

CONSTRUING COMMERCIAL CONTRACTS

- THE BACKGROUND, THE PURPOSE OR THE WORDS?

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Since this conference last year our courts have continued with their regular work of interpreting commercial bargains. The efficient despatch of that work is of vital importance if the courts are to serve the needs of parties to commercial agreements. Last year my paper highlighted the controversy which seemed to then be developing concerning the extent to which the background to an agreement should be reviewed to assist in arriving at the meaning of the agreement.

The statement by Lord Hoffman in *Investors Compensation Scheme Ltd v West Bromwich Building Society*¹ (“**Investors**”) that the background was “absolutely anything” which might assist the court in construing the agreement had caused some concern with commercial lawyers. The concern was that an approach to interpretation was emerging which would allow extensive reference to background material to arrive at the meaning of the words used in the contract when such a process was unnecessary. The fear was that the natural and ordinary meaning of the words which the parties had chosen to express their agreement would be lost in detailed consideration of all available background to the commercial bargain, with the background material then being used to arrive at a meaning of the contract which was “fair” in the eyes of the court.

There was a significant reaction to Lord Hoffman’s comments and, by the time of the seminar, the courts in both New Zealand and England (including Lord Hoffman himself) had moved to emphasise that the comments he had made on interpreting commercial contracts in *Investors* did not really involve anything radical in contractual interpretation.² The orthodox approach to the construction of contracts has been continued in cases in the last year before the New Zealand courts and before the Privy Council.

Our courts have heard a range of cases concerning the interpretation of agreements in differing commercial contexts. The cases have covered the sale or development of land³, an alleged agreement for the sale of shares in a dairy cooperative⁴, the interpretation of an

¹ 1998 1 WLR 896 912-913; Lord Hoffman’s general restatement was adopted in our Court of Appeal in *Boat Park Ltd v Hutchinson* [1999] 2 NZLR 74 and *Valentines Properties Ltd v Huntco Corporation Ltd* [2000] 3 NZLR 16, a decision which was reversed in the Privy Council without comment on the general principles.

² See e.g. the statement in *WEL Energy Group Ltd v Electricity Corporation of New Zealand Ltd* [2001] 1 NZLR 523 (CA) and the orthodox approach of the Privy Council in *Valentines Properties Ltd v Huntco Corporation Ltd* [2001] 3 NZLR 523 (CA).

³ See e.g. *Bonnar v Summerland Property Developments Ltd* 04/07/02, Heath J, HC Auckland, 134-1M02

⁴ *Mount Joy Farms Ltd v Kiwi South Island Co-Operative Dairies Ltd* [2002] BCL 100 (CA)

indemnity given against claims on the sale of a business.⁵ Somewhat unusually, the Court of Appeal has had to construe the limitation of liability provisions in a bill of lading – a key commercial document in the international sale of goods⁶. There have also been a number of cases where applications for summary judgment based on the construction of documents have been refused because the construction was not clear on the agreement itself and there was insufficient background or material relevant to the factual matrix before the court⁷.

Most judgments in the cases begin with a standard reference to the *Boat Park* and *Investors* principles. The decisions in the cases tend to show that the New Zealand courts see this as a reference to orthodox principles of contractual interpretation. The focus of the exercise of interpretation remains on the words of the commercial bargain. The provisions of the contract must be construed in the context from the perspective of a reasonable commercial man. The cases do not show any enthusiasm to extend the idea of background to which reference can be made and the approach to the factual matrix which excludes reference to previous negotiations and drafts holds good. The question of the relevance of conduct after the contract is undecided.⁸

The “commercial” approach

The commercial courts have long moved away from literalism. Most cases in which an issue of contractual interpretation arise begin with a statement of the kind made by the Court of Appeal in *Mountjoy Farms Limited v Waipahi Dairy Farm Limited & Ors*:⁹

The day has long since past in our courts where words are to be given a purely literal meaning. The words used are to be given their natural and ordinary meaning, and having regard to what those words as used in a document would convey to a reasonable person who has all the background knowledge which would reasonably have been available to the parties in the situation which they were at the time of the contract.

The courts continually emphasise the need for commonsense in approaching the construction of commercial bargains. This has been the thrust of many comments by commercial judges in England where the courts are most anxious to ensure that merchants remain confident in the courts. This is a well established concern for commercial commonsense. In *Hamilton v Mendes*¹⁰, Lord Mansfield famously observed:

⁵ *Tower Ltd v McConnell Dowell Corporation Ltd* [2002] 3 NZLR 280 (HC)

⁶ *Dairy Containers v The ship “Tasman Discoverer”* [2002] Lloyd’s Rep 528, NZCA; also [2002] 1 NZLR 265 (HC)

⁷ See eg. *McRae v Kale* [2002] BCL 421 (HC)

⁸ The New Zealand courts seem to allow such reference, see e.g. *Valentines* supra fn1; *A-G v Dreux Hldgs Ltd* (1996) 7 TCLR 617 although the position cannot really be regarded as certain.

