

Contract Interpretation: What Is It About?

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Abstract

In recent times contract interpretation has become one of the most contentious areas of the law of contract. There are fundamental divisions among commentators, practitioners and judges (often writing extra-judicially) as to the nature of the task and the permissible aids to interpretation. This article highlights the reasons for these divisions and suggests that the position of those who advocate a liberal approach to the latter issue is sometimes misunderstood. The author argues that there are no convincing reasons of principle, policy or convenience for refusing to receive evidence of prior negotiations and subsequent conduct: in particular, admitting such evidence is not, as commonly thought, inconsistent with the objective approach to interpretation. However, at the same time it is stressed that it will only be in relatively exceptional cases that the evidence will provide a helpful or reliable guide to the true intention of the parties.

1. Introduction

It would be widely accepted that, despite its relative neglect in law school curricula,¹ the law of contract interpretation is one of the most practically important areas of commercial law. Issues of interpretation occupy a good deal of the time of busy commercial practitioners and judges.² Such issues ‘are the

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¹ However, academic interest in the subject has increased markedly in recent years and there are now some excellent new books on the subject: see, for example, Gerard McMeel, *The Construction of Contracts: Interpretation, Implication and Rectification* (2007); and Catherine Mitchell, *Interpretation of Contracts* (2007). See also the valuable commentaries in Sarah Worthington (ed), *Commercial Law and Commercial Practice* (2003); and Andrew Burrows and Edwin Peel (eds), *Contract Terms* (2007).

² See Sir Robert Goff, ‘Commercial Contracts and the Commercial Court’ [1984] *Lloyd’s Maritime and Commercial Law Quarterly* 382 at 385: ‘In point of fact, if not the meat and drink, then at least the staple diet, of the Commercial Court can be summed up in one word — “Construction”. Commercial lawyers — solicitors, barristers and judges — spend a very substantial part of their time interpreting contracts. There is a dispute as to the meaning and effect of a binding contract in the circumstances which have occurred — and practitioners have to advise, and the court may be asked to decide, for example, what meaning is to be attached to certain express words in the contract, or how apparently conflicting provisions in the contract are to be reconciled, or even whether, and if so how, an apparent lacuna in the contract can be filled. In these cases, we are very often concerned with minutiae in terms of language — though minute differences in wording, or in the interpretation of words, can have a profound effect in practice.’

very lifeblood of commercial law'.³ Nevertheless, on the basis of the countless decided cases that I have read, they also tend to be the most intractable. The outcome of interpretation litigation is notoriously difficult to predict.⁴ This is partly because questions of interpretation are often seen as 'matters of impression' or intuition,⁵ and inevitably the way in which judges mentally process language and apply it to the facts will vary according to their background and experience.⁶ Even so, the division of opinion that one finds in the cases is remarkable. Time and again judges will disagree on such elementary questions as whether particular words have a plain meaning⁷ and what is the 'commonsense' or 'commercially realistic' interpretation.⁸

³ Richard Calnan, 'Construction of Commercial Contracts: A Practitioner's Perspective' in Burrows and Peel, above n1 at 17.

⁴ Who could have predicted the outcomes in, to name just a few cases, *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289 (High Court of Australia), *Haines v Carter* [2003] 3 NZLR 605 (Privy Council), *Yoshimoto v Canterbury Golf International Ltd* [2004] 1 NZLR 1 (Privy Council) ('Yoshimoto'), or indeed in the leading case itself of *Investors Compensation Scheme Ltd v West Bromwich Building Soc* [1998] 1 WLR 896 ('ICS') (House of Lords)? Of course, sometimes the answers are relatively obvious but cases are taken to the highest appellate courts because of the large amount of money at stake. For recent examples see the two restrictive covenant cases of *Thompson v Battersby* [2008] NZCA 84 (a proposed wall and deck extension not a 'building') and *Big River Paradise Ltd v Congreve* [2008] 2 NZLR 402 (Court of Appeal), aff'd [2008] 2 NZLR 589 (Supreme Court) (a covenant restricting 'subdivision' of the servient tenement to three 'allotments' prevented the owner creating 52 leasehold interests).

⁵ See *Deutsche Genossenschaftsbank v Burnhope* [1996] 1 Lloyd's Rep 113 ('*Deutsche Genossenschaftsbank*') at 122 (Lord Steyn): 'Often a question of construction can only be solved as a matter of first impression.' See also Johan Steyn, 'The Intractable Problem of the Interpretation of Legal Texts' (2003) 25 *Sydney Law Review* 5 at 8: 'Educated intuition may play a larger role than an examination of niceties of textual analysis'; and Sir Kim Lewison, *The Interpretation of Contracts* (4th ed, 2007) at para 2.12 and the cases cited therein.

⁶ See A L Corbin, *Corbin on Contracts* (rev ed, 1960) vol 3, at §535, 17–18: 'It is true that when a judge reads the words of a contract he may jump to the instant and confident opinion that they have but one reasonable meaning and that he knows what it is. A greater familiarity with dictionaries and the usages of words, a better understanding of the uncertainties of language, and a comparative study of more cases in the field of interpretation, will make one beware of holding such an opinion so recklessly arrived at.'

⁷ See, for example, *Cook v Financial Insurance Co Ltd* [1998] 1 WLR 1765 (House of Lords); *Melanesian Mission Trust Board v AMP Society* [1997] 1 NZLR 391 (Privy Council); *Sunflower Services Ltd v Unisys New Zealand Ltd* [1997] 1 NZLR 385 (Privy Council).

⁸ See, for example, *Deutsche Genossenschaftsbank* [1996] 1 Lloyd's Rep 113 (majority of House of Lords accepting an interpretation which was rejected by the Court of Appeal and castigated by Lord Steyn (at 124) as contrary to 'business common sense'); *Lim v McLean* [1997] 1 NZLR 641 (majority of Privy Council upheld an interpretation which the two dissenting judges and three Court of Appeal judges thought (at 649) made 'no sense commercially'); and *Sinochem International Oil (London) Co Ltd v Mobil Sales and Supply Corp* [2000] 1 Lloyd's Rep 339. The judges who heard the latter case were evenly split as to which interpretation made better commercial sense. Kennedy LJ (dissenting) could see 'nothing objectionable or non-commercial' (at [36]) in the interpretation favoured by the trial judge, whereas the majority judges regarded that interpretation as 'capricious and cumbersome in its operation and effects' (at [26]). As pointed out by Gleeson CJ, Gummow and Hayne JJ in *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181 at [43], 'what in respect

More importantly, however, the underlying theory remains in a state of confusion and there are fundamental divisions among commentators, practitioners and judges as to what the process of interpretation is and ought to be all about. For example, although Lord Hoffmann's well-known restatement of the fundamental principles of interpretation in *Investors Compensation Scheme Ltd v West Bromwich Building Society*⁹ ('ICS') is now widely applied by the courts and accepted by academic commentators, it is not always understood. One cannot accept his guiding principle that:

[i]nterpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract

and at the same time continue to assert that words must be given their plain meaning in the absence of manifest absurdity, or a proven technical, trade or customary usage, and that it is only permissible to have regard to the factual background if there is an ambiguity on the face of the document.¹⁰ Under Lord Hoffmann's principles the background or 'matrix of facts' is *always* admissible as an aid to interpretation and the so-called plain meaning rule is relegated to a proposition that where words do have a conventional or ordinary meaning this is simply a strong indication that they were used in that sense.¹¹

of a particular contract comprises "business commonsense", as an apparently objectively ascertained matter, may itself be a topic upon which minds may differ and in respect of which an imputed consensus is impossible'. See also J J Spigelman, 'From Text to Context: Contemporary Contractual Interpretation' (2007) 81 *Australian Law Journal* 322 at 330: 'There can be no doubt that a "business-like" interpretation or reliance on "business commonsense" is an acceptable constraint on contractual interpretation. The only difficulty is that, at least when the matter comes to the level of litigation, each party remains convinced that "a business like" [*sic*] interpretation or "business commonsense" happens to coincide with its own commercial interests. This is not always easy to resolve.' For a recent illustration, see *Kooee Communications Pty Ltd v Primus Telecommunications Pty Ltd* [2008] NSWCA 5, discussed in D W McLauchlan, 'Plain Meaning and Commercial Construction: Has Australia Adopted the ICS Principles?' (2009) 25 *JCL* 7 at 29–32.

⁹ [1998] 1 WLR 896 at 912–13.

¹⁰ See the attempts to marry the old and new approaches to interpretation in, for example, *Liberty Grove (Concord) Pty Ltd v Mirvac Projects Pty Ltd* [2008] NSWSC 113 at [16]–[20]; *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* [2008] NSWSC 274 at [26]–[28]; *Casella v Hewitt* (2008) 36 WAR 1 at [70]–[71]; *Mabbett v Watson Wyatt Superannuation Pty Ltd* [2008] NSWSC 365 at [43]; and *North Sydney Leagues Club Ltd v Synergy Protection Agency Pty Ltd* [2008] NSWSC 413 at [16].

¹¹ See, for example, *Ansley v Prospectus Nominees Unlimited* [2004] 2 NZLR 590 at [36] (the New Zealand Court of Appeal refused to 'accept the proposition that the factual matrix is to be considered only where there is ambiguity in the terms of a contract'); *Static Control Components (Europe) Ltd v Egan* [2004] 2 Lloyd's Rep 429 ('*Static Control*') at [27] (Arden LJ): 'in principle, all contracts must be construed in the light of their factual background, that background being ascertained on an objective basis. Accordingly, the fact that a document appears to have a clear meaning on the face of it does not prevent, or indeed excuse, the court from looking at the background'; and *Westminster City Council v National Asylum Support Service* [2002] 1 WLR 2956 at [5] (Lord Steyn): 'The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was

Furthermore, the principles continue to attract a hostile reception from commercial practitioners.¹² In the words of Johan Steyn, they ‘upset the horses in the commercial paddock’¹³ when first pronounced. And it seems that those horses remain jittery. Thus, Alan Berg, a well-known and insightful commentator, has recently argued that the principles are unworkable in practice and are ‘not always consistent with the reasonable expectations of the contractual parties’.¹⁴ Although disavowing an argument that ‘there should be a retreat to literalism’,¹⁵ Berg even suggests that we should abandon ‘the fiction that contracts are addressed to the original parties’ because ‘[m]ost professionally drafted commercial contracts are intended to be used by, and are therefore addressed to, people who will know the basic background to the deal, but no more than that’.¹⁶ This approach, under which the fundamental task of the court in an interpretation dispute would no longer be to discover and implement the intention of the parties, has recently attracted the powerful support of the Chief Justice of New South Wales. Writing extra-judicially, Spigelman CJ in fact suggests that there is ‘a basic defect’ in Lord Hoffmann’s restatement in that ‘[i]t is not a scheme that can be applied to a substantial range of commercial contractual relationships’.¹⁷ Others of like mind may not be prepared to go quite

used. It follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen ... [I]n his important judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912–13, Lord Hoffmann made crystal clear that an ambiguity need not be established before the surrounding circumstances may be taken into account.’

¹² See, for example, Alan Berg, ‘Thrashing through the Undergrowth’ (2006) 122 *Law Quarterly Review* 354; Calnan, above n3; and Don Holborow, ‘Contract Interpretation’ [2004] *New Zealand Law Journal* 272.

¹³ Steyn, above n5 at 9.

¹⁴ Berg, above n12 at 358.

¹⁵ Id at 359. In *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2008] 1 NZLR 277 (‘*Gibbons Holdings*’) at [119] Thomas J said that ‘[n]otwithstanding his express denial, [Berg’s] approach would herald a retreat to “literalism”’.

¹⁶ Ibid.

¹⁷ Spigelman, above n8 at 335. Compare, however, the opposite point of view expressed by Thomas J in *Gibbons Holdings* [2008] 1 NZLR 277 at [121]: ‘Berg’s suggestion that the accepted wisdom that contracts are addressed to the original parties is a “fiction” is unsupported. For the most part, parties wish their interests to be advanced and protected, and their legal advisers draft their contracts to advance and protect those interests. While there is the possibility that one or other of the parties may wish to assign their interest in the contract, assuming that they are contractually able to do so, the primary concern will be to secure the bargain the parties have struck. One of the parties will have paid or given good consideration for that advantage. Furthermore, many contracts, such as one-off contracts, by their very nature are unlikely to be addressed to potential third parties. Common examples are contracts for the sale of property. Then, relational or long-term contracts will, again for the most part, seek to define the relationship which the parties intend to endure throughout the duration of the contract. Contracts will be and are assigned, but to suggest that it is a “fiction” that they are not for the most part addressed to the original parties is a signal overstatement.’ See also Lord Bingham of Cornhill, ‘A New Thing under the Sun? The Interpretation of Contract and the ICS Decision’ (2008) 12 *Edinburgh Law Review* 374 at 387–8. The author endorsed the view of Arden LJ in *Static Control* [2004] 2 Lloyd’s Rep 429 at [29] that ‘the principles in the

so far,¹⁸ but they essentially believe in the inherent wisdom of the plain meaning and parol evidence rules and subscribe to the strict version of objective theory under which the parties 'are bound in accordance with the meaning that reasonable third parties would give to their expressions without regard to the meaning given by either of the parties themselves'.¹⁹ Their only concession to modern 'contextualism' is that the words of a contract always have to be construed in the context of the document as a whole and 'the basic objective background facts against which the contract was entered into, such as the market in which the parties were operating'.²⁰ But otherwise Lord Hoffmann's restatement, which requires one to delve into all the background facts and occasionally permits a contract to be rewritten, is viewed with considerable dismay.

Interestingly, although the practitioner perspective is that the *ICS* approach is one of 'extreme liberalism',²¹ others,²² including myself,²³ argue that the approach is essentially quite conservative. This is principally because it excludes evidence of prior negotiations and, by inference, subsequent conduct, both of which may sometimes provide a reliable guide to, *inter alia*, the parties' intention at the time of the contract. In other words, Lord Hoffmann's restatement is welcomed but regarded as too restrictive. It is argued that, if all the relevant background must be considered before determining the meaning of a contract, excluding the prior negotiations is unprincipled and unworkable, and the policy reasons advanced in support of the exclusion are unconvincing. The practitioner perspective, however, turns from dismay to incredulity at any

ICS case lead to a more principled and fairer result by focusing on the meaning which the relevant background objectively assessed indicates that the parties intended' and added: 'Notable for its absence in the criticisms made of the *ICS* formulation is the one accusation which, if established, would be truly damaging: that application of this approach leads to a construction of contractual documents which does not reflect the commercial intentions of the parties. Unless that criticism can be made and brought home, it would need compelling arguments to displace the current approach to the task of seeking to give effect to the reasonable expectations of honest men.'

¹⁸ See, for example, Sir Christopher Staughton, 'How do the Courts Interpret Commercial Contracts?' (1999) 58 *Cambridge Law Journal* 303 at 304: 'Rule One [of contract interpretation] is that the task of the judge when interpreting a written contract is to find the intention of the parties. In so far as one can be sure of anything these days, that proposition is unchallenged.'

¹⁹ A L Corbin, *Corbin on Contracts* (rev ed 1963) vol 1, at §106, 476.

²⁰ Calnan, above n3 at 20.

²¹ Id at 21.

²² See, for example, Gerard McMeel, 'Prior Negotiations and Subsequent Conduct: The Next Step Forward for Contractual Interpretation' (2003) 119 *Law Quarterly Review* 272; Ewan McKendrick, 'Interpretation of Contracts: Lord Hoffmann's Restatement' in Worthington, above n1 at 139, 154–7; Donald Nicholls, 'My Kingdom for a Horse: The Meaning of Words' (2005) 121 *Law Quarterly Review* 577; and Andrew Burrows, 'Construction and Rectification' in Burrows and Peel, above n1 at 77.

