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Contractual Interpretation: A Roundabout Approach

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Introduction – Importance?

- The meaning of contracts is crucial not only for their lawful performance, but also in holding counter-parties to account, where performance is lacking.
- Accordingly, a sound understanding of the principles governing the interpretation of contracts is an essential component of any good commercial lawyer's toolkit.
- *Husain v O & S Holdings (Vic) Pty Ltd* [2005] VSCA 269 per Nettle JA at [26]:

'It is .. necessary to bear in mind the informality with which commercial agreements are frequently brought into existence. The presumption with commercial agreements is that the parties intend to create legal relations and thus make a contract. Consequently, and despite the uncertainties which may attend such arrangements, the courts do their utmost to uphold commercial bargains as binding agreements. This is particularly so where .. the parties have acted on the basis of the bargain'.

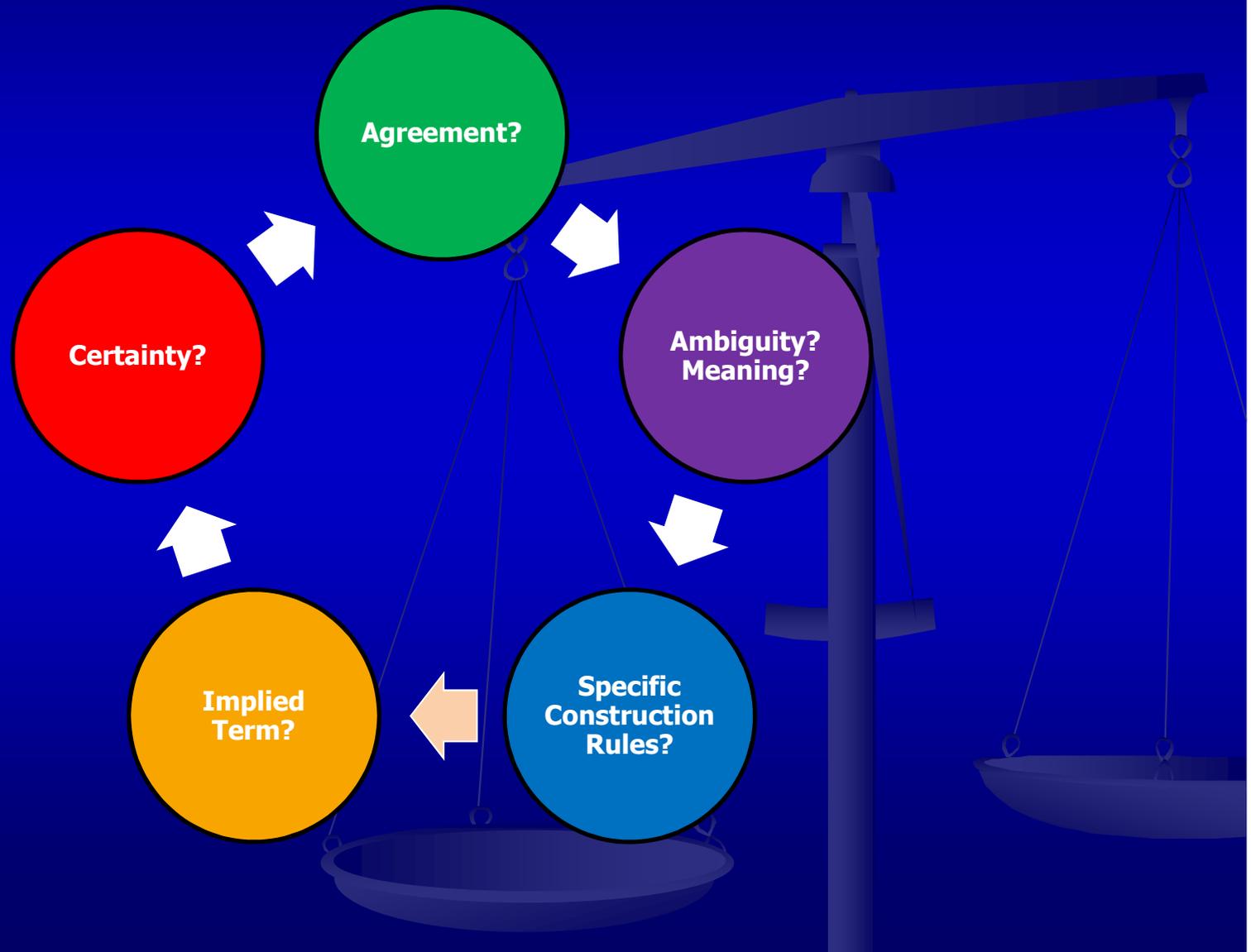
(See also: *Petelin v Cullen* (1975) 132 CLR 355 per the Court, at 359; *Vroon BV v Fosters Brewing Group Ltd* [1994] 2 VR 32 per Ormiston J at 79-83).

