## Lord Toulson gives the TECBAR Annual Lecture

## Does Rectification require Rectifying?

## 31 October 2013

Rectification is an equitable means of correcting the text of a written form of contract or other legal instrument by changing or inserting words which the court is satisfied have been included or omitted by mistake. A mistake may be either mutual or unilateral, and the courts have developed different rules depending on whether both parties shared a common mistake or only one party was mistaken.

The interface between the law governing the construction of a written contract and the rectification of a written contract has changed over the years. Up to the 19th century, if a written agreement appeared to be complete and not ambiguous, the court would not allow oral evidence to be given or extrinsic matters of any kind to be taken into account as an aid to its construction. This was known as the "parol evidence" rule, but its operation was not confined to oral evidence. *In Shore v Wilson*[1] Tindal CJ said:

> "the general rule I take to be, that where the words of any written instrument are free from ambiguity in themselves … such instrument is always to be construed according to the strict, plain, common meaning of the words themselves; and that in such a case evidence *dehors* the instrument, for the purpose of explaining it according to the surmised or alleged intention of the parties to the instrument, is utterly inadmissible."

This strict common law rule was partially alleviated by the development of the equitable remedy of rectification, but initially this was confined to cases where there was an antecedent contract from which the written form of contract differed. In *Murray v Parker*[2] Sir John Romilly MR said:

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[1] [1842] 9 Cl & Fin 355 (HL), 365

[2] [1854] 19 Beav 305, 308

> "In matters of mistake, the court undoubtedly has jurisdiction, and though this jurisdiction is to be exercised with great caution and care, still it is to be exercised, in all cases, where a deed, as executed, is not according to the real agreement between the parties. In all cases the real agreement must be established by evidence, whether parol or written; if there be no previous agreement in writing, parol evidence is admissible to shew what the agreement really was; if there be a previous agreement in writing which is unambiguous, the deed will be reformed accordingly; if ambiguous, parol evidence may be used to explain it, in the same manner as in other cases where parol evidence is admitted to explain ambiguities in a written instrument."

Similarly in *MacKenzie v Coulson*[3] Sir W.M. James V-C said:

> "Courts of Equity do not rectify contracts; they may and do rectify instruments purporting to have been made in pursuance of the terms of contracts. But it is always necessary for a Plaintiff to shew that there was an actual concluded contract antecedent to the instrument which is sought to be rectified; and that such contract is inaccurately represented in the instrument."

In *Shipley UDC v Bradford Corporation*[4] Clauson J expressed the view, obiter, that although it might be difficult to prove a case of mutual mistake in the absence of a previous instrument, James V-C's statement in *MacKenzie v Coulson* was incorrect (or, as he politely put it, not to be interpreted as applying in a case of a mutual mistake which could be clearly established by other means).

Clauson J's reasoning and conclusion were adopted by Simonds J in *Crane v Hegeman-Harris & Co Inc*[5]:

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[3] [1869] LR 8 Eq 368, 375

[4] [1930] 1 Ch 375, 397

[5] Noted at [1971] 1 WLR 1390, 1391. The judgment was delivered on 9 February 1939.

> "The Judge held, and I respectfully concur with his reasoning and his conclusion, that it is sufficient if you find a common continuing intention in regard to a particular provision or aspect of the agreement. If you find that in regard to a particular point the parties were in agreement up to the moment when they executed their form of instrument, and the formal instrument does not conform with that common agreement, then this court has jurisdiction to rectify although it may be there was, until the formal instrument was executed, no concluding and binding contract between the parties."

Simonds J added that the jurisdiction was to be exercised only upon convincing proof that the concluded instrument did not represent the common intention of the parties. His judgment was affirmed by the Court of Appeal.[6]

There may, of course, be cases where a court can be fully satisfied, even without an antecedent agreement, that an offeree must have appreciated that there was a mistake in the text of an offer made to him (for example, a decimal point in the wrong place); or, where the contract does not lend itself to analysis in terms of offer and acceptance, that any reasonable person aware of the background would conclude that the parties must have used the wrong words. Following *Shipley UDC,* one would have expected that rectification was broad enough to cover such cases. In *Shipley UDC* itself the written contract was not preceded by an oral contract or indeed by a draft agreement in different terms.

However, such cases have been accommodated by a loosening of the rules of construction. The cases of *Prenn v Simmonds*,[7] *Reardon Smith*[8] and *ICS Limited v West Bromwich Building Society* [9] are too well known to require further discussion, but it is worth re-stating Lord Hoffman's 4th and 5th propositions in *ICS*:[10]

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[6] [1939] 4 All ER 68

[7] [1971] 1 WLR 1381

[8] [1976] 1 WLR 989

[9] [1998] 1 WLR 896

[10] Page 913

> "(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words … The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used wrong words or sentences (see *Mannai Investments Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 2 WLR 945).
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> (5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common-sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had."

Critical to this approach is how a reasonable person would understand the meaning of the terms proposed by the other party. This in itself is not a new principle. In the famous case of *Smith v Hughes*[11] Blackburn J said:

> "If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms."

