



## **Daventry District Council v Daventry District Housing Ltd [2011] EWCA civ 1153**

### **Rectification “A Potential Conundrum”**

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#### **Introduction**

1. The local authority, Daventry District Council (“DDC”), succeeded in its claim against a registered social landlord (“RSL”) for rectification of a clause in a housing transfer contract, but only on appeal, and only by a majority decision. Moreover, the three judgments in the Court of Appeal (delivered on 13th October 2011) reveal markedly differing approaches to the law of rectification for common mistake, as applied to the unusual facts of this case. The decision also throws up questions about rectification for unilateral mistake and in particular whether dishonesty is required.

#### **Background**

2. DDC transferred its residential housing stock to the RSL under a transfer contract. As well as the housing, some of DDC’s staff were transferred to the RSL. The transferring staff were members of DDC’s pension scheme (part of the Local Government Pension Scheme “LGPS”) and the transfer had to cater for their pension arrangements in the future. It was agreed that the RSL would take over responsibility for the transferring employees’ pensions within the LGPS, but those pensions would be fully funded as at the transfer date. Because DDC’s pension fund was in deficit at that time, additional funding had to be injected into the pension scheme to make good the deficit attributable to the transferring employees, so that their benefits were fully funded at the transfer date.
3. The mechanism for ensuring that the pension deficit attributable to the transferring employees was made good as at the transfer date was the subject of DDC’s rectification



claim. It was common ground that the parties agreed a reduction from the purchase price to be paid by the RSL to DDC for the housing stock in the sum of £2.4m, representing the agreed estimate of the amount of the pension deficit attributable to the transferring employees. DDC maintained that it was also agreed that the RSL would then pay the £2.4m over to the administrators of the pension scheme, thereby making good the deficit referable to the transferring employees. In this way, the deficit was to be made good by means of a payment effected by the RSL, but in effect funded by DDC: the price reduction in effect left £2.4m in the RSL's hands which would otherwise have been paid to DDC. This mechanism resulted in a saving on the levy payable by DDC on the purchase price and was recognised in guidance published by central government as a legitimate levy reduction method.

4. The RSL disputed that it was ever agreed that it would pay £2.4m to the pension scheme. It maintained that, in return for the £2.4m purchase price reduction, it agreed to pay DDC an additional £2.4m from anticipated VAT recoveries, leaving DDC no worse off and achieving the same levy saving. DDC did not accept that, arguing that the additional money from the VAT recoveries was in fact only worth £1.2m, since it was agreed that the VAT recoveries would be shared 50:50 in any event, and that this extra £1.2m represented the RSL's agreed 50% contribution to the pension deficit, in return for DDC agreeing to pay 50% of certain costs incurred by the RSL.
5. The transfer contract unambiguously provided for DDC and not the RSL to make the £2.4m payment to the pension scheme. DDC contended that this was a mistake and claimed rectification.

### **The Court of Appeal's decision**

6. The trial judge (Vos J) dismissed DDC's claim. The Court of Appeal allowed an appeal by a majority decision (Lord Neuberger MR and Toulson LJ, Etherton LJ dissenting) upholding the rectification claim on the ground of common (or mutual) mistake. The majority judgments suggest that, if it had been necessary, they might well have allowed the appeal



on the alternative ground of unilateral mistake, but the dissenting judgment rejected the unilateral mistake claim.

