

ESTOPPEL BY CONVENTION AND PRE-CONTRACTUAL UNDERSTANDINGS: THE POSITION AND PRACTICAL CONSEQUENCES

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Recently, the House of Lords held in Chartbrook Ltd v Persimmon Homes Ltd that an understanding or common assumption reached by contracting parties in the course of their pre-contractual negotiations, including "an assumption that certain words will bear a certain meaning" can provide the basis for an estoppel by convention claim. This was reaffirmed by the New Zealand Supreme Court in Vector Gas Ltd v Bay of Plenty Energy Ltd. Both the House of Lords and the Supreme Court assumed that this was well established. Given that the issue was unsettled in England and with two divergent lines of authority in Australia, the House of Lords and Supreme Court should not have assumed this. In light of this development in the law, it is also argued that where the evidence proves that the parties established an understanding as to the meaning of a term in a proposed contract, then surely that is the meaning of that term, as a matter of interpretation. In addition, allowing consideration of pre-contractual negotiations to prove an estoppel by convention has undermined the rule that pre-contractual negotiations are inadmissible as an aid to interpretation of a contract.

I INTRODUCTION

Where two parties arrive at a common understanding of their relationship, they may be precluded from departing from the terms of that understanding, where it would be unconscionable to do so.¹ This is the doctrine of estoppel by convention. In 2009, the House of Lords in *Chartbrook Ltd v Persimmon Homes Ltd* (*Chartbrook*) held that an understanding or common assumption reached by contracting parties in the course of their pre-contractual negotiations, including "an

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¹ Gerard McMeel *The Construction of Contracts: Interpretation, Implication and Rectification* (Oxford University Press, Oxford, 2007) at 367.

assumption that certain words will bear a certain meaning" could provide the basis for an estoppel by convention claim.² This was similarly declared by the New Zealand Supreme Court in *Vector Gas Ltd v Bay of Plenty Energy Ltd (Vector Gas)*.³ The House of Lords and the Supreme Court (no doubt in reliance on the House of Lords) assumed that it was well established that an understanding or common assumption reached by contracting parties in the course of their pre-contractual negotiations could provide the basis for an estoppel by convention claim. However, this was not the case. The issue was in fact unsettled in England and Australia, with there being two divergent lines of authority in Australia. In the light of the divergent authority, the House of Lords and Supreme Court should not have assumed that an understanding or common assumption reached during pre-contractual negotiations could provide the basis for an estoppel by convention claim.

Also, there are two important criticisms of the decisions in *Chartbrook* and *Vector Gas*. First, the decisions fail to recognise that where the evidence proves that the parties established an understanding as to the meaning of a term in a proposed contract, then that is the meaning of that term, as a matter of interpretation. Second, allowing consideration of pre-contractual negotiations to prove an estoppel by convention has undermined the rule that pre-contractual negotiations are inadmissible as an aid to interpretation of a contract (the exclusionary rule).⁴

This article first examines the development of estoppel by convention and why it has been increasingly utilised by the courts. Second, it sets out the requirements to establish an estoppel by convention in New Zealand, England and Australia. Third, considering the differences between the requirements across jurisdictions, it examines the key issues surrounding the scope of the doctrine. Fourth, it analyses the cases of *Chartbrook* and *Vector Gas*, and argues that the doctrine was not as well established as the House of Lords and Supreme Court assumed. This point is demonstrated by English authority, and the divergent lines of authority in Australia. Fifth, it argues that where the evidence establishes a convention as to the meaning of a word, then that should be the meaning of the term as a matter of interpretation. Finally, it argues that the ability to rely on pre-contractual negotiations to establish an estoppel by convention claim has undermined the exclusionary rule.

II DEVELOPMENT OF ESTOPPEL BY CONVENTION

Estoppel by convention is a relatively recent doctrine. It has been described as a "major qualification of, or departure from, orthodox principles of the law of contract" because it is

² *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] AC 1101 at [47] [*Chartbrook*].

³ *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 [*Vector Gas*].

⁴ See *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1997] UKHL 28, [1998] 1 WLR 896 at 912–913.

dependent on a common assumption or understanding, not a contract.⁵ In 1977, it was described in *The law relating to Estoppel by representation* in the following terms:⁶

When the parties have acted in their transaction upon the agreed assumption that a given state of facts is to be accepted between them as true, then as regards that transaction each will be estopped against the other from questioning the truth of the statement of facts as assumed.

Some commentators assert that this statement should be perceived as an illustration of estoppel by convention rather than a definition, because there has been a considerable expansion in the scope of the doctrine of estoppel since this statement.⁷ The modern form of estoppel by convention was first judicially recognised in 1981 in *Amalgamated Investment & Property Co Ltd v Texas Commerce International Bank (Texas Bank)*.⁸ Lord Denning MR, frustrated by the lack of consistency between estoppel formulations, set out a "general principle shorn of limitations":⁹

If parties to a contract, by the course of their dealing, put a particular interpretation on the terms of it, on the faith of which each of them to the knowledge of the other acts and conducts their mutual affairs, they are bound by that interpretation just as much as if they had written it down as a variation of the contract.

This statement of principle has been cited with approval on numerous occasions as defining the doctrine of estoppel by convention.¹⁰ However, Lord Denning MR did not explicitly refer to estoppel by convention.¹¹ Only Eveleigh and Brandon LJ recognised estoppel by convention as a separate form of estoppel.¹² Notwithstanding this, the decision has been influential because it recognised estoppel by convention as a separate form of estoppel for the first time.¹³ The decision also recognised that estoppel by convention could arise where there was no contractual relationship

5 McMeel, above n 1, at 367.

6 Alexander Turner (ed) *The law relating to Estoppel by representation* (3rd ed, Butterworths, London, 1977) at 157.

7 Rory Derham "Estoppel by convention – Part I" (1997) 71 ALJ 860 at 860.

8 *Amalgamated Investment & Property Co Ltd v Texas Commerce International Bank* [1982] QB 84 [*Texas Bank*].

9 *Ibid*, at 122.

10 See *Johnson v Gore Wood & Co* [2000] UKHL 65, [2002] 2 AC 1 at [33] per Lord Bingham; *PW & Co v Milton Gate Investments Ltd* [2003] EWCH 1994, [2004] Ch 142 at 183.

11 See McMeel, above n 1, at 369. He suggests that "Lord Denning's general principle is a helpful account of the rationale for intervention in cases of estoppel by convention".

12 John McKenna "Estoppel by Convention and the Sanctity of Contract" (paper presented to the Current Legal Issues Seminar Series, Queensland, May 2009) at 1.

13 KR Handley *Estoppel by Conduct and Election* (Sweet & Maxwell Limited, London, 2006) at [8-003].

between the parties.¹⁴ Since the *Texas Bank* decision, estoppel by convention has been recognised in many common law jurisdictions including England, Australia, Singapore, Canada and New Zealand.¹⁵

Estoppel by convention may be distinguished from other forms of estoppel due to the requirement of "mutuality".¹⁶ It is essential that both parties adopt the assumption as a basis for their transaction.¹⁷ However, a belief in the truth of the assumed version of facts is not necessary. The parties may know that the assumption which is the basis of their transaction is untrue.¹⁸

Since the *Texas Bank*¹⁹ decision, there has been a huge increase in the number of cases in which estoppel by convention has been pleaded, and considered by the courts. There are two possible explanations for this. Firstly, if a party can prove an estoppel by convention, this may be a 'king hit' in a dispute about the meaning of, or obligations under, a written contract. Parties see it as a short cut to achieving the desired outcome in a contract dispute. The more that parties plead estoppel by convention and the courts consider claims established, the more popular it becomes. Secondly, no orthodox contract remedies are available in the situation where parties contract on the basis of an understanding or common assumption. Rectification is not available because the choice of words in the contract did not result from a mistake.²⁰ Furthermore, the doctrine also operates much more widely than rectification. Rectification is only available when parties have clear and convincing proof there has been a mistake in the contract.²¹ With the widening of the doctrine of estoppel by convention, it can apply to "any assumptions of fact or law made at any time in any legal relationship".²² As stated by Lord Hoffmann in *Chartbrook*, this includes assumptions as to the meaning of words.²³ Established estoppels are also not available because there is generally no representation or promise by one party to the other.²⁴

14 Ibid, at [8-006].

15 Ibid, at [8-003].

16 Ibid, at [8-001].

17 Ibid.

18 *Grundt v Great Boulder Proprietary Mines Ltd* (1938) 59 CLR 641 at 676.

