COMMERCIAL COMMON SENSE IN CONTRACT INTERPRETATION: OBSERVATIONS ON THE COURT OF APPEAL IN *TECHNIX V FITZROY* AND *THE MALTHOUSE V RANGATIRA*

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The contemporary principles of contract interpretation require courts to have regard to a number of factors to determine the meaning of a contract, including the plain meaning of the express contractual language, the contract's context, and commercial common sense. These principles superseded the narrower plain meaning rule, which directed courts to interpret contracts in a manner largely consistent with the plain and ordinary meaning of their express words. Since their manifestation some 20 years ago, these principles have undergone change, development and elaboration to the extent that some commentators now claim the approach to contract interpretation more closely resembles the former plain meaning rule, with courts giving "primacy" to the words of the contract in order to deliver "commercial certainty". This article argues that while courts must give primacy to the express contractual language, that does not mean courts should maintain an unwavering loyalty to the plain meaning of those words, even if their meaning is clear. Courts that adopt this approach, referred to by some as the "conservative approach", risk obscuring the true meaning of a contract that can only be obtained through the careful balancing of a contract's internal and external factors, including commercial common sense. This article demonstrates the problem with the "conservative approach" through the analysis of two Court of Appeal decisions, and argues that courts should not overstate the circumstances in which departure from the plain meaning of a contract should occur.

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I INTRODUCTION

Contract interpretation is an objective process that courts undertake in order to ascertain the meaning of a contract. The principles of interpretation provide that a court should decide on the meaning of a contract through the determination of what a "reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract" would take the contract to mean.[1]

As part of this process, courts are directed to take into consideration not only the natural and ordinary meaning of the express language of a contract, but a number of other interpretation factors to reach a conclusion as to the contract's meaning. These include the contract's internal and external context and commercial common sense.

This approach to contract interpretation (the "contemporary approach"), which is derived from Lord Hoffmann's restatement of the principles of contract interpretation in *Investors Compensation Scheme Ltd v West Bromwich Building Society* (*ICS*),[2] superseded the "plain meaning rule", which directed the interpretation of a contract in a manner largely consistent with the natural and ordinary meaning of its express language. New Zealand's contract interpretation principles closely follow the *ICS* principles, as was confirmed by the Supreme Court in *Vector Gas Ltd v Bay of Plenty Energy Ltd* (*Vector*), *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* (*Zurich*) and most recently in *Bathurst Resources Ltd v L & M Coal Holdings Ltd* (*Bathurst*).[3]

Since *ICS*, the contemporary approach has been subject to change, development and elaboration.[4] In the United Kingdom, the Supreme Court has defined interpretation as a "unitary exercise" which requires the relevant interpretation factors, namely the contract's language, context and commercial common sense, to be considered "at once" in order to ascertain a contract's meaning.[5]

More recently, the Supreme Courts in both the United Kingdom and New Zealand have reinforced the importance of contractual language and its natural and ordinary meaning in the interpretation process. As will be discussed later in this article, this shift in emphasis toward the contractual

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1 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [60].

2 *Investors Compensation Scheme Ltd [ICS] v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912–913.

3 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [22]; *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 1, at [60]; and *Bathurst Resources Ltd v L & M Coal Holdings Ltd* [2021] NZSC 85 at [43].

4 Richard Calnan *Principles of Contractual Interpretation* (2nd ed, Oxford University Press, Oxford, 2013) at 49.

5 *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, [2017] AC 1173 at [11]–[12]. See also Ryan Catterwell "Striking a Balance in Contract Interpretation: The Primacy of the Text" (2019) 23 Edinburgh L Rev 52 at 53.

language, referred to by some as the "conservative" approach, has led commentators to conclude that the significance of a contract's context and commercial common sense has been greatly diminished, and the principal source of understanding of a contract's meaning is to be derived from the express words of a contract.

This article will argue that there is a risk in this "conservative" approach; namely, an unwavering loyalty to the plain meaning of contractual language can obscure the true meaning of a contract that can only be ascertained through the careful balancing of the contract's internal and contextual factors (including commercial common sense). The manifestation of this risk is illustrated in two Court of Appeal decisions, *Technix Group Ltd v Fitzroy Engineering Group Ltd* (*Technix*) and *The Malthouse Ltd v Rangatira Ltd* (*The Malthouse*),[6] where the Court of Appeal's treatment of the relevant interpretation factors (and commercial common sense in particular) differed markedly between the two decisions.

Further, this article will argue that New Zealand courts should not overstate the circumstances in which departure from the plain meaning of a contract on the basis of commercial common sense should occur. While recent authorities have indicated that a departure from plain meaning should only occur in situations that are exceptional or extreme, there is a clear line of authority which makes plain that departure should not be limited to such narrow circumstances, and it should occur if, after the careful balancing of all of the relevant interpretation factors, it is evident such a departure is necessary to give effect to a contract's intended meaning.

II THE PRINCIPLES OF CONTRACTUAL INTERPRETATION

A The United Kingdom's Position

The contemporary approach to the interpretation of written contracts in the United Kingdom is effectively grounded in Lord Hoffmann's restatement in *ICS*.[7] Articulated in the form of five principles, Lord Hoffmann described interpretation as a process where the meaning of the contract in question would be understood by a "reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract."[8] Further, such background "includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man", save the previous negotiations of the parties and any declarations of subjective intent.[9] However, Lord Hoffman later qualified his position in *Chartbrook Ltd v Persimmon Homes Ltd* where he determined

6 *Technix Group Ltd v Fitzroy Engineering Group Ltd* [2011] NZCA 17; and *The Malthouse Ltd v Rangatira Ltd* [2018] NZCA 621.

7 *ICS v West Bromwich Building Society*, above n 2, at 912–913.