7. In considering the common mistake claim, the Court of Appeal had to consider the effect of Lord Hoffmann's judgment in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1AC 1101, and in particular the requirement that the parties' contractual intentions must be assessed objectively. Although Lord Hoffmann's statements about rectification in the *Chartbrook* case were not necessary to the decision in that case (and are therefore not binding on lower courts), they are nevertheless of great weight as persuasive and authoritative statements of opinion. The Court of Appeal decided to accept the correctness of the principles as stated by Lord Hoffmann, although Toulson LJ was clearly uncomfortable about this (see paragraphs 157 and 172-181).
8. The Court of Appeal noted Lord Hoffmann's approval of the summary of the principles applicable to common mistake given by Peter Gibson LJ in *Swainland Builders Ltd v Freehold Properties Ltd* [2002] 2 EGLR 71 and, noting Lord Hoffmann's statement that the parties' intention must be assessed objectively, re-phrased the principles as: (1) the parties must have had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the document to be rectified; (2) which existed at the time of execution of that document; (3) the common continuing intention must be assessed objectively; and (4) by mistake, the document does not reflect that intention (see Etherton LJ at paragraph 80).
9. The problem in the present case, which gave rise to the differences between the judges in the Court of Appeal, centred on events that occurred after a non-binding agreement in principle (similar to heads of terms) had been agreed but before execution of the formal contract. The key question was whether those events showed that the common intention evidenced by the prior agreement in principle ceased before execution of the contract because one party changed its mind before completion. The problems were exacerbated by differences between the parties' subjective intentions (i.e. what the evidence showed they actually intended) and their intentions as objectively ascertained (i.e. what an observer would reasonably conclude them to have intended, given what they did and said).



Those differences arose because the RSL's principal representative (Mr. R) was fully aware of DDC's subjective understanding and contractual intention, and knew that this was contrary to what he had caused his own board to understand and intend, but deliberately refrained from telling either party that the other understood the deal differently.

10. This led to the position that: (i) DDC (subjectively) intended that the RSL would make the £2.4m payment; (ii) Mr. R knew this; (iii) the terms agreed in principle (objectively understood) were that the RSL would pay the £2.4m; (iv) but Mr. R presented those terms to the RSL's board in such a way that it (subjectively) believed and intended that DDC would pay the £2.4m; (v) the final contract obliged DDC to pay the £2.4m.
11. So, DDC (rightly) believed that the prior accord (i.e. the non-binding agreement in principle) was that the RSL would pay the £2.4m; but it wrongly believed the final contract provided for this (having mistakenly failed to notice the true effect of the contract). By contrast, the RSL wrongly believed that the prior accord was that DDC would pay, but it was right in believing that this is what the contract provided for. In this sense, both parties were mistaken, but their mistakes were different: DDC's was as to the effect of the contract, the RSL's was as to the (objectively) agreed terms.
12. This difference between the nature of each party's mistake is what gave rise to Toulson LJ's concern about the objective approach to ascertaining the parties' contractual intentions which *Chartbrook* requires. As he said (see paragraph 177), in these circumstances rectification would bind one party (here, the RSL) to a bargain which it did not intend.

### **Analysis**

13. It was common ground (on the appeal at least) that the non-binding agreement in principle was that the RSL would make the £2.4m payment to the pension scheme: that is what an objective interpretation of the contemporaneous documents showed. As noted above, that was in line with DDC's subjective intention throughout, but was contrary to the RSL's subjective intention: it never intended to make the £2.4m payment and, as a result of Mr. R's actions, it understood and intended that DDC was to make this payment. Despite that subjective understanding at board level, it was held that an objective observer would have



concluded that the deal recorded in the agreement in principle was that the RSL would make the £2.4m payment. There was therefore a common “prior accord” that the RSL would make the £2.4m payment.