19 *Texas Bank*, above n 8.

20 McKenna, above n 12, at 1.

21 Ibid, at 2.

22 Ibid.

23 *Chartbrook*, above n 2, at [47].

24 McKenna, above n 12, at 1.

III REQUIREMENTS OF ESTOPPEL BY CONVENTION

The requirements to prove an estoppel by convention differ from jurisdiction to jurisdiction. Some statements of the requirements are more expansive than others.

A New Zealand

In New Zealand, the requirements to prove estoppel by convention were set out by Tipping J in the Court of Appeal in *National Westminster Finance New Zealand Ltd v National Bank of New Zealand Ltd (National Westminster Finance)*:²⁵

- (1) The parties have proceeded on the basis of an underlying assumption of fact, law or both, of sufficient certainty to be enforceable;
- (2) Each party has, to the knowledge of the other, expressly or by implication accepted the assumption as being true for the purposes of the transaction;
- (3) Such acceptance was intended to affect their legal relations in the sense that it was intended to govern the legal position between them;
- (4) The proponent was entitled to act and has, as the other party knew or intended, acted in reliance upon the assumption being regarded as true and binding;
- (5) The proponent would suffer detriment if the other party were allowed to resile or depart from the assumption; and
- (6) In all circumstances it would be unconscionable to allow the other party to resile or depart from the assumption.

This statement of principle has been endorsed at appellate level in Australia, except for the extension of the doctrine to include assumptions of law.²⁶

B England

In *Norwegian American Cruises A/S (formerly Norwegian American Lines A/S) v Paul Mundy Ltd (The Vistafjord)*, Bingham LJ set out a three-stage test for estoppel by convention:²⁷

25 *National Westminster Finance New Zealand Ltd v National Bank of New Zealand Ltd* [1996] 1 NZLR 548 (CA) at 550.

26 McKenna, above n 12, at 9. See *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Co Ltd* [2008] WASCA 119, (2008) 66 ACSR 594; *Attorney-General of the Australian Capital Territory v Eastman* [2008] ACTCA 6, (2008) 163 ACTR 46.

27 *Norwegian American Cruises A/S (formerly Norwegian American Lines A/S) v Paul Mundy Ltd (The Vistafjord)* [1988] 2 Lloyd's Rep 343 (CA) at 352.

It applies where (1) the parties have established by their construction of their agreement or their apprehension of its legal effect a conventional basis, (2) on that basis they have regulated their subsequent dealings, to which I would add (3) it will be unjust or unconscionable if one of the parties resiled from that convention.

This test refers to estoppel by convention based on a post-contract convention, which is the most usual application of the doctrine. Gerard McMeel suggests that, based on modern authorities, the ingredients of estoppel by convention are: a course of conduct (usually after the contract), a common understanding, communication of that understanding, acts of reliance by one party on that understanding and unconscionability.²⁸

C Australia

In *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (*Con-Stan Industries*), the High Court of Australia characterised the doctrine as:²⁹

... a form of estoppel founded not on a representation of fact made by a representor and acted on by a representee to his detriment, but on the conduct of relations between the parties on the basis of an agreed or assumed state of facts, which both will be estopped from denying.

IV SCOPE OF ESTOPPEL BY CONVENTION

Although the courts have established these general tests in New Zealand, England and Australia, there are still unresolved issues about the scope of the doctrine.

A Common Assumptions of Fact, Law or Both?

It is well established that there must be a common assumption shared by all parties to a relevant current or proposed legal relationship.³⁰ Spencer Bower's definition of estoppel by convention limited the doctrine to assumptions of fact to found an estoppel by convention claim.³¹ However, the English case of *Texas Bank* expanded the scope of estoppel by convention to include both assumptions of fact, and assumptions as to the legal effect of a contract.³² The New Zealand Court of Appeal in *National Westminster Finance* accepted that assumptions of law could provide a basis for the doctrine.³³ The High Court of Australia in *Con-Stan Industries* prima facie required the

28 McMeel, above n 1, at 371.

29 *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226 at 244 [*Con-Stan Industries*].

30 *Unruh v Seeberger* [2007] HKCFA 9 at [133].

31 Turner, above n 6, at 157.

32 Derham, above n 7, at 865.

33 *National Westminster Finance New Zealand Ltd v National Bank of New Zealand Ltd*, above n 25, at 550.

assumption to be one of fact.³⁴ However, this statement has also been interpreted as "intended to have limited effect" because the court seemingly endorsed the *Texas Bank* decision, where an assumption of law could support an estoppel.³⁵

B A Requirement of Unconscionability?

An unresolved issue is whether unconscionability must be established to prove the estoppel. None of the English Court of Appeal judges who decided *Texas Bank* asserted that it must be unconscionable to allow the other party to go back on the common assumption to establish an estoppel by convention.³⁶ Lord Denning only asserted that an estoppel would arise where it would be "unfair or unjust" for the other party to the transaction to resile from the common assumption.³⁷ Moreover, there have been no Court of Appeal nor House of Lords decisions that have included unconscionability as an essential requirement in proving an estoppel by convention.³⁸ Estoppel by convention has been applied in both Singapore and Australia without reference to unconscionability.³⁹ By contrast, in New Zealand, in *National Westminster Finance*, Tipping J specifically included unconscionability as a requirement.⁴⁰

If unconscionability is a requirement, KR Handley suggests that it should be discarded.⁴¹ This is because it is inherently unconscionable for a party to resile from a common assumption, where the party alleging the estoppel has detrimentally relied on the common assumption.⁴² A court is unlikely to hold parties to an assumption where allowing a party to resile from it would not cause injustice.⁴³

34 *Con-Stan Industries*, above n 29, at [22].

35 *Eslea Holdings Ltd v Butts* (1986) 6 NSWLR 175 at 188.

36 Handley, above n 13, at [8-021].

37 *Texas Bank*, above n 8, at 122.

38 Handley, above n 13, at [8-024].

39 *Con-Stan Industries*, above n 29; *Singapore Island Country Club v Hilbourne* [1997] 1 SLR 248 (CA).

40 *National Westminster Finance New Zealand Ltd v National Bank of New Zealand Ltd*, above n 25, at 550. However, Tipping J emphasises prior to this that unconscionability underlies all manifestations of estoppel and that, (at 549) "the broad rationale of estoppel, and this is not a test in itself, is to prevent a party from going back on his word ... when it would be unconscionable to do so", which suggests he never intended unconscionability to be a separate requirement. See *Rattrays Wholesale Ltd v Meredith Young & A'Court Ltd* [1997] 2 NZLR 363 (HC).

41 Handley, above n 13, at [8-024].

42 *Ibid*, at [8-024].

43 *Hamel-Smith v Pycroft & Jetsave Limited* EWHC, unreported, 5 February 1987, endorsed by Bingham J in *The Vistafford*, above n 27, at 351–352.

C Common Law or Equitable Estoppel?