It is not normally reasonable to expect a party to understand the proposed terms of a contract, whether oral or written, to be different from the ordinary meaning of the language used, but there may be exceptions to that general rule where the circumstances compel a different conclusion. For those with a penchant for use of the words "objective" or "subjective" (which can sometimes cloud rather than clarify), the law is broadly objective but does not entirely disregard what one party reasonably understood to be the terms proposed by the other.

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[11] [1871] LR 6 QB 597, 607

To read a contract by reference to the relevant background as meaning something contrary to the meaning of the words on their face is to re-write the document in all but name. It is sometimes referred to as rectification by construction. So where do the rules of construction of contracts now leave rectification for mutual mistake?

In answer to that question Professor Andrew Burrows expressed the view in 2007 that:

> "rectification has not merely been rendered less important by modern developments in the law of construction but is on the point of being rendered largely superfluous." [12]

In making that comment Professor Burrows anticipated that the rule which bars a court when construing a contract from taking pre-contractual negotiations into account would shortly be given its final quietus. As we now know, his expectation was wrong. In *Chartbrook Limited v Persimmon Homes Limited*[13] the House of Lords declined to set the rule aside.

Reflecting on construction and rectification after *Chartbrook* in 2010,[14] Sir Richard Buxton said that much was left in the air, not only with regard to the relationship between construction and rectification, but also within the jurisprudence of rectification itself. He concluded:

> "*Chartbrook* would appear as a matter of form or theory to have settled the issue of the admissibility of evidence of prior negotiations in questions of construction, perhaps for something like the next 30 years. However, the law in practice may turn out to produce a somewhat different effect. Although *ICS* continues to attract some advocates as a comfortable alternative to close analysis of the actual agreement, once the limits of principle 5, stressed in *Chartbrook*, are recognised, it can be seen as occupying no ground distinct from that of rectification; but with

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[12] Contractual Terms, 2007 (and Burrows and Peel), e 1999.

[13] [2009] UKHL 38, [2009] 1 AC 1101

[14] [2010] CLJ 253, 261

> the handicap, not enjoyed by rectification, that evidence of prior negotiations is not admissible. Accordingly, in cases that fall within the structure of principle 5 practitioners, and courts, are likely to find it more sensible to move directly to rectification … However, on any view of its reach rectification should in practice transcend its present status as a safety net in cases where the inadmissibility of prior negotiations in issues of construction produces a conclusion that those negotiations show to be plainly wrong. Rectification should in future occupy the whole of the field when it is necessary to correct errors in the formal expression of a contractual consensus."

Practitioners will naturally continue to advance their case both ways. They will argue (as in *Chartbrook* itself) that against the relevant background the agreement should be construed as meaning something other than its language would suggest, but they will also seek to rely in the alternative on rectification, bolstered by reference to pre-contractual negotiations. The process will not be tidy but there are also other problems. Ironically, while the common law rules of interpretation have become more expansive, if not elastic, the equitable doctrine of rectification for mutual mistake has become more complicated and rigid.

First, rectification for mutual mistake has been confined to cases where there is an antecedent consensus. Where the court is satisfied that there has been an obvious mistake but there has been no antecedent agreement, the court will not order rectification of the written agreement but can read it as if it said something different. That appears, at least, to be the current state of our jurisprudence. If so, the boundary between construction and rectification is jagged, but that of itself may not make a practical difference.

Of more practical importance, there will continue to be situations in which the case for showing that there is a mutual mistake in the written contract depends, to a greater or lesser extent, on establishing that there has been an antecedent contrary consensus, but where the inadmissibility of pre-contractual negotiations will preclude the party advancing that case from relying on the earlier consensus in support of a construction argument. In that type of case the hunt will be on to establish the necessary antecedent consensus to found rectification.

That leads to three questions: what must be the nature of the consensus, what must be the nature of the mistake and how is it to be established?

The first of those questions is the easiest to answer, although it is not entirely uncontroversial. In looking to see whether there has been an antecedent consensus, the court will follow the same approach as to the question whether there was an antecedent contract. It will view the matter from the standpoint of the reasonable person, including the principle stated by Blackburn J in *Smith v Hughes*.

In *Joscelyne v Nissen*[15] the Court of Appeal re-affirmed the correctness of *Shipley UDC* and *Crane v Hegeman-Harris & Co Inc*. It added the rider that in a case of rectification based on an antecedent accord, the accord must have been outwardly expressed or communicated between the parties. As I have said, I have no difficulty with the proposition that a court considering whether there has been a prior accord should follow the same approach as it would when considering whether there had been a fully concluded antecedent contract. However, sometimes contractual terms may be inferred from the way in which parties have acted. To impose an additional stricter requirement for some verbal expression in the case of an antecedent non-binding agreement would be unsound as a matter of principle. I prefer the view expressed by Mummery LJ and others that reference in the authorities to an outward expression of the accord should be seen "more as an evidential factor rather than a strict legal requirement in all cases of rectification".[16]

