

The Interpretation of Commercial Contracts – Hunting for the Intention of the Parties

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Introduction

1 “*It is extraordinary*”, said Lord Dyson, “*how many cases are still being reported in the law reports in the 21st century on how to interpret a contract.*”¹ To be added to the sea of reported decisions is an ever-growing collection of unreported decisions, academic articles and extra-judicial speeches. It is not without some irony, therefore, that I am about to spill even more ink on this topic.

2 You may be wondering why I am about to do so. The answer, in my mind, is simple. In almost fifteen years on the bench, I have seen a range of incorrect or inappropriate contractual interpretation arguments: including the overly narrow approach of reading a single word in a manner entirely divorced from its context; the approach of last resort, seeking to overturn unmistakably clear language by aspirational reference to vague norms of commerciality; and the legally incorrect approach of attempting to sneak in evidence of subjective intent under the guise of ‘surrounding circumstances’. In this paper, I hope to provide a practical refresher of the relevant principles, and to also offer some thoughts on various unsettled areas of law. Although the focus will be on the interpretation of existing commercial contracts, many of these principles are also applicable to the drafting of contracts.

What do we mean by “interpretation”?

3 The solemn incantation of the phrase “interpretation of commercial contracts” is a recurrent theme in both judgments and academic writings (and one repeated in both the heading and

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¹ Lord Dyson, ‘The Contribution of Construction Cases to the Development of the Common Law’ (Speech delivered for the 2015 Keating Lecture, 25 March 2015, London).

the body of this paper). There is a risk that by giving something a label, we may imbue it with an appearance of complexity or significance that is otherwise lacking. All too often, thereafter, complexity develops, as it were to fill the vacuum of expectation.

- 4 Interpretation of texts (and by “texts”, I include any form of visual communication of ideas, in words or images or both) is something we do every day. Children learn to do it at a very early age, even before they learn to read. A child will look at a picture, or series of pictures, and describe what, to the child, is depicted. There is nothing mysterious about the process of interpretation; and I am reminded of Molière’s Monsieur Jourdain, who discovered to his surprise that for “these 40 years now I’ve been speaking in prose without knowing it”. So, too, we have been interpreting texts for (and you may insert the appropriate number of years at this point, according to your individual veracity or imagination) years without knowing it.
- 5 The process of interpretation may be described as the process of ascription of meaning to, or derivation of meaning from, a text. In some cases, the process is simple. We look at a cinema ticket. It tells us that we have paid to see a particular film on a particular day at a particular time in a particular cinema of whichever megaplex we attend. It does not require much, except a rudimentary grasp of the English language, to interpret a text of that nature. There is very little scope for variant interpretations.
- 6 On the other hand, the interpretation of a novel, a poem, or a painting is a far more complex process. It is inherently subjective. When we embark upon the task, we are saying what the novel or poem or painting means to us; what it tells us. We are ascribing meaning or deriving meaning accordingly.
- 7 It is at this point that the process of interpretation which is the subject of this paper departs from ordinary human experience. Interpretation, as I have described it so far, is necessarily subjective. We have moved well beyond the days when there was one canonically accepted “meaning”, or “reading”, of a text. Dr Samuel Johnson may have sought to declare, magisterially and authoritatively, the “meaning” of a play by Shakespeare or a poem by Dryden; and many other scholars, of greater or lesser eminence, have essayed the same task since the 18th Century. But if the post-modernist school of thought has taught us anything (and in my view one may doubt that it has taught us very much), it is that texts have no fixed, definite and eternal meaning. There are several reasons why that is so. I shall mention two.
- 8 First, written texts use language as their building blocks. Common experience, supported by the wide range of dictionaries available both in hardcopy format and online, tells us that words of the English language have no fixed, definite and unalterable meaning. The definition or denotation of words changes over time. Every word is capable of conveying a range of

meanings. The “meaning” that a word should have – its connotation – in a particular written text depends fundamentally on a consideration of that text as a whole.

- 9 Second, a person’s interpretation of a text necessarily is influenced by the context in which it is done. The “context” is both personal and social. We have a very different world view now to that of Dr Johnson and his English contemporaries more than two centuries ago.
- 10 There is, therefore, some inconsistency. Human experience insists that interpretation is personal and subjective. By contrast, the law, at least in the field of contractual (and statutory) interpretation, insists upon ascribing a fixed and objective meaning to a particular text. There are very good reasons why this should be so. They include, most fundamentally, the need for certainty. Parties to a commercial contract should be able to organise their affairs knowing what the contract “means”. Citizens should be able to conduct themselves knowing that their actions are (or in some cases are not) within the law.
- 11 The process of construction of a contract may thus be said to be the ascription of legal meaning or effect to the words of the contract. It is the outcome of a process of analysis that is said and intended to be objective. In seeking objective certainty, the courts seek to promote efficiency in commercial dealings. One strange consequence of the courts’ approach to construction is that the objective meaning and effect ascribed to the parties’ bargain may differ from the subjective understanding of the parties, or indeed their mutual subjective understandings. There is a remedy – rectification – for the latter; the former is part of the price of certainty.
- 12 At the conclusion of this paper, I will suggest a heresy: namely, that the phrases used to describe the process of objective interpretation of commercial contracts are categories of indeterminate reference. By this, I mean that the process does not necessarily yield consistent outcomes. The phrases cloak the application of value judgments to the particular issue; and they allow for variable judgments to be made as to the result of their application to particular facts. They are, in short, labels used to justify the choice of a particular interpretation, or to disguise what is (and necessarily must be) the individual judge’s reaction to the text that she or he is asked to interpret. However, before I venture further along the path of heresy, I shall do my best to describe the orthodox, and legally acceptable, process of construction of commercial contracts. After all, that is what I was asked to address, and no doubt what you have come along to hear.

Overview:

13 The focus of this paper is on written contracts. At least, there is usually no doubt as to the terms of the bargain (of course, there is the ever-present problem of implied terms, but these may affect oral contracts as well). The logical starting point to a discussion of the interpretation of contracts is determining what evidence can be led in this process. In this portion of the paper, I intend to focus on three areas of common difficulty:

- (1) in what circumstances can a court legitimately look at extrinsic material to guide its interpretation of a contract?
- (2) For what purposes can evidence of the pre-contractual negotiations of the parties be deployed?
- (3) When can a court receive evidence of conduct and events subsequent to the formation of the contract?

14 After discussing these questions, I shall give a practical overview of *how* to interpret a commercial contract, including the importance of reading the relevant instrument in a harmonious manner, and the role of norms of ‘commerciality’. It may be thought that these principles are simple, and do not require explanation. I disagree. As was stated last year by Leeming JA,² an

uncontroversial generalised proposition is capable of concealing sharp divisions when it is sought to be applied at a lower level of abstraction.

15 To take one brief example, it is well established that, when construing a commercial contract, a court should favour a businesslike interpretation over a non-businesslike one.³ This ‘rule’ has its limits: it is equally well established that commerciality is no basis for re-writing the agreement which the parties actually made.⁴ Against these clear principles, consider the following questions which confront judicial officers:

- (1) what if there is considerable (and reasonable) disagreement over what is a commercial outcome?⁵

² *Cherry v Steele-Park* [2017] NSWCA 295 at [47] (Leeming JA).

³ See, eg, *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 656-7 [35] (French CJ, Hayne, Crennan and Kiefel JJ).

⁴ *Kooee Communications Pty Ltd v Primus Telecommunications Pty Ltd* [2008] NSWCA 5 at [27] (Basten JA, Giles and Tobias JJA relevantly agreeing).

⁵ The former Chief Justice, the Hon James Spigelman AC QC, once wrote that ‘[t]he only difficulty is that, at least when the matter comes to the level of litigation, each party remains convinced that a ‘businesslike’ interpretation

- (2) What if the natural meaning of the language points one way, but commercial considerations point another, with neither being sufficiently clear to outweigh the other?
- (3) What if the commercial context of a long-term contract shifts considerably between its commencement and when the relevant dispute arises?
- 16 Many more examples could be given to demonstrate the complexities lurking underneath the apparently still waters of interpretation. With these preliminary thoughts in mind, it is now time to consider the questions of admissibility of evidence.