- There are five key (often inter-related) questions which need to be asked when determining the true meaning of a commercial contract, or any of its terms.
- The **Contractual Roundabout**. An holistic approach to contractual interpretation.

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The Contractual Roundabout



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1. Concluded Agreement?

- Three essential questions:
 - Does there exist a common intention between the parties?
 - Is what the parties have purportedly agreed upon, capable of forming a binding agreement?
 - And, did the parties intend to be bound by the purported agreement?
(See: *Air Great Lakes Pty Limited v K.S. Easter (Holdings) Pty Limited* (1985) 2 NSWLR 309 per Mahoney JA at 326; *Toyota Motor Corp v Ken Morgan Motors* [1994] 2 VR 106 per J.D. Phillips J at 183; and, *Simmons and Another v Story* [2001] VSCA 187 per Winneke P at [34]).
- *Thorby v Goldberg* (1964) 112 CLR 597 per Menzies J at 607:
‘It is a first principle of the law of contracts that there can be no binding and enforceable obligation unless the terms of the bargain, or at least its essential and critical terms, have been agreed upon. So, there is no concluded contract where an essential or critical term is expressly left to be settled by future agreement of the parties’.
- The Plaintiff carries the burden of proving whether a binding contract has come into existence (balance of probabilities). It is a question of fact. (See: *Challenge Charter Pty Limited v Curtain Bros Pty Limited* [2004] VSC 1 per Gillard J at [89]).

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2. Interpretation (1)

- Differentiation between the 'nature of legal relations created' (interpretation) and the 'creation of legal relations' (manner of contractual creation. ie: binding agreement, misrepresentation, unconscionability, 'non est factum', etc).
- The supremacy of the 'objectivity principle' when it comes to contractual interpretation.

- *Toll (FCGT) Pty Ltd v Alphapharm Pty Ltd* [2004] HCA 52 per the Court at [40]:

'This Court .. has recently reaffirmed the principle of objectivity by which rights and liabilities of the parties are determined. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern contractual relations. What matters is what each party by words and conduct would have led a reasonable person to believe. .. The meaning of the terms of a contractual document is determined by what a reasonable person would have understood them to mean. That normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, the purpose and object of the transaction'

(See also: *Pacific Carriers Ltd v BNP Paribas* [2004] HCA 35 per the Court at [22]).

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2. Interpretation (2)

- The need for ambiguity on the face of the contract itself, before looking further beyond at the 'surrounding circumstances' which led to the contract. (Pre not post contractual conduct to be considered).
- Contractual interpretation is entirely based on the premise of 'objective perception'. Objectively (not what each of them subjectively thought), what did the parties agree upon? The parties contractual intentions (what did they intend to agree upon) can be objectively determined by going behind the contract (or the ambiguous term) and examining the surrounding circumstances.
- *Codelfa Constructions Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 per Mason J at 352 (Stephen & Wilson JJ concurring):

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

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2. Interpretation (3)

- *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 3 ALLER 570 per Lord Wilberforce at 574, cited by Mason J in *Codelfa* at 350):

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

- A recent affirmation of the 'commercial purpose' or 'commercial objects' approach in determining what amounts to 'reasonable endeavours'. *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7 at [35] (French CJ, Hayne, Crennan & Kiefel JJ) [footnotes omitted]:

'The meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean. That approach is not unfamiliar. As reaffirmed, it will require consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract. Appreciation of the commercial purpose or objects is facilitated by an understanding "of the genesis of the transaction, the background, the context [and] the market in which the parties are operating". .. A commercial contract is to be construed so as to avoid it "making commercial nonsense or working commercial inconvenience"'.