⁹ [2001] NZCA 372

¹⁰ (1761) 2 Burr 1198 at 1124; 97 ER 787 at 795

The daily negotiations and property of merchants ought not to depend upon subtleties and niceties; but upon rules, easily learned and easily retained, because they are the dictates of common sense, drawn from the truth of the case.

These observations were recently repeated by Lord Bingham in *Owners of cargo lately laden on board "Starsin" & ors v Owners and/or demise charterers of "Starsin" ("The Starsin")*¹¹ case, where the House of Lords had to decide whether a bill of lading was a contract with the owner or the charterer of a ship, by examining the signature provisions on the bill, and their Lordships were most anxious to arrive at a conclusion which would make sense to a commercial man.

A general commonsense approach to the construction of a commercial bargain is perhaps exemplified by the statement of Lord Diplock in *Antaios Cia Navaera SA v Salen Rederiana AB*:¹²

If a detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense.

All this means is that the courts will use good business sense in determining what the words of a contract mean. It does not mean that the approach to interpretation allows a subjective view of the commercial purpose of the agreement to override the natural ordinary meaning of the commercial bargain. This is a question of balance where a court will be choosing between competing meanings, but, our courts have often warned of the dangers where courts go too far in applying a view of purpose to the exercise of construing a contract and disregard the words which the parties have chosen in their contract.¹³

A court construing a commercial contract should assume that commercial parties intended their bargain to function in accordance with the clear and natural meaning of the words used in it, rather than in accordance with some other meaning which might be available if the background is considered and a particular view of the commercial purpose is taken.

I will now review two recent cases. The first strongly underlines an orthodox approach to construction.

An orthodox approach to the construction of a commercial contract was adopted by the Privy Council on *Canterbury Golf Ltd v Hideo Yoshimoto* ("**Yoshimoto**")¹⁴. The Privy Council

¹¹ [2003] UKHL 12 page 6,7

¹² (1985) AC 191 HL at 201.

¹³ See eg. *Attorney General v Forestry Corporation of New Zealand Limited* [2000] 3 NZLR 172 at page 19 para 60 and 61.

¹⁴ [2002] UKPC 40

showed itself unwilling to allow consideration of background or purpose to deflect from the primary task of construing the words of the agreement.

In the Court of Appeal, Justice Thomas had invited the Privy Council to take up his suggestion that reference to the background to the transaction should include evidence of earlier negotiations and draft agreements. He suggested that the time to depart from the approach set out by Lord Wilberforce in *Prenn v Simmonds*¹⁵ had arrived. In *Prenn v Simmonds* Lord Wilberforce had said that evidence of pre-contractual negotiations was generally unhelpful in construing an agreement and should not be considered as part of the background. Such evidence would often reflect the view of one party or the other and, in any event, the parties had chosen to express their agreement in the contract. Earlier negotiations and drafts had been overtaken by the agreement actually entered into.

In allowing the appeal, the Privy Council expressly refused to enter into any debate about evidence of pre-contractual negotiations, although Justice Thomas had found support for his interpretation of the agreement in two provisions in earlier drafts of the contract. Their Lordships said that they did not think that this was a suitable case for re-examining the law because, in the *Yoshimoto* case, the evidence was, as Lord Wilberforce had predicted it would be in *Prenn v Simmonds*, unhelpful.¹⁶

Facts

Mr Yoshimoto had agreed to sell shares in a company, NZPIL, to CGI. The company owned land which was to be developed as a golf course.

The planning situation under the relevant legislation and local plans was complicated. NZPIL faced various planning issues. NZPIL had promoted a change to the Christchurch Transitional District Plan (“**Plan Change**”) allowing, among other things, access over a paper road. They needed approval for it. The Council did not approve this part of the Plan Change. At the time of the contract the council had said that access had to be through an existing road, not a paper road as NZPIL wanted. An appeal in the Planning Tribunal was pending from this at the time of the contract.

A second planning problem was the flood plan management scheme which the local council was promoting. If the scheme was to be applied, a resource consent would be needed. At the time of the contract, NZPIL had opposed the scheme and a hearing was pending.

