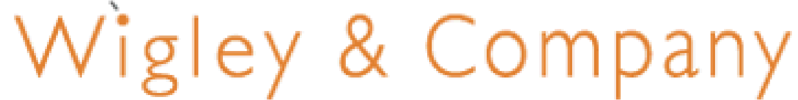

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QUEEN'S COUNSEL BATTLES AIR NEW ZEALAND: CAN A SUPPLIER UNILATERALLY CHANGE CONTRACT TERMS?

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How does a vendor, selling to multiple customers, change its standard contract terms? In practice it is largely impossible to get every customer to sign up to new terms. An October 2004 High Court decision (*Barton v. Air New Zealand*) suggests some solutions and pitfalls.

Air New Zealand in its Koru Club membership contract reserved the right to change the terms of the agreement, the rights of access to Koru Club lounges and so on. The Koru Club changed George Barton QC's access midway through his Koru Club membership, so that members could not visit lounges when they weren't flying. Dr Barton unsuccessfully challenged this in Court. In doing so, the case teased out some of the ways in which vendors selling to multiple customers can change the terms applicable to particular services (and the situations where that is difficult or risky).

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1 Why did George Barton QC sue Air New Zealand?

1.1 Dr Barton renewed his Koru Club membership for two years in 2001, at a time when members could use Koru Club lounges when they weren't flying. However, for operational reasons, in June 2002, Air New Zealand wrote to members advising that they could only use the lounges when they were flying.

1.2 Several months later, Dr Barton tried to access the lounge when his granddaughter was traveling and he wasn't. But access was refused.

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1.3 While ultimately unsuccessful, it's good to see senior lawyers pursuing public interest cases such as this. It's a reminder of Dr Barton's involvement many years ago in litigation around getting inexpensive access to the predecessor to our High Court Rules, without having to go to the cost of buying an annotated version of the Rules (then, *Sim on Procedure* and now *McGechan* as well).

2 The Koru Club Contract

2.1 Without going fully into the details[1], the Koru Club contract allowed Air New Zealand to change its terms and conditions *"… at any time with or without notice as Air New Zealand may decide in its absolute discretion"*. Another clause confirmed that Air New Zealand does not guarantee or warrant Koru Club rights and privileges *"… will be available or will be available at any time or place … "* and that Air New Zealand is not liable for any loss etc. The agreement went further to confirm that Air New Zealand *"… reserves the right in its absolute discretion to withdraw, cancel, vary, or in any way change, at any time without notice, any of the Privileges offered or advertised as available to the Member … "*. There was a further clause dealing specifically with reservation of Air New Zealand's right to restrict, limit, curtail or discontinue the availability of any lounge or facility in its absolute discretion. In short, Air New Zealand could change the agreement and its services any way it wanted before the contract ended.

2.2 Dr Barton accepted that, for reasons of regulating the extent of access to lounges, some changes and restrictions on lounge access were appropriate under the contract. But such possible changes could not extend too far. The Judge concluded that the change made by Air New Zealand (enabling access only when the member is flying) was *"… in the nature of regulation of access to the lounges rather than an abrogation of Privileges"*. Therefore, subject to the following issue around illusory contracts, Air New Zealand could do what they did (that is, midway through the contract, unilaterally alter rights of access to the lounge in this relatively limited operational way).

3 Illusory Contract?

3.1 The terms in the Koru Club contract give extremely wide, if not unfettered, ability to Air New Zealand to completely change any or all of the terms of the members' agreements during their course. Contracts of course are built on consideration[2]. Consideration is a fundamental feature of contracts.

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[1] Which are set out in the Judgment: *Barton v. Air New Zealand* (France J, 6 October 2004: CIV 2002-485-838 (Wellington Registry)).

[2] Although there is some dilution of that fundamental principle of the law of contract. See our article, *Heresy: Consideration not needed in Contracts* (*http://www.wigleylaw.com/HeresyConsiderationNotNeededInContracts.html*).