8 At 912.

9 At 913.

that evidence of previous communications between the parties may be admitted as part of the background where that communication may "throw light upon what [the parties] meant by the language they used [in the contract]".[10]

In *ICS*, Lord Hoffmann also stated that "[t]he meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words", but words should be given their natural and ordinary meaning as this "reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents". However, if the contract's background demonstrates that something had gone wrong with the contract's language, then "the law does not require judges to attribute to the parties an intention which they plainly could not have had".[11]

The principles espoused in the *ICS* restatement have been developed and refined in subsequent judgments by the House of Lords and the United Kingdom Supreme Court (UKSC). In particular, where a court determines that something has gone wrong with the language of a contract and there is, in fact, a mistake on the contract document, courts are entitled to remedy that mistake through contractual construction, to which there is no "limit to the amount of red ink or verbal rearrangement or correction which the court is allowed".[12] However, the fact that a contract appears unduly favourable to one of the parties is not a sufficient reason for determining that a contract does not mean what it says.[13]

In more recent judgments, the UKSC has emphasised the importance of the ordinary and natural meaning of contractual language in the interpretation process. In *Rainy Sky SA v Kookmin Bank*, for instance, the UKSC stated that "[w]here the parties have used unambiguous language, the court must apply it".[14] In *Arnold v Britton*, the same Court stated that commercial common sense and surrounding circumstances "should not be invoked to undervalue the importance of the language of the provision which is to be construed" and that the meaning of a contractual provision usually is "most obviously to be gleaned from the language of the provision".[15]

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10 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] AC 1101 at [33]. See also Lord Bingham "A New Thing Under the Sun? The Interpretation of Contract and the *ICS* Decision" (2008) 12 Edinburgh L Rev 374 at 389.

11 *ICS v West Bromwich Building Society*, above n 2, at 913.

12 *Chartbrook Ltd v Persimmon Homes Ltd*, above n 10, at [25].

13 At [20].

14 *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900 at [23].

15 *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619 at [17].

Further, a court should be more ready to depart from the natural meaning of a contract's words "the less clear they are" or "the worse their drafting".[16] In *Wood v Capita Insurance Services Ltd*, however, the UKSC recognised the importance of both the text and the context in the interpretation process, stating "[t]extualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation".[17] The Court went on to emphasise that how the text and context will be used in the interpretation process will depend on "the circumstances of the particular agreement or agreements".[18]

What these recent UKSC judgments mean has been subject to debate among academics and other commentators. In the view of some commentators, these judgments, particularly that of *Arnold v Britton*, represent a significant shift in contractual interpretation from one that emphasised not only contractual language, but potentially a wide range of other factors, to one that focused primarily on the language of the contract.[19]

Sir Geoffrey Vos, writing extra-judicially, took these judgments to mean that contractual interpretation now involves choosing between two available meanings of the words used in the contract and that there was not, except:

> … in a most exceptional case or a case of obvious absurdity, any scope for adjusting the language to reflect what the objective observer would think the parties must actually have meant …

According to Vos, the final components of the *ICS* restatement in relation to the law not attributing parties to the contract an intention they could not have had based on reference to a contract's factual background and commercial common sense, have now been rendered meaningless.[20] On the other hand, David McLauchlan contended that it was more likely that these recent judgments were "spelling out what was either explicit or implicit in the *ICS* principles in the first place" and any such claims around the demise of the *ICS* principles were greatly overstated.[21]

While there may be some disagreement as to the extent to which these judgments have marked a greater focus on the natural and ordinary meaning of contractual language over other factors in the interpretation process, they do clearly suggest that a consensus has emerged on the approach that

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16 At [18].

17 *Wood v Capita Insurance Services Ltd*, above n 5, at [13].

18 At [13].

19 See for example R Craig Connal "Has the Rainy Sky Dried Up? *Arnold v Britton* and Commercial Interpretation" (2016) 20 Edinburgh L Rev 71 at 76; and Rohan Havelock "Return to Tradition in Contractual Interpretation" (2016) 27 KLJ 188 at 201–202.

20 Geoffrey Vos "Contractual Interpretation: Do Judges Sometimes Say One Thing and Do Another?" (2017) 23 Canta LR 1 at 11. At the time of writing Vos was Chancellor of the High Court of England and Wales.

21 David McLauchlan "A Sea Change in the Law of Contract Interpretation?" (2019) 50 VUWLR 657 at 677.

should be taken to contractual interpretation. All these cases emphasise that interpretation is a "unitary exercise" where regard must be given to both the contractual language and "all the relevant surrounding circumstances" in order to determine what a "reasonable person … would have understood the parties to have meant ".[22]

This involves "an iterative process by which each of the rival meanings is checked against the provisions of the contract and its commercial consequences are investigated".[23] The unitary process of interpretation requires a court, in considering the correct interpretation of a contract, to consider all the factors relevant to the task of interpretation,[24] such as a contract's wider context and background, and to evaluate the factors "at once to determine the correct interpretation"[25] as the contract "document, its context and the commercial consequences of the rival contentions are indispensable and inseparable components of the interpretation process".[26]

Accordingly, a court should not simply determine that words in a contract have a particular meaning and then ask whether that meaning is displaced by the contract's context,[27] nor should a court render "consideration of the factual background [of a contract] otiose" by determining that a meaning put forward by a party in litigation is not an available meaning of the words that are determinative to the outcome of a dispute.[28]

B New Zealand's Position

New Zealand's approach to contractual interpretation follows closely the current approach in the United Kingdom, with Lord Hoffmann's restatement in *ICS* being adopted into New Zealand law by the Court of Appeal in *Boat Park Ltd v Hutchinson*.[29] The principles of contractual interpretation were confirmed by the New Zealand Supreme Court in *Vector*, *Zurich* and *Bathurst*, where the Court echoed the *ICS* principles, in particular the "reasonable person" test.[30]

While the unitary process of interpretation, as it has been articulated in the UKSC, has not been explicitly adopted by the New Zealand courts, the principles which underlie contract interpretation in

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22 *Rainy Sky SA v Kookmin Bank*, above n 14, at [21].

