

THE ADMISSIBILITY AND USE OF EVIDENCE OF PRIOR NEGOTIATIONS IN MODERN CONTRACT INTERPRETATION

CAITLIN MOUSTAKA*

This article examines the juridical approach in Australia to ‘the rule’ that evidence of prior negotiations is excluded as an aid to the interpretation of written commercial contracts. It analyses three fundamental problems with the rule. First, the unclear bounds of the formulation of the rule and exceptions. Second, the unpredictable application of the rule and, thus, admissibility and use of evidence of prior negotiations. Thirdly, the uncertain foundation of the rule. The article concludes that the divergence in authority is partly attributable to differing conceptions of the appropriate balance between party autonomy and the law, which flow from the objective and subjective theories of contract respectively.

CONTENTS

I	Introduction	204
II	Locating ‘the Rule’ Within the Contract Interpretation Framework ...	208
	A Foundational concepts	209
	B An overview of the modern process of interpretation	214
	C The ‘rule’ and exceptions	216
	D Summary	221
III	Recognising the Underlying Influence of the Objective and Subjective Theories of Contract	222
	A Contract theory and the purpose of interpretation	222
	B Summary	227
IV	Problems with the Formulation and Application of the Rule	227
	A Unclear boundaries	228
	B Unpredictable judicial application	239
	C Uncertain foundation	243
	D Summary	248
V	Conclusion	249

* BEc, LLB (Hons) (W.Aust.). The author would like to thank Professor Robyn Carroll and anonymous persons for their great assistance and invaluable comments in the course of producing this article. The views expressed in this article are those of the author. The author remains responsible for any errors and omissions.

I INTRODUCTION

A and B, two sophisticated commercial corporations, are parties to a contract in writing. Under the contract, A grants B the right to develop A's land. In return, B promises to pay A an amount each year determined by reference to the current market value of the land. Prior to execution of the contract, A and B extensively negotiate the method of determining the 'current market value'. In the course of negotiations, A sends a letter to B clarifying whether 'X' is included in determining the current market value. B responds by letter that it is not. If a dispute subsequently arises between A and B as to whether X is included in determining the current market value, can the evidence of prior negotiations be used to inform the proper interpretation of the contract? In Australia, I argue that the answer is unclear.

Contractual interpretation issues arise with 'monotonous regularity'¹ and 'are the very lifeblood of commercial law'.² Further, issues of interpretation can be determinative of rights and liabilities in respect of substantial sums.³ There are contract interpretation cases, such as the example of A and B, in which evidence of prior negotiations is probative of the meaning that parties (mutually) intended to convey by the language used in the contract.⁴ However, the orthodoxy in Australia is that evidence of prior negotiations is excluded as

¹ Richard Calnan, 'Construction of Commercial Contracts: A Practitioner's Perspective' in Burrows and Peel *Contract Terms* (2007) 17; V K Rajah, 'Redrawing the Boundaries of Contractual Interpretation: From Text to Context to Pre-text and Beyond' (2010) 22 *Singapore Academy of Law Journal* 513 [2]; *GMA Garnet Pty Ltd v Barton International* [2009] FAC 439 [100], citing D W McLauchlan, 'Contract Interpretation: What Is It About?' (2009) 31 *Sydney Law Review* 5.

² Robert McDougall, 'Construction of Contracts: The High Court's Approach' (Paper delivered at The Commercial Law Association Judges' Series, 26 June 2015) 1. See also Sir Robert Goff, 'Commercial Contracts and the Commercial Court' [1984] *Lloyd's Maritime and Commercial Law Quarterly* 382, 385; Sir Johan Steyn, 'The Intractable Problem of the Interpretation of Legal Texts' in Sarah Worthington (ed), *Commercial Law and Commercial Practice* (Hart Publishing, 2003) 123, 123.

³ In the most recent contractual interpretation case heard by the High Court, the proper meaning of the contract was determinative of the parties' rights and obligations in respect of approximately \$262,000,000: *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 (**Mount Bruce Mining**) (the value of the claim was calculated from the judgment below: *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd (No 2)* [2014] NSWCA 425. See also *Tatts Group Ltd v State of Victoria* [2014] VSC 302; *Lend Lease (Millers Point) Pty Ltd v Barangaroo Deliver Authority* (2014) 30 BCL 254 [4].

⁴ Lord Nicholls of Birkenhead, 'My Kingdom for a Horse: The Meaning of Words' (2005) 121 *Law Quarterly Review* 577, 583; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [32]-[33] (Lord Hoffmann); Roy Goode, *Commercial Law* (2nd ed, London, Penguin, 1995) 97. See for example *W & K Holdings (NSW) Pty Ltd v Laureen Margaret Mayo* [2013] NSWSC 1063 [16] (Sackar J).

an aid to the interpretation of written commercial contracts.⁵ This is effected by what I will call ‘the rule’, which is a severable component of the broader ‘exclusionary rule’ that excludes direct evidence of intention and subsequent conduct as well as evidence of prior negotiations.

However, whether evidence of prior negotiations is used in the process of interpretation, and if so, how, is contentious and unsettled, as confirmed by the reasoning and outcome of recent Australian contract interpretation cases. The most recent opportunity for a superior court to re-examine the rule arose before the House of Lords in *Chartbrook Ltd v Persimmon Homes Ltd* (*Chartbrook*).⁶ Baroness Hale remarked that ‘[i]t is perhaps surprising that questions of such practical and theoretical importance in the law of contract should still be open to debate and development.’⁷

From a doctrinal perspective, the boundaries of the rule are ‘in some respects unclear’.⁸ In particular, the ambit of the exceptions to the rule and the external influence of other contractual claims and principles of interpretation are problematic and underexplored in Australian literature. From a practical perspective, the diversity of authority renders it difficult for a judge of first instance to recognise what is evidence of ‘prior negotiations’, when it is permissible to have recourse to such evidence, and the inferences, if any, that can properly be drawn.⁹ For practitioners, the intricacy of the applicable principles of interpretation render advising on the ambit of admissible material and the probable treatment of prior negotiations and interpretive outcome difficult.¹⁰ For parties, the current treatment of evidence of prior negotiations in Australia causes, rather than prevents, vast amounts of time and money to be

⁵ *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [118] (Finn J). ‘The rule’ and supporting authority is discussed in detail below. See in particular §2.1.

⁶ [2009] 1 AC 1101.

⁷ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [101] (Baroness Hale).

⁸ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 913 (Lord Hoffmann).

⁹ See for example *McCourt v Cranston* [2012] WASCA 60 [26] (Pullin JA) [25]-[26]; *Ray Brooks Pty Ltd v NSW Grains Board* [2002] NSWSC 1049 [67] (Palmer J); *Mopani Cooper Mines plc v Millennium Underwriting Ltd* [2008] EWHC 1331 (Comm) [120], [122] (Clarke J).

¹⁰ Gerard McMeel, *The Construction of Commercial Contracts: Interpretation, Implication, and Rectification* (Oxford University Press, 2nd ed, 2011) 230-1 [5.159]; Richard Calnan, ‘Construction of Commercial Contracts: A Practitioner’s Perspective’ in Andrew Burrows and Edward Peel (eds) *Contract Terms* (Oxford University Press, 2007) 17, 23; JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 277 [9-01]; Lord Bingham of Cornhill, ‘A New Thing Under the Sun? The Interpretation of Contract and the ICS Decision’ (2008) 12 *Edinburgh Law Review* 374, 375.

spent on the resolution of interpretive disputes.¹¹ Moreover, injustice can result from the inadmissibility of evidence of prior negotiations as an interpretive aid, as the outcome of contract interpretation cases may not accord with the actual agreement of the parties.¹² This invites an evaluation of the contemporary Australian legal position as to the admissibility and use of evidence of prior negotiations as an interpretive aid.

I argue that the approach to the admissibility and use of evidence of prior negotiations in the interpretation of commercial contracts is influenced by judicial adherence to the objective or subjective theory of contract. That is, the underlying theory of contract and attendant balance between party autonomy and the law is integral to the treatment of evidence of prior negotiations. This is a particularly pertinent observation in connection with the admissibility and use of evidence of prior negotiations because such evidence may be the best evidence of the parties' common 'intention' as to the meaning of the language used in the contract.¹³ Under the objective theory, which is almost unanimously cited as underlying the modern approach to interpretation,¹⁴ the court is concerned with policy considerations and communal standards of responsibility, rather than the parties' actual agreement.¹⁵ A narrow view of the admissibility and use of prior negotiations follows, as the purpose of interpretation is to give effect to the parties' presumed intention from the contract. Conversely, under a narrow conception of the subjective theory, the function of the court is more passive because parties are held to have freely and

¹¹ Gerard McMeel, *The Construction of Commercial Contracts: Interpretation, Implication, and Rectification* (Oxford University Press, 2nd ed, 2011) pp vii, 230-1. While McMeel was speaking of the position in England, this statement is equally (if not more) true of the state of affairs in Australia.

¹² Gerard McMeel, 'Prior Negotiations and Subsequent Conduct – The Next Step Forward for Contractual Interpretation?' (2003) 119 *Law Quarterly Review* 272, 294; Lord Nicholls of Birkenhead, 'My Kingdom for a Horse: The Meaning of Words' (2005) 121 *Law Quarterly Review* 577, 586; V K Rajah, 'Redrawing the Boundaries of Contractual Interpretation: From Text to Context to Pre-text and Beyond' (2010) 22 *Singapore Academy of Law Journal* 513 [46].