²³ D W McLauchlan, 'Contract Formation, Contract Interpretation, and Subsequent Conduct' (2006) 25 *University of Queensland Law Journal* 77 at 93.

suggestion that the exclusion be lifted. This is seen quite simply as ‘the wrong approach’.²⁴ It will lead to uncertainty, unnecessary time and cost in having to trawl through vast amounts of probably irrelevant information, and potentially adverse effects for third parties who only have access to the written document.

Where then does the truth lie? What, in principle, is the correct approach to contract interpretation? Everyone agrees, for example, that the approach must be objective, but what does ‘objective’ mean in this context? Is, say, a clearly proven actual intention, communicated between the parties, to be ignored? If not, can there be a general exclusion of pre-contract negotiations? Is this justified by the often expressed arguments based on commercial convenience and policy? Do reasons of convenience and policy outweigh the logic of allowing resort to negotiations as part of the process of determining and implementing the intention of the parties? If not, can there be any objection to the admissibility of evidence of the parties’ subsequent conduct? These and related matters are traversed in this article.²⁵ In particular, it will be suggested that the answer to the latter five questions ought to be in the negative.

2. *Some Preliminary Points*

There are several important points that need to be stressed before, with the help of an example modelled on the facts of a contentious case, embarking on a discussion of the issues raised in the previous paragraph. My aim here is to try to ensure that the liberal approach to interpretation I am advocating is not misconstrued or misunderstood.

First, *the great majority* of interpretation disputes that come before the courts have the common feature that the parties did not, at the time of formation, contemplate the situation that has arisen.²⁶ There is no question, therefore, of their having formed an actual intention as to the meaning of the relevant words. Accordingly, the court can only seek to resolve the dispute by reference to the parties’ presumed intention.²⁷ As Thomas J has pointed out:

²⁴ Calnan, above n3 at 18.

²⁵ The article does not consider the effect of so-called ‘entire agreement’ clauses: clauses stating, for example, that the agreement constitutes the entire contract between the parties and supersedes all prior representations, agreements, negotiations or understandings. It is highly questionable whether such clauses are effective to preclude the promisee from alleging the existence of a collateral contract or oral term, let alone relying on prior negotiations to ascertain the meaning of a term actually contained in the written contract: *ProForce Recruit Ltd v The Rugby Group Ltd* [2006] EWCA Civ 69 (*ProForce Recruit*) at [41], [59]. See generally Elisabeth Peden and J W Carter, ‘Entire Agreement — and Similar — Clauses’ (2006) 22 *Journal of Contract Law* 1; Catherine Mitchell, ‘Entire Agreement Clauses: Contracting Out of Contextualism’ (2006) 22 *Journal of Contract Law* 222; and Mitchell, above n1 at 131–48.

²⁶ See generally Lewison, above n5 at para 2.13.

²⁷ See E Allan Farnsworth, *Farnsworth on Contracts* (2nd ed, 1990) vol 2, at 254: ‘In many disputes arising out of contemporary business transactions ... the parties gave little or no thought to the impact of their words on the case that later arose. Perhaps the contract is embodied in a printed form that neither party prepared; perhaps its clauses have been lifted

[T]he doctrine of presumed intent is the law's method of giving some meaning to any number of contracts where the events giving rise to the dispute were not anticipated at the time the contract was made. In this way the doctrine of presumed intent provides the community with a universal law of contract which could otherwise founder on the impossible task of ascertaining the parties' intention when in reality they had none.²⁸

In such cases the task of the court is to ascertain the meaning that the document would convey to a reasonable person with knowledge of the background. And any attempt by counsel in these cases to burden the court with a large volume of evidence concerning the parties' negotiations, in an endeavour to establish an actual intention that in reality simply did not exist, ought to incur the wrath of an adverse costs order.

Of course, very often counsel will present voluminous evidence to the court even if they are not seeking to establish an actual intention, allegedly encouraged to do so by the *ICS* principles. Sometimes this may be necessary, such is the increasingly complex nature of the dealings that are the subject of commercial litigation nowadays. One suspects, however, that on many occasions the evidence is unnecessary and more the result of counsel not having refined the issues, or poor case management in other respects. Perhaps then the lawyers ought to bear the brunt of the blame for any mounting costs of litigating interpretation disputes, not the principles governing those disputes.

Second, in any event, when an actual intention is alleged that appears inconsistent with the ordinary meaning of the words in question, yet counsel attempt to persuade the court to interpret those words according to that intention, it will often be the case that the only appropriate course is to seek rectification. This is because, rather than attaching a particular meaning to words deliberately chosen, the parties did not in fact turn their minds to those words at all. They, or at least the claimant, may simply have overlooked the ramifications or effect of

from a form book; perhaps the deal is a routine one struck by minor functionaries ... The court will then have no choice but to look solely to a standard of reasonableness. Interpretation cannot turn on meanings that the parties attached if they attached none, but must turn on the meaning that reasonable persons in the positions of the parties would have attached if they had given the matter thought. If the contract is on a widely used standard form, the use of this purely objective test has the advantage of promoting uniform interpretation, without regard to the chance circumstances of the parties'.

²⁸ *Attorney-General v Dreux Holdings Ltd* (1996) 7 TCLR 617 ('*Dreux Holdings*') at 632. In the more recent case of *Gibbons Holdings* [2008] 1 NZLR 277 at [96] (SC) his Honour said, *inter alia*: 'The doctrine [of presumed intent] has necessarily had an impact on the way judges and lawyers approach contractual interpretation in general. Aware that in many, if not most, cases the parties did not, because of unforeseen events, have an actual intention in respect of the particular clause in issue, the doctrine permits Judges and lawyers to arrive at an interpretation without compromising the basic premise that the contract must not be interpreted subjectively. The presumed intent is imputed to the parties. Inevitably, and understandably, judges and lawyers come to impute an intention to the parties without questioning the process. The imputation becomes a habit of thought or attitude of mind.'

the words and at best simply assumed that they sufficed.²⁹ There will be no basis for ‘reconstructing’ the language as a matter of interpretation in such cases unless, as in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd*³⁰ and in the *ICS* case itself, a reasonable person with knowledge of the background would infer that something went wrong with the language and therefore would interpret it as having the meaning alleged.

Third, in assessing the merits of Lord Hoffmann’s restatement as well as more liberal approaches to interpretation that would allow resort to the likes of prior negotiations and subsequent conduct, it is all too easy to attach too much significance to the difficult cases that reach the appellate courts and to lose sight of the reality that most issues of interpretation that cross a practitioner’s desk *can* be advised upon and solved by a reading of the words in the context of the document as a whole. There will usually be no answer to the solution derived from giving the words their ‘ordinary’ or conventional meaning. It is often overlooked, or at least not mentioned, that Lord Hoffmann himself is clearly of that view. His fifth principle stresses that ‘we do not easily accept that people have made linguistic mistakes, particularly in formal documents’.³¹ Indeed, earlier, in the *Mannai Investment* case, he said that ‘[w]e start with an assumption that people will use words and grammar in a conventional way’,³² and later, in *Bank of Credit and Commerce International SA v Ali*,³³ he emphasised that ‘the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage’ and that in the *ICS* case he ‘was certainly not encouraging a trawl through “background” which could not have made a reasonable person think that the parties must have departed from conventional usage’.³⁴ It is a gross exaggeration, therefore, to suggest that his principles now make the task of reliably advising clients on interpretation issues ‘pretty much impossible’.³⁵

Finally, to allow evidence of negotiations, and even subsequent conduct, to be received as an aid to interpretation does not mean that the inquiry becomes

²⁹ Good recent examples are provided by *Ryledar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 (*‘Ryledar’*) and *Chartbrook Ltd v Persimmon Homes Ltd* [2008] EWCA Civ 183 (*‘Chartbrook’*).

³⁰ [1997] AC 749 (*‘Mannai Investment’*).

³¹ *ICS* [1998] 1 WLR 896 at 913.

³² *Mannai Investment* [1997] AC 749 at 774.

³³ [2002] 1 AC 251 (*‘Bank of Credit and Commerce’*). See also Bingham, above n17 at 376: ‘it is one thing to abjure pedantic literalism, as we all do; it is quite another to suggest that the terms in which the contracting parties have chosen to express their bargain are not in all cases important and in most decisive’.

³⁴ *Bank of Credit and Commerce* [2002] 1 AC 251 at [39]. It is interesting to note that Lord Hoffmann was the dissenting judge in this contentious case. He criticised the majority (at [37]) for giving ‘too little weight to the actual language and background’ of the document in question. It cannot be suggested, however, that he was backtracking from his principles. He was simply unconvinced that there was anything in the background that would lead a reasonable person to think that the parties must have departed from conventional usage of the words. See Mitchell, above n1 at 44–7.

³⁵ Holborow, above n12 at 274.

one as to the subjective intentions of the parties. It depends on what one means by 'subjective intentions'. There is no problem if this phrase means 'undisclosed' or 'uncommunicated' intentions. No one would suggest that a court should be able to interpret the words in accordance with the secret intention of one of the parties. Evidence of uncommunicated thoughts and intentions is generally irrelevant in contract formation and interpretation disputes. Certainly, little credence should be attached to evidence of parties who go into the witness box and, with the benefit of hindsight, give their different and unsubstantiated versions of what they each *meant* at the time of the contract (as opposed to what they *said* or *wrote* to each other at or prior to that time).³⁶ It is entirely another matter, however, to suggest, as it often is, that the actual intentions of the parties are irrelevant.³⁷ That cannot be right. As Lord Nicholls, writing extra-judicially, has pointed out, the fact that pre-contract negotiations 'may afford direct evidence of the parties' actual intentions ... is not a reason for banning their use. That would be perverse'.³⁸ Thus, where there is convincing evidence of communications between the parties pointing to a conclusion that they shared a particular meaning of the words in dispute at the time of the contract, that meaning surely must prevail.³⁹ So, too, the meaning intended by *one* party should prevail where that party was led reasonably to believe that the other party accepted that meaning. This is because, as we shall see, that meaning *is* the objective meaning of the contract.

³⁶ For this reason the High Court of Australia in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at [35] was justifiably critical of the attention paid by the trial judge to '[w]ritten statements of witnesses, no doubt prepared by lawyers, [that] were received as evidence in chief' which contained 'largely irrelevant information about the subjective understanding of the individual participants in the dealings between the parties'.

³⁷ See, for example, *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 ('*Codelfa*') at 352: evidence of 'the actual intentions, aspirations or expectations of the parties before or at the time of the contract' is not admissible because the court's task is to determine the 'presumed intention' of the parties; and *McLaren v Waikato Regional Council* [1993] 1 NZLR 710 at 725. See also Kim Lewison, *The Interpretation of Contracts* (3rd ed, 2004) at 29: 'Once it has been established that a contract has been formed, the actual intentions of the parties as to the meaning or effect of the contract become irrelevant.' This statement appears to have been omitted from the author's fourth edition (above n5).

³⁸ Nicholls, above n22 at 583 (see text at n115 for the full quotation). In the recent case of *Gibbons Holdings* [2008] 1 NZLR 277 at [122] Thomas J said: 'The notion that an intention can be imposed on the parties contrary to their actual intention is repugnant to any concept of fairness, common sense and the reasonable expectations of honest men and women. It should be repugnant to the common law.'

³⁹ See *Ryledar* (2007) 69 NSWLR 603 at [266] (Campbell JA): 'a subjective intention to use words with some meaning other than the meaning that an ordinary hearer of the words would put on them, if the hearer were not in the specific context in which the words were spoken, comes to be taken into account, in deciding what are the terms of the contract, only because there is some form of communication between the parties, or context, such that a reasonable person would realise that the more usual meaning of the words was not intended'.

3. *Common Assumptions, Agreed Meanings and Prior Negotiations*

Suppose Shipowner (S) enters into a contract to hire his ship to Charterer (C) for a term of 2 years. The contract includes a special term negotiated by C stating that C shall have ‘the option to re-deliver the vessel after 12 months’ trading subject to giving 3 months’ notice’. Fourteen months into the charter C gives 3 months’ notice of her intention to re-deliver. S protests, arguing that the option to re-deliver could only be exercised when the vessel had been trading for 12 months and that accordingly the necessary notice had to be given 9 months from the commencement of the charter. Nevertheless, C re-delivers the ship upon the expiry of the notice she gave (that is, after the ship had traded for 17 months). S claims substantial damages based on the difference between the contract rate and the market rate for the alleged remaining 7 months of the charter. The dispute hinges on the meaning of the phrase ‘after 12 months’ trading’. S contends that it meant ‘when the vessel has traded 12 months’ or ‘on the expiry of 12 months’ trading’, whereas C contends that the meaning was ‘at any time after the vessel has traded for 12 months’. Who is right? How do we go about deciding that? What are the permissible aids to interpretation?

Most practising lawyers like to think that they can give reliable advice as to the true interpretation of contracts crossing their desks simply by pondering the words in question and, if need be, consulting their dictionaries. They reside in ‘that lawyer’s Paradise ... where, if the writer has been careful, a lawyer, having a document referred to him, may sit in his chair, inspect the text, and answer all questions without raising his eyes’.⁴⁰ However, in the example outlined above, perhaps they will recognise early on that both meanings are plausible and that further reflection and help is required. After consulting the office’s dusty contract textbooks, they will learn that their task is to determine the most reasonable interpretation, taking into account ‘the factual background known to the parties at or before the date of the contract, including evidence of the “genesis” and objectively the “aim” of the transaction’.⁴¹ If the textbook is in fact up-to-date, they will probably be referred to Lord Hoffmann’s restatement of the principles of interpretation in *ICS* which, as we have seen, states that the task is to ascertain ‘the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract’.⁴² They will also learn, much to their relief perhaps, that, ‘for reasons of practical policy’, ‘[t]he law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent’.⁴³ In these circumstances, and assuming that neither side finds anything in the admissible background to assist their cause, it is conceivable that their lawyers

⁴⁰ J B Thayer, *A Preliminary Treatise on Evidence at the Common Law* (1898) at 428–9.

⁴¹ *Prenn v Simmonds* [1971] 1 WLR 1381 (*‘Prenn’*) at 1385 (Lord Wilberforce).

⁴² *ICS* [1998] 1 WLR 896 at 912.

⁴³ *Id* at 913.

will advise that there is too much litigation risk and recommend that the dispute be settled.

However, as many readers will be aware, my example is closely modelled on an actual case: the decision of Kerr J in *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)*.⁴⁴ In that case the argument of S was successful, primarily because there were admissible and reliable indications from the parties' negotiations that they had used the word 'after' as meaning 'on the expiry of'. There had been a series of telex exchanges prior to the contract in which various charter durations and option periods for re-delivery were proposed. For example, C initially sought a 2-year charter with an option to re-deliver 'after 6 months subject to giving 2 months notice' and a further option to re-deliver 'after 12 months trading subject [to] giving 3 months notice'. This proposal was rejected and the parties eventually agreed on the formula contained in the written contract. It was clear from these exchanges that both sides were referring to an option exercisable 'on the expiry of' the period they proposed. This was their actual common understanding as to the meaning of the word 'after'. They had 'in effect both given it the same dictionary meaning to the exclusion of the other meaning'.⁴⁵

Kerr J accepted that both interpretations were plausible:

As shown by the dictionary and as a matter of ordinary parlance, although 'after' means 'later in time', it can be, and is, used in two senses. The intended meaning depends on the context. For instance, if two people embark on a 10-mile walk and agree to have a rest after five miles, they mean that they will have a rest when they have walked five miles and not at any time between five and 10 miles. On the other hand, if they take part in a race under rules which say that competitors may take refreshment after five miles, then one would say that the intended meaning is that they can do so at any time after they have covered five miles. But one can also think of many illustrations in which either meaning might be equally defensible. For instance, if someone has a service agreement for 20 years which provides that he may retire on pension after 15 years, it would be very debatable whether he could only exercise this option after 15 years and not after, say, 18 years.⁴⁶

After explaining his 'first impression' that the owners' contention was correct, he proceeded to resolve the case in accordance with the following principle:

If a contract contains words which, in their context, are fairly capable of bearing more than one meaning, and if it is alleged that the parties have in effect negotiated on an agreed basis that the words bore only one of the two possible meanings, then it is permissible for the Court to examine the extrinsic evidence relied upon to see whether the parties have in fact used the words in question in one sense only, so that they have in effect given their own dictionary meaning to the words as the result of their common intention. Such cases would not support

⁴⁴ [1976] 2 Lloyd's Rep 708 ('*The Karen Oltmann*').