23 *Arnold v Britton*, above n 15, at [77].

24 McLauchlan, above n 21, at 678.

25 Catterwell, above n 5, at 53.

26 McLauchlan, above n 21, at 662.

27 *Chartbrook Ltd v Persimmon Homes Ltd*, above n 10, at [24].

28 McLauchlan, above n 21, at 662.

29 *Boat Park Ltd v Hutchinson* [1999] 2 NZLR 74 (CA) at 81–82.

30 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 3, at [19]; *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 1, at [60]; and *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 3, at [46].

New Zealand support an approach that conforms with the United Kingdom's unitary process. In particular, the New Zealand Supreme Court in *Vector* stated that:[31]

> … a meaning that may appear to the court to be plain and unambiguous, devoid of external context, may not ultimately, in context, be what a reasonable person aware of all the relevant circumstances would consider the parties intended their words to mean.

In *Zurich*, the Court stated that "contractual language … must be interpreted within its overall context" and emphasised that "purposive or contextual interpretation is not dependent on there being an ambiguity in the contractual language".[32] Further, "the wider context may point to some interpretation other than the most obvious one and may also assist in determining the meaning intended in cases of ambiguity or uncertainty".[33]

However, in *Zurich* it was also acknowledged that "the [contractual] text remains centrally important" in the interpretation process, and that if the contractual language at issue "has an ordinary and natural meaning, that will be a powerful, albeit not conclusive, indicator of what the parties meant".[34] Further, the Court determined that departure from the ordinary and natural meaning of contractual language could be appropriate in situations where an interpretation produces a "commercially absurd result".[35] However, given the complexities around the negotiation of commercial contracts and the wide range of considerations that often impact the final structure of bargains,[36] such a conclusion as to the absurdity of an interpretation "should be reached only in the most obvious and extreme of cases ".[37]

In *Bathurst*, the Court reinforced the approach it had previously articulated in *Zurich*. The Court in particular emphasised that giving primacy to the words of a contract "accords with the policy of providing commercial certainty".[38] In relation to "commercial absurdity", the Court endorsed the position outlined in *Zurich*, and further underlined that "courts are not necessarily well placed for the assessment of what can be industry-specific considerations".[39] However, the Court also recognised

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31 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 3, at [22].

32 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 1, at [61].

33 At [63].

34 At [63].

35 At [89].

36 At [91].

37 At [93].

38 *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 3, at [46].

39 At [45].

that the promotion of "commercial certainty" should not be allowed to "defeat what the parties actually meant by the words in which they recorded their agreement".[40]

In terms of the use of a contract's factual background (or surrounding circumstances) in contractual interpretation, the New Zealand courts have accepted that reference to a contract's factual background can be made in all cases, irrespective of whether or not the words of a contract are clear as to their meaning.[41] In *Vector*, the Supreme Court acknowledged that reference to a contract's background is necessary because a plain and ordinary meaning that is devoid of external context "may not ultimately, in context, be what a reasonable person aware of all the relevant circumstances would consider the parties intended their words to mean".[42]

In *Pyne Gould Guinness Ltd v Montgomery Watson (NZ) Ltd*,[43] the Court of Appeal stated that, while the proper starting point in contractual interpretation is the ascertainment of the natural and ordinary meaning of the words of the contract in the context of the contractual document as a whole, the background must then be referred to in order to "cross-check whether some other or modified meaning was intended".[44] The reference to a contract's background or context as a "cross-check" was recognised by the Supreme Court in *Vector*, where the Court stated that the concept of the "cross-check" affirmed the proposition that a contract's meaning "which appears plain and unambiguous on its face is always susceptible to being altered".[45] While it is accepted that a contract's factual background is a necessary consideration as part of the interpretation process, it may not always be helpful in the ascertainment of the objective meaning of the contract.[46]

In terms of the scope of a contract's "background", the New Zealand Supreme Court has taken a similar approach to the United Kingdom in respect of prior contractual negotiations. In *Vector*, it was held that while evidence in relation to the subjective content of negotiations is inadmissible due to its irrelevance, "evidence of facts, circumstances and conduct attending the [contractual] negotiations is admissible if it is capable of shedding objective light on meaning".[47] Unlike in the United Kingdom, however, the New Zealand Supreme Court has determined that evidence of both pre-contractual conduct *and* subsequent conduct should be admissible for the purposes of interpretation provided it

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40 At [46].

41 Matthew Barber, Jeremy Finn and Stephen Todd *Burrows, Finn and Todd on the Law of Contract in New Zealand* (6th ed, LexisNexis, Wellington, 2018) at 191–192.

42 *Vector Gas Ltd v Bay of Plenty Energy Ltd,* above n 3, at [22].

43 *Pyne Gould Guinness Ltd v Montgomery Watson (NZ) Ltd* [2001] NZAR 789 (CA).

44 At [29].

45 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 3, at [24].

46 Barber, Finn and Todd, above n 41, at 193.

47 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 3, at [29].

can give "objective guidance as to intended meaning".[48] This position was further clarified by the Court in *Bathurst*, where the Court agreed with the approach articulated in *Vector*, and emphasised that the admission of prior contractual negotiations and subsequent conduct as evidence, including assessments of the relevance and probative value of such evidence, should be done so in accordance with the Evidence Act 2006.[49]

III CASE ANALYSIS

In this section, the way in which context might impact on interpretation is illustrated by the Court of Appeal decisions in *Technix* and *The Malthouse*.[50] These two decisions have been selected for examination as, while the Court has applied the principles of contract interpretation consistently in both decisions, the Court has reached its conclusions as to the correct interpretation of the contracts in question on the basis of different treatments of the relevant interpretation factors. The factual matrix of each decision will be detailed separately, together with the reasoning adopted by the Court, in order to understand the differences in approaches taken by the Court in these two decisions.