¹³ Lord Nicholls of Birkenhead, 'My Kingdom for a Horse: The Meaning of Words' (2005) 121 *Law Quarterly Review* 577, 583.

¹⁴ *Taylor v Johnson* (1983) 151 CLR 422, 429 (Mason ACJ, Murphy and Deane JJ); *Byrnes v Kendle* (2011) 243 CLR 253 [100] (Heydon and Crennan JJ); *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [4], [24], [50]. See further §1.3.3.

¹⁵ JM Feinman, 'The Significance of Contract Theory' (1990) 58 *University of Cincinnati Law Review* 1283, 1286-1288; Sir Anthony Mason, 'Themes and Tensions Underlying the Law of Contract' in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 298-299.

voluntarily entered into and determined the content of the contract.¹⁶ A more liberal view as to the admissibility and use of prior negotiations ensues, as the purpose of interpretation is to give effect to the actual common intention of the parties regarding the meaning of their agreement.¹⁷ It follows, in my submission, that the divergent authority on the admissibility and use of evidence of prior negotiations and unpredictable curial application of the rule is explicable by the competing underlying theories of contract and the resultant foundational tension between party autonomy and the law.

The scope of this article is limited to an evaluation of the admissibility and use of evidence of prior negotiations in the interpretation of written commercial contracts in Australia. Accordingly, I explain the approach of the Australian judicature to the admissibility and use of prior negotiations in interpretation by reference to the underlying theory of contract, rather than propose a unifying theory of contract interpretation. My analysis and observations regarding the underlying theory of contract are confined to the *interpretation* of wholly written contracts,¹⁸ and are not intended to impeach the centrality of the objective theory to the determination of questions of contract formation.¹⁹ Further, as the rule is influenced by commercial considerations²⁰ and commonly in issue in the interpretation of commercial contracts, I concentrate on the interpretation of commercial contracts, and the problems with the rule and possible contractual solutions for commercial parties.²¹ Finally, my evaluation is based on a critical examination of recent

¹⁶ Sir Anthony Mason, 'Themes and Tensions Underlying the Law of Contract' in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 298; PS Atiyah, *Rise and Fall of Contract* (Clarendon Press, Oxford, 1979) 389.

¹⁷ See for example *Cocks v Maddern* [1939] SASR 321, 327 (Napier J).

¹⁸ As to what constitutes a contract 'in writing', see generally JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 320-321 [10-07]-[10-08].

¹⁹ As to this, see for example, James Edelman, 'Three Issues in Construction of Contracts' (Speech delivered at the Conference of Supreme and Federal Court Judges, 27 January 2016).

²⁰ See for example, *Wilson v Anderson* (2002) 213 CLR 401, 418 [8] (Gleeson CJ); *Pan Foods Company Importers & Distributors Pty Ltd v Australia and New Zealand Banking Group Ltd* (2000) 170 ALR 579, 581-584 (Kirby J); JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) [1 - 22]. Cf *Visy Paper Pty Ltd v Glass Granulates* [2014] NSWSC 1387 [40].

²¹ Differing considerations apply to the exclusion of prior negotiations in the interpretation of consumer, employment, insurance and transnational contracts. In particular, in relation to consumer contracts, the *Australian Consumer Law (Competition and Consumer Act 2010)* (Cth), Sch 2 regime is relevant. In relation to the interpretation of consumer contracts, see generally N B Rao, 'The admission of extrinsic evidence of a pre-contractual nature in insurance contracts – A reply to Hon J J Spigelman AC QC' (2012) 23 *Insurance Law Journal* 194; Hon J J Spigelman AC QC, 'Extrinsic Material and the Interpretation of Insurance Contracts' (2011) 22 *Insurance Law Journal* 143. With respect to transnational contracts, wider international initiatives may apply, such as *United Nations*

Australian cases in which the court was required to determine the admissibility and use of evidence of prior negotiations adduced in support of a construction claim.²² My conclusions may also be indicative of the approach to the admissibility and use of evidence of prior negotiations and the effectiveness of contract-based solutions in other common law jurisdictions.²³

This article is structured as follows. In Part 2, I explain the meaning of foundational concepts and the circumstances in which the rule applies. I then distil the current approach to the admissibility and use of evidence of prior negotiations in construction to ‘the rule’ and four principal exceptions. In Part 3 I establish the basal influence of contract theory and the purpose of interpretation. In Part 4, I closely examine the problems with the contemporary formulation and application of the rule and exceptions by reference to recent cases. I argue that the unclear bounds and unpredictable application of the rule is explicable by inconsistent adherence to one theory of contract over another and, as a result, the major underlying tension between party autonomy and the law.

II LOCATING ‘THE RULE’ WITHIN THE CONTRACT INTERPRETATION FRAMEWORK

In order to evaluate the current approach to the admissibility and use of evidence of prior negotiations as an interpretive aid in Australia, it is essential to locate the rule within the contract interpretation framework. In this Part, I establish working definitions of basal concepts (§II.A.1) and provide an overview of the modern process of interpretation (§II.A.2). I then distil the current approach to the rule (§II.B.1) justified on grounds of principle and policy (§II.B.2) with four principal exceptions (§II.B.3).

Convention on Contracts for the International Sale of Goods (1980) Art 8(3); *UNIDROIT Principles of International Commercial Contracts* (1994), Art 4.3(a)-(b).

²² In particular, I searched LexisNexis and Westlaw AU for the 50 most recent cases involving the admissibility and use of evidence of prior negotiations in the process of interpreting wholly written commercial contracts.

²³ In particular, England and New Zealand, in which the objective theory of contract is also said to underlie the process of interpretation (*Deutsche Genossenschaftsbank v Burnhope* [1995] 1 WLR 1580, 1587; *Quainoo v New Zealand Breweries Ltd* [1991] 1 NZLR 161, 165), save that the approach in these jurisdictions is not tempered by the operation of the ambiguity requirement or plain meaning rule (*LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2003] NSWCA 74 [43]-[44] (Young CJ, Meagher and Hodgson JJA agreeing)).

A Foundational concepts

1 Definition of ‘evidence of prior negotiations’

At present, there is no comprehensive description of what is meant by ‘evidence of prior negotiations’.²⁴ Broadly, ‘prior negotiations’ describes the dynamic process of contract negotiation, in which: the terms of the agreement are gradually evolving;²⁵ statements and actions can be competing, fluctuating, and indicative of the actual intentions of each party;²⁶ and any preliminary consensus is merged into the written contract (eg a term sheet).²⁷ It may also include evidence of the parties’ without prejudice negotiations.⁴⁶

Temporally, ‘prior negotiations’ encompasses what was said or done during the course of negotiating the agreement²⁸ and at the time of executing the contract.²⁹ The evidence of negotiations can be both oral and documentary. Oral evidence includes informal discussions,³⁰ telephone conversations,³¹ and unrecorded meetings.³² Documentary evidence includes emails,³³ letters,³⁴ faxes,³⁵ and minutes of meeting.³⁶

²⁴ JW Carter, ‘Context and Literalism in Construction’ (2014) 31 *Journal of Contract Law* 100, 118.

²⁵ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 354 (Mason J).

²⁶ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 354 (Mason J); *Northbuild Constructions Pty Ltd v Capital Finance Aust Ltd* [2006] QSC 81 [51]; Lord Bingham of Cornhill, ‘A New Thing Under the Sun? The Interpretation of Contract and the ICS Decision’ (2008) 12 *Edinburgh Law Review* 374, 389.

²⁷ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 354 (Mason J); *Lindsay-Owen v Schofields Property Development Pty Ltd* [2014] NSWSC 1177 [53] (Ball J).

²⁸ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [42], cited with approval in *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 [23] (Le Miere J); *Byrnes v Kendle* (2011) 243 CLR 253 (Heydon and Crennan JJ). See generally JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 266 [8-29].

²⁹ *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235.

³⁰ See for example *Supabarn Supermarkets Pty Ltd v Cotrell Pty Ltd (No 1)* [2014] ACTSC 11.

³¹ See for example *Newey v Westpac Banking Corporation* [2014] NSWCA 319; *Lindsay-Owen v Schofields Property Development Pty Ltd* [2014] NSWSC 1177 (Ball J).

³² See for example *Lindsay-Owen v Schofields Property Development Pty Ltd* [2014] NSWSC 1177 (Ball J); *Mainteck Services Pty Ltd v Stein Heurtey SA* [2014] NSWCA 184 (Ward, Emmett and Leeming JJA).

³³ See for example *Goldus Pty Ltd v Australian Mining Pty Ltd* [2015] SASC 32; *Thundelarra Ltd v Richmond [No 2]* [2013] WASC 392 (Edelman J); *Wentworth Shire Council v Bemax Resources Limited* [2013] NSWSC 1047 (Rein J).

³⁴ See for example: *Mineralogy Pty Ltd v Sino Iron Pty Ltd (No 6)* [2015] FCA 825 (Edelman J); *Sydney Attractions Group Pty Ltd v Frederick Schulman* [2013] NSWSC 858 (Sackar J).

³⁵ *BP Australia Pty Ltd v Nyran Pty Ltd* [2004] FCAFC 163 (Carr, North and Selway JJ).