⁴⁵ Id at 713.

⁴⁶ Id at 710.

a claim for rectification of the contract, because the choice of words in the contract would not result from any mistake. The words used in the contract would ex hypothesi reflect the meaning which both parties intended.⁴⁷

As I have argued elsewhere,⁴⁸ this decision seems entirely in accordance with common sense. It would have been perverse to exclude evidence that potentially could have allowed C to get away with repudiating the parties' actual common understanding at the time of the contract (or at least the understanding that C led S reasonably to believe was accepted by C). Further, so far as I am aware, no one has suggested that the case was wrongly decided. Indeed the principle has been accepted as good law on numerous occasions by the English,⁴⁹ Australian⁵⁰ and New Zealand courts.⁵¹

However, because the principle in *The Karen Oltmann* has the potential to undermine the rule that prior negotiations are inadmissible as an aid to interpretation,⁵² various attempts have been made in recent times to 'explain' or

⁴⁷ Id at 712.

⁴⁸ D W McLauchlan, 'Common Assumptions and Contract Interpretation' (1997) 113 *Law Quarterly Review* 237.

⁴⁹ See *ProForce Recruit* [2006] EWCA Civ 69. See also, for example, *Travelers Casualty & Surety Company of Canada v Sun Life Assurance Company of Canada (UK) Ltd* [2006] EWHC 2716 (Comm) at [95]; *Jones v Bright Capital Ltd* [2006] EWHC 3151 (Ch) at [23]; and *Great Hill Equity Partners II LP v Novator One LP* [2007] EWHC 1210 (Comm) at [54]–[59].

⁵⁰ See *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290 ('*Spunwill*') at 309; *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2003] NSWCA 74 at [74]–[78]; *BP Australia Pty Ltd (formerly BP Australia Ltd) v Nyran Pty Ltd* (2003) 198 ALR 442 at [34]; *Optus Vision Pty Ltd v Australian Rugby Football League Ltd* [2003] NSWSC 288 at [71]; and *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* [2004] NSWSC 149 [182]. In the latter case Einstein J at [182] cites *Codelfa* (1982) 149 CLR 337 and *The Karen Oltmann* as authority respectively for the 'unexceptional' propositions that '[e]xtrinsic evidence is admissible to show that a particular contractual interpretation or a particular implied term which might otherwise arise was specifically considered and rejected by the parties' and that '[c]onversely, extrinsic evidence is admissible to show that the parties by agreement or common assumption adopted a particular interpretation of a word or words in a written document'. The first proposition is based on Mason J's statement in *Codelfa*, after he stressed (at 352) that evidence of statements and actions in the course of the parties' negotiations 'which are reflective of their actual intentions and expectations' is not admissible, that '[t]here may perhaps be one situation in which evidence of the actual intention of the parties should be allowed to prevail over their presumed intention', namely (at 352–3): '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. 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.' See further D W McLauchlan, 'Objectivity in Contract' (2005) 24 *University of Queensland Law Journal* 479 at 488–9.

⁵¹ *Air New Zealand Ltd v Nippon Credit Bank Ltd* [1997] 1 NZLR 218 (Court of Appeal).

⁵² According to Johan Steyn, 'Written Contracts: To What Extent May Evidence Control

're-analyse' it as concerned, not with interpretation, but with other legal doctrines. The first explanation is that the case involved a separate collateral or side agreement.⁵³ It was not, therefore, an interpretation case at all. Rather, it was a standard illustration of a well known exception to the parol evidence rule. The second explanation is that, despite Kerr J's protestation to the contrary, the case was one in which, if reliance was to be placed on the evidence of the parties' actual intention, the appropriate response would have been to grant rectification, another exception to the parol evidence rule. It is important for the purposes of this article to consider the validity of these explanations. The discussion will lead naturally on to a consideration of the ongoing objections to admitting evidence of prior negotiations as an aid to interpretation.

4. Recent Attempts to 'Explain' The Karen Oltmann

A. A Collateral Agreement?

It has been argued by Berg that the telexes in *The Karen Oltmann*:

had a dual status: they were pre-contract negotiations about the charterparty; but they also constituted or evidenced a collateral, or side, agreement that the word 'after', in relation to a specified number of months, would have a certain meaning. It was in that second status, it is suggested, that the telexes were admitted.⁵⁴

The author later amplifies his argument that the case does not provide a true exception to the rule excluding evidence of prior negotiations as follows:

The evidence was admissible not because the negotiations were part of the background facts, but because the evidence showed that the parties had agreed that a term used in the main contract would bear a certain meaning. The position was no different from what it would have been if, a day before the contract was signed, one of the parties had noticed that the contract failed to define a crucial term and had faxed the other party saying 'We propose that this term should mean X. Do you agree?' and the other party had sent a fax back 'Yes, we agree'.⁵⁵

Of course, on one view it does not matter what conceptual label one attaches to the principle so long as it is accepted as providing a mechanism for recognising and implementing a clearly proven actual mutual intention. Nevertheless, the argument is surprising. It seems extremely artificial to say that the parties in *The Karen Oltmann* made a *separate* side agreement as to the meaning of the word. The parties in truth made *one* agreement, with the evidence

Language' (1988) 41 *Current Legal Problems* 23 at 29, it has the potential to 'swallow up the rule'.

⁵³ It does not matter for present purposes whether a two-contract or one-contract analysis is employed: that is, whether the agreement is a term of a separate contract, collateral to the charterparty, or term of the one contract comprising the telex communications and the terms contained in the charterparty.

⁵⁴ Berg, above n12 at 355.

⁵⁵ Id at 360.

conclusively establishing that they used a word contained in that agreement in a particular sense and intended it to have that meaning. What perhaps gives the argument some plausibility is Kerr J's reference to the parties negotiating on 'an agreed basis' and in effect giving the words 'their own dictionary meaning'. However, as Lawrence Collins LJ has correctly pointed out in the recent case of *Chartbrook Ltd v Persimmon Homes Ltd* ('*Chartbrook*');

[I]t is plain from the facts that there had been no actual agreement on the meaning of the word 'after'. What happened was that the parties were negotiating on a common understanding of what the point in contention between them was, namely the period within which the notice had to be given so as to expire at the end of a period which the owners wanted to be of maximum duration and minimum flexibility where the charters wanted the precise opposite. There was no agreement on the word 'after' except in this sense: because they were negotiating on a common understanding of what each was endeavouring to achieve they were using the word in the same sense.

On analysis, in my judgment, *The Karen Oltmann* does not lay down any special 'private dictionary' exception. All that Kerr J was saying was that the negotiations could be looked at to see whether the parties had negotiated on an agreed basis that the words bore only one of two possible meanings. I doubt whether this differs in any material respect from admitting evidence of prior negotiations in construing a contract.⁵⁶

Furthermore, it seems to me that the argument that the parties should be treated as having made a separate side agreement assumes that words have fixed or proper meanings independent of their users, and therefore it is at heart a reaffirmation of a plain meaning rule. The truth is that no words have a fixed or settled meaning. Rather it is some *person* who gives a meaning to them. There is either a person who uses them to convey *his or her* meaning or a person who hears or reads them and gives them a meaning of *his or her* own.⁵⁷ Where the

⁵⁶ [2008] EWCA Civ 183 at [120]–[121]. See also *euNetworks Fiber UK Ltd v Abovenet Communications UK Ltd* [2007] EWHC 3099 (Ch) ('*euNetworks Fiber*') at [194]–[195] (Briggs J): '[Counsel argued] that, for there to be established a private dictionary between the parties, it is necessary to show that the meaning which it is desired to be ascribed to the particular word, phrase or term is one upon which the parties expressly or by necessary implication agreed, rather than merely one about which, without any mutual discussion about it, they can be shown to have had a common understanding ... I am not persuaded that this is a rigid exclusionary rule. Kerr J used both the words of mutual agreement and common intention in his definition of the principle. In my judgment, if there is a private dictionary principle at all which admits evidence of the parties' negotiations in aid of construction, the better view is that the question whether the private meaning was expressly or impliedly agreed, or merely the subject of a common understanding, goes to the weight rather than to the admissibility of that evidence.'

⁵⁷ See Corbin, above n6 (1971 Pocket Part) at §543A: 'Words, in themselves alone, have no "meaning"; it is always some *person* who has a "meaning", a person who uses them to convey his thoughts (*his* "meaning"), or a person who hears or reads the words and thereby receives a "meaning" and understanding (a "meaning" and thoughts that are *his own*). This latter person may be one who is a party to the agreement, the judge, or any other third person.' [original emphasis].

issue is one of interpretation of a contract the meaning sought must be: the meaning attached by the parties or, if they attached different meanings then, applying the objective principle, the meaning attached by one party where that party was led reasonably to believe that the other party accepted that meaning. Indeed, as Stephen Smith has pointed out,⁵⁸ where it is established that the parties actually attached a particular meaning to certain words in their contract, that *is* the objective meaning. After explaining that ‘meaning is always objective’ in that ‘[a] word *means* what it is reasonably understood to mean rather than what the speaker intended (or, confusingly, ‘meant’) it to mean’, he says:

In saying that the objective meaning of an agreement is its *only* meaning, it is not suggested, of course, that particular words or combinations of words always have the *same* meaning ... [I]f John and Ann agree that whenever John says ‘dog’ he means cat, then the next time John says ‘dog’ to Ann, the meaning of what John says will be the thing ordinarily called ‘cat’. Although language must be shared, it is possible for there to be only two sharers ... [W]ords must always be understood in their context ... In the above example, the most important fact about the context in which John spoke is that John and Ann had agreed that the word ‘dog’ had a certain meaning between them.

For this reason, there can be no objection in principle to the parties to a written contract deliberately choosing their own private, and perhaps secret, code or convention as to the meaning of the terms of the contract.⁵⁹ As Professor Corbin points out:

Suppose that when A is about to write down the terms of an agreement, he says to B: Please note that when I write herein the words ‘my house’ I shall mean the house on Salem Street owned by my wife; that the words ‘500 feet’ shall mean 100 inches; that by the name ‘John Doe’ I shall mean Friar Tuck; that ‘Bunker Hill Monument’ shall mean Old South Church; and that the words ‘my children’ shall mean my two illegitimate children and not my three legitimate ones. The following document is thereupon written out and signed by A and B: ‘It is mutually agreed that I (A) will convey my house to John Doe and B promises in return to convey to my children the building situated just 500 feet south of Bunker Hill Monument.’ A valid contract has been made. It means what A told B that it should mean. *And the process of determining this meaning is a process of interpretation by means of A’s special code, and not [rectification] for mistake in expression.* [emphasis added.]⁶⁰

⁵⁸ Stephen A Smith, *Contract Theory* (2004) at 273–4. See further McLauchlan, above n50 at 488–97.

⁵⁹ See further D W McLauchlan, ‘The Plain Meaning Rule of Contract Interpretation’ (1996) 2 *New Zealand Business Law Quarterly* 80 at 89–91.

⁶⁰ Corbin, above n6 at §544, 157. See also A L Goodhart, ‘Mistake as to Identity in the Law of Contract’ (1941) 57 *Law Quarterly Review* 228 at 230: ‘It is always possible ... for either the offeror or the offeree to show that, owing to the peculiar circumstances of the case, the other party did or as a reasonable man ought to have understood the words in a sense different from the ordinary one. Thus if A says “white” when other persons would say “black,” and B knows that by “white” A means “black”, then the word “white” must be interpreted as meaning “black” when the offer is construed. Words have no inherent sanctity in themselves, but are

The view of Corbin is now reflected in §212 of the *Restatement (Second) of Contracts* where the following illustration is given:

A and B are engaged in buying and selling shares of stock from each other, and agree orally to conceal the nature of their dealings by using the word 'sell' to mean 'buy' and using the word 'buy' to mean 'sell'. A sends a written offer to B to 'sell' certain shares, and B accepts. The parties are bound in accordance with the oral agreement.

On the Corbin and *Restatement* approach, just as 'sell' can mean 'buy' it is possible that, contrary to the view of a New Zealand judge, 'apples' can mean 'pears'.⁶¹ There may be clear unimpeachable evidence that the parties, because they wish to keep the nature of their dealings secret from others, had a long-standing private code whereby 'apples' *does* mean 'pears'. The fact that such a code is unusual is simply a matter going to the *weight* of evidence needed to rebut the normal inference that the parties used language bearing its ordinary meaning. As Corbin goes on to observe:

We need not be so simple as to suppose that evidence of this sort has to be believed. The plausibility and weight of evidence are very different matters from the admissibility and relevancy of evidence. But in some instances the existence of a private or special code may be admitted by the defendant; or the fact that the plaintiff communicated his special word meanings to the defendant before the integration was written down may be proved up to the hilt, by letters taken from the defendant's own files, by his express admissions, or by the testimony of disinterested witnesses.⁶²

Of course, nothing in what is said above is to deny the conceptual *possibility* of a separate side agreement as to the meaning of a term. The point I am making

merely labels by which things are identified. As a rule words are used in their ordinary sense, but there is nothing to prevent persons from using them to connote something else.' Contrast the view of Clarke JA in *Trawl Industries of Australia Pty Ltd v Effem Foods Pty Ltd (t/as 'Uncle Ben's of Australia')* (1992) 27 NSWLR 326 at 362: 'I am prepared to accept that the parties may include in their written agreement a definition of a phrase used in that agreement which would indicate they had used that phrase to convey a meaning which it otherwise was not capable of bearing. It is otherwise if a party seeks to rely on an antecedent oral agreement to support a contention that the word or phrase in the written agreement bore an agreed meaning which, as a matter of English, it was not capable of bearing. In that instance the oral agreement would contradict the written contract and the parol evidence rule would prevent its reception into evidence.' In Corbin's view, however, the parol evidence rule has no application because (at §543, 130–1): '[t]he terms of any contract must be given a meaning by interpretation before it can be determined whether an attempt is being made to "vary or contradict" them'.

⁶¹ In *Benjamin Developments Ltd v Robt Jones (Pacific) Ltd* [1994] 3 NZLR 189 ('*Benjamin Developments*') at 207, Gallen J said: 'If a contract refers to apples, then it will not be open to parties to aver that the real intention was to refer to pears. Such a contention would not only do violence to the language which the parties have clearly adopted, but may be unfair to persons outside the negotiations who have taken the concluded expression of the agreement at its face value.' The judge's concern that allowing the parties to aver an intention contrary to the plain meaning of their language may be unfair to third parties is addressed in Part 8 of this article.

⁶² Corbin, above n6 at §544, 158.

is that such an analysis is unnecessary and usually unrealistic. However, I would also turn the argument on its head and suggest that, since it is now well established that evidence is admissible to establish the existence of a collateral contract, or a partly written and partly oral contract, despite the parol evidence rule, this actually supports the existence of the principle of *interpretation* in *The Karen Oltmann*. For why should it make a difference that the oral agreement is as to the meaning of a term contained in the written document as opposed to an agreement on a matter not covered in the document? In other words, why should the admissibility of extrinsic evidence depend on whether the evidence concerns the meaning the parties gave to the contractual language or the existence of an independent oral term?