Estoppel by convention has been widely characterised as a form of common law estoppel, like estoppel by deed and estoppel by representation.⁴⁴ However, Elizabeth Cooke observed that "estoppel by convention seems to have moved house, from the common law tradition to equitable estoppel".⁴⁵ This view is reinforced by Matthew Harvey, who noted that estoppel by convention has the features of an equitable estoppel, due to its general focus on the prevention of unconscionable conduct.⁴⁶ The correctness of the classification of estoppel by convention as a common law estoppel has been recently addressed in *Tim Barr Pty Ltd v Narui Gold Coast Pty Ltd*⁴⁷ and *Franklins Pty Ltd v Metcash Trading Ltd (Metcash Trading)*.⁴⁸

In *Tim Barr Pty Ltd v Narui Gold Coast Pty Ltd*, Barrett J suggested that estoppel by convention may have changed from a common law estoppel to an equitable estoppel, but did not find it necessary to express a definitive view.⁴⁹ The New South Wales Court of Appeal in *Metcash Trading* considered the issue in the context of reliance on pre-contractual negotiations to prove an estoppel by convention. Campbell JA argued that the question of whether pre-contractual negotiations could be relied upon to prove an estoppel by convention claim depends on whether estoppel by convention is a common law doctrine or an equitable doctrine. This is because it seems "more in accord with principle" that the parol evidence rule (a common law doctrine itself) would impede the operation of estoppel by convention if it were solely a common law doctrine.⁵⁰ This statement was supported by Allsop P, who concluded that the relationship between the parol evidence rule and estoppel by convention depends on whether estoppel by convention is a common law or equitable doctrine.⁵¹ Neither Campbell JA or Allsop P found it necessary to decide the point, so the issue remains unresolved. Notwithstanding this, these two New South Wales decisions

44 McKenna, above n 12, at 11.

45 Elizabeth Cooke *The Modern Law of Estoppel* (Oxford University Press, Oxford, 2000) at 31.

46 Matthew Harvey "Estoppel by Convention – An Old Doctrine with New Potential" (1995) 23 ABLR 45 at 46.

47 *Tim Barr Pty Ltd v Narui Gold Coast Pty Ltd* [2010] NSWSC 29.

48 *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407, (2009) 264 ALR 15.

49 *Tim Barr Pty Ltd v Narui Gold Coast Pty Ltd*, above n 47, at [335].

50 *Ibid*, at [577] per Campbell JA. This is another example of the widespread misunderstanding of the operation of the parol evidence rule. Whether the parol evidence rule restricts the operation of estoppel by convention does not depend on whether it is a common law or equitable estoppel. This is because the evidence is not directed at adding to, varying or contradicting the terms of the contract, and therefore the consideration of pre-contractual negotiations does not contravene the parol evidence rule.

51 *Ibid*, at [34] per Allsop J.

suggest that it is now unclear whether estoppel by convention is a common law or equitable estoppel.

V **ESTOPPEL BY CONVENTION AND PRE-CONTRACTUAL UNDERSTANDINGS: CHARTBROOK AND VECTOR GAS**

As noted in *Cheshire & Fifoot's Law of Contract*,⁵² estoppels "provide a potential means of circumventing the obstacles to incorporation of pre-contractual terms", and estoppel by convention has been utilised in this manner.⁵³ In *Chartbrook*, Lord Hoffmann held that an understanding or common assumption reached by contracting parties during negotiations could provide the basis for an estoppel by convention claim.⁵⁴ The New Zealand Supreme Court in *Vector Gas* reaffirmed this proposition, no doubt in reliance on *Chartbrook*.

However, in England, Neuberger J in *PW & Co v Milton Gate Investments Ltd* cast doubt on this proposition.⁵⁵ In Australia, Campbell JA observed in *Metcash Trading* that it is unsettled whether an estoppel by convention claim could be based on a common assumption or understanding reached during pre-contractual negotiations, with two lines of authority diverging on the point.⁵⁶ In *Johnson Matthey Ltd v AC Rochester Overseas Corporation (Johnson Matthey)*, McLelland J held that a common assumption or understanding reached during pre-contractual negotiations could not provide the basis for an estoppel by convention claim.⁵⁷ This decision has been followed in a number of subsequent decisions.⁵⁸ Rolfe J in *Whittet v State Bank of New South Wales* declined to follow *Johnson Matthey*,⁵⁹ and his approach has also been followed in a number of cases.⁶⁰ In Australia, it has not been necessary for a court to decide which line of authority is correct because estoppel by

52 NC Seddon and MP Ellinghaus *Cheshire & Fifoot's Law of Contract* (9th ed, Butterworths, Australia, 2009).

53 *Ibid*, at 10.3.

54 *Chartbrook*, above n 2, at [42].

55 *PW & Co v Milton Gate Investments Ltd*, above n 10.

56 *Franklins Pty Ltd v Metcash Trading Ltd*, above n 48, at [577]. See also Handley, above n 13 at [8-012]; Seddon and Ellinghaus, above n 52, at 10.3.

57 *Johnson Matthey Ltd v AC Rochester Overseas Corporation* (1990) 23 NSWLR 190 at 195.

58 See *Bentham v ANZ Banking Group* SC New South Wales No 1578 of 1991, 26 June 1991; *Skywest Aviation Pty Ltd v Commonwealth* (1995) 126 FLR 61 (ACTSC); *Australian Co-operative Foods Ltd v Norco Co-operative Ltd* [1999] NSWSC 274, (1999) 46 NSWLR 267 per Bryson J.

59 *Whittet v State Bank of New South Wales* (1991) 24 NSWLR 146 at 153.

60 See McHugh JA in *State Rail Authority of New South Wales v Heath Outdoor Pty Ltd* (1986) 7 NSWLR 170 (NSWCA); *Lezam Pty Ltd v Seabridge Australia Pty Ltd* [1992] FCA 206, (1992) 35 FCR 535 at 541, Sheppard J doubted the generality of the rule in *Johnson Matthey*.

convention claims have not turned on the ability to rely on pre-contractual negotiations.⁶¹ Before addressing the divergent authorities in more detail, it is necessary to examine the decisions of the House of Lords and Supreme Court in *Chartbrook* and *Vector Gas*.

A *Chartbrook Ltd v Persimmon Homes Ltd*

Before specifically addressing estoppel by convention, Lord Hoffmann addressed the issue of whether the House of Lords should depart from the exclusionary rule. The exclusionary rule prohibits the admission of evidence of pre-contractual negotiations as an aid to interpretation.⁶² His Lordship concluded that "there was no clearly established case for departing from the exclusionary rule".⁶³ However, in his view, it did not exclude the use of evidence of pre-contractual negotiations for other purposes.⁶⁴ It was in this context that his Lordship (with whom all of the Lords concurred) specifically addressed the private dictionary principle and estoppel by convention.

Lord Hoffman saw the private dictionary principle as a possible exception to the exclusionary rule.⁶⁵ The private dictionary principle was derived from the judgment of Kerr J in *The Karen Oltmann*. This interpretation principle allows the admission of extrinsic evidence to prove that the parties have in effect negotiated on an agreed basis that the words bore only one of two possible meanings.⁶⁶ Lawrence Collins LJ, in the English Court of Appeal decision in *Chartbrook*, doubted that this principle was much different from admitting evidence of pre-contractual negotiations in the interpretation of a contract, but accepted this principle.⁶⁷

However, Lord Hoffmann disapproved of the application of the private dictionary principle to situations where there are two conventional meanings of a word.⁶⁸ His Lordship stressed that extending the private dictionary principle to situations where parties have a choice between two

61 See *Ryledar Pty Ltd v Euphoric Pty Ltd* [2007] NSWCA 65, (2007) 69 NSWLR 603; *Franklins Pty Ltd v Metcash Trading Ltd*, above n 48; *Equiscorp Pty Ltd v Glengallan Investments Pty Ltd* [2006] QCA 194.