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2. Interpretation (4)

- A temporary misadventure by Australian intermediate appellate Courts: peeking behind contracts at the 'surrounding circumstances' where no ambiguity? (See: *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407 per Allsop P at [15], [16]; *Nolan v MBF Investments Pty Ltd* [2011] VSCA 114 per the Court at [200]-[203]).
- The HCA's response in *Western Export Services Inc & Ors v Jireh International Pty Ltd* [2011] HCA 45 at [3]-[5]:
'Until this Court .. disapproves or revises what was said in Codelfa, intermediate appellate courts are bound to follow that precedent. .. We do not read anything said in [Pacific Carriers] and [Toll] as operating inconsistently with what was said by Mason J in .. Codelfa'.
- Summarised:
 - Objectively, did the parties intend to reach an agreement?
 - What did the parties agree upon? Is the 'agreement' ambiguous on its face?
 - If so, then having regard to the 'surrounding circumstances' leading up to the agreement, objectively, what was the common intention of the parties and what was the 'commercial purpose' of the agreement?

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3. Specific Rules of Construction – Contra Proferentem?

- The ‘contra proferentem principle’. Exclusion clauses (or even permissive clauses in favour of one party, ie. a security arrangement) should where ambiguous, be interpreted as any other clause, and if capable of one or more meanings, be construed against the interest of the party benefitting from that clause.
- *Darlington Futures Ltd v Delco Australia Ltd* (1986) 161 CLR 500 per the Court at 510-511:

‘[t]he interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in light of the contract as a whole, thereby giving weight to the context in which the clause appears including the nature and object of the contract, and, where appropriate, construing the clause contra proferentem in the case of ambiguity. .. [t]he principle .. does no more than express the general approach to the interpretation of contracts and it is of sufficient generality to accommodate the different considerations that may arise in the interpretation of a wide variety of exclusion and limitation clauses in formal commercial contracts between business people where no question of the reasonableness or fairness of the clause arises’.

(See also: *Creasy’s Grain Enterprises Pty Ltd v Clarke & Barwood Lawyers* [2004] VSC 77 per Habersberger J at [13]; *Ankar v Natwest* (1987) 169 CLR 549).

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4. Implied Terms

- Does a term need to be implied to reflect the parties intentions? Oversight?
- Implied term necessary to uphold the core bargain?
- A court won't rewrite a contract.
- The implied term must 'go without saying'.
- Examples:
 - Business efficacy;
 - Trade Custom;
 - Reasonable notice on termination (say, under a distribution agreement);
 - Obligation to act in good faith, or implied duty to co-operate; and
 - Implied duty not hinder performance.

(See generally: *Alstom Ltd v Yokogawa Australia Pty Limited & Anor (No. 7)* [2012] SASC 49; *Bytan Pty Ltd v BB Australia Pty Ltd* [2012] VSCA 233; *Morton v Elgin-Stuczynski* [2008] VSCA 25; *Crawford Fitting Co v Sydney Valve & Fittings Pty Ltd* (1988) 14 NSWLR 438; *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 at 282-283; *Hillas & Co v Arcos Limited* (1932) 147 LT 503).

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5. Contract Uncertain?

- In *Biotechnology Australia Pty Limited v Pace* (1988) 15 NSWLR 130 Kirby P at 135 to 137 referred to and summarised the following legal principles which ought be applied when considering the notion of certainty in contract.

