

The rectification of commercial contracts

A Guest Article by James Hardy and Berkeley Edwards
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“But ... surely we can’t have agreed to that?”

Picture the scene: an agreement has been signed between your company and another company to build Europe’s largest dedicated roller disco and the project has just completed. The agreement contains a provision that sets out how the remuneration for the project will be calculated. Based on your figures, despite the difficult economic times, you should be in line for a healthy profit.

While you wait for the champagne to chill and lace up your skates for a test run of the track, you decide to just run through the payment provisions of the agreement one last time. Upon re-reading the agreement you notice that, in your instructions to your lawyers, you omitted the word “not” from the vital clause and this error was incorporated into the agreement. It looks as though, instead of endless weekends sipping champagne at the bar of your roller disco, you’re headed for the insolvency practitioners.

Are you obliged to comply with the letter of the agreement even though it is not what you intended?

Almost every area of life has felt the effect of the global financial downturn. From the property market to the high street, the entertainment industries to the financial markets, the world is a different place from the world in which we lived two years ago. Before the downturn started, parties were contracting with each other in a world of seemingly endless expansion and development. Now, those same parties find themselves bound to agreements that were negotiated and concluded in a very different world from that in which it was expected that they would be implemented. A contract that contains a wording error could cause even more serious consequences now than it might have done a few years ago.

The law of rectification

One way for the parties to an agreement to improve their apparent positions is by way of the legal remedy of “rectification”. The principle refers to the court’s ability to correct mistakes in documents that fail properly to record the parties’ true agreement. This can be undertaken in a number of different ways.

The equitable remedy of rectification relies on the fact that the courts do not rectify the contracts themselves, but rather rectify “instruments purporting to have been made in the pursuance of the terms of contracts”¹ and can be applied in the event of common mistake or unilateral mistake (i.e. if both parties or just a single party makes a mistake).

¹ *Mackenzie v Coulson* [1869] LR 8 Eq 368 per James V-C

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The route involving common mistake has historically been based on, among other conditions, the need for the parties to the agreement to have made an outward expression of such common mistake (*Rose v Pim* [1953] 2 QB 450). Like the basis for many points of law, the facts of this case were arcane to say the least.

It involved one party ordering “feveroles” from another party in the belief that feveroles were Mexican horse beans. The other party equally did not know what feveroles were and delivered Tunisian horse beans. The buyer brought an action in rectification. However, because there was no outward expression by one party to the other of their common mistake, the agreement could not be rectified.

In his judgment, celebrated horse bean enthusiast Lord Denning noted: “There could be no certainty at all in business transactions if a party who had entered into a firm contract could afterwards turn around and claim to have it rectified on the ground that the parties intended something different. He is allowed to prove, if he can, that they agreed something different.”

However, in the wake of this case the courts have begun to treat the outward expression of common intention “more as an evidential factor rather than a strict legal requirement in all cases of rectification”². If it can be shown from other evidence, or by admission, as was the situation in this case, that the parties shared a common intention up to the time that the agreement was entered into, then it is not necessary that they should have such expressed common intention to each other.

The commercial sense

But what happens, as in our case, if a contract contains a clause that, on its strict wording, appears to make no commercial sense? This is a matter that troubles an increasing number of people in times of economic downturn and was recently considered by the House of Lords in *Chartbrook v Persimmon Homes Limited*.

This case referred to a contract under which Persimmon would construct a mixed residential and commercial development on land in Wandsworth owned by Chartbrook. The contract provided for a fixed sum payment followed by a further payment, which depended on how much money the residential element of the development made (the “Additional Residential Payment” or “ARP”).

² Per Mummery LJ in *Munt v Beasley* [2006] EWCA Civ 370

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A complex formula was drafted in order to outline how the ARP would be calculated. Each party walked away happy, not realising that their respective readings of the formula led to a difference of more than £3.5 million.

The High Court and Court of Appeal ruled that the contract should be construed in a way that followed the letter of the wording of the contract, despite the fact that such a reading of the agreement made no commercial sense. On appeal, the House of Lords overturned these decisions by ruling that the commerciality of an agreement must be taken into account when considering the rectification of a contract.

It was ruled that, when looking at a contract, a so-called “purposive” approach must be taken: what had the contract been drafted to achieve?

Lord Hoffman stated: “... the process of interpretation ... is to decide what a reasonable person would have understood the parties to have meant by using the language which they did ... All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant.”

Conclusion

It would therefore appear that, in our scenario, all is not lost and the roller disco may still open as planned. If it can be established that the clause in question makes no commercial sense (and if possible, in order to bolster such argument, it can be established that the parties expressed their true intention to each other before the contract was executed), then, in light of this recent decision, the parties may be able to agree to insert the required wording in order to give effect to the commercial intentions of the parties.

The clarification of the law in this area offered by this decision might also help to avoid costly litigation in the future.

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