

Words, Words, Words! What Did You Mean: Contractual Interpretation and the Reasonable Business Person¹

The Honourable Justice Ruth McColl AO²

- 1 In today's talk, I wish to focus on three aspects of the role of the parties' intentions in contractual interpretation.³
- 2 First, the objective theory of contract with its focus on the parties' presumed, rather than actual, intention. Secondly, some practical consequences of the objective theory, including the proposition that that theory can lead to an interpretation of the contract which none of the parties intended. Thirdly, to look at an area where the parties' actual intention can, in certain circumstances, be taken into account; the law of rectification.

The objective theory of contract

- 3 I turn first to the objective theory of contract. That theory, in short, as explained in 1983 by the High Court in *Taylor v Johnson*, is that contract law is concerned not with the real intentions of the parties to a contract, but rather with the outward manifestations of those intentions.⁴ *Taylor v Johnson* has been described as enunciating the "extreme form of objective theory, commonly known as the 'detached objectivity' (or 'fly on the wall') theory, under which a contract is formed when to all outward appearances the parties are agreed on the same terms and on the same subject matter, regardless of the actual intention and state of knowledge of either party."⁵ The objective theory stands to be contrasted with the subjective theory of contract pursuant

¹ Address to the Commercial Law Association of Australia, 18 August 2017.

² Justice of the Court of Appeal, Supreme Court of New South Wales.

³ The views expressed in this address are my own and do not represent those of any of my colleagues on the Supreme Court. I acknowledge the invaluable assistance of Phoebe Winch, my legal researcher, in the preparation of this address.

⁴ *Taylor v Johnson* (1983) 151 CLR 422 (at 428) per Mason ACJ, Murphy and Deane JJ; [1983] HCA 5.

⁵ D W McLauchlan, "Objectivity in Contract" [2005] UQLawJI 28; (2005) 24(2) University of Queensland Law Journal 479 (at 484).

to which the making of a contract depends on the parties' actual intention, requiring an agreement of wills, and that the will and its expression conform.⁶

- 4 A year before *Taylor v Johnson*, in 1982, in *Codelfa Construction Pty Ltd v State Rail Authority (NSW)*, Mason J gave a more expansive explanation of the objective theory:⁷

“... [W]hen the issue is which of two or more possible meanings is to be given to a contractual provision we look, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties' presumed intention in this setting. We do not take into account the actual intentions of the parties and for the very good reason that an investigation of those matters would not only be time consuming but it would also be unrewarding as it would tend to give too much weight to these factors at the expense of the actual language of the written contract.” [Emphasis added.]

- 5 Accordingly, in the law of contract, the object sought to be achieved in construing any commercial contract is to ascertain what the mutual intentions of the parties were as to the legal obligations each assumed by the contractual words in which they (or brokers acting on their behalf) chose to express them.⁸ The judicial task is not to discover the actual intentions of each party to the contract, nor what the contracting parties subjectively intended, believed or understood. Rather, the question is what each party by words or conduct would have led a reasonable person in the position of the other party to believe.⁹

- 6 The question is: how did this come about? This requires, or at least I think is enhanced by, delving into some history.

- 7 In his 1879 work, *Principles of the English Law of Contract and of Agency in relation to Contract*, Sir William Anson observed that “the law of contract so far as its general principles are concerned has been happily free from

⁶ *Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd* (1985) 2 NSWLR 309 (*Air Great Lakes*) (at 335) per McHugh JA.

⁷ (1982) 149 CLR 337 (*Codelfa*) (at 352); [1982] HCA 24.

⁸ *Pioneer Shipping Ltd v BTP Tioxide Ltd* [1982] AC 724 (at 736) per Lord Diplock.

⁹ *Westport Insurance Corp v Gordian Runoff Ltd* (2011) 244 CLR 239; [2011] HCA 37 (at [82]) per Heydon J; see also *McCutcheon v David MacBrayne Ltd* [1964] 1 All ER 430 (at 433) per Lord Reid quoting William Gloag, *Law of Contract*, (2nd ed 1929) (at 7).

legislative interference: it is the product of the vigorous common sense of English judges.”¹⁰

8 Sir William would not find the law of contract, particularly in the consumer context, so free of legislative interference these days of course. But, as this talk will explain, there is still room in the field of commercial contracts in particular for the application of “vigorous common sense”.

9 The rationale for the objective theory of context was explained by Lord Devlin as being concerned with the proposition that:

“... in most commercial contracts many more than the original parties are concerned. The contract is embodied in a document which may pass from hand to hand when the goods it represents are sold over and over again to a string of buyers, or when money is borrowed on it, or insurances arranged. The spirit of the contract gets lost on these travels and the outward form is all that matters. For the common law the sanctity of the contract means the sanctity of the written word in the form in which it is ultimately enshrined. Normally, evidence is not admissible of conversations or correspondence leading up to the contract; they cannot be used to amplify or modify the final document. That document must speak for itself. For the common law has its eye fixed as closely on the third man as on the original parties; and the final document is the only thing that can speak to the third man.”¹¹

10 Another explanation given by Allsop P in *Franklins Pty Ltd v Metcash Trading Ltd*¹² when still President of the New South Wales Court of Appeal was that:

“...the reality of commercial life and bargaining can be seen to underpin and explain the objective theory. Sometimes, beyond platitudes and obvious commercial aims, negotiating parties may well be at pains not to expose what they want from the terms and operation of an agreement. To do so may damage their bargaining position. In such cases, as in many cases, the bargaining that takes place is over what *words* are acceptable and the commercial aims and objects of negotiation give a framework and context to understanding what the bargained-for words mean.” [Emphasis in original.]

11 In 1875 in *Printing and Numerical Registering Co v Sampson*, Sir George Jessel, Master of the Rolls, spoke of public policy requiring “that men of full age and competent understanding shall have the utmost liberty of contracting,

¹⁰ (1st ed 1879), Preface, cited in *Chitty on Contracts*, (32nd ed 2015, Sweet & Maxwell), Vol 1, General Principles (at [1-003]).

