PART XI – INTERPRETATION

I GENERAL PRINCIPLES

A *Objective Interpretation*

In interpreting contracts, the court aims to determine the objective meaning of the text of the document (*Brambles Holdings*).

The court is not trying to ascertain the meaning subjectively attributed to the document by the parties.

The evidence available to the court may have a significant effect on the result reached. Prima facie, no extrinsic evidence is allowed to determine the meaning which a reasonable person would ascribe to the terms, unless there is ambiguity.

Brambles Holdings v Bathurst City Council:

Facts
- B and BCC entered into another contract
- The contract did not expressly say that it covered liquid waste
- Clause 21 specified a fee to be charged for *general commercial refuse* and *domestic refuse* and required a portion to be remitted to the council
- Clause 2(b) defines trade refuse to include *liquid refuse* (and hence liquid waste)

Issue
- B argued the contract did not apply to liquid waste
- There was evidence that in 1990/1991 neither BH nor BCC believed the contract related to liquid waste
  - Subjectively, the evidence suggest neither B nor BCC thought it pertained to liquid waste

Reasoning
- Heydon JA nevertheless found that the contract related to liquid waste:

  > *The construction of a contract is an objective question for the court, and the subjective beliefs of the parties are generally irrelevant.*

- The hypothetical view of the reasonable person is preferred to the actual view of the actual parties to ensure that the meaning of contractual terms is sufficiently certain

- Arguably, this approach overrides the intention of the parties:
  - Policy response: too much uncertainty would be produced if parties were allowed to argue their own understandings
  - But there is still a fundamental inconsistency with foundational principles of contract theory
  - Even so, the objective manifestations of intention are all that the courts have to go on when evaluating evidence
  - Harm to certainty caused by entertaining subjective beliefs is far greater than the rare case where an objective approach has the effect of overruling them

Decision

- Because clause 2(b) relates to liquid refuse in the context of trade waste, clause 21 implies a reference to liquid refuse when referring to commercial waste
- BCC is entitled to collect the portion of fees for liquid waste owing to it under the contract

B *Extrinsic Evidence*

If the words are not ambiguous, whether any extrinsic evidence admissible in interpreting the meaning of a document remains unsettled in Australia.

Broadly, two approaches have been adopted in the line of case law dealing with the admission of extrinsic evidence for purposes of interpretation:

1. Narrow approach – only admissible to resolve ambiguity (*Codelfa* per Mason J (1982))
2. Broader approach – evidence always admissible in construing a contract (*Manufacturers' Mutual Insurance* per McHugh JA, approved, in obiter, by *Brambles* per Ipp JA (2001))

Codelfa may be taken as authority for the narrower approach.

Codelfa Constructions v SRA:

Reasoning

- Extrinsic evidence is only admissible to resolve ambiguity (Mason J in *Codelfa* (1982))
- *Codelfa* is a decision of the High Court.
- Mason J:
  - In the event that terms are ambigous, evidence of the parties' subjective understanding is not admissible:

    > *[I]n so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations … (evidence) is not admissible*

  - However, Mason J later states that

    > *it is possible that evidence of mutual intention, if amounting to concurrence, is receivable as to negative an inference sought to be drawn from the surrounding circumstances.*

Conclusion

- Evidence of the surrounding circumstances is not admissible unless there is ambiguity
- Evidence of parties' intention is not admissible unless it is being used to rebut a conclusion to be drawn admitted evidence, and even then parties must be in concurrence

However, extrinsic evidence might reveal ambiguities not visible on the face of the document (eg, if the promisor leaves his estate to his daughter Mary, extrinsic evidence may reveal that he in fact has two daughters called Mary).

Further, very few words ever have a single meaning. Some reference to context is necessary to infer the correct meaning, because language is *fundamentally* ambiguous. Thus, there is no need to show a particular ambiguous term (or, if there were – as per Mason J – the requirement would always be satisfied).