Admissible Evidence in the Process of Construction

- 17 The main piece of ‘evidence’ used in the process of construction is, of course, the contract document itself. In addition, however, parties often seek to refer to extrinsic material in order to support the interpretation for which they contend. In this portion of the paper, I shall discuss the circumstances in which this can be done. After doing so, I shall then say some words about the particular cases of pre-contractual negotiations and post-contractual conduct.
- 18 Where a contract is alleged to be partly oral and partly written, evidence of the oral negotiations is admissible to prove (if it does) the oral terms. Equally, where it is alleged that the terms of a contract are spelled out in several documents, all those documents are admissible. In neither example can the material – oral or written – be said to be “extrinsic”.
- 19 Extrinsic material, by its definition, is anything external to the terms of the agreement. This can consist of the economic conditions subsisting at the relevant time, details of typical practice in the industry, knowledge of the statutory background to the agreement, communications exchanged in negotiation and so forth. Before I proceed to discuss the cases in which this evidence has been held to be admissible, I should sound a note of caution about succumbing to the seduction of immediately reaching for extrinsic evidence:
- (1) first, there is a clear distinction between theoretical admissibility and substantial probative value.⁶ In the ordinary case, the surest guide to the intention of the parties

or ‘business commonsense’ happens to coincide with its own commercial interests’: James Spigelman, ‘From Text to Context: Contemporary Contractual Interpretation’ (2007) 81 *Australian Law Journal* 322 at 330.

⁶ To this effect, see the recent comments of French CJ, Nettle and Gordon JJ that ‘ordinarily [the] process of construction is possible by reference to the contract alone: *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104 at 116 [48]. Of course, if the extrinsic material is not relevant, it is not admissible: *Evidence Act 1995* (NSW), s 56(2). Ordinarily, however, the court should not decide a substantive point – the possible value and application of extrinsic material – by an evidentiary ruling.

is what has actually been written and signed on the face of the document itself, and this is almost always the most persuasive 'proof' to the judge.

- (2) Second, this 'presumption', for lack of a better word, is much stronger in cases where contracts are the result of negotiation and legal advice, as many commercial contracts are. The reason is simple: each of the relevant external circumstances is expected to have been merged into the concluded contract itself. Indeed, this merger, and the certainty it promotes, is a key factor underpinning the importance of contract law in the commercial world.
- (3) Third, attempts to use extrinsic evidence to justify what a party *wishes* had been written into a contract will ordinarily fail. As is well established, it is not the job of the courts to rewrite unwise commercial bargains under the guise of construction.⁷

20 That being said, there remain cases in which extrinsic material is required to help ascertain what the parties' intention was. The most obvious example is the case of a genuinely ambiguous contract. Perhaps the actual text of a key provision is susceptible to two meanings, or there are two provisions which conflict without it being apparent which should dominate. So long as the following discussion is understood as being limited to relatively rarer cases, and not taken as an invitation to burden a court with voluminous and marginally relevant documents, it is time to proceed.

A. *An Ambiguity Gateway?*

21 The first question to be addressed is when a court is permitted to look at extrinsic material. The answer (and the problem) is found in the well-known expression of Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*, where his Honour said:⁸

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.

22 The difficulty with this passage is whether the "*true rule*" requires the existence of ambiguity before any recourse to extrinsic material is permitted. The simple answer is that it depends on the purpose for which that evidence is to be used. In a 2015 paper titled '*Construction of*

⁷ *McGrath v Sturesteps; Sturesteps v HIH Overseas Holdings Ltd (in liq)* (2011) 81 NSWLR 690 at [17] (Bathurst CJ).

⁸ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352 (Mason J).

Contracts: The High Court's Approach,⁹ I discussed the concept of an 'ambiguity gateway' in extensive detail. I do not intend to repeat that analysis, but rather to briefly summarise it for the benefit of those who have not read that paper, and then demonstrate how the position I then took has been confirmed by recent authority.

23 I noted, as an initial matter, that:

The 'true rule' appears at first blush to ban any use of evidence of surrounding circumstances – which I will call 'extrinsic evidence' – when construing contracts, unless there is ambiguity in the language of the contract. However, as is clear from *Codelfa* itself, there are other bases on which extrinsic evidence can be admitted. Only two paragraphs before the statement of the 'true rule', Mason J affirmed his own earlier observation in *DTR Nominees Pty Ltd v Mona Homes Pty Ltd* that:

A court may admit evidence of surrounding circumstances in the form of 'mutually known facts' 'to identify the meaning of a descriptive term' and it may admit evidence of the 'genesis' and objectively the 'aim' of a transaction to show that the attribution of a strict legal meaning would 'make the transaction futile'...

24 After a discussion of the relevant High Court authorities between 2000 and 2015, I concluded that the best interpretation of the true rule is one which operates disjunctively, and that there are therefore

...three separate purposes for which extrinsic evidence can be admitted: (1) To identify the meaning of a descriptive term; (2) To explain the genesis or aim of a transaction; or (3) To assist in the interpretation of ambiguous language.

25 This is then combined with the second (restrictive) sentence of the true rule, which provides that *Codelfa* expressly prohibits the use of extrinsic evidence:

(4) To contradict the language of the contract when it has a plain meaning; or (5) To establish subjective intentions of the parties, even where shared by both parties.

26 Consequently, although resolving ambiguity is *one* purpose for which extrinsic evidence can be legitimately deployed, the existence of ambiguity is not a hurdle which must be cleared before a court can look at the material.

Ambiguity is a Conclusion:

27 This approach to the so-called ambiguity gateway is not only consistent with the approach of the High Court, but is also sound in principle. This is because the existence or otherwise of an ambiguity is a conclusion which can only be safely reached *after* all the relevant evidence has

⁹ Justice Robert McDougall, 'Construction of Contracts: The High Court's Approach' (Paper delivered at the Commercial Law Association Judges' Series, 26 June 2015, Sydney).

been considered.¹⁰ Postponing the admission of extrinsic material until after ambiguity is identified therefore presents somewhat of a logical conundrum. An example to demonstrate this point is the recent decision in *Victoria v Tatts Group Limited*. At issue was the interpretation of the phrase “*new gaming operator’s license*”, which was described as turning on whether the relevant phrase was:¹¹

restricted to a gaming operator’s licence granted under Pt 3 of the 1991 Act (as it might be amended, re-enacted or replaced from time to time) [or whether it] had a broader generic meaning which covered any statutory authority whose effect was to confer on the holder substantially the same rights as were conferred on Tatts by its gaming operator’s licence at the time of its expiration.

28 What is immediately apparent is that the relevant ambiguity (namely whether a “*new gaming operator’s license*” was restricted to that granted under an earlier Act or whether it had a generic meaning) only became knowable *after* the relevant context was considered. To put it loosely, it was an observation of the changing statutory background that made the relevant ambiguity a patent one. It was, therefore, in recognition of the conclusionary label of ‘ambiguity’ that I also said in my earlier paper that:

[E]xtrinsic evidence is always provisionally admissible (compare Evidence Act 1995 (NSW), s 57) to answer the preliminary question of whether ambiguity exists. If ambiguity is found to exist, then the evidence becomes admissible unconditionally to assist in the interpretation of that ambiguous language. Whereas if the preliminary inquiry reveals that the language is plain, the extrinsic evidence can go no further in illuminating its meaning (and, clearly, it would not need to anyway).

Recent Authority:

29 In the three years since I wrote in 2015, the High Court has handed down several decisions relating to contract law. None of these decisions, however, resolved on an authoritative basis whether an ambiguity gateway exists in Australia.¹²

30 That is not the position reflected in the judgments of the NSW Court of Appeal; instead, the clear position in this state is that ambiguity is not a threshold which must be met before

¹⁰ See, for example, the comments of Leeming JA that: ‘[T]o say that a legal text is ‘clear’ reflects the *outcome* of that process of interpretation. It means that there is nothing in the context which detracts from the ordinary literal meaning’: *Mainteck Services* (2014) 89 NSWLR 633 at 654 [77].

¹¹ *Victoria v Tatts Group Limited* (2016) 90 ALJR 392 at 394 [5] (French CJ, Kiefel, Bell, Keane and Gordon JJ).

¹² In *Mount Bruce Mining v Wright Prospective Pty Ltd* (2015) 256 CLR 104, the High Court noted that there was a divergence of views regarding what requirements *Codelfa* imposes, but said that this was not the occasion to resolve those differences: see at 117 [52] (French CJ, Nettle and Gordon JJ), 132 [111] (Kiefel and Keane JJ) and 134 [119]-[120] (Bell and Gageler JJ).

extrinsic material can be admitted into evidence. In *Synergy Protection Agency Pty Ltd v North Sydney Leagues' Club Ltd*,¹³ it was said that:

The primary judge ... appeared to adopt a principle that background or extrinsic material can only be examined once some textual ambiguity in the contract is revealed. This is not so.