62 See *Investors Compensation Scheme Ltd v West Bromwich Building Society*, above n 4, at 912–913.

63 *Chartbrook*, above n 2, at [41].

64 *Ibid*, at [42].

65 *Ibid*, at [43].

66 *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd's Rep 708 at 712.

67 *Chartbrook Ltd v Persimmon Homes Ltd* [2008] EWCA Civ 183, [2008] 2 All ER (Comm) 387 at [121]. Lord Hoffmann later stated at [45] that "Lawrence Collins LJ was right in saying that the admission of the evidence infringed the exclusionary rule". This is not what Lawrence Collins LJ held, in fact he accepted the unrestricted 'private dictionary' principle derived from *The Karen Oltmann*. Compare Lord Hoffmann who confines the application of the principle at [47].

68 *Chartbrook*, above n 2, at [45]. This was the case in *The Karen Oltmann*, where the parties understood the word "after" to mean "on the expiry of" (at 712).

conventional meanings of a word would be "illegitimate".⁶⁹ This is because the extension would "destroy the exclusionary rule and any practical advantages it may have".⁷⁰ Therefore, he confined the application of the private dictionary principle to situations where the parties have agreed on an unconventional meaning of a word.⁷¹

However, his Lordship then recognised that estoppel by convention was a "legitimate safety device", which would "in most cases prevent the exclusionary rule from causing injustice".⁷² He stressed that estoppel by convention must be pleaded and clearly established.⁷³ His Lordship recognised that an estoppel by convention may arise where parties had a common assumption as to the meaning of a term or terms in a proposed written contract:⁷⁴

If the parties have negotiated an agreement upon some common assumption, which may include an assumption that certain words will bear a certain meaning, they may be estopped from contending that the words should be given a different meaning.

Importantly, his Lordship saw estoppel by convention as lying outside the exclusionary rule because the starting point is that "as a matter of construction, the agreement does not have the meaning for which the party ... raising the estoppel contends".⁷⁵ The purpose of estoppel by convention is to preclude a party from relying on the meaning derived from the interpretation of the agreement where the parties have negotiated on the basis of a common assumption.⁷⁶ Therefore, he concluded that an understanding or common assumption reached during pre-contractual negotiations could provide the basis for an estoppel by convention claim.⁷⁷

⁶⁹ Ibid, at [47].

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² Ibid.

⁷³ Ibid. Contrast the approaches of Tipping, McGrath and Wilson JJ in *Vector Gas Ltd*, above n 3, who considered estoppel by convention, even though it had not been pleaded by Vector Gas at [48], [85] and [140] respectively.

⁷⁴ Ibid, at [47].

⁷⁵ Ibid. Compare the approach of Tipping J in *Vector Gas*, above n 3, at [23], "words can never be *construed* as having a meaning they cannot reasonably bear, except in the case of the private dictionary principle or estoppel". Later in his judgment, at [33], Tipping J also acknowledged that "a clear drafting or linguistic error, combined with equal clarity as to what was intended, can be remedied by way of interpretation".

⁷⁶ Ibid.

⁷⁷ Ibid.

B Vector Gas Ltd v Bay of Plenty Energy Ltd

The New Zealand Supreme Court had the opportunity to decide the contractual interpretation dispute in *Vector Gas* in light of the House of Lords' decision in *Chartbrook*. The judges were highly influenced by Lord Hoffmann and his comments in relation to estoppel by convention.

Importantly, three out of the five judges on the Bench – Tipping, McGrath and Wilson JJ – held that an estoppel by convention claim could be based on an understanding or common assumption reached during pre-contractual negotiations.⁷⁸ This was the first time that estoppel by convention had been addressed by the Supreme Court and therefore it was surprising that the Supreme Court did not address the scope of the doctrine more fully. Perhaps part of the reason why this did not occur was that estoppel by convention was not pleaded by Vector Gas. Only the private dictionary principle was pleaded in the lower courts, which requires different considerations. None of the three judges who addressed estoppel by convention saw the lack of pleading as a barrier to its being discussed and applied because it was inherent in Vector Gas' case before the lower courts that there had been an agreement as to the meaning of "\$6.50 per gigajoule".⁷⁹

1 Material facts

Vector Gas concerned an agreement for the supply of gas between Vector Gas Ltd and Bay of Plenty Energy Ltd (BoPE). Vector Gas gave notice of termination of the agreement. BoPE disputed the validity of the termination. Pending resolution of this dispute by the courts, the parties reached an agreement that Vector Gas would continue to supply gas to BoPE at a cost of \$6.50 per gigajoule. The issue facing the Supreme Court was whether the price for the supply of gas by Vector Gas included the costs of its transmission to the premises of BoPE. The exchange of written correspondence between the parties showed that the parties had agreed that \$6.50 per gigajoule was exclusive of transmission costs.

2 Tipping J

Tipping J approached the issue by stating that the court's task in an interpretation dispute is to "establish the meaning the parties intended their words to bear".⁸⁰ As interpretation disputes have always been approached on an objective basis, the court examines what a "reasonable and properly informed third party would consider the parties intended the words of their contract to mean" and "the court embodies that person".⁸¹ In order to be properly informed, the court must consider the

78 Contrast Blanchard and Gault JJ who did not consider estoppel by convention, deciding in favour of Vector Gas on interpretation of the disputed provision. See *Vector Gas Ltd*, above n 3, at [12] and [159].

79 *Ibid*, at [48].

80 *Ibid*, at [19].

81 *Ibid*.

context in which the contract was made and the background facts known to the parties.⁸² However, the objective approach does not force the court "to ascribe to the parties an intention that a properly informed and reasonable person would not ascribe to them when aware of all the circumstances in which the contract was made."⁸³

In relation to admissibility of extrinsic evidence, his Honour regarded irrelevance as the touchstone for the exclusion of evidence.⁸⁴ Extrinsic evidence that merely proves the subjective intentions of the parties is irrelevant, and is therefore inadmissible.⁸⁵ However, extrinsic evidence is admissible if it is capable of shedding objective light on the meaning one or both parties intended their words to bear.⁸⁶ There were no "persuasive pragmatic grounds" to exclude relevant evidence.⁸⁷ In his view, this approach maintained the crucial line between subjectivity and objectivity of approach.⁸⁸

His Honour specifically addressed the admissibility of evidence that showed an agreement or understanding as to meaning between the parties. In his view, evidence is admissible "which shows objectively the meaning the parties intended their words to convey",⁸⁹ and includes "any objectively apparent consensus as to meaning operating between the parties".⁹⁰ Although the final written contract records the ultimate consensus of the parties, "the way that consensus is expressed may be based on an agreement as to meaning reached during negotiations".⁹¹ Therefore, evidence that shows the existence of an agreement as to the meaning of words is not only relevant but should be decisive.⁹² Consequently, extrinsic evidence is admissible to show objectively what both or all parties intended their words to bear, an agreement as to meaning or an estoppel.⁹³

Following this conclusion, his Honour examined the decision of Kerr J in *The Karen Oltmann*. He acknowledged that this case is sometimes referred to as a private dictionary meaning case, but

82 Ibid.

83 Ibid, at [21].

84 Ibid, at [29].

85 Ibid.

86 Ibid.

87 Ibid, at [29]. Contrast the view of Lord Hoffmann in *Chartbrook*, above n 2, at [34].

88 Ibid, at [30].

89 Ibid, at [27].

90 Ibid.

91 Ibid, at [28].

92 Ibid, at [32].

93 Ibid, at [31].

disagreed that that was the basis of the decision.⁹⁴ In his view, the "best analysis" of Kerr J's decision in *The Karen Oltmann* was that the parties had either reached an agreement as to meaning (the parties had "consensually resolved which meaning was to apply") and were bound by that agreement, or "an estoppel had been created".⁹⁵ The case was not decided on the basis of "special meaning" (the private dictionary principle) because there were two conventional meanings of the word "after".⁹⁶