¹¹ Lord Devlin, “Morals of the Law of Contract” (1962), reprinted in P Devlin, *The Enforcement of Morals* (1965, Oxford University Press) (at 44).

¹² (2009) 76 NSWLR 603; [2009] NSWCA 407 (*Franklins v Metcash*) (at [21]).

and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider – that you are not lightly to interfere with this freedom of contract.”¹³ Taken at a high level of generality, one might think that a theory of contract which did not look to what the parties to a contract actually intended to agree, but looked to their presumed intention, might rub up against what Sir George Jessel wrote.

- 12 However, Sir George was writing in a period when the vigorous common sense of the English common law was still moulding the law of contract. Much of this history was explored by the New South Wales Court of Appeal in 1985 in *Air Great Lakes*.
- 13 *Air Great Lakes* concerned the question whether the parties had entered into a binding contract to sell and purchase respectively the goodwill of a regional commuter airline business. One of the questions in the case was the extent to which that question was to be resolved merely by reference to a document they had executed headed “Terms of Agreement”, which spoke in language of futurity, including referring to the “proposed agreement” and to what extent, if at all, the Court was entitled to examine conversations between the parties to determine its construction.
- 14 You might think that by 1985 the dust might have been well settled on the provenance of the law of contract. However, McHugh JA, in particular, took the opportunity to look at its history and the extent to which regard could be had to the parties’ actual intentions.
- 15 As McHugh JA explained, until the end of the nineteenth century there was a law of contracts and not a law of contract. In 1826 Chitty Jnr called the first and many subsequent editions of his famous work: *Practical Treatise on The Law of Contracts*.¹⁴ According to his Honour, the slowness to develop a unified theory of contract inevitably meant that more attention was paid to the

¹³ (1875) LR 19 Eq 462 (*Sampson*) (at 465).

¹⁴ By 2015, Chitty was in its 32nd edition.

particular facts of the case and the actual intentions of the parties than was likely to be the case under a unified theory, which covered all contracts, and whose rules were necessarily much more abstract.¹⁵

- 16 Thus, it is hardly surprising, as McHugh JA explained that many statements can be found in nineteenth century cases which indicate that the making of a contract depended upon the actual intention of the parties. “Was there a consensus ad idem?” was the question generally asked. This was because, for much of that century the influence of Continental writers, particularly Savigny, the German jurist, and Pothier, the French jurist, was very great.¹⁶
- 17 Fundamental to Savigny’s theory of contract was the requirement that there be an agreement of wills and that the will and its expression be in correspondence.¹⁷ McHugh JA doubted, however, that the subjective theory of contract was as well-established in the nineteenth century as is sometimes made out.¹⁸
- 18 As Hope JA explained in *Air Great Lakes*,¹⁹ the objective theory of contract “was most strongly developed in America.”
- 19 Consistently with this, it was, according to McHugh JA, the publication by O W Holmes Jnr, the American Supreme Court Justice, of *The Common Law* in 1881 (a work which has been continuously in print ever since) which hastened the emergence of both a unified theory of contract and the supremacy of the objective theory of contract.

¹⁵ *Air Great Lakes* (at 335).

¹⁶ See, for example, Anson, *Principles of the English Law of Contract*, (3rd ed 1884, Clarendon Press) (at 2).

¹⁷ See Holland, *Elements of Jurisprudence*, (10th ed 1906, Clarendon Press) (at 114, 253).

¹⁸ *Air Great Lakes* (at 335) referring to, for example, *Kennedy v Lee* (1817) 3 Mer 441 (at 451); 36 ER 170 (at 174) per Lord Eldon LC; *Browne v Hare* (1858) 3 H & N 484 (at 495 – 496); 157 ER 561 (at 565 – 566) per Bramwell, B; Chitty Jnr, *The Law of Contracts*, (1826) (at 19 – 28).

¹⁹ (At 315).

20 Thus, in 1911 the renowned American appellate judge, Judge Learned Hand, wrote in *Hotchkiss v National City Bank of New York*,²⁰ that:

“... A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent.”

21 Although in *Air Great Lakes*, McHugh JA wrote that, from the start of the twentieth century, “most courts and writers ... championed the objective theory”,²¹ it was only in 1983, two years before *Air Great Lakes* was decided, that Mason ACJ, Murphy and Deane JJ said in *Taylor v Johnson*,²² “[w]hile the sounds of conflict have not been completely stilled, the clear trend in decided cases and academic writings has been to leave the objective theory in command of the field.” In so holding, their Honours referred with approval to Holmes J’s statement of the objective theory in *The Common Law*.²³ According to their Honours, “[i]n the United Kingdom, the decisive turning point leading to the near eclipse of the subjective theory was probably the speech of Lord Atkin in *Bell v Lever Brothers Ltd* [1932] AC 161, at pp 217-227.”

22 By 1988, while still Chief Justice of this State, Gleeson CJ said in *Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd*.²⁴

“Although there are qualifications to it, this general test of objectivity is of pervasive influence in the law of contract.”²⁵ Two passages from speeches of Lord Diplock illustrate the point. In *Gissing v Gissing* [1971] AC 886 at 906, his Lordship said:

‘As in so many branches of English law in which legal rights and obligations depend upon the intentions of the parties to a transaction, the relevant intention of each party is the intention which was reasonably understood by the other party to be manifested by that party’s words or conduct notwithstanding that he did not consciously

²⁰ 200 Fed 287 (1911) (at 293).

²¹ (At 335).

²² (At 428 – 432; especially 429).

²³ (At 428).

²⁴ (1988) 18 NSWLR 540 (at 549).

²⁵ The passage emphasised in bold was referred to with approval in the High Court in *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471; [2004] HCA 55 (at [34]) per Gleeson CJ, McHugh, Kirby, Hayne and Callinan JJ.

formulate that intention in his own mind or even acted with some different intention which he did not communicate to the other party.'