31 More recently, in *Cherry v Steele-Park*,¹⁴ Leeming JA (with whom Gleeson and White JJA relevantly agreed)¹⁵ analysed the relevant High Court authorities which had been delivered since 2015. His Honour noted that in both *Victoria v Tatts Group Ltd* and in *Simic v New South Wales Land and Housing Corporation*,¹⁶ the High Court considered the impact of the surrounding circumstances *before* concluding that there was ambiguity in the text itself. Leeming JA concluded with the observation that although neither judgment in its terms stated that ambiguity was not required to admit external evidence, the High Court's factual application clearly suggests this, and that application should be taken at face value.¹⁷

32 At present therefore, and absent any statement to the contrary from the High Court, the position in this state at least is that resort may be had to extrinsic material without having first identified any ambiguity in the text. Of course, this does not mean that *all* extrinsic material is admissible for *all* purposes. Instead, it is necessary that the material:

- (1) fit within one of the permitted bases established in *Codelfa*, such as that the extrinsic material informs to the genesis of the transaction; and
- (2) not contravene any of the exclusionary rules in *Codelfa*, such as the rule against establishing the subjective intentions of the parties.

33 To illustrate these examples further, it is useful to consider the particular cases of pre-contractual negotiations and post-contractual conduct.

B. Pre-Contractual Negotiations

34 It is essential, before we begin to discuss the topic of pre-contractual negotiations, not to overstate its importance. One of the central premises of contract law, and the certainty which the commercial world requires, is that pre-contractual negotiations are subsumed by the final

¹³ [2009] NSWCA 140 at [22] (Allsop P, Tobias and Basten JJA agreeing).

¹⁴ [2017] NSWCA 295.

¹⁵ *Cherry v Steele-Park* [2017] NSWCA 295 at [79]-[82] (Leeming JA).

¹⁶ (2016) 260 CLR 85.

¹⁷ *Cherry v Steele-Park* [2017] NSWCA 295 at [82] (Leeming JA).

contract. Ordinarily, it would be unfair and contrary to commercial practice (and, particularly in the case of long-term contracts, extremely difficult) to require a party to find and then trawl through historical communications simply to uncover the meaning of a formal written document.

- 35 With that in mind, we start with the classic formulation of the relevant principles, which can be found (once again) in the judgment of Mason J in *Codelfa*:¹⁸

Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable.

- 36 What is immediately apparent is that his Honour's comments are not directed at the admissibility into evidence of pre-contractual negotiations, but rather at the purpose for which that evidence is used.¹⁹ This is a matter of some importance. As a useful rule of thumb, to the extent that pre-contractual communications refer to matters *external* to the terms of the contract, they are admissible (subject, of course, to other rules of admissibility). But to the extent that the evidence to be relied upon involves discussion or negotiation of the *actual* terms of the contract those communications will likely tend to reveal no more than the subjective intentions of the party, and are thus inadmissible.²⁰

- 37 Four examples (progressing from easier to harder) will help to illustrate this distinction in a practical way. In *MacDonald v Longbottom*,²¹ a contract was formed by the following sequence of letters:

Offer: ... [H]e now desires me to offer you for your wool 16s. per stone, delivered in Liverpool, less two months discount, and as there is now so little between you, I hope to receive your acceptance of the above offer in due course. (Signed) "WILLIAM STEWART."

Acceptance: [I]n reply beg to say that I agree to your offer for the wool of 16s. per stone, less two months' discount, at the rate of 5l. per cent., for ready money." (Signed) "MACDONALD, JUN."

¹⁸ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352 (Mason J).

¹⁹ For a brief discussion of this distinction, see Daniel Reynolds, 'Construction of contracts after Mount Bruce Mining v Wright Prospecting' (2016) 90 *Australian Law Journal* 190 at 192-3.

²⁰ This is not to say that there are not (rare) cases where very difficult questions of fact and degree arise. To take a recent example, in *Cherry v Steele-Park*, NSW Court of Appeal split 2:1 over whether certain pre-contractual correspondence between the parties was admissible. Careful attention to the distinction between discussions on the terms of the contract and those external to those terms, however, will hopefully help avoid many of these difficulties.

²¹ (1859) 120 ER 1177.

- 38 Besides the vague reference to “*your wool*”, the contract is silent on what wool is, in fact, to be purchased. Lord Campbell CJ admitted evidence of prior conversations to determine what was meant by “*your wool*”.²² This was because the use of the pre-contractual discussions was not used to influence the meaning of any term of the contract, but rather to identify the subject matter of the contract. In a related fashion, pre-contractual communications can also be used to identify the parties to a contract.²³
- 39 This is an entirely different scenario from that presented in *Phoenix Commercial Enterprises Pty Ltd v City of Canada Bay Council*.²⁴ In that case, a letter written during the course of negotiations set out the appellant’s understanding of the effect of part of the contract. The letter then concluded with the expression “*We trust that the above accurately reflects the mutual intentions. Should there be a difference please advise*”. The Council did not respond. The NSW Court of Appeal held that the letter was inadmissible as it was no more than evidence of the sending party’s subjective understanding of the terms of the contract.²⁵ To put it in the language of our rule of thumb, the letter involved discussion of the actual terms of the contract, and not matters external to those terms.
- 40 The third example is perhaps the most instructive. In *Codelfa* itself, evidence of pre-contractual communications was admitted to demonstrate a common understanding as to how work under the contract was to be performed (namely on a continuous basis). This appears to infringe our rule of thumb which prohibits admitting evidence of discussions of any terms of a contract.
- 41 Upon closer inspection, however, this is not so. This is because the relevant terms being negotiated in *Codelfa* were terms regarding price, and not terms regarding how work was to be performed. Evidence of the “common understanding” as to work hours was held to be admissible for the purpose of determining whether a related term should be implied into the contract. Consequently, the discussions which were admitted were entirely external to the contractual document itself. Those discussions demonstrated the mutual objective basis which grounded the remaining negotiations of the actual terms of the contract (e.g. as to the amount of payment). It is for this reason that Mason J said that “*the consequence is that the discussions [as to work hours] did not have the character of negotiations in the course of*

²² *MacDonald v Longbottom* (1859) 120 ER 1177 at 1179 (Lord Campbell CJ).

²³ See, eg, the decision of the High Court in *Edwards v Edwards* (1918) 24 CLR 312 which permitted recourse to extrinsic evidence to construe a deed which transferred property to a Mr John Edwards where there were multiple persons known by that name.

²⁴ [2010] NSWCA 64.

²⁵ *Phoenix Commercial Enterprises Pty Ltd v City of Canada Bay Council* [2010] NSWCA 64 at [139] (Campbell JA). Of course, had the respondent Council confirmed this mutual understanding, this may have been relevant for other purposes.

which the parties gradually evolved the terms of a bargain ultimately embodied in written form".²⁶ As a result, those discussions were never merged into the terms of the contract, nor did they suggest what the parties' actual intentions were.

42 Properly understood, therefore, this aspect of *Codelfa* is also entirely compatible with the rule of thumb which I earlier identified as the discussions as to work hours were also external to the terms of the contract.

43 Finally, in the interests of completeness, it is necessary to throw a (small) spanner in the works, and examine a fourth case which appears to be outside our rule of thumb. Also in *Codelfa*, Mason J tentatively suggested that:²⁷

There may perhaps be one situation in which evidence of the actual intention of the parties should be allowed to prevail over their presumed intention. If it transpires that the parties have refused to include in the contract a provision which would give effect to the presumed intention of persons in their position it may be proper to receive evidence of that refusal.

44 I suggest that considerable care be taken with this passage, and that there are only rare cases where this rule, properly understood, can be applicable. *MCA International BV v Northern Star Holdings Ltd* was one such case. In that case, various banks placed Northern Star into receivership. MCA commenced proceedings seeking a declaration that, upon the proper construction of a "Limited Recourse Guarantee" entered into between the banks and MCA, MCA's consent was required before the receivers sold any assets of Northern Star. This construction was open on the language of the relevant provisions.

45 There was, however, correspondence between the parties which showed unequivocally that the parties had considered including such a 'veto' provision, and then decided not to do so. This correspondence was admitted into evidence. In so holding, Rogers CJ Comm Div said:²⁸

If I may be permitted to say so the present dispute vividly demonstrates the need for the exception to the general rule of exclusion stated in *Codelfa*. In my view, the documents make clear that, after a vigorous exchange of views it was the common intention that MCA was to have no veto on steps taken by the Banks for purpose of enforcing the charge. Whatever ambiguity there may be perceived in the phraseology of cl 9.1, in my view, is removed by the correspondence exchanged between the solicitors.

46 Despite Mason J suggesting that this exception involved admitting evidence of the parties' actual (mutual) intention, I consider that this ruling is still compatible with both our general rule of thumb and the objective theory of contract. This is because another way of understanding

²⁶ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 354 (Mason J).

²⁷ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352 (Mason J).

²⁸ *MCA International BV v Northern Star Holdings Ltd* (1991) 4 ASCR 719 at 727.

