AUCKLAND DISTRICT LAW SOCIETY INC. SEMINAR

CONTRACT LAW
REVIEW OF RECENT CASES

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CONTRACT LAW UPDATE

Introduction

1. This review covers some significant recent contract law decisions over the last year or so[1]. In that period a number of contract cases have reached the Supreme Court. While there have been decisions in areas of substantive law, such as the requirements for the application of the Contracts Privity Act 1982, most of the recent decisions continue to reflect the related difficulties of expressing meaning clearly in contractual provisions and of determining meaning where a dispute arises between contracting parties.

Laidlaw v Parsonage [2] **- designation of person under section 4 of the Contracts Privity Act 1982**

2. In *Laidlaw v Parsonage* the Court of Appeal held that the designation of the purchaser as Mr Parsonage "and/or nominee" was sufficient to bring the nominee of the purchaser within section 4 of the Contracts (Privity) Act 1982 ("**CPA**"). As a result the nominee was entitled to the benefit of the warranties under an agreement for the sale and purchase of a property. This allowed the nominee to sue for breach of the warranty in the agreement for sale and purchase that the building had been completed in accordance with the obligations under the Building Act 1991.

3. In upholding the decision of Abbott AJ in the High Court, the Court of Appeal followed the line of cases and text book writing[3] which takes a broad approach to the interpretation of section 4 of the CPA. It overruled the earlier decisions which adopted a narrow approach to the section.[4] This narrow approach was founded on the argument that the nominee does not take the benefit of the contract under the contract but by reason of the nomination. The approach of Justice Tipping in *Rattrays Wholesale Limited v Meredith Young & A'Court Limited*[5] was adopted. The nominee takes the benefit under the contract and the nomination. The contractual promise was made to the purchaser and his or her nominee and this was sufficient designation in terms of section 4.

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[1] For further Contract Reviews for 2006-2008, see www.pauldavid.co.nz
[2] [2010] 1 NZLR 286
[3] See, e g *Law of Contract in New Zealand*, Burrows, Finn & Todd, 3rd Ed, pages 478 - 480
[4] See, e g *Field v Fitton* [1988] 1 NZLR 482 (CA)
[5] [1997] 2 NZLR 363

4. The Supreme Court declined the application for leave to appeal on the basis that the appeal had no prospect of succeeding. The court found the reasoning in the Court of Appeal "entirely convincing". Accordingly, the law on this point can now be regarded as settled.

McIntyre v Nemesis DBK Limited [6] **- test for avoidance of contract as a result of economic duress**

5. The Court of Appeal dismissed an appeal from a High Court decision that an agreement to increase the payment of a joint venture party was not void for economic duress. The court adopted the approach set out in the Privy Council authority of *Attorney General for England and Wales v R* [7] to the question whether the contract was void for duress and asked:

- Whether there had been an "illegitimate threat or the exertion of illegitimate pressures"; and
- If so, did that result in "compulsion or coercion"?

6. The Court of Appeal did not approach the case on the basis of the more detailed "features" of economic duress identified in its earlier decision in *Pharmacy Care Systems Ltd v Attorney*[8].

7. The alleged duress was said to be present in continued threats by one joint venture party who was contractually bound to manage a sub-division project to stop his management work unless he was paid more. The court was content to proceed on the basis that a threat to break a contract is unlawful and will generally be illegitimate. In adopting this approach, it emphasised that care must be taken to distinguish between illegitimate threats and legitimate warnings.

"Where one party warns the other that, as a matter of commercial reality, it will not be able to perform its contractual obligations unless changes are agreed to, this does not amount to a threat."

[6] (2010) 1 NZLR 463
[7] [2003] UKPC 22, [2004] 2 NZLR 577
[8] (2004) 2 NZCCLR 187 (CA); (2004) 17 PRNZ 308 (SCNZ) - the approach in this case had been criticised in academic writing and the Supreme Court, in declining leave in *Pharmacy Care*, had referred to the law being well settled by *Attorney General v R (supra)*.

8. After reviewing the evidence, in particular the contemporaneous correspondence between the parties, the Court concluded that the conduct of the contracting party, although reprehensible in many respects, did not amount to, and, indeed, was not construed by the other party to the contract, as a threat to breach the contractual obligation to provide management services by stopping work. It was rather an expression of dissatisfaction at not being paid for the additional work which the ongoing joint venture justified. In what it regarded as a "finely balanced" conclusion, the Court found that the conduct did not cross the line between forceful and illegitimate pressure.