Earlier drafts of the contract are considered to evidence prior negotiations on the basis that drafts do not reflect the final consensus of the parties,³⁷ despite the fact that each may express a degree of consensus. In contrast, previous contracts between the parties fall outside the operation of ‘the rule’ because they are considered to reflect a final consensus that can be objectively ascertained (as opposed to ‘mere negotiations’).³⁸

Whether deleted words evince the parties’ prior negotiations has long been the subject of controversy.³⁹ The traditional view is that deleted words are inadmissible pursuant to the rule, as the words are no longer part of the contract that falls to be construed.⁴⁰ Subsequent cases distinguished between the deletion of words from a negotiated contract and a standard form contract. Evidence of the deletion of words from a negotiated contract remained inadmissible, as the insertion of words by one draftsman which were later deleted was considered the same as any other preliminary suggestion put forward and rejected before execution of the contract.⁴¹ Whereas, words struck out from a standard form contract (whether during negotiations or from the final contract) were admissible as *both* parties decided not to include those parts of the agreement.⁴² Modern cases have relinquished this distinction.⁴³

³⁶ See for example: *Wentworth Shire Council v Bemax Resources Limited* [2013] NSWSC 1047 (Rein J).

³⁷ *National Bank of Australasia Ltd v J Falkingham & Sons* [1902] AC 585, 591; *Prenn v Simmonds* [1971] 1 WLR 1381; *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [159]-[164]; *Righi v Kissane Family Pty Ltd* [2015] NSWCA 238 [75]-[80] (Emmett JA, Ward and Gleeson JJA agreeing); *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [26]. Cf *Pepe v Platypus Asset Management Pty Ltd* [2013] VSCA 38 [23] (Neave JA and Hollingworth AJA).

³⁸ *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co* [2001] EWCA Civ 735 (Rix LJ), cited with approval in *Shepparton Projects Pty Ltd v Cave Investments Pty Ltd (No 2)* [2011] VSC 384 [18] (Croft J); *Mainteck Services Pty Ltd v Stein Heurtey SA* [2014] NSWCA 184 [87]-[93] (Ward, Emmett and Leeming JJA). See for example, *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 (Le Miere J); *Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd* [2014] WASC 164 (McLure P, Newnes and Murphy JJA); *Fuji Xerox Finance Limited v CSG Limited* [2012] NSWSC 89 (Sackar J).

³⁹ *Timber Shipping Co SA v London & Overseas Freighters Ltd* [1972] AC 1 [15] (Lord Reid); Tom Davie, ‘The Admissibility of Deleted Words’ (1993) 28 *Australian Construction Law Newsletter* 28.

⁴⁰ *A & J Inglis v John Buttery & Co* (1878) 3 App Cas 552, HL (Sc), 558 (Lord Hatherley), 569, 571-2 (Lord O’Hagan), 576 (Lord Blackburn); *Building and Engineering Constructions (Aust) Limited v Property Securities No 1 Pty Ltd* [1960] VR 673, 681 (Pape J); *Mobil Oil Australia v Kosta* (1969) 14 FLR 343 (Blackburn J).

⁴¹ *Timber Shipping Co SA v London & Overseas Freighters Ltd* [1972] AC 1 [15] (Lord Reid).

⁴² *Timber Shipping Co SA v London & Overseas Freighters Ltd* [1972] AC 1 [15] (Lord Reid); *Mottram Consultants Ltd v Bernard Sunley & Sons Ltd* [1975] 2 Lloyd’s Rep 197 (Lord Cross; Lord Hodgson and Lord Wilberforce agreeing); *NZI Capital Corporation Pty Ltd v Child* (1991) 23 NSWLR 481, 490-494 (Rogers CJ).

Consequently, it is now established that it is permissible to consider deleted words as an aid to construction.⁴⁴

Several difficulties are apparent with the classification of evidence of prior negotiations. What is the distinction between drafts of the contract (which are excluded) and the deletion of words from previous drafts (which are considered), if any? If the deletion of words from a draft contract is an action giving effect to the negotiations of the parties, why is this evidence not excluded by the rule?

Irrespectively, the mere fact that evidence falls within one of the abovementioned types is not determinative of the admissibility of the evidence or the applicability of the rule. Prior negotiations may be admitted in support of another contractual claim or pursuant to an exception to the rule. Conversely, evidence of prior negotiations may not be considered by reason of the operation of another principle of contract construction.

2 *Delineating the interpretation of contracts in writing*

(a) *Definition of contract interpretation*

‘Contract interpretation’ is the process of determining the meaning of a contractual agreement that the words can legitimately bear,⁴⁵ and consequently, the obligations the parties have undertaken to each other.⁴⁶ Questions of interpretation are questions of law to be determined by the court.⁴⁷

⁴³ *Esso Australia Ltd v Australian Petroleum Agents’ & Distributors’ Association* (1993) 3 VR 642, 647 (Hayne J); *Burger King Corporation v Hungry Jack’s Pty Ltd* [2001] NSWCA 187 [137]-[139]; *Ginger Development Enterprises Pty Ltd v Crown Developments Australia Pty Ltd* [2003] NSWCA 296 (Davies AJA; Mason P and Sheller JA agreeing); *Wachmer v Jaksic* [2007] WASC 313 [181]-[187].

⁴⁴ *Wachmer v Jaksic* [2007] WASC 313 [187], applied in *Mineralogy Pty Ltd v Sino Iron Pty Ltd* [2013] WASC 194 [175]-[178].

⁴⁵ *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [121] (Beech J); *Hancock Prospecting Pty Ltd v Wright Prospecting Pty Ltd* (2012) 294 ALR 550, 566 [78] (McLure P); *Goldus Pty Ltd v Australian Mining Pty Ltd* [2015] SASC 32 (Parker J). See also Sir Kim Lewison and David Hughes, *The Interpretation of Contracts in Australia* (Thomson Reuters, 2012) 116-120 [3.14.5].

⁴⁶ S A Smith, *Contract Theory* (Oxford University Press, 2004) 271; Catherine Mitchell, ‘Entire Agreement Clauses: Contracting Out of Contextualism’ (2006) 22 *Journal of Contract Law* 222, 236. See in particular, Sir Johan Steyn, ‘To What Extent May Evidence Control Language?’ (1988) 41(1) *Current Legal Problems* 23, 26.

⁴⁷ *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, 821 (Charles JA); Gerard McMeel, ‘The Principles and Policies of Contractual Construction’ in Andrew Burrows and Edward

Importantly, the function of the court is to interpret the meaning of the contract, not the process prior to execution of the contract.⁴⁸

(b) *Contract interpretation distinguished from other contractual claims*

As the operation of the rule⁴⁹ is confined to the process of interpretation, it is also important to distinguish the process of interpretation from other contractual claims.

It is well established that evidence of prior negotiations *is* admissible for the purpose of rectification.⁵⁰ Rectification is an equitable remedy grounded in the premise that the contract, when properly interpreted, does not conform to the parties' true agreement.⁵¹ In addition, evidence of prior negotiation is also admissible where the validity of the contract is challenged on the basis of one or more vitiating factors, such as fraud, misrepresentation or mistake.⁵² It is unsettled in Australia whether it is permissible to adduce evidence of prior negotiations in support of an estoppel by convention claim.⁵³ Regardless, these are not exceptions to the rule; they operate outside it.⁵⁴

Peel (eds) *Contract Terms* (Oxford University Press, 2007) 27, 31. Cf *Life Insurance Co of Australia Ltd v Phillips* (1925) 36 CLR 60, 78-79 (Isaacs J).

⁴⁸ Sir Kim Lewison, *The Interpretation of Contracts* (Sweet & Maxwell, 5th ed, 2011) 77 [3.04].

⁴⁹ Set out below at §1.4.

⁵⁰ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352; *Ryledar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603; *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 233 (Kirby P); Cheshire & Fifoot, *Law of Contract* (LexisNexis, 10th ed, 2012) [10.8], [10.11]; *Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd* [2014] WASCA 164 [134] (McLure P, Newnes JA agreeing).

⁵¹ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 346 (Mason J) *Ryledar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 [122]-[128], [130]-[143].

⁵² *Goldsbrough, Mort & Co Ltd v Quinn* (1910) 10 CLR 674; JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 283 [9-12]; Gerard McMeel, *The Construction of Commercial Contracts: Interpretation, Implication, and Rectification* (Oxford University Press, 2nd ed, 2011) 204 [5.96].

⁵³ Campbell JA summarised the divergent authority in *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15, see particularly [577]. See further Kristina Bunting, 'Estoppel by Convention and Pre-Contractual Understandings: The Position and Practical Consequences' (2011) 42 *Victoria University of Wellington Law Review* 511, 519.

⁵⁴ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [42] (Lord Hoffmann); JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 607 [18-06].

(c) *Distinguishing the interpretation of contracts in writing*

The principles of interpretation and applicability of the rule differ where the contract is partly oral and partly in writing or there is a dispute relating to formation of the contract. In other words, different rules apply where a court is concerned with the meaning of known terms in a wholly written contract, as against the proof of additional terms or determination of whether a contract exists.⁵⁵

3 *The 'intentions' of the parties*

'Intention' refers to 'a mental capability, power or faculty directed towards the attainment of a particular objective or outcome', which can be attributed to both humans and artificial persons or cohesive organisations.⁵⁶ There are three relevant distinctions for present purposes. First, the 'actual intention' of the parties is distinct from their 'presumed intention'. While the outcome may be the same, actual intention is that which is subjectively held by contracting parties.⁵⁷ In contrast, presumed intention is the construct of 'the reasonable person' tasked with determining the intention of the parties from a particular perspective. Secondly, there is a distinction between 'expressed' (and unexpressed) intention on the one hand, and 'communicated' (and uncommunicated) intention on the other hand. Expressed intention refers to the intention of the parties stated in the contract.⁵⁸ Whereas, communicated intention includes the situation where parties communicate their intentions to each other, which is not necessarily expressed in the contract. Thirdly, in line with the natural meaning of the terms, the 'individual' intention of a contracting party is distinct from the 'mutual' or 'common' intention of contracting parties.⁵⁹

⁵⁵ *Sola Basic Australia Ltd v Morganite Ceramic Fibres Pty Ltd* [1989] NSWCA 187 (11 May 1989) 13-14 (Priestley JA).