Northern Star is that the parties' rejection of a veto provision subsequently formed part of the objective circumstances known to them both when the remaining terms of the contract were settled and agreed upon. After stating the possibility that evidence of rejection of a term might be admissible, Mason J said:²⁹

After all, the court is interpreting the contract which the parties have made and in that exercise the court takes into account what reasonable men in that situation would have intended to convey by the words chosen. But is it right to carry that exercise to the point of placing on the words of the contract a meaning which the parties have united in rejecting? It is possible that evidence of mutual intention, if amounting to concurrence, is receivable so as to negative an inference sought to be drawn from surrounding circumstances.

47 The reason why I suggest considerable care be taken with this passage, however, is because although Mason J limits the exception to situations where the parties have refused to include a certain *provision* in their contract, other cases have extended this rule to situations where the parties appear to have rejected giving a word a certain meaning. There is, in practice, little distinction between admitting evidence of a united rejection of meaning, and united acceptance of meaning, as often showing what the parties intended to reject will demonstrate what the parties meant.

48 There is a line of authority,³⁰ in both this state and in other states, that suggests that it is permissible to admit evidence of pre-contractual negotiations for this purpose. In my view this is difficult to reconcile with principle. Of course, such evidence may be admissible for other purposes: for example, to support a claim of conventional estoppel.

C. *Post-Contractual Conduct*

49 Take the case where two commercial parties have stipulated that payment must be made "promptly". There is evidence available to the effect that those parties have adopted a mutual practice of making payments within 10 business days. Is that subsequent practice admissible to the construction of the term "promptly"? The answer to this question is "no". In *Agricultural*

²⁹ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352-3 (Mason J).

³⁰ See, eg, *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290 at 309-10, where Santow J held that it was permissible to lead evidence showing that the parties negotiated on the basis that their language has a certain meaning.

& *Rural Finance Pty Ltd v Gardiner*,³¹ a majority of the High Court affirmed the earlier remarks of Lord Reid that:³²

the general principle [is] that 'it is not legitimate to use as an aid in the construction of [a] contract anything which the parties said or did after it was made'.

50 This principle is based upon the objective theory of contract.³³ The argument proceeds as follows: if the meaning of a contract is a question of law; and if that meaning is to be determined in accordance with the understanding of a reasonable businessperson; then it must follow that post-contractual conduct is irrelevant to construction as that conduct simply reflects each party's subjective understanding of the contract.

Identification of Terms:

51 Evidence of post-contractual conduct can be admitted for the purposes of determining whether a contract has been concluded, and identifying the terms of a partly-written, partly-oral contract. The distinction between the identification of terms and their construction was drawn by the NSW Court of Appeal in *Brambles Holdings Ltd v Bathurst City Council*.³⁴

52 The justification for allowing subsequent conduct to identify terms can be found in the judgment of Lord Hoffman in *Carmichael v National Power Plc*.³⁵

In a case in which the terms of the contract are based upon conduct and conversations as well as letters ... [t]he evidence of a party as to what terms he understood to have been agreed is some evidence tending to show that those terms, in an objective sense, were agreed. Of course the tribunal may reject such evidence and conclude that the party misunderstood the effect of what was being said and done. But when both parties are agreed about what they understood their mutual obligations (or lack of them) to be, it is a strong thing to exclude their evidence from consideration.

³¹ (2008) 238 CLR 570.

³² *Whitworth Street Estates Ltd v Miller* [1970] AC 583 at 603 (Lord Reid), approved by the High Court in *Agricultural & Rural Finance Pty Ltd v Gardiner* (2008) 238 CLR 570 at 582 [35] (Gummow, Hayne and Kiefel JJ).

³³ *Toll (FGCT) Pty Ltd v Alphapharm* (2004) 219 CLR 165 at 179 [40] (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ). Note also that it is the objective basis of Australian contract law that is the distinction between Australia's refusal to permit evidence of post-contractual conduct, and that of other contract laws, such as UNIDROIT. To this effect, see *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 76 NSWLR 603 at 614 [6] – 615 [9] (Allsop P).

³⁴ (2001) 53 NSWLR 153 at 164 [26] (Heydon JA).

³⁵ *Carmichael v National Power Plc* [1999] 1 WLR 2042 at 2050-1 (Lord Hoffmann), quoted in *County Securities Pty Ltd v Challenger Group Holdings Pty Ltd* [2008] NSWCA 193 at [21] (Spigelman CJ).

Implication of Terms in Fact:

- 53 A more difficult (and interesting) question arises when a court is asked to *imply* a term into a contract. In such a case, is a court *identifying* the terms of the contract, such that subsequent conduct can be permissibly used, or is it instead *construing* the meaning of the contract as a whole,³⁶ in which case it cannot? To keep matters interesting, the High Court has sat on the fence with respect to this question, and described the process of implication as “*an exercise in interpretation, though not an orthodox instance*”.³⁷
- 54 Of course, implication in law is part of the process of construction because it identifies the contract as a member of a class into which, as a matter of law, terms are implied. In this part of the paper, however, I am concerned with implication in “fact” or “ad hoc”: one-off implication of a term into a particular contract.
- 55 In 2015, the Victorian Court of Appeal in *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd* considered the issue of the admissibility of post-contractual conduct with regard to the implication of terms. Although their Honours noted that the question remains unsettled and declined to express a view, they collected the relevant authorities,³⁸ two of which I will briefly summarise.
- 56 The first-instance decisions point in different directions. In *Fenridge Pty Ltd v Retirement Care Australia (Preston) Pty Ltd*, Hargrave J held that subsequent conduct was inadmissible with regard to the issue of whether a term could be implied.³⁹ Central to his Honour’s conclusion, however, was that implication is an objective process, and the later subjective actions and beliefs of the parties are irrelevant.
- 57 That is all very well. But what if the subsequent conduct of the parties does not relate to their subjective understanding, but rather to objective matters? This situation arose in *Sydney City Council v Goldspar Australia Pty Ltd*. In holding that subjective conduct was admissible in the process of implication, Gyles J said:⁴⁰

³⁶ The high point of this view is the judgment of Lord Hoffman in *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10 at [18], where his Lordship said that ‘the implication of the term is not an addition to the instrument. It only spells out what the instrument means’.

³⁷ *Commonwealth Bank v Barker* (2014) 253 CLR 169 at 186 [22] (French CJ, Bell and Keane JJ). See also *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 353 (Mason J).

³⁸ *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd* [2015] VSCA 286 at [133] – [140] (Warren CJ, Kyrou and McLeish JJA).

³⁹ *Fenridge Pty Ltd v Retirement Care Australia (Preston) Pty Ltd* [2013] VSC 464 at [177] (Hargrave J).

⁴⁰ *Sydney City Council v Goldspar Australia Pty Ltd* (2006) 230 ALR 437 at 498 [164] (Gyles J).

I can see no difficulty in regarding subsequent conduct as relevant to the question as to whether a term is necessary to give business efficacy to the contract. Indeed, if a contract has been performed without adhering to, or without inconsistency with, the claimed term, without complaint or commercial difficulty, that would be powerful evidence that the term is not necessary. The law prefers facts to prophecies ... It would be odd to imply a term as necessary where such a conclusion would be contrary to the facts as they later appeared. If conduct may be relevant to negative the implication of a term as being necessary then it should also be relevant to support the implication of a term on the same basis.

58 Whilst recognising that the issue remains unsettled by authority, I consider the better view to be that subsequent conduct and events are admissible with regard to the implication of terms, *but only* where that subsequent conduct and events illuminate an objective matter, as opposed to subjective understandings of the contract. This approach also has the benefit of being consistent with the approach taken to pre-contractual negotiations.

59 The position we have reached, therefore, with regards to post-contractual conduct is that it is:

- (1) admissible for the purpose of determining whether a contract has been formed,⁴¹ and for identifying the parties to, and terms of, that contract; and
- (2) admissible for the purpose of determining whether a term should be implied into a contract (although subject to rules against evidence of subjective intent); but
- (3) inadmissible for the purpose of construing the terms of any contract.

The Process of Construction

Introduction:

60 I turn now to the actual process of interpreting commercial contracts. In *Electricity Generation Corporation v Woodside Energy*, the High Court set out the following passage:⁴²

The meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean... [I]t will require consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract. Appreciation of the commercial purpose or objects is facilitated by an understanding “of the genesis of the transaction, the

⁴¹ In a sense, this might not even be described as subsequent conduct as until the moment where it is determined that a contract was formed, there is nothing in existence to which conduct can be subsequent.

⁴² *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 656-7 [35] (French CJ, Hayne, Crennan and Kiefel JJ).

background, the context [and] the market in which the parties are operating". [U]nless a contrary intention is indicated, a court is entitled to approach the task of giving a commercial contract a businesslike interpretation on the assumption "that the parties ... intended to produce a commercial result". A commercial contract is to be construed so as to avoid it "making commercial nonsense or working commercial inconvenience".