In *Ashington Piggeries Ltd v Christopher Hill Ltd* [1972] AC 441 at 502, his Lordship said:

'In each of the instant appeals the dispute is as to what the seller promised to the buyer by the words which he used in the contract itself and by his conduct in the course of the negotiations which led up to the contract. *What he promised is determined by ascertaining what his words and conduct would have led the buyer reasonably to believe that he was promising. That is what is meant in the English law of contract by the common intention of the parties. The test is impersonal. It does not depend upon what the seller himself thought he was promising, if the words and conduct by which he communicated his intention to the seller would have led a reasonable man in the position of the buyer to a different belief as to the promise; nor does it depend upon the actual belief of the buyer himself as to what the seller's promise was, unless that belief would have been shared by a reasonable man in the position of the buyer.* The result of the application of this test to the words themselves used in the contract is 'the construction of the contract'.'" [Emphasis added.]

- 23 Despite the pervasiveness of the objective theory of contract by 1988 in this country, in *Pacific Carriers Ltd v BNP Paribas*²⁶ in 2004, the High Court saw it as necessary to reaffirm the principle of objectivity by which the rights and liabilities of the parties to a contract are determined. *Pacific Carriers* concerned the construction of two letters of indemnity, in particular, the question whether BNP Paribas (BNP) was obliged to indemnify Pacific Carriers Ltd, the time charterer of the vessel on which a cargo of legumes consigned by New England Agricultural Traders Pty Ltd (NEAT), a company which became insolvent, was carried. I mention in passing what may be obvious, that the venture was described as "something of a disaster."²⁷ The two letters of indemnity were both signed by Ms Dhiri of BNP in the space reserved for "Banker's signature". At the trial before Hunter J in the Commercial Division of the Supreme Court, Ms Dhiri gave evidence that she told NEAT that execution by BNP was only for verification of the signatures.

²⁶ (2004) 218 CLR 451; [2004] HCA 35 (*Pacific Carriers*).

²⁷ *Ibid* (at [3]).

- 24 The High Court (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ) said of this evidence:²⁸

“What is important is not Ms Dhiri's subjective intention, or even what she might have conveyed, or attempted to convey, to NEAT about her understanding of what she was doing. The letters of indemnity were, and were intended by NEAT and BNP to be, furnished to Pacific. Pacific did not know what was going on in Ms Dhiri's mind, or what she might have communicated to NEAT as to her understanding or intention. The case provides a good example of the reason why the meaning of commercial documents is determined objectively: it was only the documents that spoke to Pacific. The construction of the letters of indemnity is to be determined by what a reasonable person in the position of Pacific would have understood them to mean. That requires consideration, not only of the text of the documents, but also the surrounding circumstances known to Pacific and BNP, and the purpose and object of the transaction. In *Codelfa Construction Pty Ltd v State Rail Authority of NSW*, Mason J set out with evident approval the statement by Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen*:

‘In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.’ [Footnotes omitted.]

- 25 As the High Court said in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*,²⁹ referring to *Pacific Carriers*:

“[40] This court, in *Pacific Carriers Ltd v BNP Paribas*, has recently reaffirmed the principle of objectivity by which the rights and liabilities of the parties to a contract are determined. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe. References to the common intention of the parties to a contract are to be understood as referring to what a reasonable person would understand by the language in which the parties have expressed their agreement. The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction.³⁰

...

²⁸ Ibid (at [22]).

²⁹ (2004) 219 CLR 165; [2004] HCA 52 (*Toll*).

³⁰ Similar recent statements to like effect can be found in *Electricity Generation Corp v Woodside Energy Ltd*; *Woodside Energy Ltd v Electricity Generation Corp* (2014) 251 CLR 640; [2014] HCA 7; *Ermogenous v Greek Orthodox Community of SA Inc* (2002) 209 CLR 95; [2002] HCA 8 (at [25]).

[42] Consistent with this objective approach to the determination of the rights and liabilities of contracting parties is the significance which the law attaches to the signature (or execution) of a contractual document. In *Parker v South Eastern Railway Co*, Mellish LJ drew a significant distinction as follows:

'In an ordinary case, where an action is brought on a written agreement which is signed by the defendant, the agreement is proved by proving his signature, and, in the absence of fraud, it is wholly immaterial that he has not read the agreement and does not know its contents. The parties may, however, reduce their agreement into writing, so that the writing constitutes the sole evidence of the agreement, without signing it; but in that case there must be evidence independently of the agreement itself to prove that the defendant has assented to it.'

[43] More recently, in words that are apposite to the present case, in *Wilton v Farnworth* Latham CJ said:

'In the absence of fraud or some other of the special circumstances of the character mentioned, a man cannot escape the consequences of signing a document by saying, and proving, that he did not understand it. Unless he was prepared to take the chance of being bound by the terms of the document, whatever they might be, it was for him to protect himself by abstaining from signing the document until he understood it and was satisfied with it. Any weakening of these principles would make chaos of every-day business transactions.'"
[Footnotes omitted.]

26 The High Court in *Toll* felt compelled to emphasise the objective theory of contract because:

"[35] A striking feature of the evidence at trial, and of the reasoning of the learned primary judge, is the attention that was given to largely irrelevant information about the subjective understanding of the individual participants in the dealings between the parties. Written statements of witnesses, no doubt prepared by lawyers, were received as evidence in chief. Those statements contained a deal of inadmissible material that was received without objection. The uncritical reception of inadmissible evidence, often in written form and prepared in advance of the hearing is to be strongly discouraged. It tends to distract attention from the real issues, give rise to pointless cross-examination and cause problems on appeal where it may be difficult to know the extent to which the inadmissible material influenced the judgment at first instance."

27 The last word must go, of course, to the High Court's decision in March this year in *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd*,³¹ in which Kiefel, Bell and Gordon JJ held that:

³¹ [2017] HCA 12; (2017) 91 ALJR 486.

“[16] It is well established that the terms of a commercial contract are to be understood objectively, by what a reasonable businessperson would have understood them to mean, rather than by reference to the subjectively stated intentions of the parties to the contract. In a practical sense, this requires that the reasonable businessperson be placed in the position of the parties. It is from that perspective that the court considers the circumstances surrounding the contract and the commercial purpose and objects to be achieved by it.”
[Footnotes omitted.]