His Honour regarded estoppel by convention as an alternative, primarily in situations where parties have reached an agreement as to meaning (where words are capable of two conventional meanings as in *The Karen Oltmann*), but also where parties have adopted a special meaning (and the private dictionary principle applies).⁹⁷

First and foremost, his Honour decided the case in favour of Vector Gas on interpretation of the expression "\$6.50 per gigajoule". Taking into account the parties' objective agreement during pre-contractual negotiations as to the meaning of this expression and the commercial context, his Honour concluded that a reasonable and properly informed reader would have considered \$6.50 per gigajoule to be exclusive of transmission costs.⁹⁸

His Honour's alternative ground was estoppel by convention. Due to the prior finding that there was an objective agreement reached between Vector Gas and BoPE that \$6.50 per gigajoule was exclusive of transmission costs during pre-contractual negotiations, BoPE was precluded from relying on a different meaning.⁹⁹

94 Ibid, at [36]. Tipping J gives the impression that he agrees with the analysis of the House of Lords' analysis of the decision in *The Karen Oltmann*, however this is misleading. In his view, one of the explanations of the decision was that there was an agreement that "after" would bear one of two meanings, and extrinsic evidence to that effect was admissible. Contrast the view of the House of Lords' that where there are two conventional meanings of a word, admission of evidence to prove an agreement as to meaning infringed the exclusionary rule and that a party must prove estoppel by convention or rectification to succeed. See *Chartbrook*, above n 2, at [45].

95 Ibid, at [37].

96 Ibid.

97 Ibid, at [35]. Earlier at [25], Tipping J stated that the private dictionary principle "can also be regarded as a linguistic example of estoppel by convention", which fails to recognise that the private dictionary principle and estoppel by convention are distinct principles, although arising in similar circumstances.

98 Ibid, at [45].

99 Ibid.

3 *McGrath J*

In determining the appropriate approach to interpretation of the provision in question, McGrath J focused on the contextual approach to interpretation of commercial agreements.¹⁰⁰ His Honour acknowledged that the courts have shifted away from the prevailing view that contract interpretation turns on the plain meaning of the contract. Instead the courts have recognised that the context of the contract and the purpose of the parties may shed light on the meaning of the disputed provision.¹⁰¹

Most importantly, his Honour reaffirmed Lord Hoffmann's conclusion in *Chartbrook* that pre-contractual negotiations are admissible only to establish relevant background facts, or to support a claim for rectification or estoppel.¹⁰² His Honour identified estoppel by convention as the relevant estoppel on the facts. In addressing estoppel by convention, his Honour noted that the existence of a mutual assumption was its "distinguishing characteristic" and that its effect "is to prevent a party from going back on the mutual assumption if it would be unjust to allow him to do so".¹⁰³

His Honour reaffirmed the view of Lord Hoffmann in *Chartbrook* that estoppel by convention and rectification were "two legitimate safety devices" which prevented the exclusionary rule from causing injustice.¹⁰⁴ Pre-contractual negotiations can be relied upon to prove an estoppel by convention because the evidence is:¹⁰⁵

... not directed at proving terms additional to or differing from those in the written agreement. It is directed at proving that it would be unconscionable in the circumstances to allow a party to rely on those terms.

His Honour pointed out that estoppel by convention is particularly important because it precludes parties from departing from a common understanding which they have acted upon.¹⁰⁶ In his view, allowing evidence of pre-contractual negotiations to support an estoppel by convention is a "principled supplementary approach to contract interpretation", and that it will be applicable in many situations in which the private dictionary principle applied.¹⁰⁷

¹⁰⁰ *Ibid*, at [57].

¹⁰¹ *Ibid*.

¹⁰² *Ibid*, at [67].

¹⁰³ *Ibid*, at [68]–[69].

¹⁰⁴ *Ibid*, at [73].

¹⁰⁵ *Ibid*.

¹⁰⁶ *Ibid*, at [74].

¹⁰⁷ *Ibid*. McGrath J assumes the private dictionary principle is no longer good law. However, Lord Hoffmann in *Chartbrook*, above n 2, at [47] only stated the private dictionary principle could not be extended to include situations where parties choose between two conventional meanings of a word. This principle is still good

After setting out the relevant principles of contract interpretation and estoppel by convention, his Honour proceeded to determine the interpretation issue on the facts. On an objective approach to interpretation, taking into account the background and purpose of the parties, his Honour found in favour of Vector Gas. This finding was reinforced by his argument that the only commercially sensible interpretation was that \$6.50 per gigajoule was exclusive of transmission costs.

In the alternative, his Honour relied on estoppel by convention, and importantly was prepared to examine the pre-contractual negotiations to determine whether an estoppel by convention could be established.¹⁰⁸ After examining the relevant pre-contractual negotiations, his Honour held there was strong evidence that the parties had a common understanding that "\$6.50 per gigajoule" was exclusive of transmission costs, and that Vector Gas had relied on this common understanding in entering into the agreement. He held that in the circumstances it would be unconscionable to allow BoPE to depart from the common assumption. Therefore, the appeal was allowed.¹⁰⁹

4 *Wilson J*

Wilson J asserted that the general principle of interpretation is that the words of an agreement "should be given their ordinary meaning in the context of the contract in which they appear, because the parties are presumed to have intended the words to be given that meaning".¹¹⁰

His Honour identified three exceptions to this principle, where consideration of extrinsic evidence is permissible to aid in contract interpretation. One of his exceptions was estoppel by convention. His Honour stated that estoppel by convention arises where parties have a common understanding that the words will not carry their ordinary meaning, and therefore parties are estopped from contending the words should carry their ordinary meaning.¹¹¹ His Honour asserted that estoppel by convention "effectively subsumes the 'private dictionary principle'".¹¹² In determining whether an estoppel by convention arose on the facts, his Honour considered "all relevant correspondence between the parties".¹¹³

law where parties attach an unconventional meaning to a word. It is open to argument that the parties attached an unconventional meaning to "\$6.50 per gigajoule" here.

¹⁰⁸ Ibid, at [86].

¹⁰⁹ Ibid, at [95]–[97].

¹¹⁰ Ibid, at [119].

¹¹¹ Ibid, at [124].

¹¹² Ibid. Like McGrath J, Wilson J failed to recognise that the private dictionary principle is still good law where parties agree that the words will bear an unconventional meaning in a written contract.

¹¹³ Ibid, at [141].

His Honour agreed with Lord Hoffmann in *Chartbrook* that estoppel by convention must be clearly established. However, he questioned the need for it to be pleaded asserting that estoppel by convention is not a cause of action and only arises in response to a party contending the words should be given their ordinary meaning.¹¹⁴ However, this assertion is debateable given that some commentators have asserted that estoppel by convention is a cause of action.¹¹⁵

On interpretation of the disputed provision, his Honour concluded that the only commercially sensible interpretation was that \$6.50 per gigajoule was exclusive of transmission costs.¹¹⁶ In the alternative, his Honour relied on estoppel by convention. The extrinsic evidence showed that the parties had negotiated the agreement on the basis that "\$6.50 per gigajoule" was exclusive of transmission costs. Therefore, BoPE was estopped from relying on the ordinary meaning of "\$6.50 per gigajoule".¹¹⁷

Thus, the majority of the court held that support for an estoppel by convention claim based on a pre-contract understanding could be derived from pre-contractual negotiations. Therefore, *Vector Gas* provides clear authority for this proposition, as noted by Associate Judge Abbott in *Henderson v Henderson*.¹¹⁸ However, prior to *Chartbrook* and *Vector Gas*, there were a number of English and Australian authorities which cast doubt on whether an understanding or common assumption reached during pre-contractual negotiations could provide the basis for an estoppel by convention claim.