These considerations are reflected in the approach of McHugh JA in *Manufacturers' Mutual Insurance*, which allows evidence of surrounding circumstances to be admissible when interpreting the terms regardless of whether a specific ambiguity in a term can be identified. Significantly, *Codelfa* has been largely distinguished in later decisions.

C *The Parol Evidence Rule and Ambiguity*

1 *Role of the parol evidence rule*

The parol evidence rule normally does two things:

1. It stops external evidence being admitted to add terms (incorporation); and
2. It regulates the contextual evidence that can be used to establish the meaning of terms (interpretation)

Ambiguity is the main exception to the parole evidence rule (in its capacity to limit evidence used to interpret the terms of a contract).

2 *Types of ambiguity*

Ambiguity can result when the language used in a written document

1. Is capable of more than one meaning (patent ambiguity);
2. Does not have a readily ascertainable meaning (patent ambiguity);
3. Although it appears ostensibly unproblematic, facts can be proved which cast doubt on its meaning (latent ambiguity); or
4. Is used in an inconsistent manner.

However, the extent to which contextual evidence is admissible to identify (and resolve) ambiguity in the meaning of terms is unsettled. The impact of the two approaches to introducing evidence (see above part I, section B):

- In circumstance 3, the approach of Mason J could be problematic, because it only permits the introduction of evidence where there is patent ambiguity.
- McHugh J, on the other hand, would adopt a wide approach allowing evidence to discover ambiguity, and resolve uncertain meanings where they are found to arise

3 *Requirement of ambiguity*

There must be genuine uncertainty. The fact that the words do not mean what one of the parties hoped they meant is insufficient to draw on extrinsic evidence.

Because ambiguity is an elusive concept, its utility as a criterion of admissibility has been doubted.

4 *Current approach*

The generally accepted position is that evidence of other surrounding circumstances is prima facie inadmissible under the parole evidence rule (*Codelfa* per Mason J).

Extrinsic evidence is, however, admissible if the contractual provision is ambiguous (*Codelfa* per Mason J). Evidence may also be admissible in the absence of ambiguity (*Manufacturers' Mutual Insurance* per McHugh JA).

Even if Mason J's approach prevails, courts may nevertheless be able to circumvent the operation of the parol evidence rule by taking a generous view as to what constitutes ambiguity. Modern Courts take a very creative approach to determining the existence of ambiguity.

Thus, though prima facie no evidence is admissible to contextualise the terms of an agreement, if there appears to be any possibility of ambiguity, external evidence will be allowed to assist in resolving the uncertainty (and potentially discovering further ambiguity).

II SPECIFIC PRINCIPLES

A *Multiple Meanings*

If words in a term are capable of being given more than one meaning, the Court will give the words their most reasonable meaning. (Although, if ambiguity is – as McHugh JA has argued – inherent in language, then the 'reasonable' approach is always to be chosen; arguably, this characterises judicial interpretation.)

However, if there is no ambiguity on the face of the document, the Court must give the term its unambiguous meaning, even though to do so may appear unreasonable (*ABC v APRA*).

ABC v APRA:

Facts

- ABC and APRA entered into an agreement in writing whereby APRA licensed the appellant to use certain musical works
- Clause 2 of the agreement provided for the amount to be paid for the license as follows:
    - Set amounts per head of population for years commencing 1 July 1963 to 1966
    - For each year thereafter – 2.3p x population of Australia (adjusted for the cost of living)
- Clause 2 of the agreement specified that changes in the cost of living in each year were calculated by taking the movement in the CPI for the December in the relevant financial year and comparing it to the previous December quarter
- This meant that changes to the cost of living were not cumulative, but only relative to the previous year
- ABC paid in accordance with the formula contained in the agreement
- Some time later, APRA realized that the amounts were not cumulative and sought to recover the difference

Issue

- Can clause 2 be given a meaning that says that the cost of living is to be calculated by comparing the CPI for that year to the CPI in the original year (1963)?