61 I emphasise that the question which the court must answer when interpreting a commercial contract is "*what would a reasonable businessperson have understood the terms to mean?*" It is not "*what is the most commercial construction?*", nor "*what does the purpose of the contract require this language to be?*" As a result, each of the principles which we will discuss is not a rule of law,⁴³ but rather a clue which may assist the court in answering the central question.

62 Importantly, therefore, each of those considerations may have a greater or lesser role to play in any individual case, as the strength of the relationship between that consideration and the intention of the parties waxes and wanes. It is important that practitioners do not slavishly follow a list of principles without carefully evaluating the causative relationship between that principle and the understanding of a reasonable businessperson. For example, I remarked last year in *Reliance Rail Pty Ltd v Permanent Custodians Ltd*⁴⁴ that:

[W]here the court is dealing with a contract intended to create long-term relationships and to govern those relationships over many years, the significance of matters external to the contract is much diminished, and the language of the contract assumes even greater importance. The reason is obvious: people relying on or who are affected by contracts of this kind may have only the text to guide them, and may be ignorant of external circumstances.

63 Another example would be attempting to give a commercial construction to a contract which plainly has non-commercial goals as its purpose. Approaching the issue of construction with the mindset that it must be given a commercial interpretation would deflect attention from the real question.

64 In this portion of the paper, I intend to discuss the process of construction by reference to the key principles. As the process of construction starts and ends with the text of the agreement, the role of a court is not to guess at what the parties meant to say, but rather to determine what is meant by what they did say. This, however, does not mean that a practitioner should approach a contract with a dictionary in one hand and a pair of scissors in the other. Instead, the meaning of the text of the contract is illuminated by a consideration of:

- (1) the natural meaning of the relevant words used in the provision;

⁴³ Thus Kerr LJ said "[r]ules of construction are not rules of law; they are merely guidelines to the presumed intention of the parties in the light of events which have occurred": *Mitchell (George) (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 284 at 310.

⁴⁴ [2017] NSWSC 1111 at [25]

- (2) how the provision interacts with the remainder of the contract; and
- (3) the commercial context in which the provision and the contract operate against, along with a consideration of *probative* extrinsic material which bears upon the meaning.⁴⁵

65 I will consider each of these in turn. In separating these three topics, I do not wish to be taken to be suggesting a three-stage approach to construction, where a practitioner or a court examines these matters sequentially and records its findings at each stage. Instead, the process of construction is a holistic one, perhaps akin in some respects to the ‘instinctive synthesis’ used for sentencing in criminal law. Thus, construction requires all the circumstances to be considered together, such as the words of the agreement in light of their commercial background, and given their appropriate weight.

66 It is for this reason that, in some previous papers, I have sought to explain the interpretative process through worked examples. I have chosen to take a different approach today, to allow me to discuss the principles in perhaps more depth than usual. To the extent that I deal with each of the topics identified in a separate manner, this is simply as a matter of convenience. It will allow me to give examples of considerations relevant to each without causing undue confusion.

A. *The Meaning of Words*

67 The starting point for construction is to determine the literal meaning – the definitions or denotations – of the words which were used in the actual agreement.⁴⁶ This is a question of fact. However, the interpretation and *legal meaning* (or effect) of a contract is a question of law.⁴⁷ The question of law to be determined by the court is not what the words of the provision mean in the abstract,⁴⁸ but rather how a *reasonable businessperson would understand those words to have been used* in the context of the whole of the contract.

68 At this point, it is helpful to draw a distinction between ordinary words and terms of art.

The Meaning of Ordinary Words:

⁴⁵ As I have already discussed the cases of pre-contractual negotiations and post-contractual conduct, I do not intend to further deal with those topics in this portion of the paper.

⁴⁶ *Zhang v ROC Services (NSW) Pty Ltd* (2016) 93 NSWLR 561 at 575 [53] – 576 [54] (Leeming JA, Macfarlan JA and Emmett AJA agreeing).

⁴⁷ *Collector of Customs v Pressure Tankers Pty Ltd and Pozzolanica Enterprises Pty Ltd* (1993) 43 FCR 280 at 287 (Neaves, French and Cooper JJ).

⁴⁸ Note also the caution expressed by Gleeson CJ that ‘there are many instances where it is misleading to construe a composite phrase simply by combining the dictionary meanings of its component parts’: *XYZ v The Commonwealth* (2006) 227 CLR 532 at 544.

69 In determining the legal meaning of ordinary words, the reasonable businessperson (and indeed any person), having first considered their dictionary meaning, must have regard to the textual context.⁴⁹ To take a simple example, the word ‘set’ contains 464 definitions in the *Oxford English Dictionary*. A contract which allowed an iron ore producer to ‘set’ in motion a review of prices would be using the word in a very different manner to a contract which required that producer to ‘set’ the price of its exports by reference to various considerations. It is also important to consider the grammatical context in which a word operates.⁵⁰ Careful attention must be given to the use of commas, distributive language, the use of the disjunctive or the conjunctive, headings and so forth.

70 However, neither the dictionary nor considerations of formal grammar are determinative. Fowler’s *Modern English Usage* is an idiosyncratic view of the “rules” of grammatical usage once prevailing among educated English speakers of a certain social stratum. It is not a recognised authority on the interpretation of commercial contracts. A commercial document should be construed without undue emphasis on niceties of language and overly technical interpretations.⁵¹ The extent to which this ‘rule’ applies depends on the facts of each case. Thus, where a contract has been professionally drafted after extensive negotiation, it may be appropriate to take a more grammatically rigorous approach. Equally, however, in the case of a commercial contract constituted by exchange of loosely drafted emails, a strict examination of a ‘provision’ with an eye attuned to the nuances of grammar will rarely assist in ascertaining the objective intention of the parties.⁵² It is not very helpful to attempt to use detailed grammatical and syntactical analysis where it is clear that nobody in the position of either party communicated with that level of precision.

71 There is little more that can be said by way of principle in terms of determining the meaning of ordinary words. This is because, in general, an understanding of meaning in the English language is intuitive, and attempts to explain why a word means what it does ordinarily confuses rather than enlightens.⁵³

72 There are times, however, when mastery of the English language does not assist in providing a meaning for the contentious phrase. Consider, for example, the phrase “*will provide cars,*

⁴⁹ In *Manufacturers Mutual Insurance Ltd v Withers* (1988) 5 ANZ Insurance Cases 60-853, McHugh JA said that ‘[f]ew, if any, English words are unambiguous or not susceptible of more than one meaning or have a plain meaning. Until a word, phrase or sentence is understood in the light of the surrounding circumstances, it is rarely possible to know what it means’.

⁵⁰ See the judgment of Leeming JA in *Zhang v ROC Services (NSW) Pty Ltd* (2016) 93 NSWLR 561 at 575 [52] – 579 [76] for an example of a detailed analysis of grammar within a contract.

⁵¹ *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 at 771 (Lord Steyn).

⁵² *Mainteck Services Pty Ltd v Stein Heurtey SA* (2014) 89 NSWLR 633 at 658 at [96]-[96] (Leeming JA, Ward and Emmett JJA agreeing).

⁵³ *Norwich Union Life Assurance Society v British Railways Board* [1987] 2 EGLR 137 at 138 (Lord Hoffman).

motorcycles, and other vehicles". At issue is the legal meaning of the words "*other vehicles*" (the dictionary definition not being difficult to understand). At this point, a common approach is to turn to established maxims of construction to determine what the parties must have meant (the keen law student recognising the applicability of the *ejusdem generis* maxim). I suggest, however, that this does not add much to the discussion.

- 73 It is quite obvious, even without recourse to a Latin maxim, that a fighter jet is not included within this provision even though a fighter jet is a vehicle. That much follows immediately when it is recognised that legal meaning is determined by what a reasonable businessperson would have understood the provision to mean. When the relevant controversy becomes more sensible, for example whether a truck is captured by this definition, the answer will only be provided by careful reference to the remainder of the contract and the surrounding circumstances, and not by reference to maxims in the abstract. For this reason, practitioners should be wary of simply invoking 'rules of construction' to achieve a certain outcome. Instead, they would do well to treat those rules as guides of commonsense, which inform an understanding of what a reasonable businessperson would understand.

Terms of Art:

- 74 There are times when words are chosen not for their ordinary English meaning, but rather for an industry-specific or legally settled meaning. It can fairly be presumed that the reasonable businessperson who reads the relevant contract is aware of that specific settled meaning. Consequently, the commercial approach to the construction of a contract generally requires effect to be given to these terms of art.
- 75 Evidence is admissible to determine whether a word has a specific or customary meaning in an industry, even in the absence of ambiguity.⁵⁴ However, and importantly, the authorities consistently state that the customary meaning must be "*known definitely, clearly and generally to the people in that locality or trade*",⁵⁵ "*so notorious that everybody contracts on the basis of it*",⁵⁶ or so "*well known and acquiesced in that everyone making a contract in that situation can reasonably be presumed to have imported that term into the contract*".⁵⁷
- 76 An example where a customary meaning was given to otherwise ordinary words can be found in *Appleby v Pursell*, where the relevant contract required the lessor of a block of rural land to

⁵⁴ *Appleby v Pursell* [1973] 2 NSWLR 879 at 889 (Reynolds JA).