14. It was also common ground that the final form of the contract as executed unambiguously provided for the payment to be made by DDC. That accorded with the RSL’s subjective intention, but was contrary to DDC’s subjective intention.
15. So the final form of the contract was the polar opposite of the “prior accord”. The central question, therefore, was whether the final form of the contract accorded with the parties’ common intention, as objectively ascertained, at the time of its execution. That brought into sharp focus the circumstances surrounding the inclusion of that provision in the final form of the contract. The clause in the contract which required DDC to make the £2.4m payment was introduced as an 11<sup>th</sup> hour amendment (and importantly not by the RSL or DDC but by the RSL’s funders) during the drafting process conducted by the parties’ solicitors and after the agreement in principle had been finalised.
16. Etherton LJ identified the relevant question as being whether, on an objective assessment, the proposal of that clause (by the RSL’s bankers) showed (objectively) that the RSL had changed its mind and intended DDC to make the £2.4m payment. He concluded (as the trial judge had also concluded) that it did: a reasonable observer would conclude that the RSL communicated to DDC that it intended to contract on different terms to those set out in the agreement in principle (see paragraphs 91 to 93). In short, the common intention recorded in the prior accord did not continue up to the point of execution of the contract.
17. Lord Neuberger agreed that Etherton LJ had posed the correct question, but he gave the opposite answer: a reasonable observer would conclude that the RSL had made a mistake in proposing the clause which achieved the opposite result to that set out in the “prior accord” (see paragraphs 207-216).
18. Toulson LJ thought that the approach adopted by the other two judges led to a conundrum (see paragraphs 158-159). That approach focuses on the proposal and approval of the final



form of the document and asks whether it shows a change of mind. But the final form of a document will almost always have been approved in some way (albeit by mistake) before it was executed and rectification of that document will only be required if on an objective analysis its effect is different from the effect of the prior accord. If the proposal or agreement of the final form of the document is to be taken, objectively, as indicating a change of mind or agreement to a different deal, rectification could never be obtained. Hence the conundrum: if this approach were applied strictly, it would “...undermine the very purpose of rectification, which exists for the correction of mistakes” (158).

19. Toulson LJ resolved the conundrum by posing a different question. Given the starting point of the common intention set out in the prior accord, he asked whether, objectively assessed, during the process leading up to execution of the final contract, there had been any intention to depart from or vary that common accord (see paragraphs 160 and 170). He answered that question in the negative: an objective observer would not conclude that, during the process of drafting the contract, the parties were intending to negotiate different terms to those embodied in the agreement in principle.

## Discussion

20. The three judges in the Court of Appeal were clearly influenced, albeit in different ways, by their perceptions of the merits of the claim: whether DDC ought to be granted rectification of the contract in the light of Mr. R’s conduct, weighed against its own failure to spot the change in the contract, which, although only introduced at the 11<sup>th</sup> hour by solicitors acting for 3<sup>rd</sup> party lenders, was in clear terms. Toulson LJ had “ no qualms about the justice of the result “ (182); any concerns which Lord Neuberger had about landing the RSL with a rectified contract that it may never have agreed to were “dispelled” by Mr. R who “carried a great deal of the blame for the misunderstanding that had arisen” (220).
21. This emphasis on the conduct of Mr. R and the failure of DDC to spot the change to the contract could have led to a decision based on unilateral mistake (i.e. that of DDC as to the effect of the contract and whether it gave effect to its intentions). That would have required greater analysis of whether unilateral mistake requires proof of dishonesty by the



non-mistaken party in failing to draw the other party's attention to its mistake. Again, there appeared to be a division of opinion on this point, with Etherton LJ concluding that dishonesty was necessary and had not been proved on the judge's findings of fact (paragraphs 95-99), while Toulson LJ thought it at least possible that a less rigid approach should be taken to the degree of knowledge of the other party's mistake that is required – the relevant knowledge being “...easier to judge than define” (see paragraph 184).

22. The odd results to which the requirement for an objective assessment of the parties' intentions gave rise in this case are largely due to the complex and unusual facts; it is to be hoped that those principles will usually deliver a more straightforward result. Nevertheless, the analysis of the principles applicable to common mistake rectification and the framework for identifying the key issues could be of use in other cases. Further development of the principles for unilateral mistake rectification will have to wait for another day.

### **1 November 2011**

**Jonathan Evans** (Wilberforce Chambers) and **Colin Ricciardiello** (Sharpe Pritchard) were respectively junior counsel and solicitor for DDC.

This note does not provide specified legal advice and should not be acted or relied upon as doing so. If you would like further information or specific advice, please contact Colin Ricciardiello (0207 405 4600 or [cricciardiello@sharpepritchard.co.uk](mailto:cricciardiello@sharpepritchard.co.uk))