VI ESTOPPEL BY CONVENTION AND PRE-CONTRACTUAL UNDERSTANDINGS: DIFFERING VIEWS

The House of Lords and Supreme Court assumed it was well established that an understanding or common assumption reached by contracting parties in the course of their pre-contractual negotiations could provide the basis for an estoppel by convention claim. However, the following authorities have taken a different view of the issue.

A PW & Co v Milton Gate Investments Ltd

In this English High Court case, Neuberger J indicated that an estoppel by convention could not be based on an understanding or common assumption reached during pre-contractual

114 *Ibid*, at [130].

115 See McMeel, above n 1, at 18.21, who submits that estoppel by convention meets the criteria for a cause of action, and supports his point with reference to the *Texas Bank* decision.

116 *Ibid*, at [145].

117 *Ibid*.

118 *Henderson v Henderson* HC Auckland, CIV-2009-404-005557, 26 April 2010 at [45].

negotiations.¹¹⁹ His Honour relied on the reasoning of the English Court of Appeal in *Keen v Holland*.¹²⁰ In *Keen v Holland*, the Court of Appeal dismissed the estoppel by convention claim because the parties did not establish a common assumption upon which they regulated their subsequent conduct.¹²¹ Instead the common assumption was reached prior to the entry into the written contract.¹²² In the Court of Appeal's view, extending estoppel to cover situations where an understanding or common assumption was reached prior to entry into the written contract would amount to extending estoppel by convention further than had "yet been established by any authority".¹²³

Neuberger J recognised that the English Court of Appeal judgments in *The Vistafjord* and *John v George* supported the view that estoppel by convention is a "wide and flexible doctrine", and did not exclude the possibility of an estoppel arising before the contract was entered into.¹²⁴ However, his Honour asserted that those cases were not concerned with an estoppel that was based on a convention which had arisen from pre-contractual negotiations.¹²⁵ Therefore, in light of the Court of Appeal judgment in *Keen v Holland*, "it would be wrong to extend too readily the circumstances in which estoppel by convention can apply".¹²⁶ It is clear from these statements that, in his Honour's view, an estoppel by convention claim could not be based on an understanding or common assumption derived from pre-contractual negotiations.

B Johnson Matthey Ltd v AC Rochester Overseas Corporation

1 Material facts

In this case,¹²⁷ the plaintiff coated substrate, which was used in producing catalytic converters, and the defendant manufactured motor vehicles. The plaintiff and defendant entered into a joint venture for the manufacture of catalytic converters in Australia. Article 13.3 of the agreement allowed the defendant to terminate the contract by written notice if the plaintiff failed, in the reasonable opinion of the defendant, to be competitive with other responsible suppliers of coated substrate. Some years later, the defendant notified the plaintiff that they were terminating the

119 *PW & Co v Milton Gate Investments Ltd*, above n 10, at [162].

120 *Keen v Holland* [1984] 1 WLR 251.

121 *Ibid*, at 261F–262A.

122 *Ibid*.

123 *Ibid*.

124 *PW & Co v Milton Gate Investments Ltd*, above n 10, at [166].

125 *Ibid*.

126 *Ibid*, at [169].

127 *Johnson Matthey Ltd v A C Rochester Overseas Corporation*, above n 57.

agreement because the defendant had failed to be competitive, forming this opinion based on the prices of substrate from the United States.

The defendant raised estoppel by convention on the basis that there was a common assumption of fact between the parties that a comparison could only be made with another Australian supplier for the purposes of art 13.3. He sought to rely on the pre-contractual negotiations to prove the common assumption which provided the basis for the estoppel claim.

McLelland J excluded evidence of a common assumption reached during the pre-contractual negotiations for two reasons; the operation of the parol evidence rule and policy reasons in support of excluding from consideration evidence of pre-contractual negotiations.¹²⁸ However, his reasons are unconvincing and do not support the proposition that a common assumption reached during pre-contractual negotiations cannot provide the basis for an estoppel by convention claim.

2 *Parol Evidence Rule*

McLelland J held that the contract between the parties was wholly in writing. This was put beyond doubt by the entire agreement clause in article 18.9. Therefore, the parol evidence rule applied.¹²⁹ This rule provides that extrinsic evidence which adds to, varies or contradicts the terms of a written contract is inadmissible.¹³⁰ McLelland J believed estoppel by convention was in the nature of an agreement.¹³¹ Therefore, allowing evidence of pre-contractual negotiations to prove a common assumption and therefore establish an estoppel by convention claim would contravene the parol evidence rule and would be "subversive of the policy on which the rule is founded."¹³²

However, McLelland J misconstrued and misapplied the parol evidence rule. Evidence of pre-contractual negotiations to establish an estoppel by convention is not aimed at proving terms additional to, or differing from the written agreement. It is directed at proving that it would be unconscionable in the circumstances for one party to rely on the plain meaning of the contract, when the parties had a different common understanding.¹³³ Therefore, reliance on evidence of pre-contractual negotiations in this case does not contravene the parol evidence rule.

In addition, as pointed out in the United Kingdom Law Commission report on the parol evidence rule, the rule "no longer exists in the form suggested, causes no injustice and is now

128 *Ibid*, at 195.

129 *Ibid*.

130 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at [10].

131 *Johnson Matthey Ltd v A C Rochester Overseas Corp*, above n 57, at 195.

132 *Ibid*.

133 See *Vector Gas*, above n 3, at [73].

merely a feature in the historical development of the common law".¹³⁴ The rule no longer requires a court to exclude evidence which should be admitted in order to ascertain or give effect to the true intention of the parties.¹³⁵ Therefore, there can be little doubt that the rule does not exclude reliance on evidence of pre-contractual negotiations for the purpose of proving an estoppel by convention. The comments of the Law Commission have been supported by most leading texts, including *Chitty on Contracts*.¹³⁶ The editors of *Cheshire & Fifoot* also argue that it is unrealistic and impractical for the operation of the parol evidence rule to restrict the application of estoppel to the construction of written contracts.¹³⁷ This is because evidence of pre-contractual negotiations is admissible when estoppel is applied to the creation, variation and termination of contracts.¹³⁸

3 Policy reasons

McLelland J also argued that there were policy reasons in favour of excluding evidence of pre-contractual negotiations to support an estoppel by convention claim. These reasons are equally unconvincing. They have been consistently criticised by commentators in the context of admission of pre-contractual negotiations as an aid to interpretation of a contract.¹³⁹

First, his Honour asserted that allowing consideration of pre-contractual negotiations would "shake the security of written contracts".¹⁴⁰ On the contrary, this approach may increase certainty in contract law. As Lord Nicholls argued, allowing consideration of pre-contractual negotiations may actually increase certainty, because it may prove that the parties had a common understanding as the meaning or obligations, and prevent arguments being made that would otherwise be untenable.¹⁴¹ If parties know that support for an estoppel by convention claim can be derived from pre-contractual negotiations, it will prevent parties from making spurious arguments on the meaning of words in or obligations under a written contract that can be disproved by those negotiations.

134 United Kingdom Law Commission "Law of Contract – The Parol Evidence Rule" (Law Com No 154, 1986) at 1.6.

135 Ibid, at 1.7.

136 H Beale (ed) *Chitty on Contracts* (30th ed, Thomson Reuters (Legal) Limited, London, 2008) at [12-096]–[12-099].

137 Seddon and Ellinghaus, above n 52, at [10.3].

138 Ibid.

139 See David McLauchlan "Contract Interpretation: What is it about?" (2009) 31 Sydney L Review 5; D Nicholls "My Kingdom for a Horse: The Meaning of Words" (2005) 121 LQR 577.

140 *Johnson Matthey Ltd v A C Rochester Overseas Corp*, above n 57, at 195.

