls, above n107, at 578; McKendrick "Interpretation of Contracts & the Admissibility of Prior Negotiations" above n39, at 269.

<sup>408</sup> McKendrick, *ibid*; See also discussion in *Chartbrook*, above n3, at [35].

*Property Investment*<sup>409</sup> is a decision where the pre-contractual evidence played a decisive role in the Court's interpretation.<sup>410</sup> Dunedin were entitled to repay a loan early, subject to the Bank being reimbursed for all expenses incurred 'in connection with the loan.' The issue was whether the Bank could recoup a substantial fee in regards to a swap agreement. Pre-contractual material was admissible to establish objective background facts. In reality, the evidence demonstrated the parties clearly considered the fee was "in connection with the loan." In effect, the evidence demonstrated actual mutual intent to meaning. The Court, however, claimed not to use the evidence to determine meaning. Rather, it decided the evidence confirmed a 'commercially sensible' finding that the Bank was able to recoup the fee. As discussed, McLauchlan argues Blanchard J's judgment in *Vector* demonstrates a judge using evidence of prior negotiations as proof of their intended meaning.<sup>411</sup>

### B. Harmonisation with International Instruments

Three international instruments evidence the liberal approach advocated for in this paper.<sup>412</sup> The United Nations Convention on Contracts for the International Sale of Goods (1980),<sup>413</sup> the *Principles of European Contract Law* (1999)<sup>414</sup> and *Unidroit Principles of International*

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<sup>409</sup> Above n76.

<sup>410</sup> See McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151, at 240-241; McMeel "Prior Negotiations and Subsequent Conduct" above n35, at 282.

<sup>411</sup> McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" above n151 at 239. See discussion at 2.2.D. McLauchlan 'Contract Interpretation: What is it About?' above n57, at 26-27 argues *Eastmond v Bowis*, above n77, is another example of a court invoking the exception to find proof of meaning. It is interesting to note *Vector*'s submissions to the Supreme Court detailed the decisions in *Bank of Scotland* and *Eastmond* to demonstrate the process the court undertakes when admitting negotiations under the objective background fact exception. See Supreme Court Transcript, above n115, at 49-56.

<sup>412</sup> It is beyond the scope of this paper to address these instruments, their background and shortcomings in substantive detail.

<sup>413</sup> ('CISG'). This convention aimed to adopt uniform rules to govern contracts which took into account different social, economic and legal systems. The convention aimed to contribute to the removal of legal barriers in international trade and promote the development of international trade,

<sup>414</sup> ('PECL'). The principles are based on no single legal system. They aim to provide a bridge between civil and common jurisdictions.

*Commercial Contracts*<sup>415</sup> stipulate a contract is to be interpreted according to the parties' common intention, even if this differs from a literal interpretation.<sup>416</sup> If that intention cannot be established then the contract is to be interpreted in reference to the meaning a reasonable person, of the same kind as the parties, in the same circumstances, would attribute.<sup>417</sup> Previous negotiations are specified as part of the "relevant circumstances" available in the determination of both tests.<sup>418</sup> It must be noted the reference to 'common intent' in these instruments is a subjective test, one not advocated for in this paper. The consistency rather lies in the second test, where the reasonable person is in the position of the parties, facilitating a finding of actual intent. Essentially the instruments place primacy of actual intention over reasonable intention.<sup>419</sup> More importantly, previous negotiations are available as an aid in interpretation. Abandoning the exclusionary rule will harmonise our domestic approach, as far as possible, with international practice. Many have observed this consistency is desirable.<sup>420</sup> New Zealand does not want to risk isolation in this field of commerce, furthermore it would seem odd for the approach regarding domestic contracts for sale to differ from international standards. One point of distinction to note is New Zealand has ratified the Convention, whereas the United Kingdom is absent as a contracting party.<sup>421</sup>

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<sup>415</sup> (1994 and 2004 revision). For the most part the principles in this document aim to reflect concepts found in many, if not all, legal systems. The principles are intended to provide a system of rules especially tailored to the needs of international commercial transactions.