Consequences of the objective approach

28 What are some consequences of the objective approach?

The parol evidence rule

29 I've already touched on one: the extent to which in interpreting a contract, the court can have regard to prior negotiations and general dealings of the parties. Needless to say, this requires some expansion as it is that which, particularly in recent years, has caused some grief, especially for intermediate courts of appeal in determining how to apply what Mason J described as “the true rule” in *Codelfa* as follows:

“The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning. Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious knowledge of them will be presumed.”³²

30 This was an exposition of the parol evidence rule which excludes extrinsic evidence (except as to surrounding circumstances), including direct statements of intention (except in cases of latent ambiguity) and antecedent negotiations, to subtract from, add to, vary or contradict the language of a written instrument.

31 No doubt legal practitioners among you will recall that this rule was clearly articulated in 1833 in *Goss v Lord Nugent* by Denman CJ.³³ Although, as Mason J said in *Codelfa*, “the traditional expositions of the rule did not in

³² *Codelfa* (at 352).

³³ (1833) 5 B & Ad 58 (at 64 – 65); 110 ER 713 (at 716).

terms deny resort to extrinsic evidence for the purpose of interpreting the written instrument, [the rule] has often been regarded as prohibiting the use of extrinsic evidence for this purpose.”³⁴

32 Mason J attributed this “to the theory which came to prevail in English legal thinking in the first half of [the twentieth] century that the words of a contract are ordinarily to be given their plain and ordinary meaning.”³⁵ For example, the object of the parol evidence rule is to exclude evidence of prior negotiations in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations, the prior oral agreement of the parties being inadmissible in aid of construction, though admissible in an action for rectification,³⁶ to which issue I will come.

33 Thus, when the question is which of two or more possible meanings is to be given to a contractual provision, the court looks, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties’ presumed intention in this setting. The court does not take into account the actual intentions of the parties and for the very good reason, as Mason J explained in *Codelfa*, that an investigation of those matters would not only be time consuming but it would also be unrewarding as it would tend to give too much weight to these factors at the expense of the actual language of the written contract.³⁷

What does the contract really mean?

34 The second consequence of the objective theory I want to address is to look at how its application can work in some ways at cross purposes to Thomas Hobbes’ doctrine of freedom of contract, the central tenet of which was that parties to a contract should be left to make bargains and have the utmost

³⁴ *Codelfa* (at 347).

³⁵ *Ibid* (at 348).

³⁶ *Ibid* (at 352).

³⁷ *Ibid*.

liberty of contracting with limited outside intervention.³⁸ The concept assumes freedom to decide whether to contract and freedom to negotiate contractual terms.³⁹

35 Once, however, you understand contracts as requiring interpretation in accordance with an objective theory of contract, which is only concerned with the presumed intention of the parties as objectively ascertained, not their actual or “subjective” intention, it is hardly surprising to find that the court may interpret a contract as having a meaning not advanced by either party. The common law impinges on the parties’ freedom of contract in that respect, and to a large extent.

36 This proposition is well established, both in texts and authorities.

37 Cheshire & Fifoot⁴⁰ complained that the objective approach can be taken to extremes because “[t]he parties may be bound by the objective meaning even if it does not conform to the interpretation advanced by either [and] even if the parties themselves concurred in some other meaning. That seems to go too far, and to offend the fundamental principle that contractual obligation must be assumed by the parties rather than imposed *ab extra*.” [Emphasis added; footnotes omitted.] However, Cheshire & Fifoot recognised that the “principle may need qualification where third parties are likely to rely on the objective meaning of a document.”⁴¹

38 In *Williston on Contracts*,⁴² under the heading “Intent to Contract”, the learned American author said:

“The common law does not require any positive intention to create a legal obligation as an element of contract. Conversely, though both parties may think they have made a contract, they may not have done so. The views of parties to an agreement as to what are the requirements of a contract, as to what mutual assent means, or consideration, or what contracts are enforceable without a writing, and what are not, are wholly immaterial The

³⁸ LexisNexis, Encyclopaedic Australian Legal Dictionary, online, accessed 16 August 2017.

³⁹ *Sampson*.

⁴⁰ *Law of Contract*, (10th ed 2012) (at [10.31]).

⁴¹ *Ibid*.

⁴² (3rd ed 1957) s 21 (at 37 – 39).

only intent of the parties to a contract which is essential is an intent to say the words and do the acts which constitute their manifestations of assent.” [Emphasis added; footnotes omitted.]

- 39 In *Australian Broadcasting Commission v Australasian Performing Right Association Ltd*,⁴³ Gibbs J stated in the following well-known passage:

“It is trite law that the primary duty of a court in construing a written contract is to endeavour to discover the intention of the parties from the words of the instrument in which the contract is embodied. Of course the whole of the instrument has to be considered, since the meaning of any one part of it may be revealed by other parts, and the words of every clause must if possible be construed so as to render them all harmonious one with another. If the words used are unambiguous the court must give effect to them, notwithstanding that the result may appear capricious or unreasonable, *and notwithstanding that it may be guessed or suspected that the parties intended something different*. The court has no power to remake or amend a contract for the purpose of avoiding a result which is considered to be inconvenient or unjust. On the other hand, if the language is open to two constructions, that will be preferred which will avoid consequences which appear to be capricious, unreasonable, inconvenient or unjust, ‘even though the construction adopted is not the most obvious, or the most grammatically accurate’, to use the words from earlier authority cited in *Locke v. Dunlop* [(1888) 39 Ch D 387, at p 393], which, although spoken in relation to a will, are applicable to the construction of written instruments generally; see also *Bottomley’s Case* [(1880) 16 Ch D 681, at p 686]. Further, it will be permissible to depart from the ordinary meaning of the words of one provision so far as is necessary to avoid an inconsistency between that provision and the rest of the instrument. Finally, the statement of Lord Wright in *Hillas & Co. Ltd. v. Arcos Ltd* [(1932) 147 LT 503, at p 514], that the court should construe commercial contracts ‘fairly and broadly, without being too astute or subtle in finding defects’, should not, in my opinion, be understood as limited to documents drawn by businessmen for themselves and without legal assistance (cf. *Upper Hunter County District Council v. Australian Chilling and Freezing Co. Ltd.* [(1968) 118 CLR 429, at p 437]).” [Emphasis added.]