141 Nicholls, above n 139, at 587. Although Nicholls made this argument in the context of admission of pre-contractual negotiations as an aid to interpretation, it is analogous to estoppel by convention.

Secondly, McLelland J argued that evidence of pre-contractual negotiations is also "inherently less reliable" due to the passage of time.¹⁴² While evidence of pre-contractual negotiations is sometimes unreliable, often there will be a reliable exchange of correspondence (as in *Vector Gas*). Therefore, unreliability should not be a factor in determining whether evidence should be considered, but rather the weight that should be given to that evidence.¹⁴³

Thirdly, McLelland J adopted the view of Kirby P in *State Rail Authority of New South Wales v Heath Outdoor Pty Ltd*¹⁴⁴ that relying on pre-contractual negotiations as a basis for estoppel encourages expensive and time consuming litigation.¹⁴⁵ However, the cost and time involved in litigating disputes may be reduced if pre-contractual negotiations can prove an understanding or common assumption. Parties may not seek to rely on the plain meaning of the terms of the written contract if they know that the other party can prove they had a different common understanding as to the meaning of, or obligations under the written contract.

This case has been followed a number of times despite McLelland J's unconvincing reasoning for excluding evidence of pre-contractual negotiations. These authorities demonstrate that an estoppel by convention claim could be based on a common assumption or understanding reached during pre-contractual negotiations and was not as well established as the House of Lords and Supreme Court assumed.

C Whittet v State Bank of New South Wales

In this case,¹⁴⁶ Rolfe J declined to follow *Johnson Matthey*,¹⁴⁷ illustrating that it was unsettled in Australia whether an understanding or common assumption reached during pre-contractual negotiations could provide the basis for an estoppel by convention claim prior to *Chartbrook* and *Vector Gas*.

1 Material facts

The plaintiff's husband wanted a loan from the bank to support his business. The bank wished to take security in the form of a mortgage over the plaintiff and her husband's house. The plaintiff consented to the mortgage with the understanding that the bank's entitlement in the event of default

¹⁴² *Johnson Matthey Ltd v A C Rochester Overseas Corp*, above n 57, at 195.

¹⁴³ McLauchlan, above n 139, at 29.

¹⁴⁴ *State Rail Authority of New South Wales v Heath Outdoor Pty* (1986) 7 NSWLR 170. As noted by Derham, above n 7, at 868, Kirby P does not provide strong support for McLelland J's view because he was prepared to consider oral evidence to determine if it gave rise to promissory estoppel.

¹⁴⁵ *Johnson Matthey Ltd v A C Rochester Overseas Corp*, above n 57, at 195.

¹⁴⁶ *Whittet v State Bank of New South Wales*, above n 59.

¹⁴⁷ *Johnson Matthey Ltd v A C Rochester Overseas Corp*, above n 57.

by her husband was limited to \$100,000. However, the mortgage signed by the plaintiff and her husband was not limited to \$100,000 but was an "all moneys" mortgage.

As Rolfe J noted, if *Johnson Matthey* was followed, evidence of pre-contractual negotiations relied on by the plaintiff to prove an estoppel by convention, including evidence of an "arrangement" between the plaintiff's solicitor and the bank, would not be admissible. Without this evidence, the plaintiff would not be able to establish an understanding or common assumption, and would therefore be unable to establish an estoppel by convention. This would lead to an unjust result given the strength of the evidence of an understanding that the mortgage was limited to \$100,000.

2 *Clear and convincing proof*

Rolfe J took the opportunity to consider the reasoning of McLelland J in *Johnson Matthey* and, after careful consideration of the authorities, declined to follow it.¹⁴⁸ His Honour held that pre-contractual negotiations could be relied on to prove an understanding or common assumption, providing the basis for an estoppel by convention claim. It is the requirement of clear and convincing proof which protects the integrity of the written document.¹⁴⁹

D Ryledar Pty Ltd v Euphoric Pty Ltd

In this New South Wales Court of Appeal case, Tobias JA directly addressed the question whether evidence of pre-contractual negotiations was excluded by operation of the parol evidence rule.¹⁵⁰ His Honour noted the authorities for and against the proposition including Allsop J's comment in *Branir Pty Ltd v Owston Nominees (No 2) Pty Ltd*,¹⁵¹ that a common law rule about the construction of documents (parol evidence rule) should not override an equitable remedy based on unconscionability arising out of pre-contractual negotiations (referring to estoppel by convention).¹⁵² However, as argued above, the parol evidence rule should not be considered to operate to exclude evidence of pre-contractual negotiations for the purpose of proving an estoppel by convention, whether or not estoppel by convention is a common law or equitable doctrine.

Although this case would have been the perfect opportunity to clarify the present state of the law on the issue in Australia, his Honour did not find it necessary to decide the point, because, as in many other cases, the claim of estoppel by convention failed on other grounds.

¹⁴⁸ *Whittet v State Bank of New South Wales*, above n 59, at 153.

¹⁴⁹ *Ibid.* A high threshold of proof allows cases to be considered individually on their facts, which allows flexibility. This would not be the case if there were an absolute bar to consideration of pre-contractual negotiations.

¹⁵⁰ *Ryledar Pty Ltd v Euphoric Pty Ltd*, above n 61.

¹⁵¹ *Branir Pty Ltd v Owston Nominees (No 2) Pty Ltd* [2001] FCA 1833, (2001) 117 FCR 424.

¹⁵² *Ibid.*, at [446].

VII ESTOPPEL BY CONVENTION AND THE MEANING OF WORDS

The finding by the House of Lords and by the New Zealand Supreme Court that an understanding or common assumption reached by contracting parties during pre-contractual negotiations, including assumptions as to the meaning of words, could provide the basis for an estoppel by convention claim raises the question why common assumptions or agreements as to meaning are not considered at the interpretation stage. Under extreme versions of the objective approach to interpretation, evidence of the actual intentions of the contracting parties is rejected in favour of their presumed intention.¹⁵³ Therefore, evidence of common assumptions or agreements as to meaning is not admissible because it is merely seen as evidence of the subjective intentions of the parties. However, the private dictionary principle derived from *The Karen Oltmann* is perceived as an exception to this rule. It allows evidence to be adduced that parties had agreed that a word or words in a written contract would bear only one of two possible meanings.¹⁵⁴

Lord Hoffmann disapproved of the application of the private dictionary principle where parties have agreed on one of two conventional meanings of a word. Instead, he held that estoppel by convention would apply in this situation, preventing the exclusionary rule from causing injustice.¹⁵⁵ Like rectification, estoppel by convention lay:¹⁵⁶

[O]utside the exclusionary rule, since they start from the premise that, as a matter of construction, the agreement does not have the meaning for which the party seeking rectification or raising an estoppel contends.

However, as noted by Professor McLauchlan, the problem with this approach is that it assumes that words have a fixed meaning, when in fact words are given a specific meaning by the people who use them.¹⁵⁷ Professor McLauchlan succinctly makes the point:¹⁵⁸

If the parties have in fact negotiated on the basis of a common assumption that a particular term of their proposed contract has a certain meaning and the evidence establishes that meaning, then that *is* the meaning of the term.

153 David McLauchlan "Common Assumptions and Contract Interpretation" (1997) 113 LQR 237 at 241.

154 This was accepted by the New Zealand Court of Appeal in *Air New Zealand Ltd v Nippon Credit Bank Ltd* [1997] 1 NZLR 218 (CA).

155 *Chartbrook*, above n 2, at [45].

156 *Ibid*, at [47].

157 David McLauchlan "Interpretation and Rectification: Lord Hoffmann's Last Stand" [2010] NZLR 431 at 450.

158 *Ibid*, at 451.