5. *A Case for Rectification?*

In the recent case of *Chartbrook*,⁶³ the trial judge, Briggs J, suggested that the *Karen Oltmann* principle should be re-analysed ‘as concerned with rectification, rather than construction’ and that this would ‘restore a clear boundary between the parties’ negotiations and other relevant background facts, which the private dictionary exception appears to have eroded’.⁶⁴ His Lordship rejected Kerr J’s view, quoted earlier, that rectification was not available in the cases where the principle applied. He also rejected the similar view of Lord Nicholls, writing extra-judicially, that the mistake in expression required for rectification is absent where ‘the parties intended that the words in their contract should bear a particular meaning’.⁶⁵

Briggs J’s re-categorisation is supported by a leading text,⁶⁶ but, in my view, it is unconvincing. It is true that, as his Lordship pointed out, the remedy of rectification is no longer confined to cases where words are mistakenly omitted from, or included in, a written contract. Rectification may also be granted in appropriate cases where there is a mistake as to the meaning or effect of words deliberately chosen to implement the parties’ common intention.⁶⁷ I say ‘in appropriate cases’ because, for example, rectification will not lie where the mistake occurred in the formation of the common intention, such as a mistake in

⁶³ *Chartbrook* [2007] EWHC 409; aff’d [2008] EWCA Civ 183.

⁶⁴ Id at [42]. He reiterated his view in *euNetworks Fiber* [2007] EWHC 3099 (Ch) at [189], drawing ‘some comfort’ (at [191]) from the fact that his reasoning had been endorsed by Aikens J in *Harper v Interchange Group Ltd* [2007] EWHC 1834 (Comm) at [86]–[88].

⁶⁵ Nicholls, above n22 at 586. Compare *Burrows and Peel*, above n22 at 95 (suggesting that *The Karen Oltmann* could have been decided *either* on the basis of contextual interpretation *or* rectification).

⁶⁶ Lewison, above n5 at para 3.08, 76.

⁶⁷ See, for example, *Re Bullin’s Settlement Trusts* [1976] Ch 251 at 260; *NSW Medical Defence Union Ltd v Transport Industries Insurance Co Ltd* (1986) 6 NSWLR 740 (‘*NSW Medical Defence Union*’) at 748; *Bush v National Australia Bank Ltd* (1992) 35 NSWLR 390 (‘*Bush*’) at 406 (Hodgson J): ‘rectification will not be refused merely because the common mistake is as to the legal effect of the words used, rather than as to the actual words used’; and *Commissioner of Stamp Duties (NSW) v Carlenka Pty Ltd* (1995) 41 NSWLR 329 (‘*Carlenka*’) at 345.

underlying assumptions or a mistake as to the benefits or consequences of implementing the common intention, as opposed to a mistake in reducing that intention to writing. This can lead to some fine distinctions, and much may hinge on how the common intention is formulated in the first place.⁶⁸ Most importantly for present purposes, however, the situations where rectification will be warranted despite the words in question having been deliberately chosen are quite unlike that which occurred in *The Karen Oltmann*. These are situations where, rather than attaching a particular meaning to the words, the parties overlook the ramifications or effect of the words and perhaps simply assume that they suffice. They fail to appreciate either (a) that the words provide for something very different from what was intended, or (b) that they do not have the intended effect,⁶⁹ or (c) that they have an unintended effect.⁷⁰ When the difficulty is pointed out to them, the affected parties, or at least the claimants, will acknowledge the disconformity between the words chosen and the relevant contractual intention, whereas in the *Karen Oltmann* or ‘private dictionary’ scenario they will not. Instead of the claimants saying ‘in the light of what I now know, the wrong words were chosen to implement our intention’, they will say ‘there was no mistake at all because we were fully aware of what we were doing and we used the words in the particular sense that has been established’.

It is interesting to note that when the decision in the *Chartbrook* case was recently affirmed by the Court of Appeal, Lawrence Collins LJ, the only judge to address this point (albeit dissenting in the result), observed:⁷¹

Briggs J was right to point out that ... rectification may be available even if words have been deliberately used, but where it was mistakenly considered that they bore a different meaning from their correct meaning as a matter of true construction. But I do not think he was right to suggest that *The Karen Oltmann* should have been decided on that basis. In my judgment, the problem in *The Karen Oltmann* was that the words in the contract were capable of bearing more than one possible meaning. There was no mistake either as to the words used or as to the consequence of the words used.⁷²

It should not be thought, however, that, as Lawrence Collins LJ suggests, the *Karen Oltmann* principle is confined to situations where the words in question

⁶⁸ I have elaborated on these points in D W McLauchlan, ‘The “Drastic” Remedy of Rectification for Unilateral Mistake’ (2008) 124 *Law Quarterly Review* 608 at 618.

⁶⁹ As in, for example, *NSW Medical Defence Union* (1986) 6 NSWLR 740 and *Bush* (1992) 35 NSWLR 390.

⁷⁰ As in, for example, *Carlenka* (1995) 41 NSWLR 329.

⁷¹ *Chartbrook* [2008] EWCA Civ 183 at [123].

⁷² He also rejected at [131] Briggs J’s view (at [44] of the High Court decision) that ‘it is at least reasonably clear that the private dictionary inroad into the exclusion of the parties’ negotiations from the admissible background ought not to extend to any case in which the word, phrase, clause or term is itself subject of an express definition in the contract itself’. As counsel for the appellant argued (at [100] of the Court of Appeal decision), ‘[t]here is no reason in logic or principle why the admissibility of (as opposed to weight given to) pre-contractual material should in any way depend (as the judge thought) upon whether the ambiguity in question is to be found within the confines of a defined term’.

are ambiguous, or that rectification is the only appropriate response where the words have a 'plain' meaning. In principle, for the reasons discussed in the previous section, this ought not to be so. If need be, further support can be derived, by analogy, from the case law dealing with special meanings derived from trade usage and custom.

It is well-established that parol evidence is admissible to prove that, by virtue of a custom of a particular locality or the usage of a particular trade, words were used in a sense different from that which they ordinarily bear.⁷³ Thus, in *Smith v Wilson*,⁷⁴ evidence was admitted that '1000' meant '1200' in the local rabbit trade and in *Mitchell v Henry*,⁷⁵ it was held that 'white' could be interpreted as 'black' because, by a trade usage, 'white selvage' meant a selvage that was dark. These cases 'demonstrate the fallacy of ignoring the purely relative meaning of words and the injustice of attempting to enforce a supposed rigid standard'.⁷⁶ As Coleridge J stated in *Brown v Byrne*:

Neither in the construction of a contract among merchants, tradesmen or others, will the evidence be excluded because the words are in their ordinary meaning unambiguous; for the principle of admission is, that words perfectly unambiguous in their ordinary meaning are used by the contractors in a different sense from that. What words more plain than 'a thousand', 'a week', 'a day'? Yet the cases are familiar in which 'a thousand' has been held to mean twelve hundred, 'a week' a week only during the theatrical season, 'a day' a working day.⁷⁷

The argument prompted by the trade usage and custom line of cases is as follows. If evidence is admissible to show that by trade usage white means black, there is no reason in principle why evidence of other circumstances which demonstrates the parties' shared understanding to the same effect should be inadmissible. And, importantly for present purposes, it is no answer to say that rectification of the contract should be sought in such circumstances because, as Farnsworth points out, 'where the parties have used the very words intended by them, but have used them in a way not sanctioned by the usage of others', rectification 'is neither a necessary nor even an appropriate remedy; judicial interpretation is sufficient'.⁷⁸

6. Ramifications of The Karen Oltmann as a Principle of Interpretation

If it be accepted that *The Karen Oltmann* was correctly decided *and* that neither of the explanations discussed in the previous section are satisfactory, the case

⁷³ See further McLauchlan, above n59 at 88–9.

⁷⁴ (1832) 3 B & Ad 728; 110 ER 266.

⁷⁵ (1880) 15 Ch D 181.

⁷⁶ J H Wigmore, *Wigmore on Evidence* (Chadbourn rev ed, 1981), vol 9, at 204.

⁷⁷ (1854) 3 El & Bl 703 at 716; 118 ER 1304 at 1309.

⁷⁸ E Allan Farnsworth, "'Meaning" in the Law of Contracts' (1967) 76 *Yale Law Journal* 939 at 965.

must be treated as establishing a principle of contract interpretation. A number of important consequences follow.

First, there cannot be an absolute rule that evidence of prior negotiations is inadmissible as an aid to interpretation. Such evidence ought to be admissible not only for the orthodox purpose of assisting the court in determining the factual background to the contract but also establishing that the parties reached an agreement or held a common understanding as to the meaning of the words in dispute.⁷⁹

Second, it cannot be the law that the only role of the court is to decide the *presumed* intention of the parties and hence that evidence of the actual intention and understanding of the parties is not receivable.⁸⁰ Accordingly, if the evidence establishes that the parties did actually focus their minds on the language in dispute and gave it the meaning now alleged by one of them, or at least that they were proceeding on a common assumption as to its meaning, the court should give effect to their agreement or assumption.

Third, it would be difficult to sustain an argument that this principle should be confined to situations where the words of the contract are ambiguous or ‘fairly capable of bearing more than one meaning’. For the reasons discussed in Part 4 of this article, the parties’ common intention surely cannot be defeated because the words in question appear to the court to have a plain meaning.⁸¹ Where there is convincing evidence that, at the time of the contract, the parties attached the same meaning to the words in dispute, the task of the court is to give effect to that meaning, regardless of whether those words on the surface are ambiguous or have a plain meaning.

⁷⁹ As Briggs J said in *Chartbrook* [2007] EWHC 409 at [43], if ‘the private dictionary principle [is] a rule of construction’, the question ‘as to the boundary between it and the policy exclusion of the parties’ negotiations as admissible background’ is ‘logically unfathomable’. See, however, *Proforce Recruit Ltd v The Rugby Group Ltd* [2007] EWHC 1621 (QB) at [87] (Cresswell J): ‘The [*Karen Oltmann*] exception ... should not be allowed to become a means, regularly adopted by litigants, of attempting to circumvent the fundamental principle that generally the law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent’.

⁸⁰ See, for example, *Codelfa* (1982) 149 CLR 337 at 352.

⁸¹ See also *euNetworks Fiber* [2007] EWHC 3099 at [192] (Ch) where counsel argued that ‘a private dictionary meaning may not be used to subvert the unambiguous meaning of a word, phrase or term in a contract, but only where the word, phrase or term is on its face capable of different meanings’. Briggs J, who had earlier (at [189]) reiterated the view he expressed in *Chartbrook* [2007] EWHC 409 that ‘the supposed private dictionary principle ... [is] an aspect of the law of rectification’, did not find it necessary to decide the point. Interestingly, however, he did say (at [193]) that: ‘The difficulty with [the] submission is that the *JCS* case was decided after *The Karen Oltmann*, and marked a watershed in admitting background circumstances as the context for the purposes of construction, even in the absence of a patent ambiguity. Furthermore, in the more recent cases (since the *JCS* case) which have addressed the dictionary principle, the same clear restriction enunciated by Kerr J is not to be found. He himself said that the question whether an ambiguity existed depended upon considering the disputed words “in their context”.’

Fourth, there is no reason why the principle should be limited to evidence of *actual* common intention. Surely the position should be no different where the evidence establishes that one party intended the particular meaning *and* that party was led reasonably to believe that the other party accepted this meaning. It would be very odd if such an ‘objectively’ determined agreement as to meaning did not suffice. Thus, in *The Karen Oltmann*, even if the charterers denied that they actually shared the shipowners’ assumption as to the meaning of the word ‘after’, the latter’s contention must succeed if they were reasonably entitled to infer from the communications between the parties that the charterers did share the assumption.

7. *An ‘Orthodox’ Explanation of The Karen Oltmann?*

Before considering other arguments that have been raised in support of admitting evidence of prior negotiations, it is worth noting that, somewhat surprisingly perhaps, it is also possible to mount an argument in support of the *Karen Oltmann* principle based on cases that ostensibly apply the orthodox or traditional approach to contract interpretation. These are decisions of conservative judges who not only espouse firm views concerning the certainty of meaning of language and the wisdom of the plain meaning rule, but who also subscribe to strict nineteenth century perceptions of the scope of the parol evidence rule and the version of the objective theory of contract under which the sole task of the court is to determine the parties’ *presumed* intention, so that their actual intentions and expectations are irrelevant.

In *Codelfa*, Mason J held that evidence of prior negotiations is inadmissible ‘in so far as [those negotiations] consist of statements and actions of the parties which are reflective of their actual intentions and expectations’.⁸² However, he also said:

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.⁸³

In the light of this, might not one argue that the communications between the parties irrefutably establishing the common assumption in *The Karen Oltmann* was an objective background fact and therefore admissible and determinative of the dispute between the parties? Further, if evidence of prior negotiations is admissible to identify the subject matter of the contract — for example, a conversation showing that a contract for the sale of ‘your wool’ was intended to include both wool produced on the seller’s farm and wool that the seller had bought in from other farms⁸⁴ — why should the position be different if the dispute relates to a more subsidiary term in respect of which there is reliable

⁸² (1982) 149 CLR 337 at 352.

⁸³ *Ibid.*

⁸⁴ *Macdonald v Longbottom* (1859) 1 E & E 977, 120 ER 1177, a decision approved in both *Prenn* [1971] 1 WLR 1381 at 1384 and *Codelfa* (1982) 149 CLR 337 at 349.

evidence as to the parties' intended meaning? Although undoubtedly Mason J would not have anticipated such an extension of his exception, there are some interesting examples in the case law of the courts being prepared to give it this wider operation.

Thus, in *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd*, the New South Wales Court of Appeal held that the word 'variations' in an agreement to settle the amount owing to the defendant sub-contractor under a building contract included not only changes to the works but also certain advance payments by the plaintiff, so that those payments were no longer to be brought into account.⁸⁵ Kirby P said that it was permissible 'to have regard to extrinsic evidence in order to find, from the past conduct of the parties and mutually known facts the sense in which they used the word'.⁸⁶ This did not involve 'explor[ing] their minds, as such'. The purpose was 'to determine from what was objectively known, the dictionary which they were in fact using for the word they chose'.⁸⁷ He thus in effect applied what we now know as the 'private dictionary' or *Karen Oltmann* principle.

Mason J's exception was also endorsed, albeit not by name, by the New Zealand Court of Appeal in *Potter v Potter*.⁸⁸ The court said that, although pre-contract negotiations are generally irrelevant, there is an exception when they are 'used for the very limited purpose of ascertaining what objectively observable facts, as distinct from intentions, must have been within the contemplation of both parties'.⁸⁹ The authority cited for this exception was the decision of Richmond J in *Eastmond v Bowis*,⁹⁰ a case where, despite his protestations to the contrary, the judge did in effect use the evidence of the parties' negotiations to determine the meaning they actually attributed to the words in dispute. The case concerned the meaning of the phrase 'subject to finance' in an agreement by the plaintiff to purchase the defendant's farm. Richmond J held that the plaintiff's evidence as to the meaning that he intended the words to bear was 'clearly inadmissible'.⁹¹ He also held that the negotiations between the plaintiff and the defendant's agent could not 'be resorted to as direct evidence of the intention of the parties as to the meaning of the phrase'.⁹² However, he then went on to concede that the negotiations could 'be resorted to in so far as they may disclose that facts were in the mutual contemplation of the parties of a kind which will give assistance to the Court in giving a more precise meaning to the phrase'.⁹³ And in this case they disclosed, *inter alia*, the facts that

⁸⁵ (1994) 35 NSWLR 227.

⁸⁶ *Id* at 237.

⁸⁷ *Ibid*.