This case is considered further below.

- 40 In *Byrnes v Kendle*,⁴⁴ Heydon and Crennan JJ emphasised that “[c]ontractual construction depends on finding the meaning of the language of the contract – *the intention which the parties expressed, not the subjective intentions which they may have had, but did not express*. A contract means what a reasonable person having all the background knowledge of the ‘surrounding circumstances’ available to the parties would have understood them to be using the language in the contract to mean.”

⁴³ (1973) 129 CLR 99 (*ABC v APRA*) (at 109 – 110); [1973] HCA 36.

⁴⁴ (2011) 243 CLR 253; [2011] HCA 26 (at [98]).

41 After referring to the passage from *Toll* to which I have referred concerning the irrelevance of the “subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations,” their Honours explained:

“[99] One reason why the examination of surrounding circumstances in order to decide what the words mean does not permit examination of pre-contractual negotiations is that the latter material is often appealed to purely to show what the words were intended to mean, which is impermissible. The rejected argument in *Chartbrook v Persimmon Homes Ltd* was that all pre-contractual negotiations should be examined, not just those pointing to surrounding circumstances in the mutual contemplation of the parties. The argument purported to accept that contractual construction was an objective process, and that evidence of what one party intended should not be admissible. But other parts of the argument undercut that approach. Mr Christopher Nugee QC submitted: ‘The question is not what the words meant but what these parties meant ... Letting in the negotiations gives the court the best chance of ascertaining what the parties meant’. *It would have been revolutionary to have accepted that argument.*

[100] *These conclusions flow from the objective theory of contractual obligation.* Contractual obligation does not depend on actual mental agreement. Mr Justice Holmes said [‘The Path of the Law’ (1897) 10 *Harv L Rev* 457 (at 463 – 464)]:

‘[P]arties may be bound by a contract to things which neither of them intended, and when one does not know of the other’s assent ...

[T]he making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs, – not on the parties’ having meant the same thing but on their having said the same thing.’ [Emphasis added; underlined emphasis in original; footnotes omitted.]

42 The passage in the Holmes article that was omitted from their Honours’ quotation stated:

“Suppose a contract is executed in due form and in writing to deliver a lecture, mentioning no time. One of the parties thinks that the promise will be construed to mean at once, within a week. The other thinks that it means when he is ready. The court says that it means within a reasonable time. *The parties are bound by the contract as it is interpreted by the court, yet neither of them meant what the court declares that they have said.* In my opinion no one will understand the true theory of contract or be able even to discuss some fundamental questions intelligently until he has understood that all contracts are formal, that the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs, – not on the parties’ having meant the same thing but on their having said the same thing.” [Emphasis added; underlined emphasis in original.]

- 43 The final word on this point must go to Lord Donald Nicholls who, writing extra judicially, said:⁴⁵

“The next step is to consider how the court sets about the task of identifying this objective meaning in a particular case. *This meaning is artificial in the sense that it does not necessarily correspond either with the meaning actually intended by the maker of the statement or promise or with the meaning actually understood by his hearer or reader.* Despite this difference, context is every bit as important when carrying out this objective exercise as when carrying out the everyday exercise of identifying the meaning intended to be conveyed by the writer of a letter or email. This cannot be stated too emphatically. Both exercises are exercises in interpretation.

...

The problem must be faced head-on. The objective approach is concerned with identifying presumed intention, not actual intention. So, it is said, actual intention is not relevant when seeking to identify presumed intention, the intention of the notional reasonable person in the position of the parties. If actual intention is irrelevant, pre-contract negotiations as a revelation of actual intention must be equally irrelevant.

...

Whether the notional reasonable person would have been so influenced in a particular case depends upon the facts of that case. In the *Codelfa* case in the High Court of Australia Mason J gave an example. Mason J is a staunch supporter of the traditional rule excluding evidence of actual intention. But in *Codelfa* he felt constrained to note that, by way of exception, there may perhaps be one situation where evidence of the actual intention of the parties may prevail over their presumed intention. That will be where parties have refused to include in the contract a provision which would give effect to their presumed intention. He questioned whether it could be right to carry the objective approach to the point of placing on the words a meaning the parties have united in rejecting.

This lets the cat out of the bag. This example destroys the rationale for an absolute rule. Mason J’s observation prompted Professor McLauchlan to ask a penetrating question: why allow evidence of the fact that the parties have ‘united in rejecting’ a particular meaning, but disallow evidence of the fact that the parties have united in accepting a particular meaning? There can be no answer to that question.” [Emphasis added.]

Some practical examples

- 44 I thought you may be interested in a few examples of cases where the court had determined a meaning of a contract for which neither party contended. In what, no doubt, is highly unsatisfactory to the parties, and to the legal practitioners trying to explain this to their clients, not only is this sometimes the outcome, but sometimes the members of the court do not agree on the issue of interpretation.

⁴⁵ “My Kingdom for a horse: the meaning of words” (2005) 121 LQR 577 (at 580, 582 – 584).

45 In *South Australia v The Commonwealth*,⁴⁶ a case was brought by the State of South Australia and the Attorney-General of the State against the Commonwealth whose general purpose was to establish the immediate obligatory force upon the Commonwealth of that part of the Railways Standardization Agreement of 20 October 1949 between the Commonwealth and the State of South Australia which concerned the standardization of the gauge of railway between Port Pirie and Broken Hill.

46 McTiernan, Taylor and Windeyer JJ were of the opinion that the agreement in question gave rise to political obligations only and not to legal obligations enforceable by a court. Windeyer J said:⁴⁷

“... [t]he Standardization Agreement is an agreement of the sort that ‘are outside the realm of contracts altogether’... An agreement deliberately entered into and by which both parties intend themselves to be bound may yet not be an agreement that the courts will enforce. The circumstances may show that they did not intend, or cannot be regarded as having intended, to subject their agreement to the adjudication of the courts. The status of the parties, their relationship to one another, the topics with which the agreement deals, the extent to which it is expressed to be finally definitive of their concurrence, the way in which it came into existence, these, or any one or more of them taken in the circumstances, may put the matter outside the realm of contract law.”