This is the true principle derived from *The Karen Oltmann* and basically the approach of Tipping J in *Vector Gas*. Tipping J asserted that "if the parties have reached an agreement on what meaning an otherwise ambiguous word or phrase should have for their purposes, that definitional agreement is itself an objectively determinable fact".¹⁵⁹ His Honour added that "the existence of a definitional agreement is obviously relevant, indeed it should be decisive",¹⁶⁰ and on the facts before him, held there had been an agreement between the parties that "\$6.50 per gigajoule" was exclusive of transmission costs, and that this was therefore the meaning of the words in question. In the alternative, estoppel by convention applied, which rendered the same result.

In my view, the approach of Professor McLauchlan, applied by Tipping J in *Vector Gas*, is preferable to estoppel by convention where the parties have a common assumption or agreement as to the meaning of words in dispute. An agreement as to meaning should be decisive as a matter of interpretation. This is because there are a number of requirements that need to be established to prove an estoppel by convention, including detrimental reliance, which are unnecessary to prove if agreements as to meaning are decisive at the interpretation stage. Although the Court of Appeal endorsed *The Karen Oltmann* principle in *Air New Zealand Ltd v Nippon Credit Bank Ltd*, Tipping J was in the minority on this point in *Vector Gas*. All the other judges found in favour of *Vector Gas* through an objective approach to interpretation. They did not consider the agreement reached by *Vector Gas* and Bay of Plenty Energy in their pre-contractual negotiations as part of this approach. It remains to be seen whether Tipping J's approach gains widespread approval.

VIII ESTOPPEL BY CONVENTION AND THE EROSION OF THE EXCLUSIONARY RULE

The exclusionary rule is encapsulated in the third of Lord Hoffmann's restatements of the principle of contract interpretation in *Investors Compensation Scheme*. The admissible background in contract interpretation does not include evidence of previous negotiations of parties and their declarations of subjective intent.¹⁶¹ However, there are a number of situations in which the courts have found the exclusionary rule does not apply. Firstly, it is clear from *Chartbrook* and McGrath J's judgment in *Vector Gas* evidence of pre-contractual negotiations is admissible to establish relevant background facts.¹⁶² Secondly, *The Karen Oltmann* principle has been endorsed by the New Zealand Court of Appeal in *Air New Zealand Ltd v Nippon Credit Bank Ltd*, and effectively applied by Tipping J in *Vector Gas*, therefore evidence which proves an agreement as to meaning of

¹⁵⁹ *Vector Gas*, above n 3, at [32]. See McLauchlan, above n 139, at 25, who first suggested that a common assumption may be an objective background fact and therefore be admissible and determinative of the dispute between the parties.

¹⁶⁰ *Vector Gas*, above n 3, at [32].

¹⁶¹ *Investors Compensation Scheme Ltd v West Bromwich Building Society*, above n 4, at 912–913.

¹⁶² *Chartbrook*, above n 2, at [42]; *Vector Gas*, above n 3, at [70].

a word reached during pre-contractual negotiations is admissible.¹⁶³ Lord Hoffmann's restriction of the principle to unconventional meanings has not yet been followed in New Zealand. Thirdly, evidence of pre-contractual negotiations is admissible to establish a rectification claim.¹⁶⁴ Following *Chartbrook* and *Vector Gas*, evidence of pre-contractual negotiations is now admissible to prove an understanding or common assumption which provides the basis for an estoppel by convention claim.

In practice, the exclusionary rule has been eroded to an even greater extent than is recognised by the existence of the above exceptions. As Lord Nicholls has noted, parties already plead rectification to allow evidence of pre-contractual negotiations to be placed before a Judge in the hope it will influence their interpretation of the contract.¹⁶⁵ It is likely that parties will now plead estoppel by convention for the same purpose.¹⁶⁶

One question now remains to be answered; what is left of the exclusionary rule? With the struggle to maintain the line between objectivity and subjectivity, the courts have created a number of situations where pre-contractual negotiations are perceived to be "relevant" evidence and can be taken into account to prevent injustice from occurring. It now seems that the only evidence that is inadmissible is that of the subjective intentions of the parties. However, as noted by Tipping J in *Vector Gas*, this evidence is irrelevant. Through the creation of these exceptions, the evidence that is excluded by the rule is outweighed by the evidence that is admissible under the various exceptions. The courts have eroded the exclusionary rule to the point where one wonders if it now serves any useful purpose.

IX CONCLUSION

The scope of the doctrine of estoppel by convention has varied across jurisdictions in a number of areas, perhaps in part because it is a relatively recent doctrine, and its full potential has not yet been realised by the courts. There have been issues about the scope of the doctrine and these include whether estoppel by convention includes assumptions as to law, whether there is a requirement of unconscionability and whether it is a common law or an equitable estoppel.

One particular issue of importance is whether an understanding or common assumption reached between contracting parties during pre-contractual negotiations can provide the basis for an estoppel by convention claim. The House of Lords in *Chartbrook* and the New Zealand Supreme Court in *Vector Gas* simply assumed that an understanding or common assumption reached during pre-contractual negotiations could provide the basis for an estoppel by convention claim. This paper has

163 *Air New Zealand Ltd v Nippon Credit Bank Ltd*, above n 154.

164 *Chartbrook*, above n 2, at [42].

165 Nicholls, above n 139, at 578.

166 See *Chartbrook*, above n 2, at [35].

argued that the House of Lords and Supreme Court should not have assumed this because there was divergent authority in England, and the issue was unsettled in Australia.

In the case of *PW & Co v Milton Gate Investments*, Neuberger J doubted the ability of contracting parties to establish an estoppel by convention based on an understanding or common assumption reached during pre-contractual negotiations.

In Australia, there are two divergent lines of authority. The first line of authority begins with *Johnson Matthey*. In that case, McLelland J held that an understanding or common assumption reached during pre-contractual negotiations could not provide the basis for an estoppel by convention claim. Although his Honour's reasons are unconvincing, the case has been followed in a number of subsequent decisions.

Rolfe J in *Whittet v State Bank of New South Wales* declined to follow *Johnson Matthey*, and instead held an understanding or common assumption reached during pre-contractual negotiations could provide the basis for an estoppel by convention claim. In addressing McLelland J's argument that this would undermine the integrity of the written contract, his Honour held that it was the requirement of clear and convincing proof that would provide that protection.

The conflicting decisions of *Johnson Matthey* and *Whittet v State Bank of New South Wales* demonstrate that it is unsettled in Australia whether an understanding or common assumption reached by contracting parties during pre-contractual negotiations can provide the basis for an estoppel by convention claim. This was recognised by Tobias JA in the recent New South Wales Court of Appeal case of *Ryledar Pty Ltd v Euphoric Pty Ltd*.

In my view, the decisions of *Chartbrook* and *Vector Gas* give rise to two propositions. Firstly, where the evidence establishes a convention, then surely that is the meaning of the term. I agree with the approach of Professor McLauchlan and Tipping J that the existence of an agreement as to the meaning of words should be decisive in a contract interpretation dispute. This is because words do not have a fixed meaning, and therefore the meaning that the contracting parties agree on should be the meaning of the words in question. This is preferable to estoppel by convention, which requires a party to prove a number of requirements other than a common assumption as to meaning. It is a cumbersome means of holding parties to their bargain.

This development raises further questions about the role of the exclusionary rule. Presently there are a number of situations in which the exclusionary rule does not apply. Evidence of pre-contractual negotiations is admissible to establish known background facts, an agreement as to meaning (in accordance with the principle derived from *The Karen Oltmann* and the approach of Tipping J in *Vector Gas*) and to establish a rectification claim. Following *Chartbrook* and *Vector Gas*, evidence of pre-contractual negotiations is now admissible to establish an estoppel by convention claim. This is yet another avenue for a party to place pre-contractual negotiations in front of the judge in the hope of influencing their interpretation of the contract. This begs the question; what is left of the exclusionary rule, and does it have a place in contract interpretation?