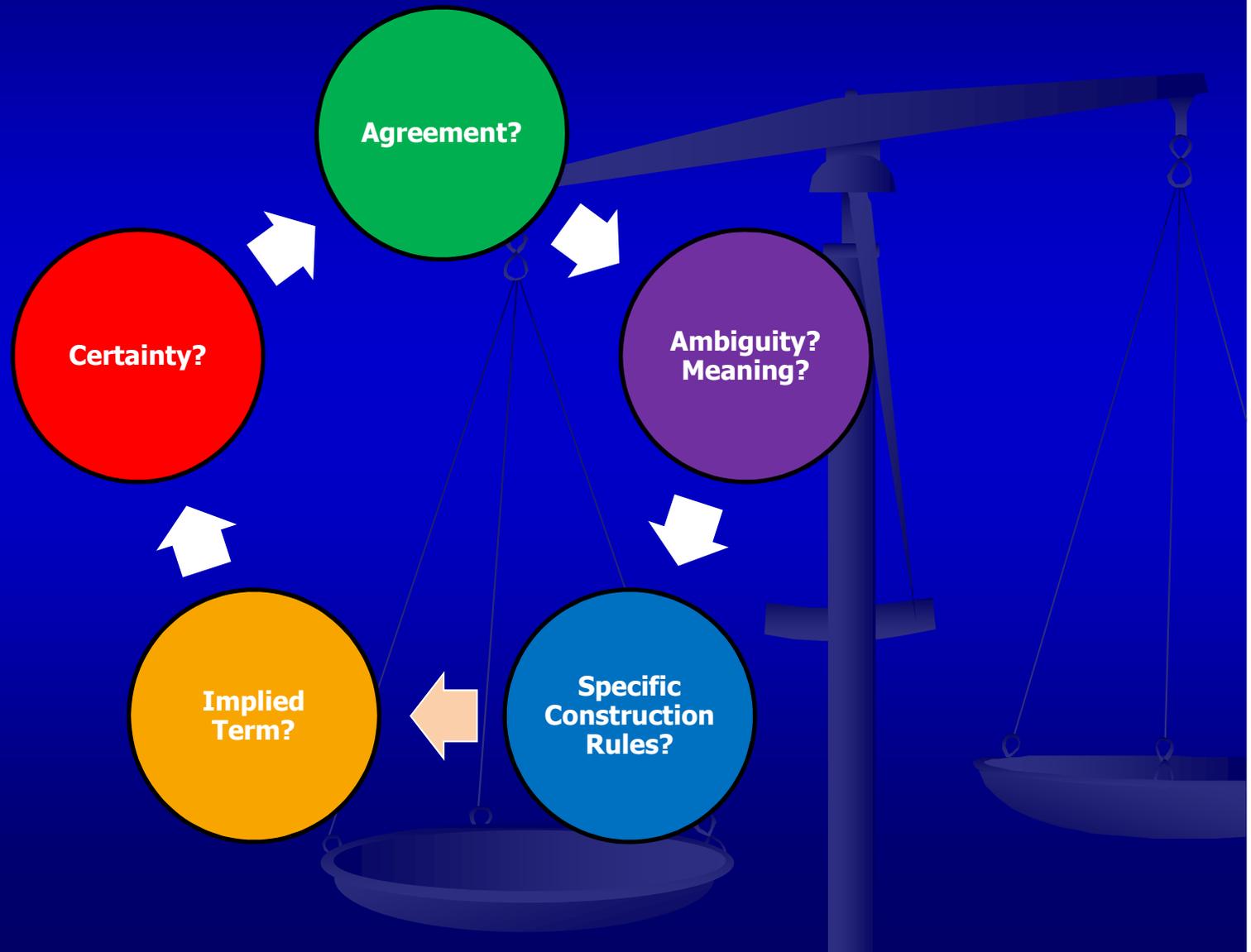
- The determination of every case depends on its own facts.
- The Court will endeavour to uphold the validity of the agreement between the parties.
- However, the Court will not uphold an agreement between parties where it asked to find what the parties themselves have failed to agree.
- Views can and will differ as to the classification of the challenged provision (certain or uncertain) and whether the Court can give effect to it.
- The Court can consider numerous relevant matters in the determination of this issue

(See also: *Ipex Software Services Pty Ltd v Hosking* [2000] VSCA 239 per Callaway JA at [25] to [30]; *Meehan v Jones* (1982) 149 CLR 571).

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Conclusion

- An overall holistic approach is best when trying to ascribe meaning to contracts.
- Clear and precise drafting of the commercial contract itself is desirable.
- However, even the best drafted contract cannot account for every [sometimes inconceivable] circumstance. The goodwill of the counterparty is still paramount in good commercial relationships, even with the best drafted contract.
- Evidence of the conduct leading up to the agreement is really important. Evidence should be preserved for a rainy day...
- Confirmation of negotiations leading up to the agreement, in writing, is always helpful at the time (transparency of negotiations) and later on (in Court).
- If in doubt as to the true meaning of the contract (performance or breach), bear in mind the fluidity of the **Contractual Roundabout**, when seeking or providing, legal advice.

'Necessitous men are not, truly speaking, free men, but to answer a present exigency, will submit to any terms that the crafty may impose upon them'

Vernon v Bethell (1762) 2 Eden 110 per Lord Henley at 113.