⁵⁶ *Cruise Oz Pty Ltd v AAI Ltd* [2015] QSC 215 [21] (Carmody J).

⁵⁷ JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 47 [2-10].

⁵⁸ JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 47-8 [2-11]. See for example the distinction drawn between 'expressed' and 'unexpressed' intention in *Byrnes v Kendle* (2011) 243 CLR 253 [98] (Heydon and Crennan JJ)

⁵⁹ JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 52-3 [2-16]: Carter states that all references to intention – ie actual, express or presumed – are references to common intention.

These different types of intention are pertinent to an understanding of the underlying theories of contract⁶⁰ and the divergent approaches to the admissibility and use of evidence of prior negotiations.⁶¹

4 *The objective approach*

A common starting point in Australian law is that an 'objective approach' is taken in the process of interpretation.⁶² Under the 'objective approach', the court is concerned with what a reasonable person in the position of the parties would have understood the disputed contractual terms to mean, rather than what each party individually understood by them.⁶³

However, that material must be analysed objectively does not of itself dictate what material can be taken into account.⁶⁴ As Professor Stephen Smith explains, 'meaning is always objective' because '[a] word *means* what it is reasonably understood to mean rather than what the speaker intended... it to mean.'⁶⁵ Consequently, it is not possible to understand or justify particular construction conclusions, nor the exclusion of evidence of prior negotiations from this process, on the basis of the objective approach alone.

B *An overview of the modern process of interpretation*

For the moment, a broad overview of the process of interpretation will suffice.⁶⁶

The approach to interpretation begins and ends with the text of the contract.⁶⁷ Consistent with the objective approach, the meaning of disputed

⁶⁰ Explained in Part III.

⁶¹ Explored in Part IV.

⁶² See for example *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 [35] (French CJ, Hayne, Crennan and Kiefel JJ) (*EGC v Woodside*).

⁶³ Andrew Burrows, 'Construction and Rectification' in Andrew Burrows and Edwin Peel (eds), *Contract Terms* (Oxford University Press, 2007) 77, 78.

⁶⁴ Andrew Burrows, 'Construction and Rectification' in Andrew Burrows and Edwin Peel (eds), *Contract Terms* (Oxford University Press, 2007) 77, 82-83; JW Carter, 'Reasonable Endeavours' in *Contract Construction* (2014) 32 *Journal of Contract Law* 36.

⁶⁵ S A Smith, *Contract Theory* (Oxford University Press, 2004) 273 (emphasis in original).

⁶⁶ I return to an examination of the influence of these principles of interpretation on the admissibility and use of prior negotiations in §2.1.2.B.

⁶⁷ Richard Calnan, *Principles of Contractual Interpretation* (Oxford University Press, 2013) 21 [2.01]; *Ryledar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 [109] (Tobias JA).

language is determined by what a ‘reasonable person’ would have understood the language to mean.⁶⁸

The reasonable person is informed by the ‘language used by the parties in the contract, the circumstances addressed by the contract and the commercial purpose or objects to be secured by the contract’.⁶⁹ The plain meaning rule and the ambiguity requirement regulate whether the reasonable person is also informed by the context external to the contract, which is commonly referred to as the ‘surrounding circumstances’.⁷⁰ The precise operation and effect of both principles is the subject of relentless controversy.⁷¹

If, ultimately, the disputed text is ambiguous and susceptible of more than one meaning, evidence of the surrounding circumstances is admissible in order to decide what the disputed language means.⁷² The notion of “surrounding circumstances” ‘can be illustrated but hardly defined’.⁷³ It includes events, circumstances and things external to the contract necessary to determine the proper construction of the disputed language.⁷⁴ But determining whether

⁶⁸ *Toll (FGCT) Pty Ltd v BNP Paribas* (2004) 219 CLR 165 [40]; *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [47] (French CJ, Nettle and Gordon JJ).

⁶⁹ *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [47]-[48] (French CJ, Nettle and Gordon JJ), citing (at fn 22) *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640, 656-657 [35]. Although, I note that the approach of French CJ, Nettle and Gordon JJ in *Mount Bruce Mining* differs from the passage cited in *EGC v Woodside* as the latter does not (at least explicitly) state that a finding of ambiguity or susceptibility of more than one meaning is a prerequisite to consideration of the surrounding circumstances.

⁷⁰ *Byrnes v Kendle* (2011) 243 CLR 253 [99] fn 135 (Heydon and Crennan JJ). The external context of the contract is interchangeably referred to as the ‘surrounding circumstances’, ‘background’, ‘setting’, and ‘factual matrix’ of the contract: JW Carter, ‘Reasonable Endeavours’ in *Contract Construction* (2014) 32 *Journal of Contract Law* 36, 50; JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 180-181 [6-04], 209 [7-01].

⁷¹ The controversy principally centres upon the stage of interpretation at which it is permissible to consider evidence of the surrounding circumstances. In the most recent High Court decision on contract interpretation, *Mount Bruce Mining*, the full bench addressed the controversy regarding the ambiguity requirement in obiter. The High Court was divided upon the issue. Three separate judgments will inevitably heighten the debate and inconsistent approach of intermediate courts in the immediate future. See also Hon Justice Kenneth Martin, ‘Surrounding Circumstances Evidence: Construing Contracts and Submissions About Proper Construction’ (2015) 42(6) *Brief* 21; Robert McDougall, ‘Construction of Contracts: The High Court’s Approach’ (Paper delivered at The Commercial Law Association Judges’ Series, 26 June 2015).

⁷² *Byrnes v Kendle* (2011) 243 CLR 253 [99] (Heydon and Crennan JJ); *Brambles Holdings Ltd v Bathurst City Council* [2001] NSWCA 61 [23] (Heydon JA).

⁷³ *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 3 All ER 570, 995 (Lord Wilberforce).

⁷⁴ *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [48]-[49] (French CJ, Nettle and Gordon JJ). This is distinct from recourse to such evidence to understand the commercial purpose or objects of the contract, which is informed by the genesis of the contract, commercial background, and market in which the parties are operating: *Electricity Generation Corporation v*

particular evidence is part of the surrounding circumstances can be the subject of debate.⁷⁵

Under the exclusionary rule, three types of extrinsic evidence are excluded as an aid to construction, namely: actual intention, subsequent conduct, and prior negotiations.⁷⁶ The focus of this article is the exclusion of evidence of prior negotiations pursuant to ‘the rule’, which is a severable component of the broader exclusionary rule.⁷⁷

C ‘The rule’ and exceptions

1 Development of the current approach

The origin of the current approach to the exclusion of prior negotiations as an aid to construction is traceable to the speech of Lord Wilberforce in *Prenn v Simmonds*.⁷⁸ His Lordship said, ‘evidence of negotiations, or of the parties’ intentions, and a fortiori of [one party’s] intentions, ought not to be received’.⁷⁹

The judgment of Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*⁸⁰ (*Codelfa*) is widely regarded as the classic exposition of the law in Australia concerning the permissible use of extrinsic

Woodside Energy Ltd (2014) 251 CLR 640, 657 [35]; *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [49] (French CJ, Nettle and Gordon JJ).

⁷⁵ *Fuji Xerox Finance Limited v CSG Limited* [2012] NSWSC 89 [90] (Sackar J); *Kimberley Securities v Esber* [2008] NSWCA 301 [5] (Allsop P and Macfarlan JA). See also Tan Yock Lin, ‘Construction of Commercial Contracts and Parol Evidence’ [2009] *Singapore Journal of Legal Studies* 301, 323.

⁷⁶ The characterisation of three types of extrinsic evidence is common in the commentary. See for example, JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 129 [4-23]. With respect to the exclusion of direct evidence of intention: *DTR Nominees Pty Ltd v Mona Homes Pty Ltd* (1978) 138 CLR 423; *Toll (FGCT) Pty Ltd v BNP Paribas* (2004) 219 CLR 165 [40]. With respect to the exclusion of evidence of subsequent conduct, although it is not settled whether evidence of subsequent conduct is admissible in Australia, ‘the more favoured view is that it is not’: *Agricultural and Rural Finance Pty Ltd v Gardiner* (2008) 238 CLR 570, 582 [35]; *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [10]-[12] (Allsop P); [58] (Giles JA); [330] (Campbell JA); *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [119].

⁷⁷ See generally JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 265-6 [8-28].

⁷⁸ [1971] 1 WLR 1381. See for example *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [240]-[241]; Yihan Goh, ‘A Wrong Turn in History: Re-examining the Exclusionary Rule Against Prior Negotiations in Contract Interpretation’ (2014) *Journal of Business Law* 360.

⁷⁹ *Prenn v Simmonds* [1971] 1 WLR 1381, 1385 (Lord Wilberforce), first cited with approval by the High Court of Australia in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596, 606 (Mason J, with whom Gibbs, Stephen and Aickin JJ agreed).