⁵⁵ *Shire of Rodney v Vibert* [1915] VLR 388 at 393 (Madden CJ).

⁵⁶ *Dovuro Pty Ltd v Wilkins* (2000) 105 FCR 476 at 516 (Finkelstein J).

⁵⁷ *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226 at 236 (Gibbs CJ, Mason, Wilson, Brennan and Dawson JJ).

“*push and stack*” the timber on that land. Under the contract, the lessor was using bulldozers to ‘charge’ down the trees and then stack them, leaving some stumps in the ground. The Court of Appeal held that it was correct to admit evidence as to the understanding of the term “*push and stack*” in the land clearing industry.⁵⁸ Thus, although “*push*” and “*stack*” both have ordinary English meanings, in the relevant industry it meant to ‘push’ the relevant tree out of the ground and uproot it. Of course, I hasten to note, the need for trial and appellate proceedings could have been avoided had the parties adopted a private dictionary which explicitly defined this term.

77 A slightly different scenario occurs where a word or phrase has a settled legal meaning, such as the phrase “*act of God*” in insurance contracts. In these circumstances, it should be inferred that the parties have contracted against this legal background, and a court should be very slow to depart from giving effect to that meaning.⁵⁹ One instance, however, where the court may do so is where it is apparent that the contract was drafted by a non-lawyer who used the ‘term of art’ without having appreciated that it was.⁶⁰ Another instance is where the contract was drafted in ‘plain English’ in order to be understood by non-lawyers;⁶¹ it would be contrary to the intention of drafting in plain English to give an ordinary word its technical meaning at law. Once again, however, it can be seen that ‘rules’ relating to technical words or terms of art are simply manifestations of the general principle of finding whatever clues inform the understanding of the reasonable businessman.

78 Although a case may (and often does) turn upon an isolated provision, the meaning of that provision is affected by an analysis of the remainder of the contract,⁶² and the context in which the agreement was reached. I turn to the application of that practice.

B. *The Harmonious Construction*

79 It is critical to read the entirety of a contract as a whole, as the meaning of one provision may be (and often is) revealed or affected by other parts of the contract.⁶³ For this reason, a

⁵⁸ *Appleby v Pursell* [1973] 2 NSWLR 879, 888-9 (Reynolds JA), 892-3 (Bowen JA).

⁵⁹ *Brett v Barr Smith* (1918) 26 CLR 87 at 93 (Isaacs J). See also *Thames & Mersey Marine Insurance Co Ltd v Hamilton, Fraser & Co* (1887) LR 12 App Cas 484, where Lord Herschell said at 494 that ‘[n]othing would be more dangerous, in my opinion, than to depart from a construction which the authorities have put upon words in common use in a mercantile instrument, even if the propriety of the decision might originally have been open to question’.

⁶⁰ *Sydall v Castings Ltd* [1967] 1 QB 302 at 313-4 (Diplock LJ).

⁶¹ *Homeowners Insurance Pty Ltd v Job* (1993) 2 ANZ Insurance Cases 60-535 at 78,102 (Hutley JA).

⁶² *Metropolitan Gas Co v Federated Gas Employees’ Industrial Union* (1925) 35 CLR 449 at 455 (Isaacs and Rich JJ).

⁶³ *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99 at 109 (Gibbs J).

practitioner will be well served by taking the time to consider the entire agreement of the parties line by line. Indeed, for each one case where external context is of significant relevance, I would venture to suggest that there are 99 cases where the context of the remainder of the agreement was more important.

80 Reading the contract as a whole ordinarily requires ensuring that:

- (1) each word and provision in the agreement has 'work' to do; and
- (2) any internal inconsistencies in the agreement are addressed.

81 Dealing with the first of these, a court should generally ensure that each provision of a contract is given effect,⁶⁴ even if that means that a slightly unnatural reading should be given to some provisions. As an example, in the English case of *Howe v Botwood*,⁶⁵ a lease required the tenant to “*pay and discharge all rates, taxes, assessments, charges and outgoings whatsoever which now are or during the said term shall be imposed or charged on the premises or the landlord or tenant in respect thereof...*”. The landlord, however had an obligation to keep “*the exterior of the said dwelling-house and buildings in repair*”. When the local authorities required a drain on the exterior to be repaired, a question arose as to whether the associated cost fell on the landlord or the tenant, as this appeared to fall within the scope of the obligations assumed by both parties.

82 The Court concluded that the cost fell on the landlord. In reaching this decision, it noted that otherwise the landlord’s obligation would be redundant as its obligation is also subsumed within the tenant’s obligation. Thus, the Court read into the tenant’s obligation the words “*except such as are by this lease imposed upon the landlord*”.⁶⁶ Another way of reaching the same result would be to note that the tenant’s obligation was a general one, whilst the landlord’s was specific. In those circumstances, it will normally be consistent with the intention of the parties to give primacy to the specific obligation, and to infer that it qualifies the general obligation.⁶⁷ This ensures that both provisions still have meaning and effect.⁶⁸

83 A different scenario arises where two provisions not only cover the same field, but do so in contradictory manners. In such a case, reading the document harmoniously may well require

⁶⁴ *Chapmans Ltd v Australian Stock Exchange Ltd* (1996) 67 FCR 402 at 411 (Lockhart and Hill JJ).

⁶⁵ [1913] 2 KB 387.

⁶⁶ *Howe v Botwood* [1913] 2 KB 387 at 391 (Channell J).

⁶⁷ A principle which has been described as ‘based on sound common sense and [which] appeals to everyone’: *Hume Steel Ltd v Attorney-General for Victoria* (1927) 39 CLR 455 at 466 (Higgins J).

⁶⁸ *Re Media Entertainment & Arts Alliance; Ex Parte Hoyts Corp Pty Ltd (No 1)* (1993) 178 CLR 379 at 386-7 (Mason CJ, Brennan, Dawson, Toohey, Gaudron and McHugh JJ)

that only one of the provisions is given effect, and the task of the court is to determine which it is. A typical example occurs when the parties have made modifications to a standard form contract, but have neglected to notice that their additions or deletions or special conditions conflict with the provisions of the standard agreement. In such a case, primacy will almost invariably be given to the special conditions agreed by the parties, as those were specifically chosen to relate to their agreement.⁶⁹ Much more difficult questions arise where two apparently 'equal' provisions create conflicting rights or obligations. In this case, the court is left to infer what a reasonable businessperson would understand from the remaining text of the agreement, and its commercial purpose and object. It is to this latter topic that I will now turn.

C. A Commercial Construction

84 It is, as I noted in my introduction, established law that a commercial contract should be given a commercially sensible construction.⁷⁰ The rationale for this is plain: it should be assumed that commercial parties seek to make commercially sensible bargains, and thus a commercially sensible construction is a good indication of the presumed intentions of the parties.⁷¹ A clear example of the application of this may be found in my decision in *Bicheno Investments Pty Ltd v Winterbottom*,⁷² to which I shall return.

85 When the authorities speak of the role of commercial considerations in the process of contractual interpretation, they may invoke a number of (overlapping but distinct) concepts:

- (1) the standard by which the commercial document is read (i.e. from the perspective of a businessperson, avoiding excessive technicality etc.);
- (2) the context for the agreement, both in terms of general industry practice and, more specifically, why *this* transaction arose; and
- (3) the basis on which a court chooses between competing constructions, particularly where one would lead to an absurd outcome.

86 As the first of these has already been discussed, I propose to deal only with the latter two.

⁶⁹ *Veolia Water Solutions v Kruger Engineering* [2007] NSWSC 46 at [53] (McDougall J).

⁷⁰ As far back as 1761, Lord Mansfield remarked that "the daily negotiations and property of merchants ought not to depend upon subtleties and niceties; but upon rules, easily learned and easily retained, because they are the dictates of common sense: *Hamilton v Mendes* (1761) 97 ER 787 at 795.

⁷¹ This was reaffirmed by the High Court last year: *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* (2017) 91 ALJR 486 at 491 [16] (Kiefel, Bell and Gordon JJ).

⁷² [2017] NSWSC 536.

Commercial Context:

87 As noted in the first part of this paper dealing with extrinsic evidence, a court is generally entitled to have regard to the surrounding circumstances of the transaction, including how it arose and the relationship between the parties. This is often called the factual matrix.