A third area of difficulty lay in the Christchurch City plan. This plan also provided for entry, as the district plan did, to the golf course through an existing road, not the paper road proposed. Access to the land by the paper road was unlawful under section 9(1) Resource Management

¹⁵ [1971] 1 WLR 1381.

¹⁶ See paragraph 25 of judgment

Act 1991 and NZPIL had to succeed in its reference of the Planning Tribunal and also achieve a change in the City plan or obtain a resource consent.

The result of all this was, at the time of the sale of the land, that there were three areas where NZPIL had to win out to allow the development to proceed as it envisaged.

The contract

The contract sought to provide for this. Recital D provided as follows:

- D. NZPIL has made application for resource consents as promoted plan change number 11 to the Christchurch City Transitional Plan, has made submissions on the proposed Christchurch City Plan and has applied for other consents as are necessary to enable the development (as later defined) to proceed.

The contract defined “development” as “a proposed development incorporating an 18 hole golf course” specifically including “access to the above to be gained off Johns Road, Christchurch”. This was a reference to the paper road which NZPIL wanted to be the access to the course.

The price was fixed at \$3.4m. This was subject to clause 6.3 which was the important clause in the dispute. Clause 6.3 provided:

- It shall be a condition precedent to the vendor’s right to demand payment in the sum of \$1m being part of the balance of the purchase price owing under this agreement that NZPIL obtains all necessary authorisations or resources consent to the Development within 12 months of the date of this agreement.

After the agreement, NZPIL was successful in opposing the flood plan management scheme and it was withdrawn. Under the transitional plan, NZPIL persuaded the Christchurch City Council to change its mind. As a result the Environment Court made an order by consent amending the transitional plan by deleting the requirement that access be through an existing road and substituted the paper road which NZPIL wanted to use.

The only remaining matter was the condition concerning access in the proposed city plan. This aspect proved a slow process. The City Council had already agreed to a consent order accepting the paper road as part of the plan change 11 and NZPIL no doubt thought there would be little difficulty in this parallel process. However, the council required public notification of NZPIL’s application. To cut a long story short, the consent was only granted some 4½ months after the 12 month period in clause 6.3. There was no dispute that CGI had taken all practical steps to obtain the approvals in accordance with its obligations under clause 6.5 of the agreement.

Mr Yoshimoto contended that the resource consent under the proposed plan was not a “necessary” resource consent under 6.3 so that he was entitled to be paid under clause 6.3. He based this argument on recital D which said that necessary consents and authorisations had been applied for. No application for the resource consent in the proposed plan had been made when the contract was signed. Accordingly, it was not a “necessary” consent. The other reason was that, once the council had agreed to the consent order by the Environment Court, the granting of resource consent under the proposed plan was something of a “foregone conclusion”.

High Court

In the High Court, Justice Pankhurst rejected the submissions by Mr Yoshimoto. The court held that recital D could not be read as restricting the plain meaning of 6.3. The resource consent on the proposed plan was a necessary consent because an essential part of the development (access) could not lawfully proceed without it. The access was not a mere matter of detail. The judge also held that there was nothing in the “foregone conclusion” argument because the test was not whether the consents would certainly be obtained, but whether they were obtained in the 12 month period.

Court of Appeal

The Court of Appeal reversed the judgment of Justice Pankhurst. Justice Thomas accepted both arguments which Justice Pankhurst had rejected. He said that the commercial objective of the contract was to provide a differential purchase price depending on whether the development potential of the land was realisable or not. The fact that there had been a consent order made in the Environment Court meant that the potential was realisable. Once that order had been made it was unrealistic to conclude that the resource consent under the proposed plan would not be forthcoming. He also said that the resource consent would have been mentioned in recital D if it was a “necessary” consent. Justice Doogue in the Court of Appeal reached the same conclusion by a slightly different route. He found that the necessary consent was one which achieved appropriate access from John’s Road by the paper road. The parties would have only contemplated that this would be achieved by Plan Change 11.

Privy Council

The Privy Council noted that the Court of Appeal had not commented on the uncontradicted expert evidence which was to the effect that the resource consent was, by no means, assured. The Privy Council was, however, content to proceed on the basis that the grant of the consent was assured. They nevertheless held that the judge in the High Court was correct. While the general commercial objective was to agree to an increase in the price if the development potential proved to be realisable, the parties had chosen a specific, express

criterion by which to establish that this was the case. The words were that all necessary consents had to be obtained. Their Lordships did not think that it was possible, given the words in the bargain, to substitute different criteria on the ground that this would better satisfy the apparent commercial objective. This would be to rewrite the bargain. Their Lordships found that the use of the paper road access would have been unlawful without the consent under the proposed plan. On that basis the consent was necessary. Clause 6.3 did not require NZPIL to obtain every consent which would be necessary for the construction and, to that extent, their Lordships, and Pankhurst J, did not construe the clause literally, but consents to the principle of constructing the golf course and buildings and the access to the course were “necessary”.