A Technix Group Ltd v Fitzroy Engineering Group Ltd

In *Technix* the Court had to determine the correct interpretation of an "option to purchase" clause in a lease of a commercial premises from Technix Group Ltd (Technix) to Fitzroy Engineering Group Ltd (Fitzroy).

The option to purchase clause contained three subclauses.[51] Subclause (a) provided Fitzroy with the right to purchase the premises through the provision of a notice in writing of its intention to investigate such a purchase. Provision of that notice would trigger further obligations for both parties in order to effect the purchase, namely an investigation into relevant costs and procedures. Subclause (b) provided Fitzroy with a right of pre-emption if Technix sought to sell the premises during the term of the lease. Subclause (c) provided Fitzroy with the right of pre-emption in the event Technix received an acceptable offer to purchase the premises from a third party (that is, Fitzroy had to make an offer to Technix on identical terms to the third-party offer).

The parties disagreed on the meaning of sub-cl (c), which stated that the right of pre-emption could be triggered "*at any time* during the term of the lease".[52] Technix contended that the meaning of the phrase "any time" was open-ended, in that it meant the right to pre-emption under sub-cl (c)

48 At [30]–[31].

49 *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 3, at [89]–[90].

50 *Technix Group Ltd v Fitzroy Engineering Group Ltd*, above n 6; and *The Malthouse Ltd v Rangatira Ltd*, above n 6.

51 *Technix Group Ltd v Fitzroy Engineering Group Ltd*, above n 6, at [6].

52 At [6] (emphasis added).

could be triggered even when the option to purchase process under sub-cl (a) was underway.[53] On the other hand, Fitzroy argued that, given the context of the whole clause and the background circumstances, the phrase should be interpreted as meaning "at any time during the term of the lease *other* than when sub-cl (a) or sub-cl (b) has been engaged".[54]

The Court agreed that the plain and ordinary meaning of sub-cl (c) was that the option to purchase could be invoked at any time.[55] However, in the wider context of the contract, the Court considered that the meaning contended for by Fitzroy was the correct one.[56]

The Court of Appeal's reasoning turned on three key points. First, if sub-cl (c) was interpreted in accordance with its plain and ordinary meaning, then that would render sub-cl (a) valueless and make the complex investigation and valuation procedures outlined within the subclause meaningless, as sub-cl (c) could be invoked prior to the completion of these potentially lengthy procedures.[57] Secondly, the parties could not have intended that the right granted to Fitzroy in sub-cl (a) could have been thwarted so easily by sub-cl (c), as such a conclusion would defy commercial common sense.[58] Thirdly, the background circumstances that led to the lease supported Fitzroy's proposed meaning, namely the fact that Fitzroy had purchased its business assets from Technix and the parties had an expectation that Fitzroy would eventually purchase the land if it was in the financial position to do so.[59]

The Court's decision-making process conformed with the unitary approach to interpretation. The Court effectively came to its decision as to the meaning of sub-cl (c) through a reading of the subclause that considered how it fitted into the overall operation of the option to purchase clause. Significant weight was attached to the contractual context in order to reject the awkward and commercially nonsensical result that would ensue if sub-cl (c) was interpreted in accordance with its literal meaning.

B The Malthouse Ltd v Rangatira Ltd

The Malthouse related to the acquisition of a 35 per cent shareholding in Tuatara Brewing Company Ltd (Tuatara), a successful craft brewer, by Rangatira Ltd (Rangatira), a private equity firm.[60] The parties entered into an investment agreement after Rangatira had been introduced to

53 At [7].

54 At [8].

55 At [9].

56 At [10].

57 At [11].

58 At [16].

59 At [21].

60 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [2].

Tuatara in order to provide management expertise and capital for the purpose of Tuatara's commercial expansion.[61]

During negotiations for the sale of the shareholding, the parties disagreed on the appropriate valuation of the company. The parties inserted into the contract a mechanism to overcome this disagreement and facilitate the sale of the shareholding. This included, at cl 9.1, a provision for the payment of an amount additional to the purchase price under the investment agreement upon Tuatara achieving before the "sunset date" of 30 December 2015 "earnings [EBITDA] that implicitly valued the company at $12 million" (the "earn-out" clause).[62] Clause 9.8 provided that Rangatira pay an additional amount upon the sale of the shares in Tuatara for an amount in excess of $12 million (the "exit event ").[63]

Tuatara was sold to Dominion Breweries in 2017 for an amount in excess of $12 million.[64] A dispute then arose between the parties as to the correct interpretation of cl 9.8. The question for the Court was whether the obligation to pay the additional amount arose only if the exit event happened prior to the sunset date of 30 December 2015 provided for the earn-out clause (no such sunset date had been written into cl 9.8).[65]

The Court of Appeal determined that cl 9.8 was not subject to the sunset date.[66] The consequence of that interpretation, therefore, was that the obligation for Rangatira to pay the additional amount to The Malthouse Ltd (Malthouse) could be incurred at any point in the future where a sale in excess of $12 million occurred.

In coming to its decision, the Court of Appeal considered, principally, the wording of cl 9.8 and how that clause fitted into the contract. The Court determined that cl 9.8 was clear enough to operate on its own terms.[67] The Court also put particular weight on the fact that cl 9.1 made explicit reference to the sunset date, whereas cl 9.8 made no reference.[68] From this, the Court concluded that the absence of reference to the sunset date in cl 9.8 was deliberate.[69]

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61 At [2].

62 At [4]. "EBITDA" means Earnings Before Interest, Taxation, Depreciation and Amortisation.

63 At [5].

64 At [6].

65 At [5].

66 At [40].

67 At [33].

68 At [36].

69 At [40].

The Court determined that nothing in the contract's background was useful in its interpretation of cl 9.8,[70] but the background was referred to in order to cross-check the meaning determined in light of the wording of cl 9.8 and the contractual context.