⁸⁸ [2003] 3 NZLR 145.

⁸⁹ *Id* at 156–7.

⁹⁰ [1962] NZLR 954.

⁹¹ *Id* at 959.

⁹² *Ibid*.

⁹³ *Id* at 959–60.

the plaintiff, although ‘a man of considerable means’,⁹⁴ had specifically discussed with the defendant’s agent his need to raise a mortgage for £6000 on the defendant’s farm and that the agent undertook to assist him in this endeavour. It was held that:

the existence of this arrangement ... is an objective fact, in the mutual knowledge of the parties, to which the Court may legitimately refer as an aid to the interpretation of the ambiguous words ‘subject to finance’ ... When they are read in the light of the extrinsic evidence it becomes apparent that the particular raising of money which the parties had in contemplation was the raising of a sum of £6,000 on mortgage of the defendant’s property by the joint efforts of [the defendant’s agent] and the plaintiff.⁹⁵

It is obvious, despite the verbal camouflage, that evidence of the negotiations was used by the judge to show what the parties actually intended the words ‘subject to finance’ to mean.

Similarly strained reasoning has been forced upon Australian judges as they seek to marry the commonsense proposition that effect should be given to a clearly proven actual mutual intention as to the meaning of words with the strictures imposed by Mason J’s judgment in *Codelfa*, namely, that in an interpretation dispute:

we look, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties’ presumed intention in this setting’.⁹⁶

Two examples will suffice for present purposes.

In *BP Australia Pty Ltd v Nyran Pty Ltd* RD Nicholson J said:

The concept of ‘surrounding circumstances’ is to be understood to be a reference to ‘the objective framework of facts’. It will include evidence of prior negotiations so far as they tend to establish objective background facts known to both parties and the subject matter of the contract. It will also include ... evidence of a matter in common contemplation and constituting a common assumption. From the evidence of that setting the parties’ *presumed intention* may be taken into account in determining which of two or more possible meanings is to be given to a contractual provision. *What cannot be taken into account is evidence of statements and actions of the parties which are reflective of their actual intentions and expectations.* Objective background facts *can* include statements and actions of the parties which reflect their mutual actual intentions. That is, evidence of the mutual subjective intention of the parties to a contract may be part of the objective framework of facts within which the contract came into existence. It is the mutuality which makes the evidence

⁹⁴ Id at 960.

⁹⁵ Ibid.

⁹⁶ (1981) 149 CLR 337 at 352.

admissible. [emphasis added.]⁹⁷

Thus, ‘evidence of statements and actions of the parties which are reflective of their actual intentions and expectations’ is inadmissible, but evidence of objective background facts which ‘can include statements and actions of the parties which reflect their mutual actual intentions’ is admissible!

The reasoning in my second example is even more difficult. In *Spunwill Pty Ltd v BAB Pty Ltd*,⁹⁸ Santow J was satisfied that the parties had formed an actual mutual intention as to the meaning of the words in dispute but felt bound to accept that it was a settled principle of contract interpretation that the object is to give effect to the apparent or presumed intention of the parties and hence ‘direct evidence of the parties’ actual subjective intentions and expectations is inadmissible’.⁹⁹ However, he went on to argue, citing as authority *The Karen Oltmann*, that ‘matters of mutual subjective intention are themselves part of the objective framework of facts within which the contract came into existence, and are thus receivable as part of the surrounding factual circumstances’.¹⁰⁰ In other words, ‘evidence of a mutual subjective intention is admissible as an objective fact that illuminates the meaning a reasonable person in the position of the parties would attach to a provision’.¹⁰¹ Consistently with this approach, the judge accepted that the existence of a mutual subjective intention (this objectively determined ‘shared subjectiveness’!)¹⁰² was simply one of the objective facts — one ‘factor to be taken into account in determining presumed intention, without necessarily being determinative’.¹⁰³ This is because ‘[e]xtrinsic evidence of facts, statements and conduct known to both parties’ is only admissible to:

illuminate the meaning that reasonable persons in the position of the parties objectively intended ambiguous language of the document to bear. Extrinsic evidence which merely illuminates the actual subjective intentions, aspirations or expectations of the parties does not assist in discovering the presumed intention and is inadmissible.¹⁰⁴

No clue is given as to what the circumstances might be in which a clearly proven actual mutual intention would not be conclusive. It is difficult to see how a court could possibly refuse to give effect to a clearly proven actual mutual intention on the ground that a reasonable person in the position of the parties would not have given the language that meaning. That seems to be a contradiction. A reasonable person in the position of the parties must surely give the language the meaning that the parties intend.

⁹⁷ (2003) 198 ALR 442 at [34]. This passage was accepted as a correct statement of the law by Hamilton J in *Braystock Pty Ltd v Garland* [2004] NSWSC 874 at [17].

⁹⁸ (1994) 36 NSWLR 290, discussed more fully in McLauchlan, above n50 at 491–2.

⁹⁹ (1994) 36 NSWLR 290 at 299.

¹⁰⁰ Id at 309.

¹⁰¹ Id at 310.

¹⁰² Id at 309, 311.

¹⁰³ Id at 310.

¹⁰⁴ Id at 309.

Nevertheless, while the reasoning of the judges in the cases discussed in this section is somewhat tortuous, those cases do provide some judicial support for the conclusion that the *Karen Oltmann* principle can be accommodated within the orthodox objective approach to contract interpretation on the basis that an actual mutual intention forms part of the admissible objective background of facts.¹⁰⁵ As we have seen,¹⁰⁶ strong academic support can also be found for the view that, where parties have formed an actual mutual intention that words shall have a certain meaning between them, that *is* the objective meaning of the words in the circumstances.

8. Other Arguments for Admitting Prior Negotiations

Lord Hoffmann's third principle in the *ICS* case states that evidence of prior negotiations is inadmissible 'for reasons of practical policy', although he concedes that the boundaries of this exclusion 'are in some respects unclear'.¹⁰⁷ His Lordship did not elaborate on the reasons of practical policy but he probably had in mind the following observation of Lord Wilberforce in *Prenn*:

The reason for not admitting evidence of [the parties' negotiations] is not a technical one or even mainly one of convenience, (though the attempt to admit it did greatly prolong the case and add to its expense). It is simply that such evidence is unhelpful. By the nature of things, where negotiations are difficult, the parties' positions, with each passing letter, are changing and until the final agreement, though converging, still divergent. It is only the final document which records a consensus ... [I]t may be a matter of degree, or of judgment, how far one interpretation, or another, gives effect to a common intention: the parties, indeed, may be pursuing that intention with differing emphasis, and hoping to achieve it to an extent which may differ, and in different ways. The words used may, and often do, represent a formula which means different things to each side, yet may be accepted because this is the only way to get 'agreement' and in the hope that disputes will not arise.¹⁰⁸

There can be no doubt that, for the reasons given, it will often be unsatisfactory to place too much reliance on evidence of the parties' negotiations. But this is not a reason for excluding all such evidence outright. The negotiations will sometimes provide a very reliable and helpful guide to the parties' intentions and, as I have argued on previous occasions,¹⁰⁹ the points

¹⁰⁵ So, too, does Lord Hoffmann's analysis of the legal ramifications of the conversation between Alice and Humpty Dumpty in *ICS* [1998] 1 WLR 896 at 914.

¹⁰⁶ See text following n57.

¹⁰⁷ [1998] 1 WLR 896 at 913.

¹⁰⁸ [1971] 1 WLR 1381 at 1384-5.

¹⁰⁹ See, for example, D W McLauchlan, 'The New Law of Contract Interpretation' (2000) 19 *New Zealand Universities Law Review* 147. See also *Yoshimoto* [2001] 1 NZLR 523 where Thomas J argued at length that there are no convincing reasons of principle or policy for an absolute rule that evidence of the parties' negotiations is inadmissible. While acknowledging that such evidence will sometimes be unhelpful and that it should be received with caution, he suggested that it may equally provide a reliable guide to the true intention of the parties. It is a question for the court to decide what weight should be given to the evidence in the particular

made by Lord Wilberforce are only valid as cautionary factors to be taken into account in determining the weight to be given to evidence of prior negotiations, not its admissibility.

Lord Nicholls, in an important extra-judicial comment, has recently endorsed this view.¹¹⁰ Starting from the premise that '[t]he question posed by the law when interpreting a contract is ... what would a reasonable person *in the position of the parties* understand was the meaning the words were intended to convey' [original emphasis],¹¹¹ he says:

Pre-contract negotiations are unlikely to help when, as often is the case, the parties did not anticipate the events which happened, or when the words chosen represented a compromise on which the parties' views differed, or when the parties contracted on one party's standard terms: the examples could be multiplied. Unquestionably the exclusionary rule serves a valuable purpose as a cautionary reminder that in general evidence of the parties' actual intentions does not of itself assist when interpreting a contract and, therefore, it is irrelevant and as such inadmissible. The exclusionary rule may usefully stand as a general rule.

But there will be occasions where the pre-contract negotiations do shed light on the meaning the parties intended to convey by the words they used. There will be occasions, for instance, when the parties in their pre-contract exchanges made clear the meaning they intended by language they subsequently incorporated into their contract. When pre-contract negotiations assist in some such way, the notional reasonable person should be able to take that evidence into account in deciding how the contract is to be interpreted.¹¹²

The author proceeded to give four reasons why there should not be an absolute rule excluding evidence of prior negotiations: it would 'introduce much needed coherence' into the law of contract interpretation, it 'would make the law more transparent', it would assist in harmonising the common law with the current international trend and, most importantly, it would avert the danger that 'justice may not be done'.¹¹³ Although I would rest my case first and foremost on logical arguments based on first principles of the law of contract, I agree with these reasons. But, as we shall see, not all do. Spigelman CJ, in his recent

circumstances of each case rather than to reject it outright and thus run the risk of holding the parties to a meaning different to that which they attached to the words in dispute. Contrast Bingham, above n17 at 389: 'In almost any contractual negotiation worth the name, the parties will have competing and sometimes fluctuating aims, which they may or may not achieve. Any detailed consideration of the exchanges to and fro is in my view liable to lead to excessive emphasis on what the parties wanted to agree and too little on what they actually did agree'. Interestingly, the author endorsed (at 389) the decision in *The Karen Oltmann* ('never to my knowledge questioned') because it seemed to him 'wholly consistent with the rule which admits evidence of the meaning of trade and technical expressions'.

¹¹⁰ He had earlier foreshadowed his reservations concerning Lord Hoffmann's third principle in *Bank of Credit and Commerce* [2002] 1 AC 251 at [31].

¹¹¹ Nicholls, above n22 at 579.

¹¹² Id at 582-3.

¹¹³ Id at 585-6.

extra-judicial contribution to the subject, has taken exception to all four reasons.¹¹⁴

A. *Coherence in the Law*

Nicholls refers here to his central point in the passage quoted above, namely that reliable evidence from the parties' pre-contract exchanges of the meaning they intended the words in dispute to bear must be able to be taken into account in interpreting the contract. He amplified the argument as follows:

This would not be a departure from the objective approach. Rather, this would enable the notional reasonable person to be more fully informed of the background context. This would recognise that pre-contract negotiations are themselves part of the background of a contract and that, like other background material, they may be relevant when interpreting a contract. They differ from other background material in that, unlike other background material, they may afford direct evidence of the parties' actual intentions. That is not a reason for banning their use. That would be perverse. That would mean that in deciding the meaning intended to be conveyed by the language chosen by the parties the notional reasonable person would always be barred from having regard to what may be the best evidence of all. He must always conjecture, he must never know. The preferable approach is to recognise that pre-contract negotiations are relevant and admissible if they would have influenced the notional reasonable person in his understanding of the meaning the parties intended to convey by the words they used.¹¹⁵

I would add two further comments. First, the contrary view leads to unsustainable distinctions. A point made earlier¹¹⁶ is perhaps worth repeating in this context. It is now well-established that, despite the parole evidence rule, evidence is admissible to establish the existence of a term agreed orally but not recorded in the parties' written document, so that the contract is in truth partly written and partly oral.¹¹⁷ Why should it make a difference that the oral agreement is as to the meaning of a term contained in the written document as opposed to an agreement on a matter not covered in the document? The admissibility of extrinsic evidence should not depend on whether the evidence concerns the meaning the parties gave to the contractual language as opposed to the existence of an independent oral term. The two scenarios may sometimes shade into one another and therefore it is absurd to treat them differently.

Second, even in the context of a 'presumed intention' approach to interpretation which eschews any concern with or reference to the actual intention of the parties, the exclusion of negotiations from the admissible background makes little sense. If the general principle is that the task of the court is to ascertain 'the meaning which the document would convey to a reasonable

¹¹⁴ Spigelman, above n8 at 331–4.

¹¹⁵ Nicholls, above n22 at 583.

¹¹⁶ See concluding paragraph of Part 4A of this article.

¹¹⁷ See, for example, H G Beale (ed), *Chitty on Contracts* (29th ed, 2004), vol 1, paras 12-096–12-099.

person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract',¹¹⁸ why should the most immediate and pertinent background be excluded? A reasonable person with knowledge of 'absolutely anything [relevant] that would have affected the way in which the language of the document would have been understood by a reasonable man',¹¹⁹ *but minus the negotiations* will usually have an incomplete picture of the background to the contract. In *Prenn*, Lord Wilberforce said that 'evidence should be restricted to evidence of the factual background known to the parties at or before the date of the contract, including evidence of the "genesis" and objectively the "aim" of the transaction',¹²⁰ but the problem is that even this information will often only appear from evidence of the communications between the parties in the course of negotiations. These communications may demonstrate, for example, that important changes took place concerning the nature and structure of, or the consideration for, the transaction, as well as the reasons for such changes, all of which may have considerable bearing on the way in which a reasonable person would understand the document eventually executed. Interestingly, as we have seen,¹²¹ it was well-established, at least in Australia and New Zealand, prior to the *ICS* case that evidence of prior negotiations was admissible to the extent that it tended to establish objective background facts that were known to both parties at the time of the contract.

Spigelman disagrees with Nicholls.¹²² He responds to the argument that there is no logical reason for excluding the negotiations from the admissible factual background by invoking Oliver Wendell Holmes' famous aphorism: 'The life of the law has not been logic but experience'.¹²³ While admitting that '[c]oherence in the law is unquestionably desirable', he sees 'no particular difficulty in the traditional approach accepted by Lord Hoffmann of having a general rule subject to exceptions'.¹²⁴ With respect, these comments are pure assertion and barely deserve a response. The author fails to address the substantive points made by Nicholls in support of his argument.

B. More Transparency

Nicholls' second reason is that allowing evidence of negotiations 'would make the law more transparent'.¹²⁵ He believes that, in practice, 'in one form or another evidence of the actual intentions of the parties often does come to the attention of the judge on disputes about interpretation' and that 'in practice judges are influenced by this evidence when it assists in determining the

¹¹⁸ *ICS* [1998] 1 WLR 896 at 912 — Lord Hoffmann's first principle.

¹¹⁹ Lord Hoffmann's second principle, as qualified in *Bank of Credit and Commerce* [2002] AC 251 at [39].

¹²⁰ [1971] 1 WLR 1381 at 1385.

¹²¹ See text following n82.

¹²² Spigelman, above n8 at 332.

¹²³ *Ibid.*

¹²⁴ *Ibid.*

¹²⁵ Nicholls, above n22 at 585.

objective meaning of the words'.¹²⁶ He therefore suggests that '[t]his should be recognised openly'.¹²⁷ Earlier in the article the author said:

In my days at the Bar the practice was that when the parties' pre-contract negotiations furnished some insight into their actual intentions, one or other of the parties would include a rectification claim in the proceedings. By this means, whatever the outcome of the rectification claim, the evidence of the parties' actual intentions would be before the court. The hope was that, either consciously or subconsciously, the judge's thinking on the interpretation issue would be influenced by this evidence.