9. The Court then considered whether there was, in fact, coercion by reference to the circumstances of this case. The court looked at whether there was protest or not, whether the person allegedly coerced was independently advised and whether steps were taken to avoid the contract after entering into it. There were other options available to the party claiming duress that had not been explored, there was no contemporaneous document evidencing any feeling that there had been coercion and the party had been independently advised. The Court agreed with the conclusion in the High Court that there had, in fact, been no coercion but rather agreement to the change in remuneration because that was the best option.

10. Although not necessary for a decision on the appeal, the Court also held that the conduct after the alleged duress had taken place meant that even if there had been duress, the agreement had been affirmed.

Dysart Holdings Ltd v Nielsen [9] **- When does an offer lapse?**

11. An offer can stipulate that it is to lapse in certain circumstances or only be capable of acceptance up until a certain time or until the occurrence of an event. Similarly, an offer can be withdrawn at any time by the offeror up until the acceptance. But where an offer is silent as to the circumstances in which it will not be capable of acceptance, what kind of change of circumstances will mean that the offer lapses? This question arose in *Dysart Timbers Limited v Nielsen.* Dysart and Mr Nielsen were involved in litigation and Dysart had been successful in the Court of Appeal and was entitled to judgment in a sum of over NZ$300,000. Nielsen sought leave to appeal to the Supreme Court. Counsel for Nielsen wrote to Dysart making an offer to settle

[9] [2009] 3 NZLR 160

the litigation. The offer and the sequence of events after the making of the offer is set out in the extract from the judgment **attached**.

12. The question was whether the grant of leave by the Supreme Court after the making of the offer meant that the offer had lapsed before acceptance on behalf of the Dysart.

13. The Supreme Court divided 3:2 on the outcome of the appeal. However, four members of the Court agreed that the approach to the question in the case was to consider the offer as a unilateral transaction and seek to determine, on an objective basis, what the offeror meant to happen. They were of the view there had, in the context of the particular offer, to be a fundamental change in circumstances for the offer to lapse. Determining whether the change in circumstances was fundamental would depend upon the terms of the offer itself and all the relevant circumstances in which it was made.

14. Justice McGrath approached the underlying legal issue in a different manner. He treated the implication of a condition in the offer that it would lapse in certain circumstances as if it was a matter of implying a term into a bi – lateral contract. He did not consider that the circumstances meant that it was necessary for a settlement agreement to be workable that the offer would cease to be open for acceptance if leave to appeal was granted by the Supreme Court. He would not imply such a term into the offer.

15. Of those members of the Court who adopted the approach of interpreting the particular offer in the circumstances, Elias CJ and Blanchard J found that there was no basis to conclude that the grant of leave by the Supreme Court after the making of the offer amounted to a fundamental change of circumstances so as to satisfy the test. Objectively, when the offer was made, the offeror must have been aware the Supreme Court might grant or dismiss the leave application, and yet the offer did not refer to the possibility that this change in the status of the litigation would see the offer lapse. The minority in the final result (Tipping and Wilson JJ) found that the crucial part of the offer was the phrase “at which time the leave application to the Supreme Court will be discontinued”. They decided that this indicated that the offer was intended to be accepted before the determination of the leave application. The

phrase provided an insight into how the offeror's mind was working. When leave was granted the offer lapsed and was no longer capable of acceptance.

16. There are points which can be made for either side on the arguments concerning the interpretation of this offer in the circumstances in which it was made. Perhaps, the best point in favour of the majority is that the circumstance in question - the grant of leave by the Supreme Court - was known to be a possible development by the offeror when the offer was made, and a reasonable person would have expected the offeror to make express provision if the offer was to lapse with the grant of leave.

17. Of course the general lesson is that if you want your offer to lapse in certain circumstances, you should expressly provide for that in the offer. That is easy to say, but can be hard to do, particularly where an offer to settle litigation is made "in the heat of battle".

Property Ventures Investments Ltd v Regalwood Holdings Ltd [10] **– cancelling contracts for the sale and purchase of land**

18. Unsurprisingly, given the commercial importance of the sale and purchase of land and buildings, there have been a number of Supreme Court cases where provisions of the standard form for the sale and purchase of real estate have been considered. This decision concerned the right to cancel a contract to sell a commercial building. The central issue which arose on the sale contract form was the effect of clause 6.5 of the standard terms of sale and purchase of real estate approved by REINZ and ADLS. That clause provides as follows:

> 6.5 Breach of any warranty or undertaking contained in this clause does not defer the obligation to settle. Settlement shall be without prejudice to any rights or remedies available to the parties at law or in equity, including but not limited to the right to cancel this agreement under the Contractual Remedies Act 1979.

