

## Terminating a contract

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*Alan Ringwood of Bell Gully Weir, Auckland considers two recent decisions on termination of contract.*

There have been two recent High Court decisions in relation to the termination of contracts: *Gore District Council v Power Co Limited* [1996] 1 NZLR 58 and *BP Oil NZ Limited v BA Motors (NZ) Limited* [1996] 1 NZLR 425.

By way of background to the first of these decisions, the Court of Appeal had to consider in *Minister of Education v De Luxe Motor Services (1972) Limited* [1990] 1 NZLR 27 the right of the Wellington Education Board to terminate unwritten school bus run contracts entered into with De Luxe Motor Services. The Board sought to terminate those contracts in order to put them out to tender. In the course of deciding that the Board was entitled to terminate the contracts on reasonable notice, Cooke P (as he then was) commented (at 31):

Whether it can be put as high as a presumption is doubtful, but we think that most Judges and practitioners today would expect to find cogent reasons in the nature of terms of the particular contract before placing on it the interpretation that there is no right to determine on reasonable notice. Counsel did not cite to us any case later than *Llanelli Railway and Dock Co v London North Western Railway Co* (1875) LR 7 HL 550 where a contract of indefinite duration has been held to be not so terminable.

That drought has at last been broken after some 120 years with the decision of Barker J in *Gore District Council v Power Co Limited*. The Southland Electric Power Board (predecessor of Power Co Limited) saw fit to enter into a deed in March 1927 with the Gore Borough Council (predecessor of the Gore District Council) on the express basis that "The provisions of this deed shall be binding upon the Board and Council for all time hereafter". In February 1995, some 68 years later, Power Co gave 15 months' notice of termination of the agreement. The reason for this was that under clause 15 of the deed Power Co supplied all of the council's electrical energy requirements "at the price of one penny per unit". At the rate of one penny per unit (now apparently 85 cents) the council was only paying \$16,639 for electricity which would normally cost \$204,529. It was argued by Power Co that the agreement was terminable on reasonable notice; that there was an implied term to that effect; that the contract had been frustrated by reason of inflation and increased demand for electricity; and that the entering into of the agreement had been a fetter on the statutory power of the Southland Electric Power Board.

There was some authority to support each of these arguments. The Court of Appeal decision in *Minister of Education v De Luxe Motor Services* (referred to above) suggests strong judicial leaning towards the terminability of contracts of indefinite duration, and the minister succeeded in part in that case because to hold that the bus run contracts were not terminable would be to fetter the discretion of the Director-General of Education to provide such school transport assistance as he thought necessary. In *Staffordshire Area Health Authority v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 Lord Denning had discerned (albeit in a widely criticised judgment) a principle emerging that circumstances may change so radically that a contractual clause may cease to bind, and had held that such a result could be brought about by severe inflation.

Justice Barker took the side of the critics in disagreeing with Lord Denning's views on the possible effect of inflation on the enforceability of contracts. Barker J discussed nine factors

which pointed to the agreement being intended to be perpetual, including the respective bargaining powers of the parties and the benefits and burdens of the contract. It might however have been sufficient for the learned judge to have finished his deliberations with his first factor, which was (at 69):

The words of the agreement are clear. It is difficult to imagine a clearer way a drafter could impose a permanent obligation than to say “the provisions of this Deed shall be binding on [the parties] for all time hereafter”. Had the parties wished to make the agreement determinable on reasonable notice, it is safe to assume that they would have done so.

Thus His Honour was able (at 70) to

uphold the plain meaning of the 1927 agreement. To imply a term to the contrary would be not only to rewrite the contract, but also to disturb the likely intentions of the parties.

It is refreshing to read a judgment which upholds rather than subverts agreed contractual terms (particularly in a “hard case”). The decision is also interesting as an example of two Southern bodies availing themselves of the jurisdiction of the Commercial List in Auckland under s24C(4) of the Judicature Act to determine the disputed construction of a contract.