47 In *South Sydney District Rugby League Football Club Ltd v News Ltd*,⁴⁸ a case concerning attempts to streamline the National Rugby League competition to 14 teams, Finn J observed that definitions of agency that take the principal and agent relationship itself as their particular focus, emphasise that that relationship “can only be established by the consent of the principal and the agent.” As his Honour said, “[t]he consents so given need not necessarily be to a relationship that the parties understand, or even accept, to be that of principal and agent:... [and] notwithstanding that they may have ‘artfully disguised’ it by express disclaimers”.⁴⁹

⁴⁶ (1962) 108 CLR 130; [1962] HCA 10.

⁴⁷ (At 153 – 154).

⁴⁸ [2000] FCA 1541; (2000) 177 ALR 611 (at [132] ff).

⁴⁹ *Ibid* (at [133] 2).

48 Thus, his Honour added, while “[i]t is legitimate for parties to avoid the ‘unwanted consequences’ of a particular category of legal relationship by seeking to cast it in a form that takes it outside that category of relationship: ... whether or not they are successful in achieving that end does not depend simply upon whether, in an express provision of their agreement, they attribute or deny to their relationship a particular legal character — be this, for example, employer and employee: ...; principal and principal or principal and agent...; or partners: ... The parties cannot by the mere device of labelling, no matter how genuinely intentioned, either confer a particular legal character on a relationship that it does not possess or deny it a character that it does possess...”⁵⁰

49 Finally, his Honour pointed out that “[s]ave where an express labelling provision is shown to be a sham, the provision itself (as a manifestation of the parties’ intent) must be given its proper weight in relation to the rest of their agreement and such other relevant circumstances as evidence the true character of their relationship. This may lead to its being disregarded entirely: ... or to its being given full force and effect... And such will depend upon whether, given the actual incidents and content of the relationship (that is, ‘the factual relation’) to which the parties have consented, they have consented ‘to a state of fact upon which the law imposes the consequences which result from agency.’”⁵¹

50 *ABC v APRA* concerned a dispute between the Australasian Performing Right Association Ltd (APRA) and the Australian Broadcasting Commission (ABC) arising out of an agreement made in 1964 and expressed to end on 30 June 1967, albeit that the contract continued indefinitely thereafter until determined by either party on 6 months’ notice.

51 Pursuant to cl 2, a contract price adjustment mechanism for the annual licence fee,⁵² the ABC undertook to pay APRA, in return for obtaining a

⁵⁰ Ibid (at [134] 3).

⁵¹ Ibid (at [135] 4).

⁵² K Dharmananda, L Firios, “Now we know our *ABC*: Reflections on the Interpretation of Contracts” (2014) 38 Aust Bar Rev 283 (*Now we know our ABC*) (at 285).

licence to performing rights for certain musical works, in respect of each financial year after 1966, an annual amount of 2.3 pence per head of population, “subject to rise or fall by a percentage equal to the percentage movement in the cost of living in each financial year. For the purpose of assessing any variations, ...the percentage movement in the consumer price index ... shall be taken for the December quarter ... and compared with the previous December quarter, then where a variation is evident such variation shall be applied to determine the rate applicable for the ... then current financial year.”

52 For some years after the conclusion of the financial year 1966, the ABC paid an annual sum to APRA calculated in respect of each financial year by multiplying the figure of 2.3 pence by the population figures as at December of that year and by then applying to the resultant figure the percentage increase in the cost of living to be attributed to that year.⁵³ That percentage was obtained by comparing the figure given in the consumer price index issued by the statistician for the December quarter of that year with the figure of the same index for the December quarter of the preceding year. Such payments were accepted by APRA without comment. However, in mid-1972 APRA claimed that the payments which had been made had been miscalculated under the agreement and, failing the ABC’s acceptance of that view, sued the ABC for what it claimed was the amount of the underpayment.⁵⁴

53 On a literal reading, cl 2 provided for the variation of a base sum (2.3 pence per head of population) by the percentage movement in the cost of living in that year. However, according to Cheshire & Fifoot, this would not serve the apparent purpose of the clause – to provide a hedge against inflation – for as long as the rate of inflation remained constant or declined, payments to APRA would not increase, even if the value of money continued to decline.⁵⁵

⁵³ 2.3 pence is referred to in the judgment, with no reference to the introduction of decimal currency on 14 February 1966.

⁵⁴ *ABC v APRA* (at 103) per Barwick CJ.

⁵⁵ See Cheshire & Fifoot (at [10.35]).

54 APRA argued that cl 2 should be read as establishing cumulative rises. The figure of 2.3 pence was not a fixed figure for use in the calculation of the annual sum in the years after 1966. The per capita figure in all of these years was to be ascertained by determining the amount per capita which had been paid in the prior financial year and then increasing or decreasing that figure by the percentage of the increase or decrease in the consumer price index for the year for which the calculation was to be made. In this way, the progressive effect of inflation would be catered for.⁵⁶

55 The ABC argued that the language of the agreement was unambiguous and that the approach it had been taking accurately reflected its terms.⁵⁷

56 In APRA's proceedings in the Equity Division of the Supreme Court of New South Wales sought a declaration as to the proper construction of cl 2. Street CJ in Eq found in favour of APRA. His Honour's reasons were not reported but the following key passage was reproduced in the High Court's judgment:

"The contractual intention which these parties have set down in this document is not an intention that there should be but one variation figure or rate to be allowed each year against the basic figure of 2.3 pence. *Rather I consider that the parties have here set down an intention to cover a cumulative adjustment.* There is little profit in attempting to justify this inference by specific reference to the words of the proviso or by embarking upon exercises in semantics in an attempt to demonstrate that this is what the parties have expressly said. The problem is one of deducing the contractual intention from the whole of this cl 2 of the agreement. The deduction or inference that I have made concerning this contractual intention is that which I have stated, namely that the parties intended that the rise should be by reference to a cumulative percentage movement since December 1965."⁵⁸ [Emphasis added.]