88 Evidence of the factual matrix can assist in the process of construction by informing the court about the relative weights it should give to various pieces of evidence. In *Agricultural & Rural Finance Pty Ltd v Gardiner*, the High Court considered documents which were contained in a publicly marketed investment scheme. The Court remarked that in those circumstances, the contractual documents should be given the meaning ordinarily conveyed by the words used,⁷³ and thus significantly downplayed the role of extrinsic material. This was because, in a public marketed scheme, it can be safely inferred that not all participants will be aware of all the external circumstances. Thus, greater weight should be given to the text of the agreement. A similar result is appropriate in the case of standard form agreements.

89 Another way in which the factual matrix can assist is by allowing the court to determine the underlying objective and genesis of the agreement. At issue in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* was the proper construction of the payment clause in a lease agreement, which provided that, when determining the yearly rent payable, the Trustees:⁷⁴

...may have regard to additional costs and expenses which they may incur in regard to the surface of the Domain above or in the vicinity of the parking station and the footway and which arise out of the construction operation and maintenance of the parking station by the Lessee.

90 Due to the car park's location in the Domain adjacent to the Sydney CBD, it became very profitable over time. The Trustees sought to increase the rent payable, in excess of the additional costs and expenses they incurred, in order to make a commercial profit. The issue for decision was whether the rent determination clause spelt out exhaustively all the matters which the Trustees were permitted to consider when setting the rent. In holding that it was an exhaustive summary, the High Court noted the following facts which demonstrated that the lease agreement had a non-commercial purpose and should be construed accordingly:⁷⁵

- (a) the parties to the transaction were two public authorities;
- (b) the primary purpose of the transaction was to provide a public facility, not to profit;

⁷³ *Agricultural & Rural Finance Pty Ltd v Gardiner* (2008) 238 CLR 570 at [38] (Gummow, Hayne and Kiefel JJ).

⁷⁴ (2002) 240 CLR 45.

⁷⁵ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 at 54 [11]-[12] (Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ).

- (c) the lessee was responsible for the substantial cost of construction of the facility;
- (d) the facility was to be constructed under the lessor's land and would not interfere with the continued public enjoyment of that land for its primary object, recreation;
- (e) the parties' concern was to protect the lessor from financial disadvantage from the transaction; and
- (f) the only financial disadvantage to the lessor which the parties identified related to additional expense which it would or might incur immediately or in the future.

91 Some of those facts were found in the extrinsic material, some were found in pre-contractual discussions, and some were found in the terms of lease. Another factor pointed to by the High Court, in addition to the above, was the absence of any mechanism for dispute resolution with regards to the rent determinations, such as provisions for arbitration or valuation. This was a further point of distinction to commercial lease contracts and again re-emphasises the importance of reading the entire contract in proper detail.

92 An analysis of *Royal Botanic Gardens*, therefore, shows that to the extent that commercial objectives, or the genesis of the transaction, are to be discerned, this must be done from objective material permissibly before the court (i.e. primarily the written contract, but in certain cases the pre-contractual negotiations, the background context etc., so long as those materials are admitted in accordance with the requirements set out at some length in the first part of this paper). Further, any commercial purpose must have been known to both parties; what is within a party's unique knowledge cannot, almost by definition, have been in the contemplation of a reasonable person in the position of the other party.

Choosing between constructions:

93 Finally, the court's view of "commerciality" is often used as a basis for deciding between competing constructions. This should not be a matter of surprise. Where there are two available interpretations, it should be assumed that the reasonable businessperson would have understood the more commercial one to be the one that is chosen. The principle is obvious, but what is less so is the basis on which courts should analyse "commerciality".

94 This principle, in my view, should not be taken too far, but rather should only be exercised in relatively clear cases. The basis for that reservation is the caution of the High Court that commercial common sense, although an⁷⁶

apparently objectively ascertained matter, may itself be a topic upon which minds may differ and in respect of which an imputed consensus is impossible.

⁷⁶ *Maggbury Pty Ltd v Hafele Aust Pty Ltd* (2001) 210 CLR 181 at 198 [43] (Gleeson CJ, Gummow and Hayne JJ).

- 95 Another reason for restraint is that, although a certain construction may appear overly favourable to one side, the court is simply not (nor can it be) privy to the negotiations of the parties. It will not know, for example, whether this provision was traded for a concession elsewhere. Consequently, the court should only be concerned with avoiding *unreasonable*, as opposed to *unfavourable*, results. Finally, the question of commerciality only arises where the court is required to choose between two available constructions; it is no part of the mandate of a court to rewrite a contract which has turned out to be a commercial disaster for one side. Except in exceptional circumstances (which I will discuss shortly), the clear words of the contract cannot be overridden. As a matter of practical reality, however, the more unreasonable the outcome, the clearer the language will need to be to sustain it.
- 96 In *Gollin & Co Ltd v Karenlee Nominees Pty Ltd*, the lease agreement between the parties provided that the yearly rent would be \$144,000 for the first three years and “*thereafter at the yearly rent agreed or determined in manner provided by [various other provisions]*”. No such agreement or determination was ever made, and the appellant submitted that in those circumstances it was under no obligation to pay rent. The High Court noted that although this construction had something to commend it as a matter of literal English, it had nothing to commend it by way of commercial efficacy or common sense.⁷⁷
- 97 In *TCN Channel 9 Pty Ltd v Hayden Enterprises*, Channel 9 had the option to terminate an agreement with a television show production company if a related contract for the provision of personal services of a television personality “*comes to an end*”. Channel 9 repudiated the contract with the television personality, and thus claimed an entitlement to terminate the production agreement. The issue for the NSW Court of Appeal was whether the term “*comes to an end*” meant what it literally said, or whether it excluded the situation where Channel 9 was the substantial cause of the end of that contract.
- 98 The Court held that the latter was the better construction. In reaching this conclusion, it noted the general principle that no party should be permitted to take advantage of its own wrong,⁷⁸ and that it would be an astonishing result for the production company to lose the large amount of money it had invested in the show as a result of the “*wrongful and arbitrary action of Channel 9*”.⁷⁹

⁷⁷ *Gollin & Co Ltd v Karenlee Nominees Pty Ltd* (1983) 153 CLR 455 at 463 [9] – 464 [10] (Mason, Murphy, Brennan, Deane and Dawson JJ).

⁷⁸ This is, of course, a very well established presumption or principle (depending on which viewpoint you take), dating back to ancient times: see *Rede v Farr* (1817) 105 ER 1188 at 1189 (Lord Ellenborough) which described this as a ‘universal principle of law’.

⁷⁹ *TCN Channel 9 Pty Ltd v Hayden Enterprises* (1989) 16 NSWLR 130 at 146G – 147B (Hope JA).

99 In *Bicheno Investments Pty Ltd v Winterbottom*,⁸⁰ the plaintiffs were the secured creditors to a company which became financially distressed, and appointed the defendants to be the receivers. It was agreed that the receivers would be remunerated by a combination of a time-based fee and an incentive fee which (loosely speaking) reflected the amount they recovered. The calculation for the recovered amount had, as one of its inputs, the amount of “*stock on hand*” as determined by a “*stock take*”. The creditors sought to argue that “*stock take*” meant a physical counting of all the stock and that, if this was not done, the receivers were not entitled to receive any of the incentive fee. I rejected the requirement of a physical counting as commercially untenable, *inter alia*, because:⁸¹

It would increase substantially the cost of the receivership (because, on the likely assumption that the receivers contracted the stocktake out to a firm such as RGIS, the cost would be a disbursement payable by the secured creditors). It would delay the selling-down of DSG’s stock and the closing of its shops. It would diminish the returns to be expected from the receivership. Nor would it achieve anything of practical utility, given what the parties knew as to the (recently confirmed) reliability of DSG’s inventory systems and inventory records.

100 In addition to these case examples, there are some further points of guidance about the role of commercial considerations in determining between competing meanings:

- (1) first, commercial common sense cannot be invoked retrospectively, but must always be done prospectively.⁸² The fact that a contract turned out to have disastrous consequences for one or indeed all parties is only relevant to the extent that that fact could have been anticipated at the time of the agreement. This much follows from the fact that a contract is interpreted according to the objective understandings at the time the agreement was made.
- (2) Second, in more difficult cases involving complex contracts, it may sometimes be necessary to undertake an iterative process of determining which construction is the most commercially sensible. This involves checking each of the rival constructions against the remainder of the contract, and investigating the associated consequences.⁸³
- (3) Third, in many cases, the more ‘commercial’ construction may not be immediately apparent. In such cases, it is suggested that less reliance should be placed on commerciality as a determining feature.

⁸⁰ [2017] NSWSC 536.

⁸¹ *Bicheno Investments Pty Ltd v Winterbottom* [2017] NSWSC 536 at [65]-[67] (McDougall J).

⁸² *Arnold v Britton* [2015] UKSC 36 at [19] (Lord Neuberger).