Much more controversial is the question of what is the nature of the mistake necessary for rectification for common mistake. Until fairly recently the cases all proceeded on the basis that the mistake had to be as to the terms of the contract, i.e. whether they accorded with the parties' true mutual intentions. An alternative was argued before the Court of Appeal in *Britoil plc v Hunt Overseas Oil Inc.*[17] The case is important for that reason and for others. The plaintiffs assigned to the defendants their interest in a UK petroleum production licence for a North Sea oilfield. The defendants were to receive a

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[15] [1970] 2 QB 86

[16] Munt v Beasley [2006] EWCA Civ 370 at [36]

[17] [1994] CLC 561.

share in the fruits of the exploitation of the field once the field became sufficiently successful. The dispute was whether that point had been reached. This turned on how interest was to be calculated on capital costs and expenses incurred by the plaintiffs. During the negotiations the parties signed non-binding heads of agreement, followed by a lengthy and complex document drafted by lawyers. It was common ground that if the relevant clause of the contract was read literally, the payout point had not been reached. The defendants argued that the clause should be read differently against the background of industry practice and other matters. Alternatively, the defendants claimed that the heads of agreement evidenced a clear agreement which favoured their interpretation and that the contract should be rectified in order to reflect the parties' antecedent agreement. The Court of Appeal was divided on both issues. The majority (Hobhouse and Glidewell LJJ) rejected the defendants' case on both grounds. Hoffmann LJ disagreed on both issues. On that issue the differences in approach to the issue of rectification are of general importance. The trial judge, Saville J, had concluded that, bearing in mind the high degree of proof required for rectification, the defendants had failed to establish that the language of the heads of agreement was sufficiently clear to establish the necessary prior agreement.

In the Court of Appeal the defendants faced an obvious problem. They were not going to be able to establish that the detailed terms of the final contract involved any mistake on the part of the plaintiffs as to the parties' substantive rights under it. So they argued the case in a different way. Hobhouse LJ said:

> "They accept that if they are to succeed on the issue of rectification they must succeed on the basis of a mistake common to both parties *that the definitive agreement gave effect to the heads of agreement*." (Emphasis added)

By this approach the defendants sought to finesse the fact that there was no common mistake as to the substantive contents of the formal contract. Its terms were what the plaintiffs intended. The alleged common mistake was as to whether they corresponded with the earlier non-binding agreement.

Hoffmann LJ in his dissenting judgment accepted the defendants' argument. He said:

> "Both sides assert that the definitive agreement was at all times intended to carry into effect unchanged the principles agreed in the heads of agreement. Accordingly it seems to me that on this point the heads of agreement show a clear outwardly expressed intention on the part of both parties which continued until the execution of the definitive agreement but which (on the assumption that I am wrong on construction) is not reflected in its terms. The necessary conditions for rectification are therefore satisfied."

Hobhouse LJ (with whom Glidewell LJ agreed) rejected that approach. He said:

> "The definitive agreement was intended to be the definitive agreement. It was carefully prepared and scrutinised over several weeks by highly qualified lawyers and their clients. …
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> It can accordingly be asked what then is the basis for the defendants' claim for rectification in the present case. It is the first sentence of Art.8 of the heads of agreement. It is contended that this sentence in this informal document which is not intended to have legal effect is to be treated as a superior statement of the parties' agreement and is to displace the clear language of the considered and carefully drafted definitive agreement.
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> It can immediately be seen that this proposition needs to be carefully examined. As a matter of logic it can lead to the result that where there is a succession of documents of increasing formality but without legal effect leading up to a final considered legal document, the ascertainment of the actual agreement between the parties can be thrown back to the successively less formal, less considered and less carefully drafted earlier documents. This cannot be right."

Hobhouse LJ drew a contrast between a case in which there was an antecedent binding agreement and one in which there was an antecedent informal agreement. Where there was a legally binding prior contract, the ground of rectification was analogous to the

remedy of specific performance, as had been pointed out by Lord Cozens-Hardy in *Lovell & Christmas v Wall*.[18]

Hobhouse LJ made an important point about the nature of the court's inquiry:

> "Further, there must be a reality to the allegation of common mistake. It is a factual allegation, not a question of law. On the defendants' argument before us no actual common mistake is required. The parties are to be treated as if they were bound by the objective interpretation of the, *ex hypothesi*, non-binding heads of agreement. Where the relevant document is a legally binding document, it is appropriate and just to hold the parties to the objectively ascertained meaning of the words used. But where they are not bound and the court is only looking at the previous document to help it answer the factual question whether or not there has been a mistake in the preparation of the legal document, the matter becomes one of fact not law. …
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> What the court is doing is looking to see if the document provides clear evidence to justify the conclusion that the plaintiffs were mistaken when they executed the definitive agreement. …
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> Each case must turn on its own facts and the evidence which is adduced, if necessary, oral as well as documentary. The court has to be satisfied that there was in truth a common mistake. It has also to be satisfied that in equity the claimant for rectification should have the relief for which he is asking."

In short, where there is an antecedent non-binding agreement, it is purely a question of fact whether there was a mistake in the drafting of the terms of the final agreement which misled both parties as to their respective rights and obligations under it. The significance of the earlier agreement is evidential and no more. Its potency as evidence is a question of fact in each case.