No one was deceived by this transparent ploy. I understand this still goes on. There is nothing improper about this, so long as the rectification claim has a seriously arguable factual basis and is brought in good faith. But the continuing vitality of this practice does suggest something is amiss. If evidence of intention, when admitted for the rectification purpose, may in practice affect how a judge views the outcome of the interpretation issue, why is it not openly admissible for this purpose?¹²⁸

Spigelman was dismissive of this reason as well, his main point being that he could see 'no particular purpose in allowing the fashionable concept of "transparency" to qualify appropriate legal doctrine'.¹²⁹ This response, apart from begging the question as to whether the exclusion of negotiations is 'appropriate legal doctrine' in the light of the underlying purpose of contract interpretation, fails to address Nicholls' main point that, since judges are influenced by evidence of the parties' intention, it is time that influence was openly acknowledged.¹³⁰

C. Harmonising the Common Law with the International Instruments

Nicholls' third reason for a liberal approach to the reception of evidence of negotiations is that 'this approach would conform to the current international trend' and thus avoid the risk of the United Kingdom 'becoming isolated on this point in the field of commercial law'.¹³¹ Spigelman, however, regards this 'permeation into international arrangements of the European civil law' as having little relevance for Australia, saying:

This is one of the many respects in which English law is likely to diverge from

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ Id at 578.

¹²⁹ Spigelman, above n8 at 332.

¹³⁰ A similar argument was made by Thomas J in *Dreux Holdings* (1996) 7 TCLR 617 at 643 in relation to the admissibility of evidence of subsequent conduct. He pointed out that 'the Courts are already influenced by evidence of subsequent conduct'. After noting that such evidence is often adduced to support alternative causes of action, he said that (at 643-4) 'it would be unrealistic to suggest that the Courts are not influenced by this evidence in arriving at a construction of the contract' and he later concluded (at 644) that '[i]f, as is to be accepted, the Courts are influenced by the extrinsic evidence in this manner it is appropriate to make that influence overt'.

¹³¹ Nicholls, above n22 at 586.

the common law of Australia, by reason of the influence upon English lawyers of the progressive integration of the United Kingdom into the European economic and political communities. For this reason alone it is necessary in the future for Australian lawyers to treat English authorities on such matters with caution.¹³²

In my view, this response is simplistic. Australia is by no means immune from such European civil law influences, as is demonstrated by the fact that all States and Territories have introduced the United Nations Convention on Contracts for the International Sale of Goods into domestic law via the various Sale of Goods (Vienna Convention) Acts.¹³³ And included among the new rules governing international sales contracts are provisions for the interpretation of contracts which mirror the liberal approach advocated in this article. Under art 8(1) of the UN Convention statements made by a party 'are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was'. Article 8(2) provides that, if the latter provision is inapplicable, a party's statements 'are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances'. Most importantly for present purposes, art 8(3) provides that '[i]n determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties'.

A strong case can be made for harmonisation of the interpretation rules for domestic contracts with the Convention's rules for international sales. For example, it would be odd if it were the law of Australia that evidence of prior negotiations is admissible to aid the interpretation of international sales contracts but not other sales contracts, or indeed commercial contracts generally. A seller in Sydney would surely be more than a little bemused to learn that the outcome of an interpretation dispute might hinge on whether his or her buyer was in Brisbane or Auckland!

Furthermore, the publication in recent times of various influential international restatements of contract law that are likely to assume increasing importance in the resolution of international commercial contract disputes strengthens the case for harmonisation. Both the *Unidroit Principles of International Commercial Contracts* (1994 and 2004 revision) and the *Principles of European Contract Law* (1999) refine and expand the principles contained in

¹³² Spiegelman, above n8 at 332–3.

¹³³ *Sale of Goods (Vienna Convention) Act* 1986 (NSW); *Sale of Goods (Vienna Convention) Act* 1986 (Qld); *Sale of Goods (Vienna Convention) Act* 1986 (SA); *Sale of Goods (Vienna Convention) Act* 1987 (Tas); *Sale of Goods (Vienna Convention) Act* 1987 (Vic); *Sale of Goods (Vienna Convention) Act* 1986 (WA); *Sale of Goods (Vienna Convention) Act* 1987 (ACT); *Sale of Goods (Vienna Convention) Act* 1987 (NT). The validity of the argument in the text is not affected by the fact that in Australia parties commonly contract out of the Convention.

the convention. The *Unidroit Principles* provide that contracts are ‘to be interpreted according to the common intention of the parties’ or, if that cannot be established, ‘according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances’. Most importantly for present purposes, both sets of principles state that ‘regard shall be had’ to prior negotiations (and indeed subsequent conduct).¹³⁴ There is much to be said for the view that, unless there are compelling reasons for doing otherwise, domestic contract law should be guided by established international practice in our increasingly global economy.¹³⁵

D. Justice May Not Be Done

Nicholls’ fourth reason is that excluding evidence of actual mutual intention may sometimes mean that justice is not done. The parties may be held to an interpretation that is contrary to their intention. Rectification will only assist where there is mistake in expression, and that will be absent ‘[i]f the parties intended that the words in their contract should bear a particular meaning’.¹³⁶

Spigelman, however, views this reason with some dismay. In what can be charitably described as an over-reaction, he said that it is ‘the ultimate Chancellors’ foot approach to the law’.¹³⁷ Nicholls was not talking about assigning to judges the power to interpret contracts according to their personal predilections as to the fair outcome. He was proposing a modest reform aimed at improving their ability to implement the first principle of contract law that parties should be held to their bargains in the sense that they truly agreed.

9. The ‘Practical Policy’ Objections

In the recent case of *Chartbrook*,¹³⁸ counsel for the defendants put forward an argument, based on Nicholls’ article, that evidence of prior negotiations is only inadmissible if, as in the kind of circumstances outlined by Lord Wilberforce in *Prenn*,¹³⁹ the evidence is unhelpful. In his submission:

Evidence of negotiations will be unhelpful if it merely illustrates the separate subjective intentions and aspirations of the negotiating parties. By contrast, if during the negotiations the evidence shows that the parties were *ad idem* as to the meaning of a word, a phrase, a clause or a term, or as to any part of the contract, then evidence to that effect will be helpful, and may permit the court to adopt a construction different from the natural meaning of the words, phrase or clause. Such an approach ... is precisely what a reasonable person would adopt in seeking to ascertain what the parties may reasonably have been understood to

¹³⁴ See *Unidroit Principles*, art 4.3, and *European Principles*, art 5:102.

¹³⁵ See the observations to similar effect by the New Zealand Court of Appeal in *Dreux Holdings* (1996) 7 TCLR 617 at 627, 642.

¹³⁶ Nicholls, above n22 at 586.

¹³⁷ Spigelman, above n8 at 333.

¹³⁸ [2007] EWHC 409; aff’d [2008] EWCA Civ 183.

¹³⁹ [1971] 1 WLR 1381 at 1384–5. See text above at n108.

mean by the words which they have chosen.¹⁴⁰

Briggs J described this as ‘a powerful submission, with much to commend it in terms of simplicity, intellectual coherence and common sense’.¹⁴¹ Nevertheless, he concluded that the submission was wrong, ‘principally because it wholly ignores the policy reasons for the exclusion of the parties’ negotiations from the admissible background, and if logically applied, would subvert the negotiations exclusion more or less completely’.¹⁴²

What are these policy reasons? There are four that are most commonly raised: first, the need for certainty, particularly in commercial dispute resolution; second, the desirability of avoiding the extra cost and time involved in prolonging civil trials through the reception of vast quantities of extrinsic evidence, much of which may be unhelpful, irrelevant or unreliable; third, admitting evidence of the parties’ negotiations would subvert the objective approach; and fourth, the reason that was relied on by Briggs J and that has received increasing emphasis of late, the potential adverse effects on third parties. In my view none of these reasons are convincing. Let us consider each in turn.

A. *The Need for Certainty*

As I pointed out at the very beginning of this article, contract interpretation cases tend to be the most intractable of all contractual disputes and their outcome is notoriously difficult to predict. It is difficult to believe, therefore, that a more liberal approach to the reception of evidence of prior negotiations would result in any greater uncertainty. Indeed, in those cases where the evidence revealed that the parties formed a common intention as to the meaning of the words in dispute, the opposite might be the case. Litigants would be aware that they could not use technicalities to hide the truth. Nicholls made this point in his article:

Where the pre-contract negotiations furnish a clear insight into the intended meaning of the disputed provision, admission of that evidence can hardly promote uncertainty. Rather the reverse. It is the exclusion of that evidence which generates uncertainty by enabling one party to contend for a meaning he knows was not intended. Since the extrinsic evidence is not admissible he is able to advance a case which otherwise would be untenable.¹⁴³

B. *Increased Cost and Time*

Over recent years serious concerns have often been expressed about the costs and inefficiencies of civil litigation in common law jurisdictions. In New Zealand, for example, senior counsel have gone so far as to suggest that the current system has largely lost commercial and practical credibility, and there appears to be general agreement on the need for an overhaul of civil procedure, including the

¹⁴⁰ [2007] EWHC 409 at [32].

¹⁴¹ Id at [33].

¹⁴² Ibid.

¹⁴³ Nicholls, above n22 at 587.

discovery rules and case management process. In this environment it is not surprising that proposals to extend the range of materials to which a court might have regard in adjudicating upon a contract interpretation dispute should be greeted with alarm. As mentioned at the beginning of this article, Lord Hoffmann's restatement has attracted hostility from within the profession. His ruling that the admissible factual background includes everything (except negotiations) that would affect the way in which a reasonable man would understand the document was seen as a recipe for a further increase in the already substantial cost of the discovery process and the length of trials. It prompted a former leading commercial judge to write that '[i]t is hard to imagine a ruling more calculated to perpetuate the vast cost of commercial litigation'.¹⁴⁴ This view was endorsed by Spigelman in the article referred to earlier. He said that 'the increased cost imposed on commerce including, but not limited to, the cost of litigation' is a 'significant reason for resisting the expansion of the scope of surrounding circumstances, indeed for restricting the extent to which this approach has already developed'.¹⁴⁵

In my view, however, expanding the factual matrix to include prior negotiations will not necessarily lead to greater costs. Costs might in fact be reduced because there will be fewer disputes over what is and is not admissible. Spigelman draws a rather long bow when he suggests that the modern tendency for briefs in commercial cases to consist of multiple trolley loads of documents is to a significant extent 'driven by the movement from text to context as an approach to contractual interpretation'.¹⁴⁶ In any event, as Nicholls points out, concerns about the length and cost of trials, while 'important practical considerations', 'should not be allowed to dictate the exclusion of relevant evidence from a trial'.¹⁴⁷ The author continued:

The answer lies in case management and appropriately tight judicial control over the evidence sought to be adduced. Rationalising this area of the law does not require that evidence of pre-contract negotiations should be admissible either in all cases or in none. This evidence would be admissible when relevant but only when relevant.¹⁴⁸

The increased costs argument also ignores the reality that many interpretation disputes will be accompanied by alternative claims for rectification of the written contract, and possibly also misrepresentation or estoppel, under which evidence of all the negotiations and surrounding circumstances must be received. Accordingly, excluding such evidence for the purpose of interpretation disputes will not have the effect of reducing the length and cost of civil trials.

¹⁴⁴ Staughton, above n18 at 307.

¹⁴⁵ Spigelman, above n8 at 334. See also Bingham, above n17 at 389–90 (admitting prior negotiations 'really would have the potential to increase, hugely, the complexity, and with it the time and cost, of commercial litigation').

¹⁴⁶ Ibid.

¹⁴⁷ Nicholls, above n22 at 588.

¹⁴⁸ Ibid.

C. *Subversion of the Objective Approach*

Nicholls also referred to, but did not discuss in any detail, '[a] further suggested matter of concern', namely, 'that the admission of direct evidence of a party's actual intention would effectively subvert the objective approach'.¹⁴⁹ He simply noted that '[i]n the *Codelfa* case Mason J said that investigation of the actual intentions, aspirations or expectations of the parties before or at the time of contract would tend to give too much weight to these factors at the expense of the language of the written contract'.¹⁵⁰ Of course, Nicholls had already made the point that admitting reliable evidence from the parties' pre-contract exchanges of the meaning they intended the words in dispute to bear would not involve departing from the objective approach. Instead, the reasonable person would simply be better informed of the factual background.¹⁵¹

There is a widespread tendency, reflected in parts of Mason J's judgment,¹⁵² to equate the former strict perceptions of the plain meaning and parol evidence rules with the objective approach. But, for the reasons already given in this article and that are discussed in more detail elsewhere,¹⁵³ I suggest that accepting and giving effect to evidence from the parties' negotiations of their actual mutual intention is not in any way inconsistent with an objective approach. As Andrew Burrows¹⁵⁴ has usefully pointed out:

It has sometimes been suggested that the exclusion of previous negotiations and declarations of intention is logically dictated by the objective approach. But that is not so and tends to confuse the approach being applied with the separate question of what evidence is to be permitted in applying that approach. To allow in previous negotiations or declarations of intention (including witness statements as to what was said between the parties) is consistent with an objective approach in that one is still ascertaining a party's intentions through objective evidence. In particular, an objective approach would not permit evidence of *undeclared* intention or of what a party thought the previous negotiations meant.¹⁵⁵

Furthermore, when Lord Hoffmann's speech in the *ICS* case is read as a whole, his 'reasonable person having all the background knowledge which would

¹⁴⁹ Ibid.

¹⁵⁰ Ibid.

¹⁵¹ See the passage quoted in the text at n115. Compare Bingham, above n17 at 389: 'the admission of such evidence for the purpose of construing a contract in my view undermines the objective basis of interpretation to which we adhere'.
Codelfa (1982) 149 CLR 337 at 347–52.

¹⁵² McLauchlan, above n50.

¹⁵³ Burrows, above n22 at 82–3. Interpretation is an objective process in that its 'concern is to insulate each contracting party from the other's subjective (but uncommunicated) intention': J W Carter and Elisabeth Peden, 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155 at 160. It is not part of the objective process to insulate a contracting party from the other party's *communicated* actual intention.

¹⁵⁴ As Burrows notes (at 83n), 'witness statements as to what a party was inwardly intending at the time would be contrary to the objective approach'.

reasonably have been available to the parties'¹⁵⁶ is a reasonable person *in the situation of the parties*, or what amounts to the same in practice, a reasonable person *in the situation of the promisee*. This reasonable person is necessarily aware of communications between the parties and would not, for example, deny shared understandings as to the meaning of their words. Nor would he or she deny a meaning which, though not shared by the promisor, the promisee was led reasonably to believe that the promisor accepted. Thus, according to Lord Hoffmann, when Alice is told by Humpty Dumpty that the word 'glory' means 'a nice knock-down argument', Alice 'would have had no difficulty in understanding what he meant'.¹⁵⁷ The objective meaning of the word 'glory' is 'a nice knock-down argument'.

D. Impact on Third Parties

Allegations of potential adverse effects on third parties have resulted in strong exception being taken, not simply to receiving evidence of negotiations, but also to the whole contextual approach to interpretation itself, and especially Lord Hoffmann's restatement. Concern for the rights of third parties has become a standard response from those who are opposed to any form of liberalisation of the law relating to contract interpretation. I believe the concern is greatly exaggerated. I have yet to see a specific example of a situation where adopting a contextual approach would adversely impact on the rights of third parties in a way that could not be avoided by the application of some other legal doctrine.