<u>Reasoning</u>

- The clause was not ambiguous, so it must be given its unambiguous meaning
  - Clause 2 specifies the factoring of inflation in to ABC's payments
  - The majority gave the clause a meaning consistent with ABC's payments; inflation is only calculated year to year

- Barwick CJ:
  - The language is plain and unambiguous
  - There is only 1 possible interpretation, even if that seems unreasonable
  - It is clear that the parties intended the measure of inflation to be cumulative, but the Court has no scope to effect that, since there is no ambiguity on the face of the document
  - It is 'not the role of the Court to attribute to parties an intention to do something for which their express words do not provide'

- Gibbs J (dissenting):
  - It seems clear that the parties' intention was for ABC to pay in proportion to the current population and extent of inflation
  - Tries to show that the term *is* ambiguous
  - Relies on a literal interpretation of the word 'each' – could mean each year individually *or* cumulatively
  - Notes the 'lack of grammatical exactitude', but this approach could potentially lead to very strange results
  - Because clause 2 is ambiguous, the Court must give it the most reasonable meaning (ie, cumulative)

<u>Decision</u>

- Clause 2 is unambiguous, so the Court is unable to give it a different meaning to that for which the parties expressly provided; ABC can continue to pay royalties at a rate indexed only relatively, to the previous year

B *Absurd Results*

If it appears that the strict interpretation of the clause is absurd (as opposed to merely unreasonable) then the courts may supply, omit, or correct words to avoid the absurdity, even in the absence of ambiguity (*Westpac v Tanzone*).

The distinction between a merely unreasonable result and an absurd result is a fine one. This distinction may be used to mask other policy choices being made by the judges, and arguably introduces a qualification to interpretation which allows a court to come to the conclusion it wants.

For example, in *ABC v APRA* and *Westpac v Tanzone*, the courts dealt with comparable problems of construction (on similar facts) and reached different conclusions about whether or not a literal interpretation should be given to the words of the contract in question.

The approach in *Westpac* is potentially more consistent with the intentions of the parties, but this depends (arguably, unnecessarily) upon the Court's view of absurdity.

Westpac v Tanzone:

<u>Facts</u>

- WBC entered into a lease with the Rs (who later sold the premises to T)
- The rent payable was calculated as follows:
  - $69,404.25 until the first review date
  - After the first review date, the amount would be increased by the greater of:
    - (a) The amount of rent payable in the prior year multiplied by 8% compounded annually; and
    - (b) The amount of rent payable in the prior year multiplied by X over Y where X equaled the CPI at the date of review and Y equaled the CPI figure at the commencement of the lease
- This meant that inflation was captured twice by (b), as the CPI change from the commencement of the contract to the current time was applied to an amount that had already been adjusted for inflation for all years except the one immediately before it
- As a result, T would owe, by 1999, $1 659 838 in rent (compared with the $208 910 if the clause was corrected to account for inflation only once)

<u>Issue</u>

- Can the clause be interpreted so as to remove the duplicate reference to inflation?

<u>Reasoning</u>

- The lease was not ambiguous – the meaning of words is very clear
- The Court cannot rectify the lease because the common mistake pertained to the meaning of the words, not a mistake made in reducing the agreement to writing
- Nevertheless, the Court *can* interpret the clause to have only one reference to inflation
  - This is because the result would be absurd, if the terms were not adjusted
  - Here, the parties did not understand how to account for inflation; it was not merely unreasonable, as in *ABC*, but also absurd

<u>Decision</u>

- The Court can interpret the payment conditions as requiring only one reference to inflation; T is successful

However, after *Westpac*, the distinction between 'absurd' and merely 'unreasonable' outcomes remains unclear. Consider the ability of courts to mask policy choices behind notions such as 'ambiguous' (see, eg, the 'deviation' cases).

C *Exclusion and Limitation Clauses*

An exclusion clause is a contractual term which completely exempts liability for act or default in relation to its content. Limitation clauses place limits on the extent of liability. The defendant relying on the limiting term to deny liability has the onus of proof regarding both its incorporation and interpretation.