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[18] (1911) 104 LT 85, 88.

*Britoil* was a forerunner to *Chartbrook*. I summarised *Chartbrook* in *Daventry District Council v Daventry & District Housing Limited:*[19]

149. "In *Chartbrook* Lord Hoffmann (whose observations about the law of rectification were supported by all the other members of the Appellate Committee of the House of Lords) said at paragraph [48] that the requirements for rectification were succinctly summarised by Peter Gibson LJ in *Swainland Builders Limited v Freehold Proprieties Limited* [2002] ECLR 71, 74:

> "The party seeking rectification must show that: (1) the parties had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the instrument to be rectified; (2) there was an outward expression of accord; (3) the intention continued at the time of the execution of the instrument sought to be rectified; (4) by mistake, the instrument did not reflect that common intention."

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151. In *Chartbrook* the claimants entered into an agreement with a house-builder for the development of a site which the claimants had recently acquired. The structure of the agreement was that the developer would obtain planning permission and, under licence from the owner, would construct a mixed residential and commercial development and sell the properties on long leases. The payment which the owner was to receive was set out in schedule 6 to the agreement. A dispute arose as to the proper construction of part of the schedule. The facts are set out most fully in the judgment at first instance of Briggs J [2007] EWHC 409 (Ch). In a nutshell, the developer's case was that, in respect of the residential part of the development, the owner was entitled to whichever was the greater of a fixed percentage (23.4%) of the net residential sales price and a

[19] [2011) EWCA Civ 1153, [2012] 1 WLR 133

guaranteed minimum of £76.34 per square foot of residential net internal area. By contrast, the owner's case was that it was entitled to the whole of the first £76.34 per square foot in any event, plus 23.4% of the surplus.

152. A syntactical reading of schedule 6 supported the owner. It was a complicated contract negotiated over 8 months. At that beginning of that period there was correspondence which on objective analysis showed a consensus that the payment should be as the developer argued, but the judge found that the meaning of schedule 6 was as the owner argued. The judge also found that the owner's representatives honestly believed that the developer's original offer accorded with the meaning which the judge gave to the contract. He found that there was therefore no common mistake entitling the developer to rectification.

153. The House of Lords held that the developer was right on the construction issue, because the linguistic argument in favour of the owner's construction was outweighed by its commercial irrationality. It was therefore unnecessary for the House of Lords to consider the rectification issue but it did so. It held that if the developer had failed on the construction issue, it would have been entitled to rectification of the contract.

154. On the hypothesis on which the rectification issue was being considered, the position was that one party (the developer) was right about the construction of the pre-contractual consensus but wrong about the construction of the written contract; the other party (the owner) was wrong about the construction of the pre-contractual consensus but right about the construction of the written contract; and both were wrong in believing that the written contract conformed with the pre-contractual consensus.

155. Lord Hoffmann said that it did not matter that the judge had found that the owner's representatives honestly believed that the terms of the prior consensus accorded with the meaning of schedule 6. He accepted the proposition (at paragraphs 57 and 59) that rectification

> required a mistake about whether the written instrument conformed with the prior consensus, not whether it conformed with what the party in question believed that consensus to have been."

Lord Hoffmann's approach in *Chartbrook* was consistent with his dissenting judgment in *Britoil*. Lord Hoffmann at [63] referred to *Britoil* but distinguished it on the basis that it was a case where the defendants had failed to establish as a fact the necessary prior common agreement or intention. With great respect I would suggest that this minimises the real significance of Hobhouse LJ's reasoning to which I have referred. The majority in *Britoil* rejected as unsound the foundation of the defendants' argument, namely its claim to found a case for rectification "on the basis of a mistake common to both parties that the definitive agreement gave effect to the heads of agreement".

Hobhouse LJ said of that proposition that "on the defendants' argument before us no actual common mistake is required". He plainly rejected the proposition that the type of mistake advanced by the defendants (namely a mistake as to whether the legal agreement accorded with the heads of agreement, as distinct from a mistake as to the effect in law of the contract) was a common mistake of the kind required by the law for the purposes of rectification.

The facts in *Daventry* were unusual. The dispute arose out of the transfer of the local council's housing stock to the defendant, a specially formed registered social landlord. Alongside the transfer of the housing stock, the staff of the housing department were to be transferred from the council to the housing company. The staff were members of a local government pension scheme and were to remain members of the scheme. The housing company was to become a participating employer in the scheme, but at the time of the transfer there was a deficit estimated at £2.4 million in the funding provided by the council to the scheme. An important part of the negotiations between the parties involved the funding of that deficit. Negotiations over the price to be paid for the housing stock involved a number of other elements. One concerned a fund called the "VAT shelter" which was expected over the course of several years to provide benefits to the housing company by way of VAT concessions on upgrading works.