19. Regalwood entered into a contract to sell a commercial building to Property Ventures for $1.5 million. It sought summary judgment for a declaration that it had validly cancelled the contract by reason of Property Venture' failure to settle and pay the full purchase price (less the deposit) after it had served a settlement notice and

[10] [2010] NZSC 47

made time of the essence. In the High Court and Court of Appeal summary judgment had been granted.

20. The reason why Property Ventures had not settled was that it claimed that there was a breach of the warranty in the contract of sale at clause 6.6(b) that the building had a current building warrant of fitness. The application for summary judgment proceeded on the assumption that there was a material breach of the warranty. The Courts below held that the breach of warranty did not permit the purchaser to decline to settle in full but that it was obliged to settle the transaction and could only bring a damages claim after settlement. In the High Court the argument focussed on the entitlement to compensation under clause 5.4 of the contract on the basis that the breach of warranty amounted to a misdescription falling under clause 5.0. Summary judgment had been granted because the claim for compensation had not been made before the time of settlement and the purchaser had not sought specific performance with an allowance for equitable compensation. The Court of Appeal had dismissed the appeal. The focus remained on the possible claim under clause 5.4. The Court held that the requirement under clause 5.4 that compensation be demanded before settlement precluded the application of clause 5.4 where a warranty did not have to be performed until settlement. The Court also doubted that the claim for breach of warranty fell within clause 5.0. It considered that such a claim fell under clause 6.0 and that clause 6.5 required damages claims to be made after full settlement.

21. In the Supreme Court, while the argument that Clause 5.4 was applicable because the breach of warranty meant that there was a misdescription of the property was maintained, greater focus was placed on the argument that the breach of warranty claim gave rise to a right of equitable set-off which meant that Regalwood was not entitled to issue a settlement notice for the full price and require settlement.

22. The Supreme Court was unanimous in its finding that summary judgment should not have been entered and that the case should go to trial. The Court held that an equitable set-off against a vendor's claim to settle was available to a purchaser of land where the requirements for such a claim were met. The question was then whether such a claim provided a basis to decline to settle if the vendor was not prepared to recognise the claim. It was held that the claim for a set-off for the assumed breach of warranty did impeach the demand by the vendor for settlement

in full so that it was not ready, willing and able to perform the contract as required when it made its demand for settlement in full.

23. The question was then whether clause 6.5 operated to exclude the right to abatement by way of set-off. The Court referred to the clause not being happily drafted and to the problem in the first sentence of the clause, if that sentence is viewed in isolation. Overall, the absence of a clear provision excluding the right to set-off meant that the reservation of the purchaser's remedies "at law and equity" preserved the right to assert a set-off. As a consequence from the time when Property Ventures sought an abatement of the price for the alleged breach of warranty and Regalwood continued to demand settlement in full, Regalwood was not in material respects ready willing and able to settle in terms of its contractual obligations. It was not entitled to cancel when Property Ventures did not settle. Justice Tipping explained in his judgment that clause 6.5 had probably been introduced to make it clear that a purchaser could not sit on its hands but that it did not mean that the purchaser could not assert a set-off. The Chief Justice disagreed on the interpretation of clause 6.5 and was of the view that it did refer to settlement in full if that point was reached. However, she reached the same result by finding that the obligation to settle under clause 6.5 did not arise because the Regalwood was not entitled to serve its settlement statement under clause 9.1 where the purchaser asserted the breach of warranty and/or the breach of warranty was a misdescription allowing a claim for compensation under clause 5.4, which would exclude the operation of clause 6.5. The case was remitted to the High Court for trial.

Interpreting contracts - again

Vector Gas Limited v Bay of Plenty Energy Limited [11]

24. This case concerned the interpretation of an agreement made between the lawyers for commercial parties to preserve the position between their clients pending the trial of a dispute concerning the supply of gas. The crucial part of the correspondence between the two law firms which contained an offer which was accepted by BOPE is as follows:

[11] SC 65/2008, [2010] NZLR

> 2 Without prejudice to its position, NGC is prepared to **agree to continue to supply gas** based on the terms of the Agreement for Supply of Gas dated 10 October 1995 (the "Agreement") pending determination of BoPE's proceeding, or 30 June 2006, whichever is the earlier, provided that BoPE undertakes to:
>
> 2.1 file that proceeding on or before 31 October 2004: and
>
> 2.2 **in the event that BoPE is unsuccessful in, or withdraws, that proceeding, pay NGC on demand, for each GJ supplied, the difference between the price set out in the Agreement and $6.50 per GJ, plus interest at the Interest Rate set out in the Agreement**.
>
> (emphasis added)