Traditionally, exclusion and limitation clauses were interpreted so as to restrict their operation. This restriction took the form of two rules of interpretation: the four corners (liability unauthorised conduct, which was 'outside the four corners of the contract', could not be limited or excluded within the contract) and *contra proferentum* rules (see below).

However, the High Court of Australia has recently indicated that the ordinary principles of construction are to apply to limitation clauses (*Darlington Futures v Delco*).

The *Darlington* principle of ordinary construction is subject to one qualification: ambiguous limitation clauses should be construed *contra proferentum* (against the party seeking to rely on them). Note that this rule of interpretation applies if *and only if* the clause is ambiguous.

Darlington Futures v Delco:

Facts

- A contract was made between a futures broker and its client
- The broker engaged in unauthorized trading and as a result the client incurred substantial losses
- The broker sought to limit its liability for these losses by relying on two exclusion clauses:
    - Clause 6 – excluded liability for 'loss arising in any way out of any trading activity undertaken on behalf of the client whether pursuant to this agreement or not'
    - Clause 7(c) – limited the broker's liability to $100 in respect of 'any claim arising out of or in connection with the relationship established by this agreement'

Issue

- How are clauses 6 and 7(c) to be interpreted?

Reasoning

- Limitation terms should be interpreted accordance to the language in which they are expressed:
    - They should not be subjected to a strained construction to reduce the ambit of their operation
    - It is preferable to look to the 'natural and ordinary meaning' of the limiting term 'in light of the contract as a whole'
    - This verdict is possibly influenced by the policy consideration that the parties should be free to contract under terms of their own choosing
        - Also, here the plaintiff was an engineering firm able to bear the loss, a situation in which there is 'no question of reasonableness or fairness'
        - Non-commercial plaintiffs who cannot bear losses may thus be able to have limiting terms interpreted against the defendant
        - Distinguish *Darlington* on the bases of: ambiguity (or lack thereof) of limiting term, frailty of party seeking to overturn the limiting term

- Clause 6:
    - Only excludes liability for trading done on behalf of (with the authorisation of) the client; these losses were not authorised, so liability is not excluded
    - But note 'or not' – perhaps implying that liability was excluded even if trading was against the agreement
        - Seems to imply that trading may be authorised whilst not being pursuant to the agreement
        - Does not conclusively indicate that liability for a trading activity may be excluded without the client's authorisation – authorisation necessary
        - The final words just refer to *authorised* activities, which may be pursuant to the agreement or not
    - Darlington is not protected by clause 6 because it is ambiguous
    - Therefore, it is interpreted against DF (who is seeking to rely upon it to exclude liability), as per the *contra proferentum* rule

- Clause 7:
  - Limits liability – focuses attention on the language of the term; no ambiguity
  - DF is protected by clause 7 because it is not ambiguous

- The difference between an exclusion clause and a limitation clause:
  - **[???]**

- Arguably, however, this means that the stronger party (who usually exempts liability) will be advantaged by a more neutral interpretation of limiting terms
  - The approach does not give sufficient consideration to the effect of power imbalances between negotiating parties

- Do the 'contra proferentum' and 'four corners' rules survive this decision?
  - Contra proferentum: interpret against party seeking to rely on an exclusion clause where that clause is ambiguous
    - Survives – there was ambiguity in clause 6, which was interpreted against DF
  - Four corners rule: a clause can only exclude liability for activities within the contract
    - Doesn't survive – so long as an exclusion clause is worded to make it clear to which activities the clause applies (so as to be unambiguous – unlike clause 6), unauthorised activity outside the contract can be excluded/limited (since clause 7 limits liability here, *despite* it being unauthorised)

Decision

- In interpreting exclusion/limitation clauses, the Court will look to the wording of the clause; where the clause is ambiguous, it will be interpreted against the party seeking to rely on it to exclude liability
- An exclusion clause can, where unambiguous, exclude liability for conduct falling outside the scope of the contract
- DF is not protected by clause 6, but clause 7 is unambiguous and applies, limiting its liability to Delco to the extent of $100

Exam note: applying UNIDRIOT principles of contract law in the context of interpretation, and comparing (ie, evaluating) the outcome to that reached under Australian law is *essential*.