The principal negotiators were a Mr Bruno on behalf of the council and a Mr Roebuck on behalf of the housing company. After discussions Mr Bruno set out written proposals covering the essential commercial matters, to which Mr Roebuck agreed. The VAT shelter was agreed to be split 50-50, subject to one qualification. The agreement relating to the pension deficit was that the price of the housing stock would be reduced by £2.4m, representing the amount of the deficit, and the deficit would be paid by the housing company. In other words, the deficit would be made good by the council but through the mechanism of reducing the price by the relevant amount. The qualification in relation to the VAT shelter was that the first slice of £2.4m should go to the council in full rather than being divided equally between the parties. In other words, after funding the payment of the deficit, the council would in due course recoup one half of that amount by receiving the first £2.4m slice from the VAT shelter rather than half that sum. By that process the net cost of making good the deficit would be shared 50-50.

There was a dispute whether this was the true effect of Mr Bruno's written proposals. The trial judge found not only that it was, but that Mr Roebuck realised that this was what Mr Bruno intended the terms to be when he agreed to them, although Mr Roebuck thought that a tenable case could be made out for a different reading of the proposals. The judge described Mr Bruno as a straightforward public servant who would not have expected any sharp dealings on the other side. For some reason Mr Roebuck (whose knowledge was accepted as being the knowledge of the housing company) told the housing company's board of directors that the terms of the deal were different from what he knew Mr Bruno to intend.

After the conclusion of the commercial negotiations the lawyers were instructed to prepare the necessary contractual documents. Third party funders were involved. The contractual documents as drawn up provided that the council should pay the amount of the pension deficit. Mr Bruno approved the draft without realising the true effect. As a matter of language, the contract was crystal clear. However, it made no commercial sense at all to anybody who understood things, as Mr Roebuck undoubtedly did. The effect of the contract was that the council would pay the deficit twice over, once by setting it off against the contract price and then by paying it. In terms of money, against their effective outlay of £4.8 million the council would in due course recoup £1.2 million, leaving the council worse off in respect of the pension deficit of £2.4m by an overall amount of

£3.6m instead of £1.2m. Conversely, the housing company would receive a windfall of £2.4m for which there was no conceivable commercial sense.

The council claimed that the agreement should be rectified. Vos J rejected the claim on the ground that objectively the prior agreement or common intention had not continued until the time of the execution of the written contract. The council appealed.

Both parties agreed that the law as stated by Lord Hoffmann in *Chartbrook* was to be applied but they disagreed as to its application. The Court of Appeal was divided. The appeal was allowed by a majority (Lord Neuberger MR and myself) but there was a strong dissenting judgment from Etherton LJ.

All members of the court were agreed that it should follow *Chartbrook* in the particular case, but that did not involve an acceptance by the majority that Lord Hoffmann's approach was necessarily right. Lord Neuberger [at 196] considered that it was right to proceed on the basis of Lord Hoffmann's analysis, even if it could otherwise be appropriate for the Court of Appeal to depart from that analysis, as to which he expressed no view. Lord Neuberger considered that it would be wrong to depart from that analysis on that appeal for two reasons; first, that any variation of the analysis would not affect the outcome, and secondly, that the case had been argued throughout on the basis of Lord Hoffmann's analysis. Lord Neuberger also commented that the analysis was "not without its difficulties" and "may have to be reconsidered or at least refined". I went further. I expressed doubt about the correctness of Lord Hoffmann's analysis but I considered the court ought to follow it in the particular case for a combination of reasons, including that we had not heard argument on the point and it would be unsatisfactory to express a firm conclusion without full argument. Sir Richard Buxton had criticised that judgment on the grounds, among others, that it was obiter and arrived at without the benefit of analysis by the lower courts. The Court of Appeal in *Daventry* would itself have been open to criticism if it had reached a final conclusion about the correctness of *Chartbrook* without the benefit of argument on the point. Further, I had no qualms about the justice of the result which would be reached by applying the reasoning in *Chartbrook*.

In *Daventry* the council and the board of the housing company shared a mistaken belief that the transfer contract accorded with their prior commercial agreement, but their reasons for sharing that mistaken belief were diametrically opposite. The council believed rightly that the commercial agreement was that the council should pay the pension deficit, and it believed mistakenly that the legal contract gave effect to the commercial agreement. The board of the housing company believed mistakenly (because it had been misinformed) that the commercial agreement was that the council should pay the pension deficit, and it believed rightly that the transfer contract was to that effect. So there was no shared mistaken belief as to the legal effect of the transfer contract, but there was a shared mistaken belief (albeit for opposite reasons) that the transfer contract gave effect to the commercial agreement. Was that mistaken belief capable in law of supporting a valid claim for rectification for mutual mistake? According to the majority in *Britoil* (not cited to the court in *Daventry*), the answer would seem to be no. The logic of Hoffmann LJ's dissenting judgment in *Britoil* and of his judgment in *Chartbrook* was that the answer was yes.

Lord Hoffmann's analysis was criticised by Professor David McLauchlan in a case note on *Chartbrook*.[20] He said:

"It is important to remember that rectification had been denied in the lower courts on the basis of two main findings of fact that the House refused to disturb. First, *Chartbrook's* intention was exactly what, we must assume for the purposes of this issue, the contract provided for. This meant that rectification was not available on the usual ground of common mistake in recording the terms of the contract. Secondly, *Chartbrook* did not know of, and had not in bad faith sought to take advantage of, *Persimmon's* mistake. Consequently, the latter could not satisfy what were thought to be the requirements for ordering rectification where there is mere unilateral mistake. In view of these undisturbed findings of fact it is difficult to accept that *Chartbrook* was mistaken, at least in any usual sense of that word. The Company intended the contract to provide the benefits that (we assume) it did provide for."