Nevertheless, the objection is firmly held and sometimes vehemently articulated. Thus, shortly after *ICS* was decided, Saville LJ in *National Bank of Sharjah v Dellborg*¹⁵⁸ expressed 'serious objections' to an approach that, *inter alia*, allowed surrounding circumstances to alter the meaning of unambiguous words that did not give rise to an absurd result. He said, *inter alia*:

[T]he position of third parties (which would include assignees of contractual rights) does not seem to have been considered at all. They are unlikely in the nature of things to be aware of the surrounding circumstances. Where the words of the agreement have only one meaning, and that meaning is not self evidently nonsensical, is the third party justified in taking that to be the agreement that was made, or unable to rely on the words used without examining (which it is likely to be difficult or impossible for third parties to do) all the surrounding circumstances? If the former is the case, the law would have to treat the agreement as meaning one thing to the parties and another to third parties, hardly a satisfactory state of affairs. If the latter is the case, then unless third parties can discover all the surrounding circumstances and are satisfied that they make no difference, they cannot safely proceed to act on the basis of what the agreement actually says. This again would seem to be highly unsatisfactory.

¹⁵⁶ [1998] 1 WLR 896 at 912.

¹⁵⁷ *Id* at 914.

¹⁵⁸ [1997] EWCA Civ 2070.

This view is endorsed by Spigelman in his article. The hostility towards Lord Hoffmann's restatement that is evident throughout the article is well illustrated by his acceptance, as noted earlier,¹⁵⁹ of the argument that the principles are unworkable in practice and 'not always consistent with the reasonable expectations of the contractual parties'.¹⁶⁰ He suggests that there is 'a basic defect' in Lord Hoffmann's restatement in that '[i]t is not a scheme that can be applied to a substantial range of commercial contractual relationships', primarily because the scheme fails to make provision for 'third party involvement in commercial transactions [which] is now of a considerably different order to the past'.¹⁶¹ Therefore, he argues, 'Lord Hoffmann's assertion that "a written contract is addressed to the parties"¹⁶² is, today, a significant oversimplification'.¹⁶³

Naturally enough, Spigelman is for this reason also strongly opposed to any expansion of Lord Hoffmann's factual background to include prior negotiations. He argues that 'the impact on and the import to third parties is ... significantly understated'¹⁶⁴ by Nicholls and concludes:

The scope of contemporary involvement by third parties with one or other of the parties to a contract, on the basis of the performance by the other party of its obligations, at least in commercial contracts of any size or longevity, is such that it should now be assumed that both parties are aware that the other party to the contract will, or may, (the test is yet to be determined) deal with its contractual rights with third parties, whether as lenders or as assignees or in some other capacity. On that basis both parties should be aware that any such a third party would rely on, and usually rely only on, the text of the agreement. Where a text purports or appears to be comprehensive in such a context, resort to the factual matrix could well be restricted and any suggestion of an expansion in the scope of 'surrounding circumstance' [*sic*] in the direction of 'absolutely everything' should be resisted.¹⁶⁵

Further support for this view is to be found in the recent judgment of Briggs J in *Chartbrook*.¹⁶⁶ As noted earlier, counsel for the defendants put forward an argument for admitting evidence of prior negotiations based on Nicholls' article. However, it was held that the need to protect third parties provided a 'compelling' policy reason for rejecting that argument.¹⁶⁷ Briggs J said:

Most modern commercial contracts are to a greater or lesser extent assignable, such that the benefit or burden of the obligations therein contained can be, and often is, transmitted to third parties who took no part in the negotiation of the

¹⁵⁹ See text following n16.

¹⁶⁰ Berg, above n12 at 358.

¹⁶¹ Spigelman, above n8 at 335.

¹⁶² *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2004] 1 AC 715 at 754.

¹⁶³ Spigelman, above n8 at 335.

¹⁶⁴ Id at 334.

¹⁶⁵ Id at 335–6.

¹⁶⁶ [2007] EWHC 409; aff'd [2008] EWCA Civ 183.

¹⁶⁷ Id at [35].

contract, and who may therefore be assumed to be wholly ignorant of what took place. Some types of commercial contracts, such as long leases of land, commonly give rise to transmission or rights and obligations long after the contract negotiators have died. Others, such as the agreement in this case, are of a more limited duration, but it is common ground that the Agreement was understood and intended to be capable of assignment by way of security to a bank, and indeed was so assigned. Furthermore, even in the absence of assignment, the rights and obligations created by a commercial contract may form an important part of the assets and liabilities of one or more of its parties, such that the reporting and auditing of its financial health may be dependent upon a proper understanding of its terms, again by persons with no participation in, or knowledge of, its negotiation.

If the parties' negotiations were, to the extent 'helpful', to be routinely admissible as an aid to contractual construction, then no such third parties reading, dealing with or having transferred to them rights or obligations under the contract could make any safe assumptions about its meaning without themselves carrying out an inquiry as to those negotiations, so as to put themselves in the same state of knowledge as the parties to the contract. Furthermore, since ambiguity is no longer (after *ICS*) a prerequisite for recourse to the admissible background, a third party's appreciation of the apparently unambiguous meaning of a word, phrase or term could be subverted by reference to the original parties' negotiations, without which no secondary meaning was even capable of being guessed at.

A conclusion that the damaging uncertainties introduced into commercial life by the susceptibility of every contract to reinterpretation by reference to the parties' negotiations needs to be prevented by a policy prohibition works no injustice on the parties themselves. The essence of the equitable remedy of rectification is that it enables effect to be given to a continuing common intention between the parties as to the meaning of a word, phrase or term provided (a) that it persisted until the making of the contract and (b) that as an equity, it does not invade the legal rights of bona fide purchasers without notice. The first of those conditions would have to be part and parcel of any rule of construction which permitted reference to be made to occasions when, during negotiations, the parties reached agreement about a particular word, phrase or term. But it is hard to see how the second condition has any part in a rule of construction, which concerns itself with the meaning to be attributed to the contract, both as between its parties and, to the extent relevant, for all other purposes. Furthermore, if a limitation upon the admissibility of negotiations designed to protect third party rights were introduced into a rule about construction, then the process of construction would become virtually indistinguishable from the remedy of rectification.

For those reasons, and with profound respect for what appears to be the contrary view of Lord Nicholls, it seems to me that there is a powerful need to preserve on policy grounds a rule which excludes the parties' negotiations from the admissible background when construing, rather than rectifying, a commercial contract.¹⁶⁸

¹⁶⁸ Id at [35]–[38].

In my view, these arguments, and also the wider arguments noted above attacking the whole contextual approach to interpretation, are unconvincing. If, as I believe, that approach, as exemplified in Lord Hoffmann's restatement, is here to stay, any force in the policy reason to protect third parties largely evaporates. It is difficult to accept that third parties would become greatly more vulnerable than they already are under the contextual approach by allowing the context to be expanded to include evidence of negotiations. Nicholls made this point succinctly in his article:

The second objection is that adopting a more liberal approach would be detrimental to the position of third parties who subsequently acquire an interest conferred by a contract. A third party, it is said, is unlikely to know anything of the content of the pre-contract negotiations. Factually, that is accurate. But that does not make good this ground of objection. When interpreting contracts courts already take into account 'objective' background matters known to the contracting parties but not necessarily known to others.

Furthermore, when interpreting a document intended for commercial circulation it may be reasonable to attach added weight to the meaning the words bear on their face. The context afforded by the nature of the document is one of the matters the notional reasonable reader will take into account. There is no reason to fear that admitting evidence of pre-contract negotiations where appropriate will risk bringing English commercial law to its knees.¹⁶⁹

However, even assuming that the concern for third parties is legitimate, I would question how that justifies potentially imposing on the parties, in a dispute between them which affects their interests only, a contractual obligation that is contrary to their actual intention.¹⁷⁰ For the reasons covered earlier in this article,¹⁷¹ Briggs J is wrong when he implies in the passage quoted above that rectification will always be available to prevent injustice. Further, and most importantly, his Lordship fails to mention that where a third party, to the actual or constructive knowledge of the parties, reasonably expects to be able to take the contract at face value and acts in reliance thereon, his or her legitimate concerns can be met, if necessary, through the application of the doctrine of estoppel.¹⁷² He also casually lumps together bona fide purchasers and assignees, seemingly overlooking that, where the third party is an assignee of a chose in action, it is already the position that the assignment operates 'subject to equities' and hence the assignee takes subject to any defence the promisor would have had

¹⁶⁹ Nicholls, above n22 at 587.

¹⁷⁰ See the observation of Thomas J in *Yoshimoto* [2001] 1 NZLR 523 at [81]: 'Nor, thirdly, is this a case where third parties might seek to rely on the literal wording of the contract, not knowing of the evidence external to the contract which would change its apparent meaning. Why third parties may be thought to be entitled to hold the parties who are privy to the contract to a meaning which is not their meaning is difficult to see.'

¹⁷¹ See text following n67.

¹⁷² See Burrows, above n22 at 97: parties may be 'estopped from denying that a contract means what it, on its face, appears to mean where a bona fide purchaser for value has relied on that meaning'.

in an action brought by the assignor. Indeed, that is why the assignee will ordinarily obtain appropriate undertakings from the assignor.

10. *Subsequent Conduct*

One of the most contentious current issues in the law of contract interpretation is whether evidence of the parties' subsequent conduct is admissible as an aid to interpretation. Currently, for example, the answer is no in England and Australia,¹⁷³ but in New Zealand the important recent decision of the Supreme Court in *Gibbons Holdings* has confirmed an earlier trend in the opposite direction.¹⁷⁴ If the arguments to date in this article are largely accepted, and evidence from the negotiations of the parties' actual mutual intention is admissible, most of the objections to allowing evidence of subsequent conduct disappear also. Indeed, there are no convincing reasons of principle or policy why a court should not be able to act on such evidence. I have dealt with this subject at length elsewhere,¹⁷⁵ so it is only necessary here to highlight some of the points that support this view.

A. *Relevance and Purpose*

Evidence of the parties' subsequent conduct may be relevant to the resolution of an interpretation dispute in a number of respects. For example, it may assist in establishing or verifying the commercial purpose of the contract or the existence of other background facts known to, or reasonably available to, the parties at the time of the contract. But, most importantly, and most contentiously, it may assist in the task of proving the existence of an agreed meaning. The fact that the parties have acted consistently with a particular interpretation, or at least the party now denying that interpretation has so acted, may sometimes provide a reliable basis for an inference that *at the time of the contract* they attached that meaning to the words in question, or that one of them attached that meaning and reasonably believed that the other did so too.

However, while evidence of such conduct should always be admissible, its probative value is, of course, entirely another matter. The conduct will rarely, if ever, be conclusive but, when taken in conjunction with other evidence of their intention and the surrounding circumstances, it may sometimes tip the evidential balance in favour of a conclusion that a particular meaning was indeed adopted at the time of the contract. In other words, the conduct will ordinarily be relevant 'only for confirmatory or supporting purposes',¹⁷⁶ or as 'a cross-check or

¹⁷³ See, most recently, *Agricultural and Rural Finance Pty Ltd v Gardiner* (2008) 251 ALR 322 at [35] (Kirby J dissenting on this issue at [115]).

¹⁷⁴ [2008] 1 NZLR 277. Predictably, concern has been expressed that the decision will result in an unnecessary increase in litigation costs: see Jack Hodder, 'The Supreme Court — A Brief Introduction to a Long Conversation' in Claudia Geiringer and Dean R Knight (eds), *Seeing the Whole World: Essays in Honour of Sir Kenneth Keith* (2008) 347 at 350.

¹⁷⁵ See McLauchlan, above n23.

¹⁷⁶ *Gibbons Holdings* [2008] 1 NZLR 277 at [50] (Tipping J).

reassurance that the meaning a court is leaning towards was that intended by the parties'.¹⁷⁷

It must be stressed that when subsequent conduct is used as an aid to interpretation (as opposed to the basis for alleging a variation or estoppel) its purpose is to elucidate, not alter, meaning. As Thomas J pointed out in a judgment that ultimately led to a change in the New Zealand law on the subject:

[The evidence] is admitted for the purpose of persuading the Court that it provides a reliable guide to the meaning which the parties attributed to the contract when it was signed. The proper construction is assisted and not changed by the subsequent conduct. In this manner, the Court's ability to give effect to the mutual intention of the parties is undoubtedly furthered.¹⁷⁸

Lord Reid's often quoted observation in *James Miller & Partners Ltd v Whitworth Street Estates (Manchester) Ltd* that evidence of subsequent conduct must be excluded because '[o]therwise one might have the result that a contract meant one thing the day it was signed, but by reason of subsequent events meant something different a month or a year later'¹⁷⁹ misses the point of tendering such evidence, which is to persuade the court that the particular interpretation that the evidence supports was the meaning attributed to the words at the time of the contract. In other words, that meaning *is* the true meaning. There can be no question of subsequent conduct leading to a contract having different meanings at different times. The most that the conduct can do is to persuade the court that the alleged meaning was in fact the meaning accorded to the contract at the time it was signed.

However, evidence of subsequent conduct will be largely irrelevant to the interpretation of the contract if in fact the parties did not contemplate the situation that has arisen and did not adopt a shared meaning at the time of the contract.¹⁸⁰ And, as I stressed earlier in this article, in most interpretation disputes that will indeed be the case, so that the court's task is to determine the presumed intention of the parties.¹⁸¹

¹⁷⁷ Id at [74] (Anderson J).

¹⁷⁸ *Dreux Holdings* (1996) 7 TCLR 617 at 641. He repeated this view in *Gibbons Holdings* [2008] 1 NZLR 277 at [114]. In the same case Tipping J said (at [59]): 'Evidence of subsequent conduct does not invite a subsequent meaning. It is directed to the original meaning; that is, the meaning of the contract when it was signed. It is a distraction to suggest that post-contract evidence is capable of changing the contract date meaning, when its sole purpose is to elucidate that meaning.'

¹⁷⁹ [1970] AC 583 at 603.

¹⁸⁰ As Thomas J pointed out in *Dreux Holdings* (1996) 7 TCLR 617 at 638, 'the parties cannot be thought to have acted on a shared meaning of the contract at the time it was completed if, in fact, there was no shared meaning at that time'.

¹⁸¹ At best, the conduct may be one factor to be considered by the court in determining the parties' presumed intention. It may assist in establishing the commercial purpose of the contract or that certain important background facts were known to the parties at the time of the contract.

B. A Requirement of Mutuality?

Some judges who have been prepared to admit evidence of subsequent conduct have felt obliged to limit it to the situation where there is *mutual* conduct which unambiguously shows actual common agreement as to the meaning of a term. In *Spunwill* Santow J held that '[o]nly conduct which amounts to clear evidence of a mutual subjective intention as to what the contract meant at the time of the contract is admissible'.¹⁸² Thus, evidence of the conduct of one party alone, which is consistent with the meaning that the *other* party alleges was held at the time of the contract, would apparently not be admissible.

A similar limitation was favoured by two¹⁸³ of the four New Zealand Supreme Court judges who ruled in *Gibbons Holdings*¹⁸⁴ that evidence of subsequent conduct is generally admissible. Tipping J said:

For good policy reasons the common law has consistently adhered to what is usually called an objective approach to contract interpretation. An objective inference from conduct in which the parties are mutually involved after they have contracted does not significantly depart from the conventional approach. I will call conduct in which both parties are involved, either actively or passively, mutual or shared conduct. Inviting inferences from the conduct of one party, in which the other party is not involved, would make a significant inroad into the need to ascertain objectively the shared intention of the parties as to their meaning. The words they have used, construed in the light of all the relevant and objective circumstances in which the parties have used them, must *prima facie* be the best guide to their meaning. But, if some mutual or shared post-contract conduct of the parties is objectively capable of shedding light on the meaning they themselves placed on the words in dispute, I consider more is to be gained than lost by allowing the Court to take it into account.¹⁸⁵

Thomas J strongly disagreed. He said that the requirement of mutuality 'is misconceived and will undoubtedly cause confusion'¹⁸⁶ and continued:

Conduct which is not, and has not been, 'shared' or 'mutual' may nevertheless point to a meaning contrary to the meaning later asserted by one of the parties. That party has acted inconsistently with the meaning it seeks to persuade the court to place upon the contract. The value of the evidence stems from the inconsistency ...