⁸³ *HP Mercantile Pty Ltd v Hartnett* [2016] NSWCA 342 at [134] (Leeming JA).

(4) Fourth, and as I have attempted to emphasise throughout this paper, commercial considerations should *only* be given effect within the scope of the language of the parties, and to the extent that they rationally inform an understanding of the parties' presumed intentions. This is because, as Lord Neuberger explained,⁸⁴ "*unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract*".

101 Finally, and despite the foregoing, there are exceptional cases where the clear and literal meaning of the words is so commercially absurd that it can be safely inferred that the parties did not intend them to have that meaning. Absurdity, however, must be objective. In *National Australia Bank Ltd v Clowes*, the NSW Court of Appeal construed a reference to a mortgage over an apartment to mean a mortgage over the shares which gave the right to use and occupy that apartment.⁸⁵ Leeming JA said that:⁸⁶

In my opinion this is a clear case where the literal meaning of the contractual words is an absurdity, *and* it is self-evident what the objective intention is to be taken to have been. Where both those elements are present, as here, ordinary processes of contractual construction displace an absurd literal meaning by a meaningful legal meaning.

102 This is conceptually distinct from rectification,⁸⁷ and does not enquire into the subjective intentions of the parties. As a matter of practical reality, however, where the error is so obvious that it allows the process of construction to dominate very clear language, this would generally be enough to simply have the instrument rectified. That is why rectification is only available after the proper construction of the contract (including any implied terms) has been resolved.

A Diversion into Heresy

103 In what follows, I draw freely and without further citation⁸⁸ upon an article by the Hon WMC Gummow AC QC, "*What is in a word? 'Legitimate' interests and expectations as common law criteria*".⁸⁹

⁸⁴ *Arnold v Britton* [2015] UKSC 36 at [79] (Lord Neuberger).

⁸⁵ For other examples, see reading "lessor" as "lessee" (*McHugh Holdings Pty Ltd v Newtown Colonial Hotels Pty Ltd* (2008) 73 NSWLR 53), "inconsistent" as "consistent" (*Fitzgerald v Masters* (1956) 95 CLR 420) and "shorter" as "longer" (*Saxby Soft Drinks Pty Ltd v George Saxby Beverages Pty Ltd* [2009] NSWSC 1486).

⁸⁶ *National Australia Bank Ltd v Clowes* [2013] NSWCA 179 at [34].

⁸⁷ For a recent discussion of the jurisdiction of rectification, see *Simic v New South Wales Land and Housing Corporation* (2016) 260 CLR 85.

⁸⁸ Some people might say, "plagiarise shamelessly".

- 104 The reality is that when disputes arise as to the proper construction of legally binding agreements, the question of construction is settled, usually by a court or by an arbitrator, in a way that is binding upon the parties. The approach to construction as I have described it earlier in this paper will be followed. But what does it mean to say that a commercial contract should be given a construction that a reasonable business person, knowing relevant matters of background and the like, would give to it? How is the court to place itself in the position of, or otherwise to inform itself as to the thought processes of, that hypothetical individual?
- 105 Again, what does it mean to say that commercial contracts should be given a “commercial” construction where possible? What is the touchstone of commerciality? And how is the court, which in general will have at the most only second hand experience of commercial dealings, negotiations and contracts, to form a view as to what outcome (of the process of construction) might be “commercial” and what outcome might not? I accept, of course, that in some cases the touchstone of commerciality is so obvious that even a judge sitting in the ivory tower of the Supreme and Federal Courts complex can resolve it. If I may say so, I think that this was plain in *Bicheno Investments*, where the plaintiff’s approach to construction, if correct and if followed by the receivers, must necessarily have reduced (perhaps substantially) the return to the plaintiff.
- 106 What judges do when they approach the question of construction from the prescribed stand point is analyse the document by reference to their own understanding (“intuition” might be a better word) of what that reasonable business person might think. In truth, I suggest, what judges do is project their own values and understandings into the words of the parties’ contract, informed by the factual matrix to the extent that it is disclosed and objectively known, and reach a conclusion that is to said to yield the “objective meaning” of the words used.
- 107 At a common sense level, pure questions of fact are generally capable of broad agreement. Many people can look at an animal in a zoo, and agree that it is an elephant, or a rhinoceros, or a hippopotamus, or some other beast. Perhaps the uninformed or the infirm of mind might dissent from the majority view, but that does not affect the essential validity of the point. Coming closer to the subject of this paper, many people can look at the dictionary definitions of a word and agree upon a single definition, with perhaps a small range of shades of meaning. But the construction of a document – of the words used in their context – is not just a question of fact. It is, as I have sought to explain, the process of ascribing legal meaning to, or deriving legal meaning from, the text.

⁸⁹ (2018) 45 *Aust Bar Rev* 23.

- 108 I suggested earlier in this paper that in ordinary life, those processes are inherently and necessarily subjective. As lawyers, we shy away from subjectivity.⁹⁰ We like to give our work the semblance of objectivity, so as to produce a result upon which all can agree. But the simple fact remains that the process of construction necessarily involves the individual's reaction to the text.
- 109 I venture to suggest that for all the incantations of objectivity and the hypothetical view of the fictive reasonable⁹¹ business person, the result of the process of construction is what the court thinks. The court may comprise one, or three, or five, or seven (or, in other jurisdictions, more) judges. If the process were wholly objective and wholly geared to producing an outcome from which subjectivity has been eliminated, one would not expect to find variances of opinion, particularly in appellate courts where the essential point has been revealed by earlier analysis and the question for decision has been refined. Yet common experience teaches us that differences of opinion, as to the meaning of a contract or for that matter a statute, are common.
- 110 I do not intend to say, and should not be thought to suggest, that the language that we use to describe the process of construction of commercial contracts is sham. On the contrary, it is an honest attempt to describe the approach that should be taken. But inevitably, it tends to disguise the fact that the process is one undertaken by individuals and, as I have now said more than once, reflects the intuitive understanding that each individual derives from a careful consideration of the text in question. That understanding may be informed by the factual matrix, but the relation and use of background facts themselves involve an element of subjectivity.
- 111 In short, I venture to suggest, the selection of the criteria for discrimination between contested meanings is to an extent illusory. It involves a fictive construct: the attribution of an understanding to a hypothetical individual. It takes into consideration a criterion – commerciality – which is not a term of fixed and definable meaning capable of rigid application to the huge range of contracts that humans make. It often invokes “common sense” which, as Lord Millet observed,⁹² “really gives the game away”. His Lordship added:

[N]o doubt the law should always accord with common sense, but it should also be principled and should be argued from principle.

⁹⁰ Except where mens rea is relevant; and since to dwell further on that point would do no more than expose the depths of my ignorance, I shall leave that point to lie where it has fallen.

⁹¹ Experience shows that all too often, business people are, sometimes ruthlessly and often pointlessly, unreasonable.

⁹² The Right Honourable the Lord Millet PC QC, ‘The Common Lawyer and the Equity Practitioner’ in *UK Supreme Court Year Book: Volume 6, Legal Year 2014-2015* (Appellate Press, 2015) 193 at 203.

112 In each case, the values derived from the source of reference are to an extent illusory, because their application may produce (and in many cases does produce) a range of well-reasoned, and apparently justifiable and inconsistent outcomes.

113 Having said that, when next I am required to consider and attribute legal meaning to a commercial contract, I shall do my best to follow faithfully and without deviation the principles laid down repeatedly by the highest authorities. The fact that others, upon a reconsideration of my decision, may come to a different view would do no more than make the point that I have set out already in this part of the paper.

Conclusion

114 I conclude by noting that there are two grave dangers inherent in my having delivered a paper such as the present.

115 The first is that I may be taken to have suggested that the process of contractual interpretation is an exact science, and an application of the preceding principles will lead inevitably and invariably to the correct answer. Of course, this is not so. One need only observe the number of decisions where judges disagree on whether a provision has a 'plain meaning' to recognise that construction is also a matter of impression. This should not be neither unexpected, nor scary.

116 The second danger, and perhaps the more serious one, is that I may be thought to have given the impression that extrinsic material is of significant importance in the ordinary case. The commercial world is one founded on certainty, and the basis for the law of contract is that each party can know what their obligations are at each point in time. The more a party must look at external factors in order to understand its obligations, the more this ideal of certainty is undermined. Hence, in the typical and everyday case, questions of interpretation turn entirely on the words of the contract, and the words of the contract alone.

117 Fortunately, the remedy for these two dangers is the same. Practitioners should pay careful attention to the specific words and terms of the contract, having regard to external material only where there is some *sensible and causal* relationship between that material and the presumed intentions of the parties. If everyone simply focused on these basic principles and not esoteric questions of law, commercial courts may find their workload significantly reduced.