In addition to this, the Court considered the commercial objectives of the contract. Rangatira argued that a relevant commercial objective of the contract was to value the company at 2013, the time the contract was entered into, and that to determine that cl 9.8 could trigger an obligation to pay an additional amount beyond the sunset date "would be inconsistent with this premise" and would make "no commercial common sense", as a sale in say 10 or 20 years' time had no bearing on the value of Tuatara in 2013.[71]

The Court did not accept that this was the commercial objective of the contract. The Court considered that the precise commercial objectives of the contract were not absolutely clear, however, it did conclude that the ultimate objective of the contract was that Tuatara would be sold.[72]

The Court's reasoning conformed with the unitary approach to interpretation. A wide range of factors were considered, including the natural and ordinary meaning of the contractual language, the contractual context, the contract's background, the commercial objectives of the contract and commercial common sense. Despite this wide-ranging analysis, however, the Court ultimately placed significant weight on the natural and ordinary meaning of the words contained in cl 9.8 and accorded a literal meaning to that clause. The Court did not consider any of the background evidence shed "any real light on the meaning" of cl 9.8.[73] In his remarks on the Court's findings as to the relevance of the background evidence, Miller J stated:[74]

> We also emphasise that, even if we are wrong in those findings, we would have expected clear explicit objective evidence … to balance the natural, well-drafted meaning we have attributed to cl 9.8 above.

The Court also emphasised the importance of the natural and ordinary meaning of contractual language, noting that "only in a very clear case should a court depart from the plain meaning of a closely negotiated commercial contract to achieve a commercial purpose".[75]

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70 At [47].

71 At [48].

72 At [50] and [53].

73 At [47].

74 At [47].

75 At [50].

C The Risks in a "Conservative Approach" to Interpretation

It has been argued by Suzanne Robertson that a shift to a more "conservative approach" to interpretation – that is, one that focuses on textual analysis and the natural and ordinary meaning of the contract's text – will bring about benefits such as greater certainty and greater predictability in the law.[76] However, it is submitted there is also a real concern and risk inherent in such a conservative approach: that is, the courts may be more willing to impose a meaning on a contractual provision simply because the natural and ordinary meaning of the contractual language has a clear, unambiguous meaning, despite strong indicators from the contract's context and factual matrix of an alternative meaning.[77]

For example, in *The Malthouse* the Court gave cl 9.8 its literal meaning, despite strong indicators of an alternative meaning from the contract's context and factual matrix. The Court relied on the natural and ordinary meaning of cl 9.8, which was that the additional payment would become payable upon the sale of the business for more than $12 million at any point in time, rather than before the sunset date of 30 December 2015, because the express language of cl 9.8 plainly stated this. However, it is suggested that when cl 9.8 is considered within its contractual context and the contract's surrounding circumstances, there is strong evidence that the clause is intended to be linked to the sunset date.

In the author's opinion, *The Malthouse* was incorrectly decided and is an example of when the court should be prepared to give a contractual provision a meaning that is consistent with contextual considerations and commercial common sense, even where the natural and ordinary meaning of that provision taken in isolation is plain and unambiguous.

Such an approach was successfully employed in *Technix v Fitzroy*, where from a literal perspective the meaning of sub-cl (c) was clear: the right of pre-emption under that sub-cl could be triggered by Technix at any point during the lease. However, once the practical and commercial consequences of that interpretation were explored and considered in the contractual context and with reference to the contract's surrounding circumstances, the Court determined that the parties could not have possibly meant for sub-cl (c) to operate on the basis of its literal meaning. Among the principal reasons given by the Court was that a literal interpretation of sub-cl (c) would render the option to purchase provided in sub-cl (a) meaningless, as a literal interpretation of sub-cl (c) would mean that

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76 Suzanne Robertson "Making Sense of Commercial Common Sense" (2018) 49 VUWLR 279 at 295. See also David McLauchlan "The Lingering Uncertainty and Confusion in the Law of Contract Interpretation" (2015) LMCLQ 406 at 432, where McLauchlan described the increased emphasis on the resolution of interpretation disputes on the basis of textual analysis with limited consideration of external context as a return to a more "conservative approach" to contract interpretation.

77 See for example the discussion regarding the English Court of Appeal decision *Fitzhugh v Fitzhugh* [2012] EWCA Civ 694 in David McLauchlan "The Lingering Uncertainty and Confusion in the Law of Contract Interpretation", above n 76, at 432–434.

Technix could trigger the pre-emption under sub-cl (c) after Fitzroy had invoked their option to purchase under sub-cl (a) and were in the process of investigating the purchase of the leased premises.[78] In addition, the surrounding circumstances also supported this interpretation, in particular the fact that there was a long-term vision for Fitzroy to buy Technix's premises.[79]

Like *Technix*, *The Malthouse* involved a situation where the contractual provision in dispute had a clear and unambiguous meaning. There was nothing in cl 9.8 which expressly restricted it to the sunset date of 30 December 2015 contained in cl 9.1. However, by interpreting cl 9.8 literally, the Court effectively rendered the temporal limitation of cl 9.1 meaningless. Under cl 9.1 it was only a possibility that Rangatira would become liable to pay the additional amount: that is, the additional amount would become payable only if Tuatara's earnings reached a specific level before the sunset date. In contrast, the Court's literal interpretation of cl 9.8 meant that payment of the additional amount by Rangatira was virtually inevitable. This is because the parties had an expectation that, at some point, Tuatara would be sold.[80] Tuatara would undoubtedly be sold for the highest amount possible in order to make the greatest return for its shareholders on their investment, and it was highly likely that Tuatara's future sale price (that is, the price of a sale that took place following the sunset date) would exceed $12 million.[81] The literal interpretation of cl 9.8 meant that the provision for payment of the additional amount in that clause no longer operated as security for Malthouse on the price that was paid by Rangatira for their shareholding. Rather, cl 9.8 provided for an obligation for Rangatira to pay an additional amount regardless of when that sale took place.