Prior to *Darlington*, *TNT v May & Baker* (1960s) applied the four corners rule to prevent an exclusion clause exempting liability for conduct unauthorised by the contract.

TNT v May & Baker:

Facts

- TNT agreed to transport M&B's goods from Melbourne to Sydney
- The goods were collected by the subcontractor (P) to be taken to TNT's Melbourne depot before being transported to Sydney
- As the depot was closed when he arrived, the subcontractor took the goods to his home and left them in his garage over night
- During the night, the goods were destroyed by fire

- M&B sued to recover damages for breach of contract
- TNT sought to rely on an exclusion clause in the contract that exempted liability for loss or damage or *misdelivery* of goods in transit or *storage*

Issue
- Are the exclusion clauses effective to prevent TNT being liable for damage to M&B's goods?

Reasoning
- Majority: the exclusion clause does not protect TNT
  - The subcontractor performed obligations in an unauthorised way
  - Limiting terms are subject to the four corners rule: liability for activities that fall outside conduct authorised in the contract cannot be excluded by a contractual term

- Windeyer J (dissenting):
  - Agreed that unauthorised activities cannot be excluded
  - But here, the only promise made to M&B was to transport the goods
  - The contract never specified the goods' storage location, just as it did not specify the goods' route of transportation
    - After all, if the goods were damaged during transit, the Court would have been unlikely to hold that the activity was unauthorised, unless a specific route was specified and they did not travel that way
  - Because the mode of storage was unspecified, P's conduct was not unauthorised and so not outside the scope of the contract
  - The four corners rule is, perhaps, outmoded – historically, it derives from Maritime law (liability could not be excluded if the route by which cargo was to be transported was not followed; the justification for limiting limitation clauses in this way was that the route followed could have a significant bearing on the likelihood of damage or loss – due to, eg, weather, pirates, other cargo, port stopovers, etc)

- Arguably, the approach of *TNT* is no longer open, given the decision in *Darlington Futures v Delco*
  - In that case, the trades were unauthorised, but liability for their performance was still able to be limited to $100

- If P had been negligent, TNT is still likely to have been unprotected by the clauses
  - However, even in *Darlington*, it is held (in *obiter*) that negligent conduct needs to be specifically referred to, whether explicitly (excluding liability for the negligence of contractors/third parties) or through using language such as 'howsoever arising'

Decision
- Applying the four corners rule, because liability for unauthorised conduct cannot be excluded, the exclusion clauses cannot be effective to exempt liability for P's unauthorised conduct
- M&B can recover damages for breach of contract

Note: it is very likely that, as a result if *Darlington Futures*, *TNT* has been overruled and would not longer be followed today.

III UNIDRIOT PRINCIPLES

A *Extrinsic Evidence*

UNIDROIT Article	*UNIDROIT Principle*	*Differences to Australia*	*Evaluation*
4.3	In ascertaining the common intention of the parties and interpreting their statements and conduct regard must be had to all the circumstances, including preliminary negotiations, established practices, subsequent conduct, nature and purposes of conduct, common meaning and usages	Parol evidence limits considering extrinsic evidence to where the term is ambiguous; practice arguably similar (*Brambles*)	Any attempt to interpret a clause severed from the environment of its negotiation is likely to produce results radically different to that envisaged by the parties; could overrule parties' implicit intentions
2.17	Entire agreement or merger clauses 'cannot be contradicted or supplemented by evidence of prior statements or agreements'. However, prior statements or agreements may be used to interpret the writing	Parol evidence rule prohibits introduction of evidence to incorporate or interpret, unless ambiguous	Avoids the creative judicial construction of ambiguity and (see, eg, Windeyer J in *ABC*); also allows additional terms to be established by extrinsic evidence

Australian contract law emphasises the importance of well-written contracts and the certainty a complete document provides. Extrinsic evidence is viewed as conducive to the misinterpretation of the parties' intention, and evidence is prima facie excluded.