In *Daventry* I referred in my judgment to Professor McLauchlan's article and said:

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[20] (2010) 126 LQR 8

176. Notwithstanding the immense respect due to Lord Hoffmann and other members of the House of Lords, I have difficulty in accepting it as a general principle that a mistake by both parties as to whether a written contract conformed with a prior non-binding agreement, objectively construed, gives rise to a claim for rectification. Take a simple example. A and B reach what they understand to be an agreement in principle. They confirm it by an exchange of letters. A believes that the correspondence means x. B believes that it means y. Neither is aware that the other's understanding is different and there is no question of either behaving in such a way as to mislead the other. They then enter into a written contract which both believe gives effect to the agreement. They are both wrong. Objectively construed, the non-binding agreement meant x but the written contract means y. On the *Chartbrook* principle, A is entitled to have the contract rectified to conform with the correspondence. I share Professor McLaughlan's difficulty in seeing why it should be right to hold B to a contract which he never intended to make and never misled A into believing that he intended to make.

177. In such a case it is hard to see why the written contract should not prevail. Rectification complements the rules of construction of contracts and serves a similar purpose. In general terms, the purpose is that the contract should give effect to what the parties intended should be the contractual bargain or, in some cases, what the party claiming rectification was led or encouraged by the other party to believe was to be the contractual bargain. Rectification in the example given above would not achieve that purpose. Rather, it would bind a blameless party to a re-formed contract which he did not intend.

Sir Nicholas Patten made the same point in a lecture to the Chancery Bar Association in 2013:[21]

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[21] Does the law need to be rectified? *Chartbrook* revisited, para 28

> "In *Chartbrook* itself Persimmon succeeded on construction. But on the hypothesis that the contract meant what Chartbrook contended, the latter had entered into a contract which it both believed and which did have the effect it intended. Yet the House of Lords would (but for its decision on construction) have required the contract to be rectified so as to conform to a prior accord which, objectively viewed, had the result intended by Persimmon. And this notwithstanding that Chartbrook was never mistaken at all. The contract always meant what it intended. In those circumstances, why should Chartbrook in effect be bound by a prior accord which was not contractual and which the judge found was understood by Chartbrook to have the same meaning and effect as the contract it eventually signed?"

In the same lecture Sir Nicholas suggested that the decision in *Chartbrook* on rectification, although technically obiter, has now to be regarded as the law in the light of what the Court of Appeal said in *Daventry.*[22] I am not sure about that, although I can understand that a lower court may feel hesitant about deciding that it was wrong. I observed in *Daventry* that this would be a bold course on a point on which the House of Lords had given a considered judgment. However, in *Daventry* the majority made it clear, in the passages to which I have already referred, that we were not deciding that *Chartbrook* should be followed in other cases. Furthermore, the decision in *Britoil* was not cited to the court in *Daventry* nor did it form any part of the court's deliberations. I have suggested that the judgment of Hobhouse LJ in *Britoil* had greater relevance than Lord Hoffmann allowed in *Chartbrook*. When a similar problem arises, as no doubt it will, it will be a matter for argument whether a court should follow the reasoning in *Britoil* or in *Chartbrook*. In principle a court should follow a binding decision of the Court of Appeal rather than a later opinion expressed obiter by the House of Lords.

Whatever may be the nature of the mistake necessary for rectification, there is also the question of how the mistake is to be established. The formula in *Swainland Builders Limited* approved by Lord Hoffman in *Chartbrook* requires the claimant to establish that there was a continuing intention up to the moment of execution of the instrument which the

[22] Para 10

instrument erroneously failed to reflect. In *Daventry* the council failed at first instance because the judge found that its approval of the legal contract in draft form negated a continuing objective intention that the agreement should accord with the earlier commercial agreement. Etherton LJ agreed. But a purely "objective" analysis in considering whether the earlier consensus has continued up to the moment of execution of the legal contract presents a difficulty. *Ex hypothesi*, on an entirely objective approach, the act of entering into an agreement which objectively differs from an earlier agreement is inconsistent with the maintenance of the earlier intention. Otherwise there would be no need to seek rectification. In *Daventry* I expressed the difficulty in this way:

> 158. There is here a potential conundrum. For mutual mistake rectification, there has to have been a prior outward accord followed by a mutual mistake in executing a legal contract at variance with the prior outward accord. If a fully formed contract is later varied, a court which is called on to enforce the contract will obviously enforce the contract in its varied form. Similarly, if a deal agreed in principle is varied by another agreement or is abrogated by one party evincing to the other an intention that the deal should be different, one can readily see the force of the rule that the court should not grant rectification of a subsequent written contract so as to make it conform with the original agreement. But one must be careful not to (mis)apply this principle in such a way that it would undermine the very purpose of rectification, which exists for the correction of mistakes. In order to be able to decide whether there has been a relevant mistake, evidence of the parties' actual understanding and intention is admissible. In most cases it would be impossible for a court to know whether the execution of the written contract involved a mistake on the part of one or both parties without such evidence. (In *Chartbrook* the trial judge duly made findings about the understanding of the various participants, and his findings formed part of the basis on which the House of Lords held that a plea of rectification should have succeeded if the developer had failed on the construction issue.)