This logical inconsistency within the contract in *The Malthouse* was the kind that the Court of Appeal recognised in *Technix* through, principally, a balanced consideration of the contractual context.

D The Impact of the "Conservative Approach" on Commercial Common Sense

A number of decisions make clear that courts can depart from the natural construction of a contract where such construction produces a commercially unreasonable result which the parties were unlikely

78 *Technix Group Ltd v Fitzroy Engineering Group Ltd*, above n 6, at [11].

79 At [21]–[22].

80 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [53].

81 It was recognised by both parties at the time the agreement was made that Tuatara was growing, and that Rangatira's involvement with the company would see its value increase. See *The Malthouse Ltd v Rangatira Ltd* [2018] NZHC 816 at [20] and [105]. In addition, a number of undertakings were made by Rangatira in the investment agreement in order to ensure that Tuatara's EBITDA (and, accordingly, Tuatara's profitability) would continue to increase, including using "all reasonable steps to promote the Business". See *The Malthouse Ltd v Rangatira*, above n 6, at [36].

to have intended.[82] This does not mean the courts are given scope to retrospectively rewrite the language of a contract in order to make the contract conform to commercial common sense; rather, courts are given the ability, where more than one construction of the contract's words is possible, to prefer a construction which gives effect to the commercial purpose of the contract.[83]

It has been argued by Vos and Havelock, among others, that the scope for a court to find a meaning of a provision that is inconsistent with its natural construction on the basis of commercial unreasonableness has diminished in recent times. These commentators attribute this change to a number of judgments by the UKSC, particularly *Arnold v Britton*, which they say emphasise the importance of the natural and ordinary meaning of contractual language in the interpretation process and minimise other interpretation factors such as commercial common sense.[84]

In New Zealand, the Supreme Court in *Zurich* emphasised the importance of contractual language in the interpretation process.[85] The Court also considered the circumstances where a court ought to depart from the natural and ordinary meaning of a contract on the basis of commercial unreasonableness, noting that:[86]

> … where contractual language, viewed in the context of the whole contract, has an ordinary and natural meaning, a conclusion that it produces a commercially absurd result should be reached only in the most obvious and extreme of cases.

The contrasting treatment of commercial common sense can be seen in the reasoning between *The Malthouse* and *Technix*. In *Technix*, the Court of Appeal accepted that a plain interpretation of the contract flouted commercial common sense, and could not have been the meaning that the parties intended.[87] In *The Malthouse*, it was common ground that the main purpose for the insertion of the cl 9 contingent payment mechanism was because the parties could not agree on a price for the sale of the shareholding.[88] The position that was taken by the trial Judge in the High Court was that the "critical commercial objective of this transaction was to establish a fair value of the shares to facilitate

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82 See for example *ICS v West Bromwich Building Society*, above n 2, at 912; *Chartbrook v Persimmon Homes Ltd*, above n 10, at [25]; *Rainy Sky SA v Kookmin Bank*, above n 14, at [21].

83 *Co-operative Wholesale Society Ltd v National Westminster Bank plc* [1995] 1 EGLR 97 (CA) at 99.

84 Vos, above n 20, at 11; and Havelock, above n 19, at 200–202.

85 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 1, at [63].

86 At [93].

87 *Technix Group Ltd v Fitzroy Engineering Group Ltd*, above 6, at [16].

88 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [3].

the sale".[89] Accordingly, it "would make no commercial sense at all"[90] not to tie cl 9.8 to the sunset date stipulated in cl 9.1, as to attribute a literal meaning to cl 9.8 would mean that liability for the additional payment could be incurred many years into the future, and there then "would be a disconnect between such an event and the parties' commercial objective of providing a mechanism to ascertain a fair value of the company as at 2013".[91]

However, the Court of Appeal did not accept this view. A significant reason for this was due to the Court's interpretation of the Supreme Court's finding in *Zurich* regarding commercial common sense, namely that departure from the natural and ordinary meaning of a contract should occur "in *the most obvious and extreme of cases*".[92] Accordingly, the Court formed the view that departure from the plain meaning of cl 9.8 should only occur in a "very clear case".[93] Unlike the trial Judge, the Court determined that the objective background evidence did not shed any light on the meaning of cl 9.8 and, accordingly, the proposition that the objective for the insertion of cl 9.8 was to protect Tuatara in the event of an early sale was "far from self-evident".[94] The Court was swayed in this regard by the suggestion of a "plausible alternative commercial purpose" by counsel for Malthouse that could explain the lack of temporal limitation in cl 9.8, which was essentially that cl 9.8 "would operate as a backstop to protect [Tuatara] if the EBITDA Hurdle [in cl 9.1] was not met".[95] The Court noted that while it was not submitted that this alternative commercial purpose "*was* the commercial objective of cl 9.8", it demonstrated that Rangatira could not show that the commercial objective it contended for was the "plainly correct" one.[96]

It is submitted that the Court of Appeal was too cautious in its findings on the commercial objective of cl 9.8. The commercial objective of cl 9.8 was clear. Rangatira sought to purchase shareholding in Tuatara under an investment agreement. There was a disagreement around the price of the shareholding. The purpose of cl 9.8, together with cl 9.1, was to operate as a post-transfer valuation mechanism in order to overcome this disagreement and facilitate the completion of a successful transaction. The literal meaning which the Court attached to cl 9.8 meant that Rangatira would become liable to pay the additional amount even if a sale took place 10 or 20 years in the future,

89 *The Malthouse Ltd v Rangatira Ltd* (HC), above n 81, at [108].