25. When BOPE was unsuccessful in the proceedings referred to in the correspondence, the question under the interim agreement was whether it had to pay the costs of the transmission of the gas in addition to the price of the gas in the agreement. Five separate judgments were given in the Supreme Court. The Court agreed as to the result – BOPE had to pay the cost of transmission on top of the price per gigajoule – and allowed the appeal against the Court of Appeal's judgment and reinstated the High Court judgment. However, different approaches were taken to the question of interpretation in the case.

26. The difficulty with the language in the offer was that it might well suggest to the reasonable reader that the price included the cost of "supply" or "transmission". (This was supported by the 1995 Agreement referred to in the offer.) This led the members of the court to consider the commercial background to the agreement (in a conventional way) and also to consider the possible relevance and admissibility of the pre-contractual negotiations between the parties to questions of interpretation.

27. Justice Blanchard found that the full commercial background clearly indicated that the agreement should be interpreted as requiring the payment of transmission costs on top of the price per gigajoule. This was based on the commercial implausibility of the parties agreeing that a price would be paid by BOPE which was much lower than the price which NGC could have obtained in the market for the gas and which BOPE would have had to undertake to pay if it had sought an injunction to be provided with gas pending the hearing of the dispute. The only sensible commercial interpretation was one which provided that transmission costs were payable in addition. His Honour's view of the clause was "merely" reinforced by examining the pre-contract negotiations. He saw no reason why those negotiations should not be

examined if they were relevant to establishing the objective background to the contract which was known to both parties and the subject matter of the contract and considered that the question of interpretation fell within that exception. He was content to leave the general admissibility of previous negotiations "for another day".

28. Justice Tipping provided a more detailed summary of the approach to the interpretation. The contractual context could be examined on any issue as to interpretation and no ambiguity in the contract was required. He could see no basis for any absolute bar on the admissibility of contractual negotiations provided the content was not merely used to prove the subjective intention of the parties. Such material was irrelevant to the objective exercise of contractual interpretation. He saw no reason why both pre- and post contract conduct could not be admitted on a question of interpretation if it tended to establish a fact or circumstance capable of demonstrating objectively what meaning the parties intended their words to bear. Such evidence would also be admissible in order to establish an agreed "private dictionary" meaning for a term used in the contract. In applying the principles to the case, he found that the crucial phrase "$6.50 per gigajoule" did not have a plain and unambiguous meaning but rather that the expression was ambiguous. He referred to the commercial reality as outlined by Blanchard J, but primarily relied on the contents of the correspondence between the parties' lawyers to find that transmission costs had to be paid on top of the price in the agreement.

29. Justice McGrath, by contrast, held that the meaning of the letter was plain in including the cost of transmission in the price when it was read in the context of the background including the 1995 agreement. He again surveyed the developments in the approach to the interpretation of contracts and the broader approach in the modern authorities to the admissibility of background which may, in a strong case, persuade a court that something has gone wrong with the language in the contract and lead to the court adopting a less likely, more commercially plausible, meaning. He expressed a preference for the general rule that evidence of previous contractual negotiations is inadmissible save where it establishes background facts known to the parties or is relied on to support a claim for rectification or a claim that the parties have adopted by convention an agreed position on the meaning of the agreement – an estoppel by convention. His preference for the established rule adopted the

approach of the House of Lords in the recent *Chartbrook*[12] decision and the policy against the admissibility of that material identified by Mason J in the Australian High Court decision of *Codelfa*[13]. On this basis he held that the correspondence was inadmissible on the question of the meaning of the term as price. While he finds that the context strongly suggested that something has gone wrong with the language in the contract, his decision that the contract should be interpreted as meaning that transmission costs are to be paid in addition to the price for the gas was based on an estoppel by convention or assumed meaning established by the correspondence leading up to the contract. The correspondence was admissible for the purposes of establishing such an estoppel.