57 Although Street CJ in Eq found that the words in cl 2 were susceptible of two possible meanings, his Honour was able, by means of inferences drawn from the agreement as a whole and favouring APRA's construction, to give effect to "the almost overwhelming probability of the intention of the parties to tie the

⁵⁶ *ABC v APRA* (at 104).

⁵⁷ *Ibid.*

⁵⁸ *Ibid* (at 103 – 104).

licence fee, or the base figure from which the same is to be deduced, to movements in the consumer price index”.⁵⁹

58 On appeal to three judges of the High Court, there was no agreement as to the proper construction of cl 2 and its proviso. Gibbs J was the only member of the High Court to agree with Street CJ in Eq’s (and therefore APRA’s) construction. His Honour held that the proviso was ambiguous⁶⁰ and that the references to “each” and “rate” in cl 2 were sufficiently uncertain that the Court could choose the most sensible of the two constructions. His Honour preferred APRA’s construction in the light of the “irrational consequences” of applying the ABC’s construction.⁶¹

59 The majority (Barwick CJ and Stephen J) could not see any ambiguity in cl 2 or its proviso. That is to say, each was of the view that the proviso was not susceptible to more than one meaning, even though they were divided on the meaning of the proviso, and on the meaning of a critical word, “rate”.⁶²

60 Barwick CJ considered that the parties had deliberately departed from the pattern of a steadily rising per capita rate such that, from 1966 onwards, the rate was fixed at 2.3 pence indefinitely.⁶³ After 1966, the per capita licence fee would simply be 2.3 pence plus a percentage increase calculated by reference to the movement in the consumer price index over the preceding year. His Honour acknowledged that the computation of the amount of the annual figure in this way may produce unusual results, but said that:

“result is produced by the application of the words in which the parties have expressed themselves, it is no part of the function of a court by some process of divination as distinct from construction of the language employed to attribute to parties an intention to do something for which their express words do not provide.”⁶⁴

⁵⁹ Ibid (at 113) per Stephen J.

⁶⁰ Ibid (at 111).

⁶¹ Ibid.

⁶² *Now we know our ABC* (at 290).

⁶³ *ABC v APRA* (at 105).

⁶⁴ Ibid.

61 Barwick CJ held that the word “rate” was readily explicable on the basis that it indicated that the percentage movement in the consumer price index applied for the entire financial year, even though it was to be calculated only by reference to the December figures. Understood in this way, the word “rate” was not a reference to the per capita figure at all, but rather to the percentage change in the consumer price index for the relevant period.⁶⁵

62 On the other hand, Stephen J reached a similar conclusion to Gibbs J that the reference to a “rate” meant the figure of 2.3 pence as adjusted by the relevant percentage movement in the consumer price index for that year. Unlike Gibbs J, however, Stephen J did not consider the use of “rate” in this way as pointing towards an aggregated figure.

63 As both Barwick CJ and Stephen J preferred the ABC’s contention, the appeal was allowed.

64 Long before APRA challenged the methodology the ABC had been applying to calculate the licence fee, in an article published in 1968, APRA’s director explained:

“Thus, the Australian Broadcasting Commission, commercial radio and television stations, theatres, dance halls, concert halls and even ‘juke box’ operators pay a yearly licence fee in accordance with *a carefully worked out tariff* based on such factors as extent of uses, audience and revenue.”⁶⁶
[Emphasis added.]

65 It would have been little comfort to that director, and to the parties generally, that Barwick CJ described accepting APRA’s contention as “requir[ing] a radical change to be made in the language chosen by the parties to express their intention”.⁶⁷ Stephen J described the method specified in cl 2 (a) – (e) as “clearly expressed”, but the operation of the proviso as, “of course, curious”.⁶⁸ Gibbs J, on the other hand, described the construction for which the ABC

⁶⁵ Ibid (at 106).

⁶⁶ *Now we know our ABC* (at 290).

⁶⁷ *ABC v APRA* (at 107).

⁶⁸ Ibid (at 114).

contended as leading to “surprising results”⁶⁹ and having “irrational consequences”.⁷⁰

66 The parties may have thought the outcome was evidence of too great an application of the “vigorous common sense of English judges”. In the upshot, the judiciary, when one includes Street CJ in Eq, were evenly divided on the meaning of the clause.

67 Two decades after *ABC v APRA* was decided, a search of AustLII revealed that the case had been cited over 500 times with the Supreme Court of New South Wales alone making up some 170 of those citations.⁷¹ Of course, the matter which has drawn so much attention is not the controversy between the members of the Bench as to the meaning of cl 2, but, rather, Gibbs J’s classic statement that it was “trite law that the primary duty of a court in construing a written contract is to endeavour to discover the intention of the parties from the words of the instrument in which the contract is embodied” and his Honour’s development of the proposition as to how that task is undertaken. It is, of course, a matter of some irony, but not entirely novel, that this classic statement emerges from a dissenting judgment, a matter perhaps more understandable when it is appreciated, as some commentators have observed, that Gibbs J’s statement reflects his former life as a lecturer on legal interpretation.⁷²

68 Finally, I wanted to touch on *Brambles Holdings Ltd v Bathurst City Council*.⁷³

69 In that case, Brambles Holdings Ltd (Brambles) agreed by deed dated 23 November 1982 to manage the respondent Council’s Solid Waste Disposal Depot. In about 1985 Brambles started to receive liquid waste at the Depot, and to charge for its acceptance. Brambles retained this money. It did not give any to the Council. In 1995, the Council asserted that Brambles was

⁶⁹ Ibid (at 108).

⁷⁰ Ibid (at 111).

⁷¹ *Now we know our ABC* (at 283).

⁷² Ibid (at 287).

⁷³ (2001) 53 NSWLR 153; [2001] NSWCA 61.

obliged to pay to it part of the fees for liquid waste it had collected since 1 October 1991. Litigation ensued.