90 At [106].

91 At [106].

92 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 1, at [93] (emphasis added).

93 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [50].

94 At [47] and [50].

95 At [51].

96 At [52].

far beyond any point in time that had a bearing on the fair valuation of the shareholding at the time it was purchased in 2013.

In a criticism of the Court of Appeal's *Malthouse* decision, David McLauchlan argued the Court did not balance "all relevant factors that would affect what a reasonable person with knowledge of the background would have understood the parties to have meant"; rather, the Court gave "the language of the (assumed) 'well-drafted' cl 9.8 … overriding rather than presumptive effect."[97] Further, McLauchlan criticises the obiter statement in *Zurich* in relation to commercial common sense (upon which the Court in *The Malthouse* relied) as it "arguably overstates the threshold for departure from a perceived plain meaning" and it cannot be right when an argument to depart from a contract's plain meaning is made "on an argument that the literal interpretation defeats the evident purpose of the contract or the term in question."[98]

The leading authorities in the United Kingdom support McLauchlan's view. While it has been made clear that commercial common sense cannot be invoked to undermine the language of a contract,[99] authorities have recognised that, where there are rival meanings, courts should look to choose a construction that gives effect to the commercial purpose of a contract and is consistent with commercial common sense.[100] Further, the more unreasonable the result that is produced by a contractual provision, then the "more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention *abundantly clear*."[101]

The fact a provision that provides for a commercially unreasonable result is clear and supposedly "well-drafted" does not preclude a court from giving that provision an alternative meaning. As was stated by Lord Hoffmann in an oft-quoted passage from *Chartbrook Ltd v Persimmon Homes Ltd*, there is no "limit to the amount of red ink or verbal rearrangement or correction which the court is allowed" and all that is needed is that it "should be clear that something has gone wrong with the

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97 David McLauchlan "Contracts don't always 'mean' what they say" [2019] NZLJ 227 at 229.

98 At 229. See *Firm PI 1 LTD v Zurich Australian Insurance Ltd*, above n 1, at [93].

99 *Arnold v Britton*, above n 15, at [17].

100 See *Co-operative Wholesale Society Ltd v National Westminster Bank plc*, above n 83, at 99 per Hoffmann LJ:

> This robust declaration does not, however, mean that one can rewrite the language which the parties have used in order to make the contract conform to business common sense. But language is a very flexible instrument and, if it is capable of more than one construction, one chooses that which seems most likely to give effect to the commercial purpose of the agreement.

See also *Rainy Sky SA v Kookmin Bank*, above n 14, at [21]; and *Wood v Capita Insurance*, above n 5, at [11].

101 *Wickman Machine Tools Sales Ltd v L Schuler AG* [1974] AC 235 (HL) at 251 (emphasis added). This statement was endorsed by the UKSC in *Rainy Sky SA v Kookmin Bank*, above n 14, at [22].

language and that it should be clear what a reasonable person would have understood the parties to have meant".[102]

In contrast, the Court in *The Malthouse* imposed a high threshold to be met in order to depart from the plain meaning of cl 9.8, stating that "only in a very clear case should a court depart from the plain meaning of a closely negotiated commercial contract *to achieve a commercial purpose*".[103] Not only was this conclusion inconsistent with the relevant authorities at the time *The Malthouse* was decided, but it now appears to be at odds with the Supreme Court's position in *Bathurst*, where it was held that the pursuit of "commercial certainty" through primarily the textual analysis of a contract should not be allowed to "defeat what the parties actually meant by the words in which they recorded their agreement".[104]

E What of Implication and Rectification?

Given the particular circumstances of *Technix* and *The Malthouse*, one may be inclined to ask whether the questions posed to the Court of Appeal in those two decisions would be better asked as matters of implication or rectification. This is because both decisions involved finding the meaning of a contract through the insertion of words that were not there.

A court may imply a term in a contract where that implication is necessary to remedy an omission that, unless remedied, may frustrate the contract's commercial purpose.[105] New Zealand courts often refer to the following five-point test established by the Privy Council in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* for the implication of terms:[106]

> (1) [the implied term] must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

In more recent times, it has been proposed that implication is a part of contract interpretation rather than a separate process altogether. Lord Hoffmann in the Privy Council decision *Attorney General of Belize v Belize Telecom Limited* suggested that the only question to be asked is whether a contract that contained the implied term sought is "what the [contract], read as a whole against the relevant background, would reasonably be understood to mean?".[107] However, the UKSC in *Marks*

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102 *Chartbrook Ltd v Persimmon Homes Ltd*, above n 10, at [25].

103 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [50] (emphasis added).

104 *Bathurst Resources Ltd v L&M Coal Holdings Ltd*, above n 3, at [46].

105 Barber, Finn and Todd, above n 41, at 217.

106 *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 16 ALR 363 (PC) at 376.

107 *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10 at [16]–[21].

and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) criticised this conclusion,[108] emphasising that the issue of whether a term should be implied into a contract should only be considered after the process of construing the express terms of the contract is complete.[109]

The New Zealand Supreme Court was quick to endorse *Belize* in *Nielsen v Dysart Timbers Ltd*.[110] However, following the decision in *Marks and Spencer*, the position in New Zealand has become less clear. In the Court of Appeal decision *Ward Equipment Ltd v Preston*, Kós P took a more nuanced approach, stating:[111]

> Implication and interpretation are not the same. Implication is however part of construction. A coherent analysis of construction is logical and desirable, recognising that all its techniques — interpretation, rectification and implication of terms — are aimed at the same object, the ascertainment of meaning of a contract.

