BUDDLE FINDLAY

Legal update on litigation and dispute resolution - July 2015

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Entry of arbitral award as a judgment unnecessary before using it for statutory demand

The High Court has confirmed that there is no need to enter a foreign arbitral award as a judgment before using it as the basis for a statutory demand.

In *Makan Distiller Limited v Natural Sugars (New Zealand) Limited* [2015] NZHC 1111 the respondent had issued a statutory demand seeking payment of the sum awarded by an overseas arbitral tribunal. The applicant contended that the demand was invalid as the award had first not been entered as a judgment pursuant to the Arbitration Act 1996 (Act) or otherwise enforced by action. It also submitted that the Court ought not to recognise the award for reasons of public policy, given that it was made under foreign law, in a foreign suit, in a short form arbitration with a decision made only on the papers, without reasons and without any right of appeal.

Associate Judge Bell dismissed both arguments, finding that:

- A foreign award may be recognised without being enforced. Thus, an award that has not yet resulted in a judgment may still be used to prove that the successful party is a creditor of the other party, for example, to claim in a liquidation, or for the purpose of a statutory demand
- There were no public policy reasons to set aside the demand. The parties had freely submitted to a foreign arbitration before a specialist body well able to determine disputes in a consistent manner. The provisions for short form arbitration simply enabled the parties to have their disputes determined quickly and efficiently on the papers, without being put to the expense of a hearing in person.

The judgment appears to give the green light to base a statutory demand on an arbitral award, without first "enforcing" it, if the other party fails to honour the award. However, care must still be taken to ensure that the general criteria for a valid statutory demand are met, as set out in section 289 of the Companies Act 1993.

Mitigation: a double-edged sword

It is a fundamental principle of contract law that a party claiming breach of contract cannot recover damages for losses it would not have suffered if it had taken reasonable steps to mitigate its loss. As a recent decision of the English High Court illustrates, there is a risk that mitigating too successfully may result in a reduction of the damages that would otherwise have been payable.

In *Thai Airways International Public Company Ltd v KI Holdings Co Ltd & Another* [2015] EWHC 1250 (Comm), the defendant had failed to deliver airline seats to the plaintiffs within the contractual timeframe. In mitigation, the plaintiff acquired alternative seats from a third party but, in the meantime, had to store its planes for 18 months and lease replacement aircraft. The total cost resulting from these actions was $162 million.

The defendant contended that the damages awarded to the plaintiff needed to be reduced to take into account the profits it had earned from operating the leased planes and the fuel savings it made as a result of the replacement seats being lighter than the originals.

The Court agreed with the defendant, holding that in breach of contract cases, credit must be given for any monetary benefit resulting from an action reasonably taken by a plaintiff to mitigate its loss. Thus, it was right to take into account profits and fuel savings when assessing damages. However, the burden of proof to establish the existence of any benefit, and its amount, was borne by the defendant.

The legal position in New Zealand is similar. Our courts have also held that "betterment" must be taken into account but have recognised that assessing the benefit to the plaintiff is not a mathematical exercise. Rather a variety of factors must be weighed

up, including the value of the betterment as a proportion of the contract and the extent to which the defendant's actions led to the necessity of the actions leading to the betterment.

Agreements to arbitrate may terminate with the contract

The recent case of *Minister of Education v PXA Ltd* [2015] NZHC 1330 illustrates that contractual agreements to arbitrate may not survive the completion of the contract.

The case involved claims by the Minister of Education against various parties involved in the allegedly defective construction of a school. When one of the defendants applied to stay the Court proceedings in favour of a contractual agreement to arbitrate, the Minister successfully opposed the application on four grounds. Two of these are discussed below.

First, the Court held that the arbitration agreement was "inoperative" in terms of article 8(1) of Schedule 1 to the Arbitration Act 1996 (Act). It held that this term was apt to describe an agreement, which whilst once applicable, was no longer so due to the passing of time, a change of circumstances, or both.

In finding that the agreement was only intended to apply during the currency of the contract, the Court was influenced by the features of the contract, including the following:

- It provided for the architect to have a primary role in ruling on the dispute. It was unlikely that the architect would have this role after the works had been completed
- There were strict time limits applying to the commencement of mediation and arbitration. This suggested urgency consistent with a dispute resolution process taking place during the life of the contract
- The right to take Court proceedings was limited to recovering undisputed payments or taking urgent injunctive or declaratory proceedings
- The contractor was not entitled to suspend works during the dispute resolution process.

The Court also held that the arbitration agreement was unenforceable as it did not meet the requirement under the Act that where a party is a consumer, it must certify in a separate written document that it has read and understood the arbitration agreement. In reaching this conclusion, the Court necessarily held that the school's Board of Trustees was a "consumer", rather than a body acting in trade.

The decision contains two important lessons for parties negotiating contracts specifying arbitration as the preferred method of dispute resolution:

- If arbitration is intended to apply to all disputes, regardless of whether they arise before or after the conclusion of the contract, make this clear from the outset
- Where one of the parties is clearly in trade but there is any prospect that another might be taken not to be, that party should sign a separate written document confirming that they have read and understood the arbitration clause.

Contractual interpretation: the High Court lays out the rules

The decision of the High Court in *New Zealand Carbon Farming Limited & Another v Mighty River Power Limited* [2015] NZHC 1274 contains a useful summary of the principles currently applicable to contractual interpretation under New Zealand law.

The case involved a dispute between the parties over the construction of an agreement for the sale and purchase of carbon credits. Before turning to the contentious clauses of the agreement, the Court confirmed that the following principles are relevant to interpreting contractual provisions:

- The starting point is the meaning that the document would convey to a reasonable person with the background knowledge reasonably available to the parties at the time of the contract. A purposive or contextual interpretation is not dependent on there being an ambiguity in the contractual language.
- If a particular meaning produces a commercially absurd result, that is a reason to read the contract in a different way than the language might suggest. This does not mean that a court may conclude that a contract does not mean what it seems to say simply because it is unfavourable to one party. A conclusion that the natural meaning of the contract produces a commercially absurd result should be reached only in the most obvious and extreme of cases.
- As to pre-contractual negotiations, exchanges which construed objectively tend to establish background facts known to both parties are relevant. So too are exchanges in negotiations which, construed objectively, cast light on meaning. However, material created by one party that is not communicated and relates to its subjective understandings and beliefs is irrelevant.

- Subsequent conduct is admissible as an aid to interpretation, although the approach to this is not free of judicial disagreement. The Supreme Court is divided as to whether such conduct must be mutual or shared or whether unilateral conduct may be taken into account.
- A "private dictionary" agreed between the parties as to the particular meaning a word is to bear may be relevant.

In the case at hand, the Court applied the above principles to find both for and against the plaintiffs on the five interpretation points in contention. The parties have been invited to make submissions as to the orders or declarations they seek to be made in light of those findings.

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