- 70 One issue for consideration was whether the contract for the management of the Solid Waste Disposal Depot regulated the charging of fees for liquid waste. Heydon JA (with whom Mason P and Ipp AJA agreed) held that it did because, objectively interpreted, the term “general commercial waste” in the contract covered liquid waste. His Honour reached this conclusion notwithstanding evidence that both parties did not share this conclusion, as such evidence was dismissed as inadmissible and the actual opinions of the parties were “irrelevant in the absence of any argument that a decree of rectification should be ordered or an estoppel by convention found.”⁷⁴ In a separate judgment, Ipp AJA appears to have gone further by saying:

“[147] ... In other words, the parties (wrongly, in my view) believed that the July 1990 contract, while governing the receipt of liquid waste, did not regulate the charging of fees for liquid wastes.”

Rectification

- 71 Finally, of course, there is one area where evidence of the parties’ actual intention is relevant: the equitable doctrine of rectification which enables a court to rectify an instrument if it does not reflect the intention of the party or parties to it.⁷⁵ Rectification ensures that the contract gives effect to the parties’ actual intention.⁷⁶
- 72 The essential principles concerning rectification were recently explained in the joint judgment of the High Court in *Simic v New South Wales Land and Housing*,⁷⁷ as follows:

“[103] Rectification is an equitable remedy, the purpose of which is to make a written instrument ‘conform to the true agreement of the parties where the writing by common mistake fails to express that agreement accurately’. For relief by rectification, it must be demonstrated that, at the time of the

⁷⁴ Ibid (at [27]; see also [46]).

⁷⁵ *Maralinga Pty Ltd v Major Enterprises Pty Ltd* (1973) 128 CLR 336 (*Maralinga*) (at 350) per Mason J (Menzies J agreeing); [1973] HCA 23.

⁷⁶ *Codelfa* (at 346).

⁷⁷ [2016] HCA 47; (2016) 91 ALJR 108 (*Simic*) per Gageler, Nettle and Gordon JJ.

execution of the written instrument sought to be rectified, there was an ‘agreement’ between the parties in the sense that the parties had a ‘common intention’, and that the written instrument was to conform to that agreement. Critically, it must also be demonstrated that the written instrument does not reflect the ‘agreement’ because of a common mistake. Unless those elements are established, the ‘hypothesis arising from execution of the written instrument, namely, that it is the true agreement of the parties’ cannot be displaced.

[104] The issue may be approached by asking — what was the actual or true common intention of the parties? There is no requirement for communication of that common intention by express statement, but it must at least be the parties’ actual intentions, viewed objectively from their words or actions, and must be correspondingly held by each party.” [Footnotes omitted.]

73 The focus of the courts in a case of rectification is on the common intention of the parties up to the time the relevant instrument was made. Courts begin with the presumption that an instrument reflects the true agreement of the parties to it. A party seeking rectification must displace that presumption by demonstrating that the instrument does not reflect the true agreement of the parties.⁷⁸ That intention must be proved by admissible evidence and proved to a high standard.⁷⁹ Thus, a person who seeks to rectify a contract upon the ground of mistake must be required to establish, in the clearest and most satisfactory manner, that the alleged intention to which he or she desires it to be made conformable continued concurrently in the minds of all parties down to the time of its execution.⁸⁰ In *Franklins v Metcash*,⁸¹ Campbell JA explained that it was “elementary that rectification is granted only upon ‘clear and convincing proof’ or ‘convincing proof’”.

74 The actual intention of each of the parties which must be established has often been referred to as their subjective intention. Nevertheless, a court, in determining whether the burden of proof is discharged, may be said to view the evidence of intention objectively, in the sense that it does not merely accept what a party says was in his or her mind, but instead considers and weighs admissible evidence probative of intention.⁸²

⁷⁸ *Maralinga* (350 – 351).

⁷⁹ *Simic* (at [41]) per Kiefel J.

⁸⁰ *Ibid* (referring to *Fowler v Fowler* (1859) 4 De G & J 250 (at 265); (1859) 45 ER 97 (at 103)).

⁸¹ (At [451] – [457]).

⁸² *Simic* (at [42]).

- 75 While it is not to be expected that parties to contractual negotiations will express themselves in terms of their intentions, it is expected that proof to the necessary standard will usually require some manifestation of the intention of each party by their words or conduct and that the requisite common intention will be a matter of inference for the court from that evidence.⁸³
- 76 The traditional approach of the courts is to grant rectification only if the instrument in question did not reflect the actual common intention of the parties. That intention is proved in the usual way, by admissible evidence to the requisite standard. The assessment undertaken by the court may be described as an objective one.⁸⁴

Conclusion

- 77 So there you have it: a quick scamper through one of, if not the, central principle of contractual interpretation. If I have left those of you who are business people somewhat discombobulated by the proposition that the commercial contracts you carefully craft, no doubt with the assistance of the finest legal advice, may not mean what you intended them to mean, you have my sympathy.
- 78 For members of the legal profession charged with the responsibility of advising on the drafting of contracts, you no doubt have already taken on board all that I have said and advise clients with the caveat that, at the end of the day, what they intended their contract to say, and understood it did, may not withstand the test of judicial scrutiny.
- 79 For the judiciary, the lesson to be learned from such decisions is that “underlying this unpredictability, all judges charged with interpreting a contract will, at one level or another, be faced with a *choice* of some kind: a choice about whether the words are susceptible to more than one meaning, a choice between alternative constructions, or a choice about the purpose or object of the transaction. Interpretive discretion is inherent in the process and arises

⁸³ Ibid (at [43]).

⁸⁴ Ibid (at [46]).

irrespective of whether the judge takes a strictly textual approach or subscribes to the notion that there is only one ‘true’ construction.”⁸⁵

80 And hopefully, none of us will think or say or sing as did Eliza Doolittle in *My Fair Lady*:

“Words, words, words!
I'm so sick of words
I get words all day through;
First from him, now from you!
Is that all you blighters can do?”⁸⁶

⁸⁵ *Now we know our ABC* (at 284) [emphasis in original].

⁸⁶ Alan Jay Lerner and Frederick Loewe, “Show Me”, *My Fair Lady*.