Art 2.17 has the potential to advantage stronger parties in situation of a large power differential between the negotiating parties (eg, corporation/consumer), because standard merger clauses may prevent the incorporation of assurances or explanations, on which the weaker party relies, which were made by the stronger party to induce their assent to the terms (estoppel may play a role here, but it may not provide an adequate remedy in all cases).

B *Express Terms*

UNIDROIT Article	*UNIDROIT Principle*	*Differences to Australia*	*Evaluation*
5.1	A contract consists of express and implied terms	Same (*Secured Income*)	Parties always forget to turn their minds to something
2.20	No standard term which could not reasonably have been expected is effective unless expressly accepted (signature not enough, needs to be reasonable)	If signed, binding (*L'Estrange*), unless highly unusual (*Toll*); not as broad an exception; possibility of appeal to HCA	Protects consumer; enforces fair business practice – state intervention? But: limitation clauses are so common place they should be expected – so ineffective to protect?

2.21	In case of conflict between a standard term and another the latter prevails	Collateral terms overruled by main contract, even if standard (*Hoyts*)	Negotiated terms should be weighted more highly
4.1	A contract shall be interpreted according to the common intention of the parties. If that cannot be established, then according to reasonable persons of the same kind as the parties	Objective interpretation (*Brambles*), even if in direct conflict with parties' intentions	Intention rarely shared; if it is, term would be so obvious that reasonable persons would have same intention; otherwise, objective approach
4.2	Statements and conduct have a subjective meaning if the other party knew or ought to have known of that meaning; otherwise the meaning according to reasonable person	Meaning not ascertained by reference to what parties intended or thought was intended (*Brambles)*; but closer to objective approach	Decreases contractual certainty; great care need be taken in applying an objective test to whether subjective meaning ought to have been known of – could overrule actual intention
4.5	Terms must be interpreted in context and so as not to deprive them of effect	Parol evidence rule: only interpreted in context if clear meaning can't first be given (*Codelfa*)	Effectively sets limits on a court's interpretation; essentially, permission to vary terms to give them effect (cf *ABC*)
4.6	If terms supplied by one party are unclear, an interpretation against that party is preferred	Same (*Darlington*); but only to limitation clauses	Penalises ambiguity; encourages clear authoring of contracts; not necessarily fair; less favourable to party seeking to rely

C *Limitation Terms*

UNIDROIT Article	***UNIDROIT Principle***	***Differences to Australia***	***Evaluation***
1.5	The parties may exclude implied terms (except the duty to act in accordance with good faith and fair dealing)	Less certain in Australia about whether able to be excluded	Certainty is preferable, whatever the position; respects intentions of the parties over enforcing a standard of conduct
7.1.6	A clause which limits liability for non-performance or permits performance substantially different from what the other party reasonably expected may not be invoked if it would be grossly unfair to do so	Limiting terms can exclude unauthorised conduct (*Darlington*), so long as the	Courts' constructions of 'fairness' may not always be in line with parties' intent or modern commercial practice; could result in

		clause is sufficiently clear; *Fair Trading Act* (Vic) also contains provisions excluding unfair terms	inefficiency; how is evidence of 'expectation' to be gathered and treated? What legal justification is there for not enforcing the promise? It could be illusory
2.20	No standard term which could not reasonably have been expected is effective unless expressly accepted	If signed, binding (*L'Estrange*), unless highly unusual (*Toll*)	Protects consumer; enforces fair business practice – state intervention?
2.21	In case of conflict between a standard term and another the latter prevails	Collateral terms overruled by main contract, even if standard (*Hoyts*)	Negotiated terms should be weighted more highly