It would be unfortunate if the principle that evidence of subsequent conduct is admissible as an aid to interpretation becomes hedged with qualifications which undermine the objective of the principle. Providing that the evidence is relevant to the question of interpretation before the court, it should be sufficient that,

¹⁸² (1994) 36 NSWLR 290 at 311.

¹⁸³ Tipping and Anderson JJ. Thomas J and Elias CJ disagreed. Blanchard J preferred to reserve his position on the general question whether subsequent conduct can be taken into account at all, although he did record (at [27]) that he had 'seen no convincing argument against such use and there is force in the argument in its favour'.

¹⁸⁴ [2008] 1 NZLR 277.

¹⁸⁵ Id at [53].

¹⁸⁶ Id at [135].

following the completion of the contract, the party concerned has acted inconsistently with the meaning it now asserts in court.¹⁸⁷

In my view, Thomas J is correct. Once one accepts that evidence of subsequent conduct is an admissible aid to determining whether the parties had formed an actual mutual intention at the time of the contract, there is no good reason why the conduct itself should have to be mutual or ‘objective’ in the sense that it is probative of the intention of *both* parties. Why should evidence of subsequent conduct that bears only upon the meaning intended by one party be excluded if separate objective evidence establishes that the other party intended the same meaning? It is difficult to see why, as Tipping J suggests, ‘[i]nviting inferences from the conduct of one party, in which the other party is not involved, would make a significant inroad into the need to ascertain objectively the shared intention of the parties as to their meaning’.¹⁸⁸ If different objective pieces of evidence independently establish that the parties held the same intention, has not a shared intention been objectively ascertained? Tipping J correctly points out that:

Post-contract evidence that logically indicates that at the time they contracted the parties attached a particular meaning to the words in dispute can be good evidence that a later attempt by one party to place a different meaning on those words is unpersuasive.¹⁸⁹

However, it is surely just as valid to say:

Post-contract evidence that logically indicates that at the time [a party] contracted [he or she] attached a particular meaning to the words in dispute can be good evidence that a later attempt by [that] party to place a different meaning on those words is unpersuasive.

Further, Tipping J accepts that evidence of ‘non-mutual’ conduct is admissible and may be helpful in establishing whether the parties formed a common intention for the purposes of a rectification suit.¹⁹⁰ Why then should it not be admissible as an aid to establishing whether ‘the parties attached a particular meaning to the words in dispute’ (and hence formed a common intention) for the purposes of an interpretation dispute?

Indeed, in many situations where subsequent conduct is relevant the only question will be whether the promisee’s otherwise clearly proven actual intention as to the meaning of the words at the time of the contract was in fact, contrary to the contention at trial, shared by the promisor. Conduct by the latter alone after the contract, such as dealings with or communications to third parties, may strongly corroborate the other evidence from, say, the prior negotiations, or even previous dealings, pointing to an affirmative answer. Why then should it matter that the promisee did not participate, actively or passively (to use Tipping J’s

¹⁸⁷ Id at [135]–[136].

¹⁸⁸ Id at [53].

¹⁸⁹ Id at [62].

¹⁹⁰ Id at [64].

words), in that conduct? Suppose that the dealings with a third party appear on the surface to be an admission by the promisor that its understanding of the contractual term in question is the same as that which the promisee now alleges (and the promisor denies) was accepted by both parties at the time of the contract. Of course, the promisor will often be able to point to other explanations for the conduct, such as a mistake in interpretation of the contract, but that will be so even if the conduct was ‘mutual’ in Tipping J’s sense. The task of the court is to determine, based on the evidence as a whole, whether the particular meaning alleged by the promisee was agreed to at the time of the contract. And, as I have said, sometimes the conduct, when considered together with other factors, may be of sufficient weight to tip the evidential balance in favour of a conclusion that the alleged meaning was so agreed to.

C. *Subsequent Conduct and Prior Negotiations*

In recent times three leading Law Lords — Nicholls, Steyn and Bingham — have in their extra-judicial writings advocated, or at least lent support to the view, that the English rule disallowing evidence of subsequent conduct should be abandoned.¹⁹¹ However, unlike Nicholls, the latter two have at the same time been content to endorse the continued exclusion of evidence of prior negotiations. Steyn said:

The decision in the *Investors Compensation Scheme* case raised questions about two sacred cows of English law, namely that the court is not permitted to use evidence of (1) pre-contractual negotiations of the parties or (2) of their subsequent conduct in aid of the construction of written contracts even if the material throws light on the subjective intentions of the parties ... In England the rule about prior negotiations may for the moment be relatively safe. I am less confident about the life expectancy of the rule excluding subsequent conduct. Business people and, for that matter, ordinary people, simply do not understand a rule which excludes from consideration how the parties have in the course of performance interpreted their contract. The law must not be allowed to drift too far from intuitive reactions of justice of men and women of good sense: the rule about subsequent conduct may have to be re-examined.¹⁹²

Bingham, too, predicted the demise of the English rule, saying that ‘like Lord Steyn, I would not put money on the survival of the rule’,¹⁹³ but he preferred to align himself ‘with the judicial dinosaurs, if such they be’¹⁹⁴ on the prior negotiations question.

However, there is a logical difficulty here. If evidence of the parties’ subsequent conduct is admissible, how can it be that evidence of negotiations or

¹⁹¹ Nicholls, above n22 at 589: ‘it is surely time the law recognised what we all recognise in our everyday lives, that the parties’ subsequent conduct ... may be a useful guide to the meaning they intended to convey by the words of their contract’; Steyn, above n5 at 10; and Bingham, above n17 at 390.

¹⁹² Steyn, above n5 at 10.

¹⁹³ Bingham, above n17 at 390.

¹⁹⁴ Id at 389.

other pre-contract indicators of their actual intentions is inadmissible? As Lord Simon pointed out in *L Schuler AG v Wickman Machine Tool Sales Ltd*:

subsequent conduct is of no greater probative value in the interpretation of an instrument than prior negotiations or direct evidence of intention: it might, indeed, be most misleading to let in subsequent conduct without reference to these other matters.¹⁹⁵

Further, in the same case Lord Wilberforce said:

[i]t is one and the same principle which excludes evidence of statements, or actions, during negotiations, at the time of the contract, or subsequent to the contract, any of which to the lay mind might at first sight seem to be proper to receive.¹⁹⁶

In my view, rejection of the English rule that evidence of subsequent conduct is inadmissible as an aid to interpretation must lead to a reconsideration of other related aspects of the traditional approach to issues of contract interpretation. It is not sensible for a court to allow evidence of subsequent conduct and at the same time continue to accept that evidence of the parties' negotiations is inadmissible. As we have seen, the primary relevance of subsequent conduct is that it may provide a reliable guide to the meaning that the particular parties actually attributed to the words in dispute when the contract was signed. If evidence of the parties' subsequent conduct is admissible, why exclude evidence of their prior negotiations which may provide an even more reliable guide to their actual intentions?

11. Conclusion

I wish to conclude by discussing another hypothetical situation. My purpose is to illustrate further the inadequacies of an approach to contract interpretation that, even accepting that there is no longer a strict plain meaning 'rule' and that evidence of the factual background must always be considered, treats the actual intentions and expectations of the parties as irrelevant and disallows resort to the prior negotiations or subsequent conduct of the parties.

Suppose that the Australian Rounders Association (ARA) signs a binding heads of agreement with the International Rounders Association (IRA) containing the terms on which the ARA will be allowed to host the inaugural World Rounders Cup in 2009. One of those terms simply states that 'the host will ensure that each stadium in which Cup games are held is clean'. Six months before the scheduled opening ceremony a dispute arises as to the meaning of the word 'clean'. An urgent court hearing is convened to determine the scope of the host's obligation.

Well, what does 'clean' mean? How are we to define the court's task? Historically, the first question would be: does the word, read only in the context of the document as a whole, have a plain meaning? If the answer is yes, that

¹⁹⁵ [1974] AC 235 at 268 ('*Schuler*').

¹⁹⁶ Id at 261.

meaning must ordinarily be taken as representing the intention of the parties. Resort to evidence of the surrounding circumstances is not permissible to alter the plain meaning unless there is an established trade usage or a manifest absurdity would result. The problem with this approach, as the present hypothetical demonstrates, is that words may have different plain meanings depending on the factual background, including the commercial purpose of the contract. As Lord Hoffmann himself has stressed, the notion that words have a natural and ordinary meaning:

is not a very helpful one. Because the meaning of words is so sensitive to syntax and context, the natural meaning of words in one sentence may be quite unnatural in another. Thus a statement that words have a particular natural meaning may mean no more than that in many contexts they will have that meaning. In other contexts their meaning will be different but no less natural.¹⁹⁷

The adjective ‘clean’ provides a good example. For example, depending on the factual background it may mean ‘empty’ (clean fishing vessel), ‘blank’ (clean paper), ‘free of illegal substances or weapons’ (clean person, vehicle, ship or building), ‘free of imperfections’ (clean timber), or ‘bearing no adverse comment’ (clean report). Of course, the most common meaning is ‘free from dirt or contaminating matter’, particularly in relation to an obligation to provide (or return) a clean venue, house or other building, although in relation to, say, a lease of a commercial building, it may go further and entail restoring the building to its original condition by removing partitions or obstructions.

Assuming that there is nothing in the heads of agreement to indicate a particular meaning and that there is no suggestion of a well established trade usage, does ‘clean’ have the common meaning referred to above? It is *possible* that it refers to the cleanliness of the venues, but that is most unlikely when the contract is interpreted against its factual background. It is much more likely that the word is meant to signify that the host is under an obligation to clear the venues of their usual advertising and sponsorship signs, as well as food and beverage outlets. This is because the IRA wish to bring in their own advertisers and sponsors and set up their own food and beverage shops.

How should this resort to the factual background to substantiate that meaning be justified by the courts? Is it that the word ‘clean’ is ambiguous? In fact, the point being made here is that, once regard is paid to the surrounding circumstances, it is likely to become obvious that ‘clean’ relates to advertising and sponsorship. Instead of extrinsic evidence *creating* uncertainty of meaning, it shows that, at least in this respect, there is no ambiguity at all.¹⁹⁸ Therefore, the

¹⁹⁷ *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 at 391.

¹⁹⁸ Contrast *Benjamin Developments* [1994] 3 NZLR 189 at 203 (objecting to use of the background to create uncertainty of meaning and then using it again to resolve that uncertainty). As pointed out by J W Carter and Andrew Stewart, ‘Interpretation, Good Faith and the “True Meaning” of Contracts: The *Royal Botanic* Decision’ (2002) 18 *Journal of Contract Law* 182 at 190, ‘if a court informs itself of the surrounding circumstances before interpreting the contract, it will often find that there is no ambiguity at all’. For a useful illustration see *Kilkerrin Investments Pty Ltd v Yiu Ying Mei Pty Ltd* [2001] QSC 88.

true justification for resort to the evidence is simply that the parties have attached a particular meaning to the word, and interpretation in accordance with that meaning is necessary in order to give effect to their intention.

The main lesson to be learned from the discussion of my hypothetical to this point is, I suggest, that the task of a court when resolving an interpretation dispute between the original parties to a contract must be, wherever possible, to give effect to what the parties actually intended the words to mean. This is contrary to the received wisdom which states that, while the general *object* of contract interpretation is to implement the parties' intention, the primary task is to determine *the meaning* of the words the parties have used. 'It is not an inquiry into *intention*, but into *meaning*, as a guide to intention'.¹⁹⁹ Such statements, as I have been saying, wrongly assume that words may have a settled meaning without regard to their users. Rather it is some person or persons who give a meaning to them, and, in the case of a contract, it is the meaning that the parties gave to the words in question, or where it is necessary to invoke the objective principle, the meaning that one party gave where that party reasonably believed that the other party shared that meaning. On this basis 'apples' *can* mean 'pears', 'sell' *can* mean 'buy' and so forth.

Let us now return to my hypothetical and suppose that the ARA concede that the IRA are entitled to bring in their own advertisers and sponsors and set up their own food and beverage outlets. Instead, the dispute is over whether the word 'clean' also requires the corporate suites and boxes in each stadium to be vacated for the duration of the tournament. This issue may give rise to no little difficulty. If one were to start with Lord Hoffmann's first principle, the meaning that the document would convey to a reasonable person with all the relevant background knowledge may be far from obvious. There may be considerable scope for argument both ways. But the question I wish to pose is this: what if there is reliable evidence from the parties' prior negotiations or subsequent conduct of their actual intention? Perhaps letters or other communications prior to the signing of the heads of agreement point to a shared understanding, or an understanding by the IRA which that party reasonably believed the ARA accepted, that corporate boxes were to be vacated. Perhaps also the existence of this understanding is confirmed by the subsequent conduct of the ARA in, say, unsuccessfully seeking to reach agreement with the corporate box owners for a release of their rights during the tournament. Should there really be any doubt at this stage of the development of the law of contract that such evidence is admissible? The notion that it is inadmissible seems so contrary to common sense that it simply must be wrong. Unfortunately, there are more than a few judges and lawyers who believe that words have meanings independent of the users of them and who still adhere to outdated understandings of the scope of the

¹⁹⁹ *Blakeley and Anderson v De Lambert* [1959] NZLR 356 at 367 (Adams J). See also *Schuler* [1974] AC 235 at 263 (Lord Simon) quoting *Norton on Deeds* (1906) at 43: 'the question to be answered always is, "What is the meaning of what the parties have said?" not, "What did the parties mean to say?" ... it being a presumption *juris et de jure* ... that the parties intended to say that which they have said.'

parol evidence rule as well as to extreme versions of the objective theory of contract under which the sole task of the court is to determine the parties' *presumed* intention so that their actual intentions and expectations are irrelevant. Those who, like myself, take a different view on these matters may well find that the following revised version of a previously published²⁰⁰ restatement of the core principles of contract interpretation has some attraction:

(1)(a) The task of a court when interpreting a written contract is to ascertain and give effect to the intention of the parties.

(b) The intention of the parties is to be ascertained from the words they have used read in the context of the document as a whole and the surrounding circumstances.

(2)(a) A written contract should, wherever possible, be interpreted in accordance with the meaning that the parties actually attached to the words in dispute or the meaning that one party attached where that party was led reasonably to believe that the other party or parties accepted this meaning.

(b) For this purpose, evidence of the surrounding circumstances and all communications between the parties, including their negotiations and subsequent conduct, is admissible.

(3) Where there is insufficient evidence to ascertain the parties' actual meaning in accordance with paragraph 2(a), the task of the court is to ascertain their presumed meaning — 'the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract'.²⁰¹

(4)(a) The fact that the words in dispute have a conventional, ordinary or 'plain' meaning is not conclusive in determining either the actual or presumed meaning of the parties. Rather it will normally be no more than a strong indication that it was the meaning adopted by the parties at the time of the contract.

(b) The 'plain' meaning will be displaced where the court is satisfied that (i) the parties attached a different meaning to the words, or (ii) a reasonable person with knowledge of the background would conclude that the parties must have used the wrong words or syntax.

(5) The fact that a particular interpretation leads to a very unreasonable result is an important consideration. 'The more unreasonable the result the more unlikely it is that the parties can have intended it'.²⁰²

²⁰⁰ McLauchlan, above n109 at 176.

²⁰¹ *ICS* [1998] 1 WLR 896 at 912 — Lord Hoffmann's first principle.

²⁰² *Schuler* [1974] AC 235 at 251 (Lord Reid).