<sup>416</sup> *PECL*, art 5:101(1); *Unidroit Principles*, art 4.1(1); *CISG*, art 8(1).

<sup>417</sup> *PECL*, art 5:101(3); *Unidroit Principles*, art 4.1(2); *CISG*, art 8(2).

<sup>418</sup> *PECL*, art 5:102(a); *Unidroit Principles*, art 4.3(a); *CISG*, art 8(3).

<sup>419</sup> Freedom of contract underpins the principles. See *Unidroit Principles*, art 1.1; *PECL*, art 1:102.

<sup>420</sup> *Attorney-General v Dreux*, above n88, at 627; *Yoshimoto*, above n7, at [89]; McMeel "Prior Negotiations and Subsequent Conduct" above n35, at 288; Nicholls, above n107, at 586-7; McLauchlan "Contract Interpretation: What is it about?" above n57, at 34; McKendrick "Interpretation of Contracts & the Admissibility of Previous Negotiations" above n39, at 275.

<sup>421</sup> New Zealand ratified the Convention on 22 September 1994. For the status of the signatories see <[www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html)>. Sally Moss "Why the United Kingdom has Not Ratified the CISG" 2005 (25) *Journal of Law & Commerce* 483 explains this is because Parliament does not see it as a legislative priority, there is little interest in ratifying the Convention and there is a fear the UK will lose its edge in international arbitration and litigation.

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## CONCLUSION

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*Vector* provided the Supreme Court with an opportunity to reconsider the rule excluding previous negotiations. The bench, however, was not unanimous. Instead the decision illustrates diverse and conflicting opinions regarding contract interpretation principles. The result is an unsatisfactory state of law in which it cannot be clearly concluded whether the rule is still applicable in a contract interpretation dispute. Resulting confusion and uncertainty is evidenced in the application of *Vector* in the lower courts.

This paper has advocated an approach that results in conceptual clarity. The purpose of interpretation is to ascertain the meaning of a document in accordance with the parties' intentions. Actual intent, where discernible, should be sought over presumed intent. Actual intent, contrary to the opinion of those adhering to a strict objective approach, can be accommodated within the objective theory because the intention must be mutually held and objectively discernible. Subjective inner intent will always remain inadmissible. Previous negotiations should therefore be admissible to the extent they evidence actual mutual objective intent. Admitting previous negotiations will result in coherent contract interpretation principles devoid of artificial limits on evidence. The exceptions to the exclusionary rule, as they stand at present, entail distinctions difficult to draw in practice and amount to unnecessary methods of ascertaining actual objective intent. These exceptions really serve to demonstrate that the rule is wrong in principle. It is suggested the best course is to admit previous negotiations on the basis of relevance in accordance with the judgment of Tipping J in *Vector*. Previous negotiations will be relevant where they establish objective background facts and to the extent they shed light on the objective meaning of the contract intended by both parties. They will be irrelevant where they constitute subjective intent. Pragmatic objections often raised to abandoning the exclusionary rule have been proved to be unconvincing. They are matters for caution and weight, but do not outweigh the advantages gained with abandonment of the exclusionary rule. Ultimately, contracts as self-imposed voluntary obligations should be interpreted in accordance with the contracting parties' intent, in order to uphold their reasonable expectations. Principle should guide this process, rather than policy.

Despite the discord in *Vector* it seems unlikely the exclusionary rule will survive much longer in New Zealand. At present it is largely devoid of substance, as most parties to a contract interpretation dispute will produce evidence of previous negotiations through the established exceptions. Perhaps the rule will never be explicitly abandoned and incremental development on a case-by-case basis will eventually see full reference to previous negotiations on account of their relevance. Or maybe, as with subsequent conduct, it will take ten years for one judgment, that of Tipping J's, to be adopted by a full bench.<sup>422</sup>

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<sup>422</sup> Thomas J in *Attorney General v Dreux*, above n88, in 1996 concluded the ban regarding subsequent conduct should be abandoned. Ten years later in 2006 the Supreme Court in *Gibbons*, above n130 accorded with this decision.

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