⁸⁰ (1982) 149 CLR 337.

evidence, including evidence of prior negotiations.⁸¹ Justice Mason referred with approval to the passage in *Prenn v Simmonds*,⁸² and said that to the extent that evidence of prior negotiations ‘establish objective background facts which were known to both parties and the subject matter of the contract... they are admissible.’⁸³ Although, ‘so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable.’⁸⁴ This distinction is the foundation for an exception to the rule, outlined subsequently in this Part.

More recently, in *Chartbrook*, the House of Lords re-examined the arguments for and against admitting evidence of prior negotiation as an interpretive aid,⁸⁵ but upheld the rule that ‘excludes evidence of what was said or done during the course of negotiating the agreement for the purpose of drawing inferences about what the contract meant.’⁸⁶

2 *The rule*

I submit that, pursuant to ‘the rule’, evidence of the parties’ prior negotiations is inadmissible in the process of interpreting a written contract for the purpose of drawing inferences about what the contract meant,⁸⁷ unless an exception applies.⁸⁸

⁸¹ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 [104]. See for example *Burns Philp Hardware Ltd v Howard Chia Pty Ltd* (1987) 8 NSWLR 642, 655-657 (Priestley JA); *Supabarn Supermarkets Pty Ltd v Cotrell Pty Ltd (No 1)* [2014] ACTSC 11 [10]; *Velvet Glove Holdings Pty Ltd v Mount Isa Mines Ltd* [2011] QCA 312 [93].

⁸² *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 348 (Mason J).

⁸³ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 (Mason J).

⁸⁴ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 (Mason J).

⁸⁵ These arguments are also advanced in Australia. The strength of these arguments in Australia are evaluated in Part IV.

⁸⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [42] (Lord Hoffmann). Cited with approval in *Byrnes v Kendle* (2011) 243 CLR 253 [98] (Heydon and Crennan JJ).

⁸⁷ *Byrnes v Kendle* (2011) 243 CLR 253 [98] (Heydon and Crennan JJ); *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [118] (Finn J); *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596, 606 (Mason J; Gibbs, Stephen and Aickin JJ agreeing) citing *Prenn v Simmonds* [1971] 1 WLR 1381, 1385 (Lord Wilberforce).

⁸⁸ *Supabarn Supermarkets Pty Ltd v Cotrell Pty Ltd (No 1)* [2014] ACTSC 11 [12]-[16]; *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [96]-[113] (Warren CJ, Harper JA and Robson AJA); *Lodge Partners v Pegum* [2009] FCA 519 [31] (Lindgren J); *Canberra Hire Pty Ltd v Koppers Wood Products Pty Ltd* [2013] ACTSC 162 [200]-[202] (Refshauge

3 *Exceptions to the rule*

I submit that there are four principal exceptions to the rule in modern contract interpretation. First, evidence of prior negotiations is admissible as part of the surrounding circumstances insofar as it tends to establish objective background facts known to both parties,⁸⁹ or objective evidence of the aim or object of the transaction.⁹⁰

Secondly, evidence of prior negotiations is admissible to establish the subject matter of the contract.⁹¹

Thirdly, evidence of prior negotiations is admissible where the parties are united in refusing to include a provision in the contract that would give effect to the presumed intention of persons in their position.⁹² In such cases, evidence of the refusal is admissible to rebut the parties' presumed intention.⁹³ But the

J); *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [118] (Finn J); *Lindsay-Owen v Schofields Property Development* [2014] NSWSC 1177 [47].

⁸⁹ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 (Mason J); *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45; *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [96] (Warren CJ, Harper JA and Robson AJA); cf *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [42].

⁹⁰ Recourse to the context of the contract as evidence of the surrounding circumstances is distinct from recourse to such evidence to understand the commercial purpose or objects of the contract, which is informed by the genesis of the contract, commercial background, and market in which the parties are operating: *EGC v Woodside* (2014) 251 CLR 640, 657 [35]; *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [49] (French CJ, Nettle and Gordon JJ). For further discussion of the distinction see Ryan Catterwell, 'The "Indirect" Use of Evidence of Prior Negotiations in Contract Construction: Part of the Surrounding Circumstances' (2012) 29 *Journal of Contract Law* 183.

⁹¹ *Macdonald v Longbottom* (1859) 1 E & E 977, approved in *Hope v RCA Photophone of Australia Ltd* (1937) 59 CLR 348, 356 (Latham CJ); *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 349, 352 (Mason J); *Sigma Chemicals Pty Ltd v Brown* [2001] WASC 39 [12]-[13]; *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [97]-[99] (Warren CJ, Harper JA and Robson AJA); *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd* [2015] VSCA 286 [77].

⁹² While this exception was tentatively expressed by Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352-353, it has been widely applied in subsequent cases. See for example, *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [100] (Warren CJ, Harper JA and Robson AJA); *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* [2008] NSWSC 274 [63]; *BP Australia Pty Ltd v Nyran Pty Ltd* (2003) 198 ALR 442 [24]; *MCA International BV v Northern Star Holdings Ltd* (1991) 4 ACSR 719, 727 (Rodgers CJ); *Esso Australia Ltd v Australian Petroleum Agents' and Distributors' Association* [1999] 3 VR 642, 647-648.

⁹³ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352-353 (Mason J). See for example, *MCA International BV v Northern Star Holdings Ltd* (1991) 4 ACSR 719, 727.

parties' refusal must be an unambiguous expression of agreement in the course of negotiations.⁹⁴

Fourthly, evidence of prior negotiations may be tendered to establish that the parties negotiated on the basis that ambiguous language had a particular meaning.⁹⁵ This is known as the 'private dictionary' exception, as the parties can in effect give their own dictionary meaning to words by reason of their common intention.⁹⁶ The ambit and influence of each exception is examined in Part IV.

4 *Distinguishing other conceptions of the rule*

My conceptualisation of the approach to the admissibility of prior negotiations in contract interpretation, being a rule and four principal exceptions, differs from that proffered by others. For example, V K Rajah, then Judge of Appeal of the Supreme Court of Singapore, observed that the modern approach to the admissibility of prior negotiations has become 'an inclusionary rule with exclusionary exceptions.'⁹⁷ This is said to follow from *Investors Compensation Scheme v West Bromwich Building Society (ICS)*,⁹⁸ in which Lord Hoffmann referred to the exclusion of prior negotiations and declarations of subjective intent as an 'exception' to the admissible background,⁹⁹ and the 'gloss' put on the rule in *Chartbrook*. Thus Rajah opines that 'the conceptual commitment to *prima facie* exclusion [in England]... has now been decisively abandoned.'¹⁰⁰ Although writing on the English position, this observation is potentially

⁹⁴ *Queensland Power Company Limited v Downer EDI Mining Pty Ltd* [2010] 1 Qd R 180 [74] (Chesterman JA).

⁹⁵ *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd's Rep 708, 712 (Kerr J). Approved in Australia in *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290, 309 (Santow J); *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* [2004] NSWSC 149 [182] (Einstein J); *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2003] NSWCA 74 [76]-[78].

⁹⁶ *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd's Rep 708, 712 (Kerr J); *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290, 309 (Santow J); *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [45].

⁹⁷ V K Rajah, then Judge of Appeal of the Supreme Court of Singapore, in 'Redrawing the Boundaries of Contractual Interpretation: From Text to Context to Pre-text and Beyond' (2010) 22 *Singapore Academy of Law Journal* 513 [18].

⁹⁸ [1998] 1 WLR 896, 913 (Lord Hoffmann).

⁹⁹ [1998] 1 WLR 896, 913 (HL) (Lord Hoffmann).

¹⁰⁰ V K Rajah, 'Redrawing the Boundaries of Contractual Interpretation: From Text to Context to Pre-text and Beyond' (2010) 22 *Singapore Academy of Law Journal* 513 [18].

applicable because of the centrality of English precedent in the development of Australian authority.¹⁰¹

However, I argue that this observation does not encapsulate the law in Australia for two reasons. First, courts generally maintain the prima facie exclusion of prior negotiations.¹⁰² The evidence must fall within one of the exceptions to the rule to be (permissibly) considered as part of the interpretive exercise. Secondly, as well as admissibility as part of the surrounding circumstances, there are three other principal exceptions to the rule that operate.

It has also been said that the rule operates to exclude evidence of prior negotiations as a direct aid to construction.¹⁰³ However, I submit that this statement overlooks the fact that prior negotiations are *not* excluded as a direct aid to construction if the evidence reflects that the parties were united in refusing to include a provision, or the parties negotiated on the basis that ambiguous language had a particular meaning.¹⁰⁴ Further, evidence of prior negotiations is also excluded as an indirect aid to construction, unless it is ‘objective’ evidence that forms part of the surrounding circumstances or it assists in establishing the subject matter of the contract.¹⁰⁵ Therefore, the rule is properly understood to exclude the use of prior negotiations as a direct *and* indirect aid to construction.

Other exceptions to the rule are cited, in addition to the four outlined above. Rectification is a common example.¹⁰⁶ However, rectification is properly regarded as a distinct equitable doctrine that is concerned with amending the contract by reference to the parties’ prior agreement or

¹⁰¹ For example, *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 347, 351-2 and *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596, 606 (Mason J; Gibbs and Stephen JJ agreeing) are based on *Prenn v Simmonds* [1971] 1 WLR 1381 (Lord Wilberforce). Further, *Byrnes v Kendle* is based on *Chartbrook: Byrnes v Kendle* (2011) 243 CLR 253 [98] n 133 (Heydon and Crennan JJ).