In the second recent decision, *BP Oil NZ Limited v BA Motors (NZ) Limited*, the Court had to consider the termination provisions of a written supply agreement whereby BA Motors agreed to purchase petroleum products from BP for “the term specified in the First Schedule to the agreement”, which was “From: 1<sup>st</sup> December 1988; To: 30th November 1993”. There was a termination clause which provided: “The Buyer shall be required to give the Seller 12 months notice in writing of its intention to terminate this Agreement on or after the due expiry date specified in the First Schedule”.

As the expiry date of the agreement approached the parties discussed future arrangements but 30 November came and went without a new agreement and without any notice being given under the termination clause. The Court had to decide two issues. The first was simply a factual issue of whether an oral agreement had been reached to continue supply on a month by month basis (it was held that no such agreement had been reached). The second was what (if any) notice BA Motors was required to give to BP, when notice could be given, and whether it had been given.

BP argued that there were two possible interpretations of the termination clause: *termination* had to be on or after the due expiry date; or *notice* had to be given on or after the expiry date. In either case it was argued that 12 months’ notice had to be given and that the contract continued to remain in force until cancelled by BA Motors in accordance with the termination clause. BA Motors argued that the agreement, taken as a whole, was a fixed-term agreement, and pointed to external evidence as to how the parties conducted themselves in support of the fixed-term premise.

Justice Hammond noted that the two commercial parties had chosen to reduce their negotiations to writing and that the contract had its own meaning. He declined to go outside the terms of the contract in interpreting it. He found however that the termination clause had two plausible meanings. It could, taken at face value, support BP’s argument that notice could be given at any time, even after the expiry of the five year term: or, in the context of the agreement as a whole, it could require notice to be given during the five year term, such that the maximum term of the agreement (if notice were given on the last day of the original five years, to expire one year later) was to November 1994.

The difficulty of this dichotomy of plausible meanings was resolved in the following way (at 430):

Once there are two reasonably plausible meanings for the clause (as I think there are in this case) then the one which is less favourable to the party who supplied the language is to be preferred. This contra proferentem (“against the profferer”) principle is much resorted to by Courts in disputes relating to standard-form contracts. And it has been particularly useful in relation to unequal bargaining situations (such as Draconian exemption clauses in consumer contracts). But I know of no authority, I see no reason in principle, why it should not apply even between parties with equal bargaining strengths. I appreciate that at the end of the day, contra proferentem is really a rule of resolution, as opposed to something which can properly be said to be an intrinsic test assisting in the ascertaining of the meaning of something. Thus the benefit of the rule is functional rather than intrinsic; it is a tiebreaker, and penalises the careless drafter of documents. But the present case is a good illustration of the utility of the principle. In the result, on the application of this principle, I prefer the second interpretation.

BA Motors had eventually given notice in October 1994. Depending on the construction of the termination clause, the contract either ran until October 1995, or could not extend beyond November 1994. By the application of the contra proferentem rule the contract was construed against BP, and it was held that the contract could not run beyond November 1994. BP's loss of profits claim was therefore restricted to the period October-November 1994. Questions of the quantum of any damages were deferred to a further hearing.

The contra proferentem rule can be viewed as a risk allocation mechanism, requiring the party responsible for a contractual ambiguity to accept the least favourable construction. It should only be resorted to when other rules of construction fail. In this case the Court found two plausible constructions, thereby opening the way for the application of the rule to break the deadlock. The judgment however gives the distinct impression that the other usual rules of construction could have given the same result. Justice Hammond identified several objections to reading the clause at face value, but noted that the clause made sense when taken in the context of the agreement as a whole. The same result could therefore have been achieved simply by preferring the latter construction. The use of the contra proferentem rule to break a tie between parties of equal bargaining strength is also not as novel as the judgment suggests. While most often encountered in the context of exclusion clauses, the rule of construction against the grantor is a rule of general application in cases of ambiguity, when other rules of construction fail, irrespective of the bargaining strengths of the parties. See for example *Chitty on Contracts*, paras 12-071, the cases there cited, and the quotation from Coke:

It is a maxim in law that every man's grant shall be taken by construction of law most forcibly against himself.

As Justice Hammond correctly noted the decision is nonetheless a useful reminder of the utility of the contra proferentem rule as a potential tiebreaker when other rules of construction fail.