159. It would be rare for a written agreement to be executed without some approval of its form at some point in time (whether by a matter of weeks, days, hours or minutes) before the moment of execution. The need for rectification will only arise if on objective analysis the form of the written contract differs from the effect of the previous non-binding agreement. If the approval of that form prior to its execution is in itself to be taken as, from an objective viewpoint, a variation of the previous non-binding agreement, ex hypothesi any rectification plea must fail, notwithstanding that the approval of the form and execution of the contract were affected by one and the same mistake. Hence the conundrum.

I went on to suggest the following way of resolving the conundrum:

160. In deciding whether on a fair view there was a renegotiation or a mistake in the drafting of the contract, it is necessary to look at all the circumstances. Have the parties behaved in such a way that they would reasonably understand one another to be involved in a process of seeking to negotiate a different deal from the one originally agreed or as involved in a process of drafting an agreement intended to accord with the deal originally agreed? Where it is suggested that there has been a change in the parties' position prior to the execution of a written contract, it is necessary to look carefully at all the facts to see whether a reasonable person would have understood himself to be involved in the negotiation of a different deal from the one originally agreed or merely seen himself as involved in a process of drafting an agreement intended to conform with the original deal. If the latter is the case, and if the approval and execution of the written contract are affected by a relevant mistake, rectification should be available. It is, of course, for the party claiming rectification to show that in that process a mistake occurred."

The other members of the court did not agree. According to Etherton LJ, the issue was whether prior to the execution of the agreement the council had objectively indicated to the housing company its intention with regard to the payment of the pension deficit which was different from the prior accord. Lord Neuberger preferred this formulation, but he added[23]:

> "On the other hand, it is self-evidently insufficient for a defendant to defeat a rectification claim simply by establishing that the terms of the provision which he put forward clearly departed from the prior accord … By the same token if, as in this case, the provision is proposed by the defendant for inclusion in a well-developed draft of the final agreement, the fact that the terms of the provision clearly depart from the prior accord cannot of itself be enough to enable the defendant to contend that its acceptance by the claimant defeats any subsequent claim for rectification."

The temptation for any judge will no doubt be to resolve the question whether there has been a sufficient objective indication of a change of intention, or a mere mistake, according to an underlying sense of what would be a just outcome. In *Daventry* Etherton LJ percipiently observed that the differences of approach between himself and other members of the court "almost certainly reflect a different instinctive view of the underlying merits of each side's case".[24] If so, this is an area which will present real difficulty for those seeking to advise litigants or potential litigants in future cases.

If I am right in considering that the law of rectification for mutual mistake has become over-complicated and capable of producing unjust consequences, how should it be reformed? I see great attraction in going back to the law as it was stated by Clauson J in *Shipley UDC*, by Simmons J in *Crane v Hegeman-Harris* and, particularly, by Hobhouse LJ in *Britoil.* Hobhouse LJ's judgment is valuable in a number of respects. It emphasises the nature of the mistake which has to be established. It draws attention to potential differences between cases where there is a prior contract, which a later contract is intended to embody more formally, and cases where the parties have reached a non-

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[23] [201]

[24] [103]

binding understanding, the evidential significance of which may vary from case to case according to the facts. It emphasises that the question whether a mistake has been made in the execution of the final contract is essentially a question of fact, and that the burden of establishing it is a high one. It also emphasises that the court has to be satisfied that in equity the claimant for rectification should have the relief for which he is asking. I see also merit in Sir Richard Buxton's argument that rectification should in future occupy the field when it is necessary to correct errors in the formal expression of a contractual consensus. This need not be confined to cases where there has been some prior consensus, if it is sufficiently plain that the document contains a textual error. The argument for this approach is not simply one of tidiness. Third parties may be affected and their legitimate interests would properly be taken into account if the remedy is in equity.

Rectification of a contract by reason of a party's unilateral mistake at the time of its execution as to its true meaning imposes on the unmistaken party a contract which is not only at variance with the document as executed, but which at the time of its execution he did not intend to make. For equity to impose such a contract on that party requires proof of some malpractice on his part such that it would be unconscionable for him to take advantage of the claimant's mistake.

Beginning with *Roberts v Leicestershire County Council*[25], a series of cases have established that, even if the defendant was not responsible for causing or contributing to the claimant's mistake, rectification will be available if the defendant was aware of the mistake but kept silent and entered into the agreement knowing what the other party intended it to be. In that type of case nothing short of actual knowledge will be sufficient.[26]

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[25] [1961] Ch 555

[26] Riverlate Properties Limited v Paul [1975] Ch 133, Thomas Bates & Son Limited v Wyndham's (Lingerie) Limited [1981] 1 WLR 505, The Nai Genova [1984] 2 Lloyd's Rep 363 & George Wimpey UK Limited v VI Construction Limited [2005] EWCA Civ 77, [2005] BLR 135.