¹⁰² For example, in *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [118], Finn J said that ‘evidence of prior negotiations is, as a rule, to be excised from the “context”.’

¹⁰³ See for example, JW Carter, ‘Context and Literalism in Construction’ (2014) 31 *Journal of Contract Law* 100, 121 n 32 citing Ryan Catterwell, ‘The “Indirect” Use of Evidence of Prior Negotiations in Contract Construction: Part of the Surrounding Circumstances’ (2012) 29 *Journal of Contract Law* 183.

¹⁰⁴ This is pursuant to the common refusal and private dictionary exceptions outlined above.

¹⁰⁵ This is pursuant to the surrounding circumstances and subject matter exceptions outlined above.

¹⁰⁶ See for example McMeel, ‘Interpretation of Contracts and the Admissibility of Pre-Contractual Negotiations’ 17 *Singapore Academy of Law Journal* 248 [41].

understanding, rather than an exercise of interpretation of the contractual language.¹⁰⁷ Estoppel by convention is another example. But it is properly regarded as ‘estopping’ parties from denying an agreed or assumed state of facts on which they have based their contract if it would be inequitable to do so,¹⁰⁸ which extends beyond the proper interpretation of the contract (where the rule would apply). Finally, on occasion, ambiguity in the contractual language is also referred to as an exception.¹⁰⁹ This is a misconception resulting from the improper conflation of the rule with the parol evidence rule, where ambiguity is an exception to the operation of the latter. The relationship between the rule and the parol evidence rule is examined in connection with the uncertain foundation of the rule in Part IV.

D Summary

Pursuant to ‘the rule’, evidence of prior negotiations is inadmissible as an aid to the interpretation of commercial contracts in writing, unless one or more of four principal exceptions apply. The ‘evidence of prior negotiations’ excluded encompasses both oral and documentary evidence of the statements and actions of contracting parties up to execution of the contract. The operation of the rule is confined to the process of interpretation.

¹⁰⁷ LH Hoffmann, ‘The Intolerable Wrestle with Words and Meanings’ (1997) 114 *South African Law Journal* 656, 667; *Ryledar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 [122]-[128], [130]-[143].

¹⁰⁸ *Con-Stan Industries of Australia v Norwich Winterthur Insurance (Australia)* (1985-1986) 160 CLR 226, 244; *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387, 404 (Mason CJ and Wilson J); LH Hoffmann, ‘The Intolerable Wrestle with Words and Meanings’ (1997) 114 *South African Law Journal* 656, 667.

¹⁰⁹ *Goldus Pty Ltd v Australian Mining Pty Ltd* [2015] SASC 32 (Parker J): The parol evidence rule does not preclude admission of extrinsic evidence where the words used in a contract are ambiguous. [39]; *Canberra Hire Pty Ltd v Koppers Wood Products Pty Ltd* [2013] ACTSC 162 (Refshauge J) ‘Such evidence of pre-contractual negotiations is also, of course, available to assist in the interpretation of contractual language that is “ambiguous or susceptible of more than one meaning”.’ [203]. See also Ryan Catterwell, ‘The “Indirect” Use of Evidence of Prior Negotiations and the Parties’ Intentions in Contract Construction: Part of the Surrounding Circumstances’ (2012) 29 *Journal of Contract Law* 183, 185.

III RECOGNISING THE UNDERLYING INFLUENCE OF THE OBJECTIVE AND SUBJECTIVE THEORIES OF CONTRACT

A *Contract theory and the purpose of interpretation*

Superior courts in Australia assert that the purpose of interpretation is to ascertain and give effect to the ‘common intention’ of the parties.¹¹⁰ But two approaches confront the court.¹¹¹ The court can discern the meaning of the contract and presume that the meaning arrived at is the intention of the parties,¹¹² or it can discern and give effect to the common *actual* intention of the parties.¹¹³ Therefore, I submit that it is helpful to analyse the purpose of interpretation and the ensuing principles for construing contracts, including the rule, under the rubric of contract theory.¹¹⁴

1 *The objective theory and ascertainment of presumed intention*

The ‘objective theory’ holds that ‘the legal rights and obligations of the parties turn upon what their words and conduct would be reasonably understood to convey, not upon actual beliefs or intentions.’¹¹⁵ In broad terms, the obligations of contracting parties are imposed by the law,¹¹⁶ and the extent to which the parties’ intentions govern the ascription to them of contractual obligations is limited.¹¹⁷ The court is concerned with policy considerations and communal

¹¹⁰ *Toll (FGCT) Pty Ltd v BNP Paribas* (2004) 219 CLR 165 [40]; *Cruise Oz Pty Ltd v AAI Ltd* [2015] QSC 215 [21] (Carmody J).

¹¹¹ *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [90] (Thomas J).

¹¹² *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [90] (Thomas J). This is consistent with the position in Australia, where there is a presumption that the parties’ expressed intention is their actual intention: *Shore v Wilson* (1842) 9 Cl & F 355, 525, 556; *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226, 237.

¹¹³ *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [90] (Thomas J).

¹¹⁴ As Professor Jay Feinman explains, contract theory ‘frames the way we look at problems, the facts and values we think relevant to their solution, and even what we consider to be problems at all.’: JM Feinman, ‘The Significance of Contract Theory’ (1990) 58 *University of Cincinnati Law Review* 1283. See also *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [24] (Allsop P).

I adopt Professor Stephen Smith’s definition of a ‘theory of contract’ as an interpretation of contract law that aims to enhance understanding of the law by explaining why certain features are important or unimportant and identifying connections between those features: S A Smith, *Contract Theory* (Oxford University Press, 2004) 5.

¹¹⁵ *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471 [34].

¹¹⁶ PS Atiyah, *Rise and Fall of Contract* (Clarendon Press, Oxford, 1979) 734; Hugh Collins, *The Law of Contract* (Butterworths, 3rd ed, 1997) 206-207.

¹¹⁷ Anne De Moor, ‘Intention in the Law of Contract: Elusive or Illusory?’ (1990) 106 *Law Quarterly Review* 632, 633.

standards of responsibility, rather than the parties' actual agreement.¹¹⁸ Consistent with this approach, the contract is afforded primacy.¹¹⁹

This overriding concern with fairness and the interdependence of the parties is evident in many contract interpretation cases and extra-judicial writings.¹²⁰ For example, in *Chartbrook*, Lord Hoffmann said that the rule may have the result that 'parties are sometimes held bound by a contract in terms which, upon a full investigation of the course of negotiations, a reasonable observer would not have taken them to have intended.'¹²¹ But, Lord Hoffmann continued, 'a system which sometimes allows this to happen *may* be justified in the more general interest of economy and predictability in obtaining advice and adjudicating disputes.'¹²²

Accordingly, under the objective theory, the purpose of contract interpretation is to discern and give effect to 'the meaning which the *document* would convey to a reasonable person'.¹²³ That is, the parties' presumed intention.¹²⁴

¹¹⁸ JM Feinman, 'The Significance of Contract Theory' (1990) 58 *University of Cincinnati Law Review* 1283, 1286-1288; Sir Anthony Mason, 'Themes and Tensions Underlying the Law of Contract' in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 298-299.

¹¹⁹ For example, in *Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd* (1985) 2 NSWLR 309, 315 Hope JA cited with approval the following statement from *Hotchkiss v National City Bank of New York* 200 Fed 287 (1911) at 293: '... A contract has, strictly speaking, nothing to do with the personal or individual, intent of the parties.'

¹²⁰ See for example *Toll (FGCT) Pty Ltd v BNP Paribas* (2004) 219 CLR 165 [40]; Sir Johan Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *Law Quarterly Review* 433, 434.

¹²¹ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [41] (Lord Hoffmann).

¹²² *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [41] (Lord Hoffmann) (emphasis added), cited with approval in *Byrnes v Kendle* (2011) 243 CLR 253 [98] n 133 (Heydon and Crennan JJ).

¹²³ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912, cited with approval in *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (Gleeson CJ, Gummow and Hayne JJ). This is consistent with the frequent assertion that references to the "common intention of the parties" 'are to be understood as referring to what a reasonable person would understand *by the language* in which the parties have expressed their agreement.': *Toll (FGCT) Pty Ltd v BNP Paribas* (2004) 219 CLR 165 [40].

¹²⁴ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352-353. Cited with approval in innumerable cases, including *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 [39], [104].

2 *The subjective theory and ascertainment of actual common intention*

The subjective theory holds that the parties voluntarily assume rights and liabilities under the contract through the act of making a promise or an agreement.¹²⁵ In this sense, the contract is created by the ‘will’ of the parties, and the parties themselves determine the content of the contract.¹²⁶ It follows that the function of the court is more passive: it applies contract doctrine to give effect to the actual agreement of the parties, on the basis that a contract entered into freely and voluntarily should be enforced without judicial oversight of the justice or fairness of the bargain.¹²⁷

Accordingly, under the subjective theory, the purpose of contract interpretation is to give effect to the *actual* common intention of the parties regarding the meaning and purpose of the *agreement* or any clause therein,¹²⁸ where such evidence is available. As the interpretive exercise is constrained by the meaning that the disputed language can reasonably bear,¹²⁹ the words of the written contract remain the focal point.¹³⁰ But the relevant intention is the actual common intention of the parties, rather than that which is presumed by a detached observer.