30. Justice Wilson expressed the view that, generally, an enforceable commercial contract should be given its ordinary meaning. This was subject to the exception that ambiguity would permit the admissibility of extrinsic evidence as an aid to interpretation. This extrinsic evidence could include prior negotiations (and post-contract conduct) provided they were used to establish shared contractual intention. Subjective statements by the parties as to contractual intent could be relevant to the question of deciding on the objective meaning of a contract. A second exception was that evidence could be called to show that the natural ordinary meaning made no commercial sense. If such a commercial nonsense was established, a meaning which made commercial sense should be preferred. The third exception was where the natural ordinary meaning was displaced because the parties had acted on an assumed and agreed meaning or common understanding – an estoppel by convention. His Honour found that the language in the contract was not ambiguous when reference was made to the agreement for supply referred to in the letter – the price included transmission costs. However, he held that this meaning made no commercial sense for the reasons outlined by Blanchard J, so that the contract had to be interpreted to mean that the price was exclusive of transmission costs. He also found that the parties had assumed in their negotiations that the price did not include transmission costs and that BOPE was bound by an estoppel by convention to that meaning. In reaching those conclusions, he considered the pre-contract correspondence as a whole.

[12] *Chartbrook Ltd v Persimman Homes Ltd* [2009] 1 AC 110
[13] *Codelfa Construction Pty Ltd v State Paid Authority of NSW* (1982) 149 CLR 337

31. Justice Gault held that the correspondence overall could be considered because it represented the parties' gradual formulation of their agreement and was accordingly all part of the contract entered into. On this basis the letter of 15 October read in the context of all the correspondence by which the terms of the contract were settled, was to be interpreted as meaning that the price did not include transmission costs.

32. Given the various approaches to the question of interpretation in the case it is difficult to make any general statement as to the position in relation to the admissibility of pre-contract negotiations, but it seems reasonable to suggest that the trend is to admit such material as part of the background to the transaction where it can be shown that it will assist in establishing the shared contractual intention. Given the different approaches, it seems inevitable that there will be further argument on this aspect of the principles governing contractual interpretation.

***Tasman Orient Line CV v New Zealand China Clays Limited and Ors* (the *Tasman Pioneer*) - Interpretation of exclusions in the Hague-Visby Rules [14]**

33. This case concerned claims for loss and damage to cargo shipped by various New Zealand cargo claimants in containers on deck on board the vessel Tasman Pioneer. The cargo was lost and damaged in unusual circumstances after the vessel grounded off the coast of Japan. The vessel grounded after the Master had decided to leave the usual route for the vessel and take a shorter route through a narrow passage to make up time on the voyage. After the grounding, instead of anchoring immediately in a nearby sheltered bay and calling for assistance, the Master took the vessel on through the passage in an effort to re-join the usual route and cover–up his decision to proceed through the passage. The High Court held that the plaintiffs' cargo was lost and damaged as a result of the decision not to anchor and call for assistance. The delay before assistance arrived meant that the plaintiffs' deck cargo became immersed in sea water as the vessel sank further by the bow.

34. It was common ground that the shipment was covered by the Hague-Visby Rules ("**HVR**"). The HVR are an international regime regulating the carriage of goods by sea. The HVR apply by force of law to shipments from New Zealand and will also often apply to shipments by the terms of the bill of lading contract under which

[14] [2010] NZSC 37

goods are shipped. The HVR provide a standardised regime of carriers' obligations which are subject to listed exclusions. The central question in the case was whether the exclusion in Article 4.2(a) applied to exclude the liability of the carrier for the plaintiffs' claims. The exclusion provides as follows:

> (2) Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from -
>
> (a) **Act, neglect or default of the master**, mariner, pilot, or the servants of the carrier **in the navigation or in the management of the ship**.
>
> (emphasis added)

35. The High Court and Court of Appeal (by a majority) found that the exclusion did not apply in the particular circumstance of the Master's conduct. The Supreme Court has recently decided that the clause applied to exclude the carrier's liability for the claim on its natural ordinary meaning. While the Court was considering the interpretation of an international convention applicable by statute in New Zealand and not a private contract, the approach taken to the clause can be likened to the interpretation of a provision in an exclusion clause in a private contract.[15] The Court rejected the argument that there was a requirement that the servant or agent act in good faith for the owner to be able to rely on the exclusion (which had found favour in the High Court) and the approach of the majority of the Court of Appeal which was to interpret the clause as being limited to acts akin to negligence, on an erroneous approach to the overall purpose of the HVR. The Court adopted a straightforward approach to the application of the Article based on the words used. It found support for its approach in the provisions of the HVR overall, the background negotiations to the HVR and the leading shipping texts. (For a fuller consideration of the case see the **attached** case note.)

[15] See, perhaps, *DHL International (NZ) Ltd v Richmond* [1993] 3 NZLR 10 (CA) for a contract case where the Court noted the importance of exclusion clauses in the allocation of risk in commercial transactions.