There may, however, be other factors which would make it unconscionable for the defendant to take advantage of the claimant's mistake even if he did not have actual knowledge of it. In *Commission for the New Towns v Cooper (Great Britain) Limited*[27] Stuart-Smith LJ said (obiter):

> "I would hold that where A intends B to be mistaken as to the construction of the agreement, so conducts himself that he diverts B's attention from discovering the mistake by making false and misleading statements, and B in fact makes the very mistake that A intends, then notwithstanding that A does not actually know, but merely suspects, that B is mistaken, and it cannot be shown that the mistake was induced by any misrepresentation, rectification may be granted. A's conduct is unconscionable and he cannot insist on performance in accordance to the strict letter of the contract; that is sufficient for rescission. But it may also not be unjust or inequitable to insist that the contract be performed according to B's understanding, where that was the meaning that A intended that B should put upon it."

This is valuable because it demonstrates that unconscionability cannot be pigeon-holed by a prescriptive formula. Sir Kim Lewison put the point well in a lecture in 2008:[28]

"In essence … where it is unconscionable for B to rely on an interpretation of a contract that A did not share, he will not be permitted to do so. In reaching its decision, the court will examine the state of mind of both parties."

I would also echo Sedley LJ's comment in *George Wimpey UK Ltd v VI Construction Ltd* that "sharp practice has no defined boundary".[29] The relationship between the parties is always important in assessing the facts. Conduct which might not be regarded as sharp practice between commercial organisations of equal competence and resources may appear in another light colour where the relationship between the parties is different.

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[27] [1995] Ch 259, 280

[28] Jonathan Brock Memorial Lecture, 21 May 2008, para 40

[29] [2005] EWCA Civ 77, [2005] BLR 135, at [65].

One of the unsatisfactory features of *Daventry* was that the court felt constrained to approach the case as one of common mistake and not unilateral mistake. Within the framework of *Chartbrook*, the analysis of common mistake was logical but that does not make it right. Would rectification for unilateral mistake have been the proper outcome? Mr Roebuck not only led Mr Bruno to believe that it was agreed that the housing company would pay the pension deficit, but he also misinformed the solicitors for the housing company and the solicitors for its financial backer as to the nature of the deal, with the consequence that they put forward a contract to the opposite effect of that which had been agreed between the parties. If enforced, this would have given the housing company a windfall which Mr Bruno plainly could never have intended but failed to spot, and which arguably it was inequitable that the housing company should retain. The trial judge said that Mr Roebuck was entitled to assume that Mr Bruno understood the effect of the clause, that he did not have actual knowledge of Mr Bruno's mistake and he was not dishonest. It would have been wrong to disturb the judge's finding of fact about what Mr Roebuck knew, but it was nevertheless not a case of the defendant merely standing by and taking adventitious advantage of an unprompted mistake by the other party. In my judgment I put the matter in this way:[30]

> 183. "My conclusion that DDC is entitled to succeed on the principle in *Chartbrook* makes it unnecessary to decide whether, if there was no common mistake, DDC should have succeeded in its rectification claim on the ground of unilateral mistake. That issue also gives rise to potentially difficult questions. Mr Roebuck knew that DDC's offer was made on the basis that DDH would pay the pension deficit, and he led Mr Bruno reasonably to believe that this was agreed. He told RBS's solicitors and DDH's solicitors that the deficit was to be paid by DDC, and thereby led RBS's solicitors (believing this to have been agreed) to propose that the Transfer Contract should include an express provision to that effect, although it was contrary to the deal which he had led Mr Bruno to believe had been agreed. For the reasons already discussed, nobody with a proper understanding of the finances of the transaction would have seen any intelligible reason for Mr Bruno

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[30] [183]

> consciously to agree on the eve of the execution of the Transfer Contract to a variation giving DDH what would amount to a windfall of £2.4 million. In such circumstances it seems to me strongly arguable that Mr Roebuck could not in good conscience stand by silently hoping that clause 14.10.3 would pass. I disagree with the judge's view that Mr Roebuck was entitled in those circumstances to assume that Mr Bruno understood that the clause contradicted their earlier agreement."

Finally, there may be third party interests which should properly be considered. The equitable nature of rectification means that this can be done. In *Daventry* the housing company's financial backers were innocent. They may have been affected by the council's claim, but there was no application by them to intervene and this aspect was not explored. Rectification of the contract had the effect between the immediate parties of preventing the housing company from obtaining the housing stock at a commercially unjustified bargain price, and there may have been no resulting unfairness to the third party, but the principle involved is that since rectification is an equitable remedy, the court has a flexible power to refuse such relief, or to attach conditions, if injustice would otherwise be caused to an innocent third party. Flexibility and avoidance of injustice are appropriate words with which to end. A court should approach any claim for rectification with caution, but caution is one thing and rigidity is another. Properly applied, rectification is a valuable means of helping to secure parties' legitimate contractual expectations.

Roger Toulson
31st October 2013