It is sometimes asserted that the subjective theory is inconsistent with the objective approach to interpretation.¹³¹ If the subjective theory is understood to

¹²⁵ JM Feinman, ‘The Significance of Contract Theory’ (1990) 58 *University of Cincinnati Law Review* 1283, 1286. The ‘subjective theory’ is interchangeably referred to as ‘classical theory’ and ‘will theory’ in contract scholarship.

¹²⁶ See for example Lord Gabor, ‘The Iterative Process of Contractual Interpretation’ (2012) 128 *Law Quarterly Review* 41, 41.

¹²⁷ Sir Anthony Mason, ‘Themes and Tensions Underlying the Law of Contract’ in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 298; PS Atiyah, *Rise and Fall of Contract* (Clarendon Press, Oxford, 1979) 389. For example, in *Yoshimoto v Canterbury Gold International Ltd* [2001] 1 NZLR 523, Thomas J said (at [71]): ‘Surely the parties are reasonably entitled to expect that the Courts will strive to ascertain their true intention or, certainly, not to arrive at a meaning of their contract which is at variance with their actual intention. They cannot expect that the judicial exercise of construing their contract will be buried under a stockpile of excessive formalism.’

¹²⁸ *Cocks v Maddern* [1939] SASR 321, 327 (Napier J).

¹²⁹ *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [121] (Beech J); *Hancock Prospecting Pty Ltd v Wright Prospecting Pty Ltd* (2012) 294 ALR 550, 566 [78] (McLure P); *Goldus Pty Ltd v Australian Mining Pty Ltd* [2015] SASC 32. See also Sir Kim Lewison and David Hughes, *The Interpretation of Contracts in Australia* (Thomson Reuters, 2012) [3.14.5].

¹³⁰ See for example *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99, 109: ‘It is trite law that the primary duty of a court in construing a written contract is to endeavour to *discover the intention of the parties* from the words of the instrument in which the contract is embodied.’

¹³¹ See for example Sir Johan Steyn, ‘To What Extent May Evidence Control Language?’ (1988) 41(1) *Current Legal Problems* 23.

be concerned with the parties' actual *uncommunicated* intention,¹³² there is an inconsistency.¹³³ But there is no apparent reason why this understanding of the subjective theory should be accepted.¹³⁴ Courts consider evidence of the parties' actual common intention from the pre-contractual negotiations (objectively through the 'reasonable person'),¹³⁵ but not evidence of the inner, unexpressed intentions or desires of the respective parties. Further, it is difficult to find any commentator who suggests it is appropriate to consider the individual or uncommunicated actual intention of any party.¹³⁶ Thus, where the subjective theory is understood as concerned with uncovering objective meanings, rather than the subjective or inner intentions of any party, any argument that the subjective theory is incompatible with the objective approach is untenable.¹³⁷ This article adopts this narrower conception of the subjective theory.

3 *The modern approach*

The subjective theory is generally considered to have become unworkable and superseded by the objective theory.¹³⁸ Moreover, the objective theory is almost unanimously cited and accepted as underlying the modern approach to the

¹³² See for example James Edelman, 'Three Issues in Construction of Contracts' (Presentation to the Conference of Supreme and Federal Court Judges, 27 January 2016) [6].

¹³³ S A Smith, *Contract Theory* (Oxford University Press, 2004) 271-272.

¹³⁴ S A Smith, *Contract Theory* (Oxford University Press, 2004) 271-272.

¹³⁵ As Smith explains, 'meaning is always objective' because '[a] word *means* what it is reasonably understood to mean rather than what the speaker intended (or, confusingly, 'meant') it to mean.': S A Smith, *Contract Theory* (Oxford University Press, 2004) 273 (emphasis in original). See generally, Andrew Burrows, 'Construction and Rectification' in Andrew Burrows and Edwin Peel (eds), *Contract Terms* (Oxford University Press, 2007) 77, 82-3. See for example *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 236 (Kirby P).

¹³⁶ See for example D W McLauchlan, 'A Contract With its Own Meaning?' [1996] *New Zealand Law Journal* 439, 440; J Edward Bayley, 'Prior Negotiations and Subsequent Conduct in Contract Interpretation: Principles and Practical Concerns' (2011) 28 *Journal of Contract Law* 179, 206; D W McLauchlan, 'A Contract Contradiction' (1999) 30 *Victoria University of Wellington Law Review* 175, 182; Gerard McMeel, 'Prior Negotiations and Subsequent Conduct – The Next Step Forward for Contractual Interpretation?' (2003) 119 *Law Quarterly Review* 272, 274. See also *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [114] (Thomas J).

¹³⁷ S A Smith, *Contract Theory* (Oxford University Press, 2004) 273; D W McLauchlan, 'The Contract That Neither Party Intends' (2012) 29 *Journal of Contract Law* 26, 28.

¹³⁸ Sir Anthony Mason, 'Themes and Tensions Underlying the Law of Contract' in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 299; JM Feinman, 'The Significance of Contract Theory' (1990) 58 *University of Cincinnati Law Review* 1283, 1285-1288.

interpretation of contracts.¹³⁹ This is exemplified by the ‘conclusions’ of the plurality in *Byrnes v Kendle*.¹⁴⁰ There, Heydon and Crennan JJ referred to a submission in *Chartbrook* that ‘[t]he question is not what the words meant but what *these parties meant* ... Letting in the negotiations gives the court the best chance of ascertaining what *the parties meant*’, and countered: ‘It would have been revolutionary to have accepted that argument.’¹⁴¹ Heydon and Crennan JJ explained that these conclusions ‘flow from the objective theory of contractual obligation’.

It follows from this adherence to the objective theory that, in many cases, judges and lawyers now habitually presume the parties’ intent ‘without questioning the process.’¹⁴² Although, in *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd (B & B Constructions)*,¹⁴³ Priestley JA said that ‘a very difficult question of legal theory’ arises from what facts extrinsic to a written contract a court may permissibly consider in deciding the proper interpretation of that contract.¹⁴⁴ His Honour noted the difficulty in finding an answer that encapsulates the variety of different situations that arise, and observed that ‘the actual practice of the courts shows different criteria being used for the selection of extrinsic material in different types of case.’¹⁴⁵ I agree.

Contrary to common acceptance of the completeness of the objective theory, I submit that the debate and confusion surrounding the formulation and application of the rule is embedded in judicial adherence to one theory of

¹³⁹ *Taylor v Johnson* (1983) 151 CLR 422, 429 (Mason ACJ, Murphy and Deane JJ); *Byrnes v Kendle* (2011) 243 CLR 253 [100] (Heydon and Crennan JJ); *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 at [4], [24], [50]; *Johnston v Brightstars Pty Ltd* [2014] NSWCA 150 [50] (Beazley P, Basten and Gleeson JJA); *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [124] (Beech J); *Cruise Oz Pty Ltd v AAI Ltd* [2015] QSC 215 [24] (Carmody J); *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290, 309 (Santow J). See generally Sir Anthony Mason, ‘Themes and Tensions Underlying the Law of Contract’ in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 299-301; D W McLauchlan, ‘Common Intention and Contract Interpretation’ (2011) *Lloyd’s Maritime and Commercial Law Quarterly* 30, 31.

¹⁴⁰ (2011) 243 CLR 253 [100].

¹⁴¹ *Byrnes v Kendle* (2011) 243 CLR 253 [99] (Heydon and Crennan JJ).

¹⁴² *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [96] (Thomas J).

¹⁴³ (1994) 35 NSWLR 227.

¹⁴⁴ *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 248 (Priestley JA).

¹⁴⁵ *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 248 (Priestley JA). See also Catherine Mitchell, ‘Obligations in Commercial Contracts – A Matter of Law or Interpretation?’ (2012) 65 *Current Legal Problems* 455, 458.

contract over another.¹⁴⁶ This is significant because of the fundamentally different purposes of interpretation that flow from the subjective and objective theories of interpretation, respectively. As the purpose of interpretation under the subjective theory is to ascertain and give effect to the *actual* common intention of the parties regarding the meaning and purpose of the parties' *agreement* or any clause therein, the utility of evidence of prior negotiations is logically heightened. In contrast, the purpose of interpretation under the objective theory – being the discernment and effectuation of the meaning that the *contract* would convey to a reasonable person – strongly supports the exclusion of evidence of prior negotiations as an aid to interpretation.

B Summary

Ultimately, the circumstances in which evidence of prior negotiations is admissible, and, if so, the purpose for which it can be used, is more readily understood in light of the theory of contract underlying contract interpretation cases. Within this framework, Part IV analyses the problems posed for contracting parties by the formulation and application of the rule.

IV PROBLEMS WITH THE FORMULATION AND APPLICATION OF THE RULE

In this Part, I examine three fundamental problems with the rule for contracting parties:

- (a) the unclear bounds of the formulation of the rule and exceptions (§IV.A);
- (b) the unpredictable application of the rule and, thus, admissibility and use of evidence of prior negotiations (§IV.B); and
- (c) the uncertain foundation of the rule (§IV.C).

¹⁴⁶ This unresolved tension between the objective and subjective theories in the law of contract has attracted judicial and scholarly consideration, but predominantly insofar as the theories relate to the formation of contracts: D W McLauchlan, 'Objectivity in Contract' (2005) 24 *University of Queensland Law Journal* 479; W Howarth, 'The Meaning of Objectivity in Contract' (1984) 100 *Law Quarterly Review* 265; J Vorster, 'A Comment on the Meaning of Objectivity in Contract' (1987) 103(2) *Law Quarterly Review* 274; W Howarth 'A Note on the Objective of Objectivity in Contract' (1987) 103 *Law Quarterly Review* 527; Anne De Moor, 'Intention in the Law of Contract: Elusive or Illusory?' (1990) 106 *Law Quarterly Review* 632.