This approach was recently endorsed by the Supreme Court in *Bathurst Resources Ltd v L&M Coal Holdings Ltd*. In *Bathurst*, the Court held that implication was an objective task, and while implication remained separate to the interpretation process in the construction of a contract as a whole,[112] central to the task of implication, as well as the starting point of the implication process, is the interpretation of the express terms of the contract.[113] The Court also affirmed the oft-used *BP Refinery* test as a tool that is useful to "test whether the proposed implied term is strictly necessary to spell out what the contract, read against the relevant background, must be understood to mean."[114]

In *Technix*, an implied term was not specifically argued by Fitzroy. However, in submissions Technix contended that to achieve Fitzroy's proposed (and successful) meaning of sub-cl (c), the Court would need to imply a term into the contract.[115] The Court disagreed with this contention and emphasised that it was "interpreting a particular contractual provision by reference to the parties' intention, not implying a new provision into the contract to deal with an issue not foreseen by the parties".[116]

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108 *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd and another* [2015] UKSC 72 at [25].

109 At [28].

110 *Nielsen v Dysart Timbers Ltd* [2009] NZSC 43 at [25].

111 *Ward Equipment Ltd v Preston* [2017] NZCA 444 at [95].

112 *Bathurst Resources Ltd v L&M Coal Holdings Ltd*, above n 3, at [116].

113 At [115].

114 At [116].

115 *Technix Group Ltd v Fitzroy Engineering Group Ltd*, above n 6, at [23].

116 At [23].

In *The Malthouse*, Rangatira also argued that there should be an implied term that the sunset date applied to cl 9.8 (among other things). In accordance with *BP Refinery*, Rangatira contended that the implied term "is either necessary for business efficacy or is so obvious that it goes without saying";[117] to not do so would mean there would be "no payment mechanic for the Contingent Payments; and … no end date for the obligation to pay the Contingent Payments".[118] Ultimately, however, Rangatira's implied term argument failed. The Court determined that it would not be appropriate to imply the term proposed by Rangatira as "to imply a term to that effect would change the balance of the bargain the parties struck.[119] Further, there was "no need for additional machinery such as the term sought to make cl 9.8 efficacious"[120] and the implied term is "far from being so obvious as to go without saying."[121]

Rectification is an equitable remedy that can be ordered where the terms of a contract do not accurately represent the mutual intention of the contracting parties. To obtain an order for rectification, a party must demonstrate:[122]

(a) the parties had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the instrument to be rectified;

(b) there was an outward expression of accord;

(c) the intention continued at the time of the execution of the instrument sought to be rectified;

(d) by mistake, the instrument did not reflect that common intention.

Rectification was not pleaded in *Technix* and, in *The Malthouse* Rangatira explicitly conceded that rectification was not available as a remedy.[123] In his analysis of *The Malthouse*, David McLauchlan suggested that Rangatira's decision not to seek rectification was due to insufficient evidence of a common mistake.[124]

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117 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [16].

118 At [16].

119 At [58].

120 At [59].

121 At [60].

122 *Swainland Builders Ltd v Freehold Properties Ltd* [2002] EWCA Civ 560, [2002] 2 EGLR 71 at [33]; see also *Hanover Group Holdings Ltd v AIG Insurance New Zealand Ltd* [2013] NZCA 442 at [30]; and *Davey v Baker* [2016] NZCA 313, 3 NZLR 776 at 787.

123 *The Malthouse Ltd v Rangatira Ltd*, above n 6, at [17].

124 McLauchlan "Contracts don't always 'mean' what they say", above n 97, at 229.

In summary, while the interpretation of a term was considered in both *Technix* and *The Malthouse* (albeit, only in passing in *Technix*), implication had no material bearing on the outcome of either decision. Rectification was not pleaded in either case.

On a broader level, there is an argument that the scope of interpretation, namely the ability for courts to depart from the plain meaning of a contract, now encroaches on the function of implication and rectification. Indeed, pulling back on this encroachment and creating a greater distinction between interpretation, implication and rectification has been used to justify shifting the focus of interpretation onto the plain meaning of the contract.[125]

The author in no way intends to wade into the extensive discussion on the interplay between interpretation, implication, and rectification. The purpose of this article is to demonstrate that it is evident the principles of contract interpretation, as they stand, do give leeway to the Courts to depart from the plain meaning of a contract to give effect to the contract's commercial purpose, and not simply in exceptional or extreme cases.

IV CONCLUSION

When presented with a question of contract interpretation, a court must ask what a "reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract" would take the contract to mean at the time it was made.

This question must be answered in accordance with a "unitary process" that has regard to a range of factors, including the plain meaning of the text, the context, the factual matrix and commercial common sense. Under the unitary process of interpretation, a court considers all of these relevant interpretative factors "at once", and checks the rival interpretations against the contractual provisions and their consequences in order to determine the contract's meaning. However, despite the wide range of factors that might be considered, authorities in the United Kingdom and New Zealand have reinforced the central importance of a contract's text in the interpretation process. Commentators such as Vos and Havelock have taken this to mean that there has been a marked shift in approach in contract interpretation, to one where the meaning of a contract is principally derived from its plain meaning except in the most exceptional or obvious cases, while others such as McLauchlan have concluded that this is merely a refinement of the principles of interpretation to an approach that is somewhat more "conservative".

In the author's view, it is clear there is an inherent risk in this more "conservative" approach to interpretation; that is, courts may be more ready to give effect to the plain meaning of a contract that is clear and unambiguous even where that meaning produces a commercially absurd result. New Zealand courts should not overstate the situation in which departure from the plain meaning of a

125 Havelock, above n 19, at 209 and 213.

contract on the basis of commercial common sense should occur. Authorities in the United Kingdom have long recognised that such a departure can occur where a contract can be construed to give effect to the commercial objective of the contract, rather than an "extreme" or "very clear" situation.

Accordingly, while the words of a contract may be centrally important in finding that contract's meaning, an unwavering loyalty to the plain meaning of those words may obscure the true meaning of the contract that can only be understood through the careful balancing of its internal and contextual factors.