

THE CONSTRUCTION OF COMMERCIAL CONTRACTS – THE NEED FOR SIMPLE PRINCIPLE

Every appeal on a commercial matter which goes to the Privy Council is seized upon by those who wish to retain the Privy Council as our final appeal court to show that we need the Privy Council to bring good sense to commercial law. The recent appeal in *Yashimoto* where the Privy Council overturned the Court of Appeal on a question of the interpretation is a good example of this. This decision and other recent decisions in both the UK and New Zealand are really better illustrations of the need to have clear principles by which courts arrive at the meaning of commercial contracts than they are support for one court system or another. Recently some confusion has been created in this important area for commercial people and their advisors. In fact the confusion of basic principle began in the UK and was adopted in New Zealand.

The question of what a commercial contract means lies at the heart of many, if not most, commercial disputes. The court or arbitrator will have to decide what the parties meant by their words. T S Elliot described poetry as the “intolerable wrestle with meaning” – It is often not easy to decide what words to use or what they mean. The beauty and difficulty of language lies often in its inherent uncertainty and ambiguity. Lawyers may work with words in a much more tradesman like way than poets but they wrestle with meaning nonetheless. This task is at the heart of their work. The most common question a commercial lawyer, whether he be draftsman or litigation lawyer, will hear:

“What does that mean?” or

“How should we best say that in our agreement?”

It was natural for courts to develop principles to assist in arriving at the meaning of the parties agreement. Contract law emphasises the agreement between the parties and an objective determination of what it means. While the court had to find the intention of the parties it was the intention as discerned from the words used in the contract in an objective sense. Parties could be found to have agreed to something which neither of them thought or intended to agree to if the words in their agreement properly carried that meaning. In the earliest times construction issues would usually concern wills or the sale of land. The courts adopted a rule that it would look no further than the written words itself. Over time the courts recognised that in a commercial context a commercial agreement had to be construed in its context. The object was still to find the intention of the parties from their written words but that contract had to be construed in its context or its “matrix” as the background was famously described by Lord Wilberforce in the case of *Prenn v Simmonds*. Other principles of interpretation were also used to assist in arriving at the meaning of the contract. An example is the absurd results rule. If the result of a particular construction was commercially absurd it was much less likely that the parties had intended to achieve that result.

The background material was only examined if the meaning of the contract was unclear. There was no ability to look at the drafts of earlier agreements or what the parties said they meant by the contract. This would be to go too far from the objective approach. The problem was very well described by Justice Hardie Boys when he said in one commercial case that the argument of one of

the parties seemed rather like looking to the background to the transaction to find ambiguity then resorting to the background to cure that ambiguity. The problem that was always identified with examination of the background was that this allowed parties to trawl through the background to the agreement to achieve a meaning which they now wanted. In short, the principles were set against allowing the parties to use background material to rewrite the contract. Such an approach was, it was thought, unhelpful.

Recently Lord Hoffmann has stressed that all language, whether contractual or not, takes its meaning from context. He suggested that the principle of looking to the background could be extended to almost anything that a reasonable man might regard as the context of the agreement in order to assist at arriving at the meaning of the words. Considerable uncertainty surrounded Lord Hoffmann's reformulation of basic principle. When was it appropriate to look at the background? How much should the court look at? What did the background consist of? The principles set out by Lord Hoffmann in the *Investors' Compensation* case were adopted by Justice Thomas in a New Zealand case called *Boat Park v Hutcheson*.

The new principles lead some to say that there was now a new school of contractual interpretation. Quite what the rules were of this new school was a little uncertain. It seemed to now be that if one party wanted to promote a particular meaning it could be allowed to look at virtually absolutely anything in the background to support that meaning. It was very uncertain as to what extent the background could be looked at. The problem with this for commercial parties was obvious. There was now uncertainty as to principles that would be applied by the court before the court ever began construing the actual contract. Short hearings determining the meaning of the words in their contract were very much a thing of the past. The principles seemed like an open invitation to one party which did not like the words of the bargain struck to examine the background to reach a different meaning.

In England a well known, now retired, commercial judge reacted with some vigour to Lord Hoffmann's reformulation.

In subsequent cases Lord Hoffmann has withdrawn from the position which he adopted. He has underlined that he did not mean by "absolutely anything" that the party was free to trawl through the background to a transaction in order to promote the meaning which it wanted of the words.

Justice Thomas with academic support has continued to question whether the courts should look further at background material in seeking to arrive at the meaning of the contract.

In both the recent Privy Council decisions of *Valentines* and *Yashimoto* the Privy Council has decided the appeals on what might be seen as old fashioned principles, in short precise judgments focussing on the words used. They have not been tempted to pick up the suggestion by Justice Thomas to re-examine the need to look at drafts in construing commercial contracts. They have decided both the appeals in an orthodox way. In similar terms the New Zealand Court of Appeal has adopted an orthodox approach to the construction of commercial contracts in other appeals.

This swinging of the pendulum back towards orthodoxy is to be welcomed. Commercial parties usually require a hearing, a prompt determination of the meaning of their bargain at reasonable costs if that can be achieved. While legal processes may be too slow for many commercial parties the unnecessary addition of time and expense which comes from broadening the principles of commercial construction is one which is to be avoided. The orthodox principles of construction which focus on the agreement between the parties and the language used in that agreement gives the best chance of our courts providing to commercial parties what they want – a hearing and a decision on the meaning which is a reasonable length and a reasonable cost. The recent appeals to the Privy Council illustrate both the uncertainties that arise in commercial litigation when the meaning of language is concerned – an ever present truth – and also the importance of having simple, straight forward principles by which commercial judges can decide the meaning of the bargain struck between commercial parties. This principle which lies at the heart of the proper function of mercantile and commercial law is rather more important overall than the debate about the court structure. If we are to replace the Privy Council it is important that our court and its judges maintain the current focus on the orthodox approach to the construction of commercial contracts. In that way the needs of commercial parties, whether New Zealand based or overseas based, will be met. In both the UK and New Zealand this movement away from commercial principle has been met with a return to orthodoxy which is to be welcomed.

Whether we need the Privy Councils is a separate more difficult issue but in commercial law we do need clear principles and an efficient approach if commercial parties are to retain confidence in the court system.