Consideration must pass both ways (eg: somebody pays me $1,000 and I sell that person my car). Enter the "Illusory Contract" principle. Under that principle, consideration for a contract will be "illusory" where it consists of a promise, the terms of which leave the performance entirely to the discretion of the promisor. Here, Dr Barton argued that, as Air New Zealand had full discretion as to whether and how to perform the contract, the consideration for the contract was illusory. This judgment is not clear on what would happen if it was held to be illusory, although presumably the contract would be unenforceable as it didn't exist, and Dr Barton at least could get a refund of his fees.

3.2 The general principle is that the Courts will endeavour to give effect to contracts (particularly those between commercial parties) however they are framed. That is so even if they include some discretion in favour of a particular party. But some decisions hold that the discretion given to a particular party can be so substantial that the consideration for the contract is illusory and the contract cannot be enforced.

3.3 Where the line is drawn between "illusory" and enforceable contracts is not entirely clear, as is apparent from the *Barton v. Air New Zealand* decision. The Judge however did not deal with this issue, concluding instead that Air New Zealand had in fact delivered on the majority of the services it had promised to do, and Dr Barton's position did not turn on Air New Zealand's ability to change all its terms and conditions. The Judge's decision was narrower. Only of relevance was the fact that Air New Zealand was making a change of a limited regulatory nature to restrict non-traveller access to the Koru lounges (and not some wider position around the ability to change all or many terms and conditions).

3.4 It remains arguable that, nonetheless, the unilateral ability to change all terms and conditions is material, even though Air New Zealand performed the majority of what was anticipated under the agreement. It is arguable that the consideration either is or is not illusory at the outset. Generally this problem can't be fixed by actual performance.

3.5 Whatever the answers, for this reason, it may be prudent for suppliers **not** to reserve full rights to change all or most terms and conditions during the course of a contract without more.

3.6 We query whether there might be an argument available that a clause, which in itself creates illusory consideration, could be severed from the otherwise enforceable terms of the contract to make it binding. As a Law Review article referred to the Judgment notes[3]:

[3] Lucke, *Illusory, Vague & Uncertain Contractual Terms* (1977) 6 Adelaide Law Review 1,3.

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"An illusory option of renewal in a lease, for example, will not normally invalidate the whole lease since its severance should not present undue difficulties".

4 Practical Implications

4.1 A supplier with numerous customers (typically on standard form terms) faces an impossible nightmare in getting new terms in place even at the end of the term of a contract, if it wants to get all those customers to sign up to the new terms. While ideally that should happen (particularly with high risk and/or mission critical types of supplies), in practice it is very difficult.

4.2 Suppliers tend to find that they have no choice but to take the risk of sending out amended terms by mail (without expecting any response) rather than getting new terms signed up. This is typically what the banks do of course when, for example, they amend their terms.

4.3 Many suppliers (and certainly those in the Telecommunications and IT sector) will want to reserve the ability to change terms midway through a contract and before it terminates. This is what Air New Zealand did of course. Likewise in employment contracts. A very good example of this is an acceptable use policy (AUP) for computer and online use. These generally do (and certainly should) form part of an internet or employment contract, yet be able to be updated during the course of the contract to meet new threats, technologies, security issues, and so on.

4.4 While there is some risk around reserving the right to change all or many of the overall terms and conditions including the AUP, it is likely to be valid and prudent to expressly reserve the right to do so in relation to specific issues such as the AUP.

4.5 If it is important for the vendor to reserve a wide ability to amend terms during the course of the contract, there may be ways of doing this which are legally enforceable. For example, a clause which allows major change to the terms at the vendor's total discretion, and gives the customer the right to terminate the service at that point and, for example, get a refund of fees, is more likely to be enforceable.

4.6 One of the potential pitfalls with changing terms in this way (such as by mailing out the terms to a customer) is proving that the terms have in fact been mailed out. There will always be a risk in this area (just as there will be in similar circumstances online (the click accept equivalent)). But, for the practical reasons noted above, that risk is often unavoidable, although if the new terms relate to particular high risk and mission critical issues, the supplier should consider whether it has no choice but to get revised terms actually accepted by signature.

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