Their Lordships could not see how the words of the contract could be read down in accordance with a particular view of the purpose of the contract. They did not believe that the Court of Appeal could qualify the words effectively to substitute a different provision ruling out one consent which was necessary. Their Lordships rejected six matters from the matrix of fact which Thomas J said would support his conclusion. Their Lordships also rejected an attempt to rely on an earlier version of clause 6.3.

That earlier version had apparently been that either acceptance of the submissions on the proposed plan or acceptance of plan change 11 within 18 months would give rise to the obligation to pay \$1m. This, it was said, showed that the parties had, in fact, contracted on the basis that either consent would be enough to trigger the obligation to pay \$1m. Their Lordships said on this point:

Their Lordships do not think it is helpful to try and construe the earlier version of clause 6.3 because it was dropped and the present clause substituted. It seems pointless to try and speculate on why the change was made. No doubt each party had their reasons for proposing it on the one hand and accepting it on the other. All a court can do is to decide what the final contract means. Their Lordships do not think that negotiations cast any doubt upon what Pankhurst J regarded as a plain and obvious meaning of “necessary consent”.

This decision represents a strong conventional approach to the interpretation of a contract. It does not allow a particular view of purpose to lead to the disregard of the contractual provisions and their natural and ordinary meaning. The decision as has been criticised as not being “purposive” enough¹⁷. However, it can be seen as a clear principled approach which keeps background and purpose, or a view of purpose, in their proper place and upholds the meaning of the words used by parties in their bargain.

¹⁷ See *Whatever is happening to contract law*. Andrew Beck NZLJ Nov 2002; 391-392; Contract NZ Law Review 2002 Beck

It is important that, as far as possible, parties who have chosen to express their bargain in a particular way which has a clear meaning, are held to that bargain. This does not, of course, mean that, if an interpretation of the contract will create a commercial nonsense given the background to the transaction, the literal meaning of the words will be followed. That is not the right approach. It does mean that where the words of a bargain are clear and can be given a perfectly sensible meaning (as was the case in *Yoshimoto*), then that meaning, and not some other which the judge sees as arising from the background or a view of the purpose, should be preferred.

International carriage of goods - contractual limitation of liability in bills of lading

New Zealand courts only rarely interpret contracts for the international sale and carriage of goods. Such cases are the grist for the courts in major trading centres like the Commercial Court in London. A good deal of the work of that court will concern the interpretation of charterparties and bills of lading and similar contracts.

The main reason our New Zealand courts do not see many cases in this area is the presence of jurisdiction clauses in the contracts in which the parties choose to litigate or arbitrate in major trading centres like London (and, to a lesser extent, New York).

In this area the need for an approach which creates confidence and certainty of outcome and upholds the reasonable expectation of merchants is paramount. Documents like bills of lading are negotiable and are transferred rapidly between commercial parties who will be bound by their terms.

***Dairy Containers Ltd v The Ship "Tasman Discoverer"*¹⁸**

In the *Tasman Discoverer* a bill of lading was issued for the carriage of 70 coils of electrolytic tin plates from Bussan in Korea to Tauranga in New Zealand aboard the *Tasman Discoverer*. When the vessel arrived, 55 of the coils were discovered to have been damaged by sea water which had entered the hold. The carrier accepted liability but there was a dispute as to the amount which the carrier could limit liability to. The shipment was from Korea and there was no compulsory liability regime for shipments from that country (on a shipment from New Zealand the Hague-Visby Rules would apply as a matter of law). The question of the limit applicable to the claim had to be decided by construing contract evidenced by the bill of lading. The contract was contained in the bill of lading issued by the carrier.

Bill of lading provisions

The bill of lading contained a clause which provided as follows:

¹⁸ Supra note 6.

6(B) ... If, in case of Combined Transport, the stage of transport where the loss of or damage to the Goods occurred is known, the liability of the Carrier in respect of such loss or damage shall be determined:

(a) by the provisions contained in any international convention or national law, ...

(b) Where no international convention or national law would apply by virtue of (a) above:

(i) By the Hague Rules contained in the International Convention for the Unification of Certain Rules relating to the Bills of Lading dated 25 August 1924 (hereinafter called the Hague Rules), if the loss or damage is proved to have occurred at sea or on inland waterways; for the purpose of this sub-paragraph the limitation of liability under the Hague Rules shall be deemed to be £100 Sterling, lawful money of the United Kingdom per package or unit and references in the Hague Rules, to carriage by sea, shall be deemed to include references to carriage by inland waterways and the Hague Rules shall be construed accordingly; or...

7. In the case of Port to Port shipment, the liability of the Carrier [...] shall be determined by [...] the Hague Rules *as referred to in paragraph (B)(b)(i) of Clause 6... (emphasis added)*

8(2) If any provision of this Bill of Lading is held to be repugnant to any extent to any international convention or national law which is applicable to this Bill of Lading *by virtue of clauses 6 and 7 [...], such a provision shall be null and void to that extent ... (emphasis added)*

The Hague Rules are an international Convention governing the carriage of goods. Parties can incorporate the Convention into their contracts by contract if it is not applicable by force of law. In this case it was agreed that the Hague Rules were applied by contract not compulsorily by force of law under clause 6(B)(b)(i).

Hague Rules provisions

The following provisions of the Hague Rules were relevant in the case:

Article III, r8 (which is known as the clause paramount) makes null and void any provision which seeks to limit or exclude liability as provided for in the Rules.

The package limitation provisions in the Hague Rules are found in Article IV, r5. This provides for a limitation not exceeding:

“£100 per package or unit or the equivalent of that sum in other currency.”

Article IX of the Hague Rules provides:

The monetary units mentioned in this convention are to be taken to be gold value.

The carrier said that the claim is limited to 55 times £100 under clause 6(B)(b)(i). The consignee claimed that the bill of lading incorporated the Hague Rules in their entirety and that, as a consequence, the limit of liability in clause 6(B)(b)(i) was the “gold value” of £100. This was based on the provisions of the Hague Rules which provide that the monetary limits are to be “gold value” and the cases which had decided that the limit of £100 was to be interpreted as being the current value of the gold which was the equivalent of £100 in 1924 (as defined by the Coinage Act 1870)¹⁹. On the “simple” sterling basis the claim for the damaged coils was severely limited, on the basis of gold value, the claimants would recover their full loss.

In the High Court, the consignee argued that clause 6(B)(b)(i) should be read down if it did reduce liability below the gold value limit in the Hague Rules. This argument was based on a *contra proferentem* approach to the wording of the contract which, it was argued, incorporated the Hague Rules in their entirety. It was also contended that the words “lawful money of the United Kingdom”, were simply added in clause 6(B)(b)(i) to make the currency of payment clear and did not make any greater change in the contract than that.

The High Court judge held that the Rules had been incorporated in their entirety into the contract, including the clause paramount. He found, as a consequence, that any limit in clause 6(B)(b)(i) had to be null and void if it was lower than the gold value measure of the limit established in the Hague Rules and the authorities interpreting those Rules. The judge also held that the phrase “£100 sterling, lawful money of the United Kingdom” was no more than clarification of the currency of payment rather than wording which changed the basic approach under the Hague Rules which make gold value the way of calculating the limit.

The Court of Appeal reversed the judgment in the High Court. The Court emphasised that this was a case concerning the interpretation of a private contract in which the parties had chosen to incorporate the provisions of an International Convention. The court found that on its clear meaning clause 6(B)(b)(i) made amendments to the Hague Rules as a matter of contract. The court analysed the words of clause 6(B)(b)(i) “piece by piece” and concluded that the

¹⁹ See *The Rosa S* [1988] 2 Lloyd's Rep 574 (HCEW); *Brown Boveri (Australia) Pty Ltd v Baltic Shipping Co* [1989] 1 Lloyd's Rep 518 (NZNSWCA)

wording in the clause plainly was an amendment to the Hague Rule limits which did not refer to gold value²⁰. The Court further noted that the wording used in the clause was in the same form as an agreement put forward by the British Maritime Association in 1950 to replace the combined effect of the Hague Rules provisions in Articles IV r5 and IX. The court held that the limit was 55 x £100.

This case is on appeal to the Privy Council. It will be interesting to see whether their Lordships agree that the contract has clearly changed the package limit which would apply under the Hague Rules. How do you think their Lordships will interpret the contract? (We will try and consider the case in our workshop if time permits).

Concluding comments

The recent decisions in the courts indicate that the element of controversy surrounding the principles which should be applied in the interpretation of contracts has subsided. While there remains a need for clarification in certain areas, the principles seem fairly well established. The task of the courts, given that reference can be made to purpose and background, is to ensure that the main focus remains on the meaning of the words used by the parties in the contract. Such an approach represents the best way of giving commercial parties what they want from the courts.

²⁰ See paragraph 25 of the judgment of the court.