Where relevant, I argue that the divergence is partly attributable to differing conceptions of the appropriate balance between party autonomy and the law, which flow from disparate underlying theories of contract.

A *Unclear boundaries*

In *ICS*,¹⁴⁷ Lord Hoffmann observed that the boundaries of the rule ‘are in some respects unclear’, but that it was not the occasion on which to examine them.¹⁴⁸ The opportunity to reconsider the rule subsequently arose in *Chartbrook*. But the House of Lords focused on the case for and against departing from the rule on the basis of the rationale, rather than the precise bounds of the rule.¹⁴⁹ Likewise, to my knowledge, since *Codelfa* there has been little, if any, *critical* examination of the bounds of the rule by Australian courts.

1 *Conception of ‘prior negotiations’*

One reason for the lack of clarity in the boundaries of the rule is that the ambit of evidence subject to the operation of the rule is unsettled. While I established a working definition of ‘prior negotiations’ above,¹⁵⁰ several difficulties are apparent with the classification of evidence of prior negotiations in practice.

It is now ‘clearly established’ that it is permissible to consider evidence of the deletion of words as an interpretive aid.¹⁵¹ But it is unclear whether that is because it is not classified as evidence of prior negotiations,¹⁵² or it is classified as evidence of prior negotiations and considered through an exception to the rule.¹⁵³ If it is the former, this generates uncertainty as to whether other types

¹⁴⁷ [1998] 1 WLR 896.

¹⁴⁸ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 913 (Lord Hoffmann).

¹⁴⁹ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [27]-[42] (cf [43]-[47] in relation to the private dictionary exception).

¹⁵⁰ See above §II.A.1.

¹⁵¹ *Wachmer v Jaksic* [2007] WASC 313, applied in *Mineralogy Pty Ltd v Sino Iron Pty Ltd* [2013] WASC 194 [175]-[178].

¹⁵² See for example *Burger King Corporation v Hungry Jack’s Pty Ltd* [2001] NSWCA 187 [137]-[139]; *Ginger Development Enterprises Pty Ltd v Crown Developments Australia Pty Ltd* [2003] NSWCA 296 (Davies AJA; Mason P and Sheller JA agreeing); *Wachmer v Jaksic* [2007] WASC 313 [181]-[187]; *A Goninan & Co Pty Ltd v Direct Engineering Services Pty Ltd (No 2)* [2008] WASC 112 [40] (Buss JA, Martin CJ and McLure JA agreeing) (reference to ‘the rule’ relating to the use of deleted words in contract interpretation).

¹⁵³ The exception being that the parties were united in refusing to include a provision in the contract. See for example *NZI Capital Corporation Pty Ltd v Child* (1991) 23 NSWLR 481; *Centrepoint*

of pre-contractual evidence are also not ‘evidence of prior negotiations’ and subject to the rule.

For example, the distinction between the deletion of words from drafts (which are not considered to evidence prior negotiations), and drafts of the contract (which are considered evidence of prior negotiations) is difficult to discern. In *Pepe v Platypus Asset Management Pty Ltd*,¹⁵⁴ ‘any changes made to the language of the clauses during the drafting process’ were not classified as evidence of prior negotiations.¹⁵⁵ In contrast, in *Watpac Construction NSW Pty Limited v Taylor Thompson Whitting (NSW) Pty Ltd*,¹⁵⁶ the agreed insertion of a qualification on the operation of a particular provision, following an objection raised by one contracting party, was considered evidence of prior negotiations.¹⁵⁷ The distinction between the deletion of text from a draft contract, and the omission of words when retyping a clause is similarly troublesome.¹⁵⁸

In addition, it can also be difficult to draw the line between mere drafts (which are considered evidence of prior negotiations) and a binding provisional agreement.¹⁵⁹

This uncertainty in classifying evidence of ‘prior negotiations’ is exacerbated by the fact that classification of evidence as ‘prior negotiations’ is not determinative of the inadmissibility of the evidence or applicability of the rule.¹⁶⁰

Custodians Pty Ltd v Lidgerwood Investments Pty Ltd [1990] VR 411; *Esso Australia Ltd v Australian Petroleum Agents’ & Distributors’ Association* [1999] 3 VR 642; *Watpac Construction NSW Pty Ltd v Taylor Thompson Whitting (NSW) Pty Ltd* [2015] NSWSC 780 [56]-[57] (Ball J).

¹⁵⁴ [2013] VSCA 38.

¹⁵⁵ [2013] VSCA 38 [23]-[27] (Neave JA and Hollingworth AJA, Buchanan JA agreeing).

¹⁵⁶ [2015] NSWSC 780.

¹⁵⁷ [2015] NSWSC 780 [57]-[58].

¹⁵⁸ *Team Services Plc v Kier Management and Design Ltd* (1993) 63 BLR 76, CA (Lloyd LJ).

¹⁵⁹ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [38] (Lord Hoffmann); *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [126] (Beech J).

¹⁶⁰ *Chemeq Ltd v Shepherd Investments International Ltd* [2007] WASCA 117 [155] (McLure JA); *Wachmer v Jaksic* [2007] WASC 313 [176].

See for example *Rugby Group Ltd v ProForce Recruit Ltd* [2006] EWCA Civ 69 [32] (Mummery LJ): There is substance in the defendant’s criticism of the trial judge that he failed to address the admissibility and use of facts about which the parties were negotiating “by simply stopping at the question whether the exchanges between the parties relied on were “negotiations” and then ruling them out as inadmissible extrinsic evidence.’

2 *The ambit of exceptions to the rule*

Logically, the bounds of the operation of the rule and exceptions are inversely related. Hence, it is fruitful to examine the scope of operation of each of the four exceptions to the rule.

(a) *The surrounding circumstances*

It is frequently noted that the distinction between the permissible and impermissible use of evidence of prior negotiations as part of the surrounding circumstances is 'by no means always apparent'.¹⁶¹ There are two relevant issues.

Firstly, what evidence of prior negotiations can be regarded as 'objective'.¹⁶² Consistent with the objective theory, the surrounding circumstances is considered to include evidence of prior negotiations that tend to establish objective background facts, but exclude evidence of prior negotiations insofar as it reflects the parties' actual intentions and expectations.¹⁶³ This distinction can be difficult.¹⁶⁴ For example, in one case, a pre-contractual meeting between the representatives of both companies, followed by an email summarising the discussion is considered an objective background fact.¹⁶⁵ Whereas, in another, pre-contractual discussions between representatives of the parties is considered an impermissible plea to the parties' subjective intentions.¹⁶⁶ Nonetheless, the distinction is commonly cited.¹⁶⁷

¹⁶¹ *Phoenix Commercial Enterprises Pty Ltd v City of Canada Bay Council* [2010] NSWCA 64 [30]. See also *Kimberley Securities Ltd v Esber* [2008] NSWCA 301 [5] and *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [24] (Allsop P), referring to the 'possible subtlety' of the distinction.

¹⁶² For example, in *The Construction of Commercial Contracts: Interpretation, Implication, and Rectification* (Oxford University Press, 2nd ed, 2011) 192-3 [5.67] Professor McMeel pertinently questions: 'Where is the line to be drawn between prior negotiations and surrounding circumstances?'

¹⁶³ *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [88]-[94] (Warren CJ, Harper JA and Robson AJA); *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 [22] (Le Miere J); *DTR Nominees Pty Ltd v Mona Homes Pty Ltd* (1978) 138 CLR 423, 249; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352; *Byrnes v Kendle* (2011) 243 CLR 253 [98] (Heydon and Crennan JJ) [98].

¹⁶⁴ *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [24] (Allsop P); *Kimberley Securities Ltd v Esber* [2008] NSWCA 301 [5] (Allsop P and Macfarlan JA).

¹⁶⁵ *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [133], [136]-[137] (Beech J).

¹⁶⁶ *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 [30], [37] (Le Miere J).

¹⁶⁷ See for example, *Chemeq Ltd v Shepherd Investments International Ltd* [2007] WASC 117 [155]-[156] (McLure JA, Wheeler JA agreeing); *Velvet Glove Holdings Pty Ltd v Mount Isa Mines Ltd* [2011] QCA 312 [34], [101] (Philippides J, Fraser and White JJA agreeing).

Another view, consistent with the subjective theory, is that negotiations and drafts, including that which evinces the parties' actual intentions, can be admissible 'if directed to one of the legitimate aspects of surrounding circumstances.'¹⁶⁸ For example, in *BP Australia Pty Ltd v Nyran Pty Ltd*,¹⁶⁹ Nicholson J said '[o]bjective background facts can include statements and actions of the parties which reflect their mutual actual intentions.'¹⁷⁰ Concurrence upon communicated intention creates the 'mutuality',¹⁷¹ which, in turn, makes the evidence admissible.¹⁷² For example, an information memorandum issued prior to execution of the contract by one contracting party, with which the other contracting party was 'comfortable', was considered permissible evidence of the surrounding circumstances.¹⁷³ Although, consistent with the divergence in approach, acceptance of the utility of the parties' mutual actual intention in interpretation is not uniform.¹⁷⁴

Secondly, the permissible use of surrounding circumstances evidence (including prior negotiations).¹⁷⁵ The accepted use is to apprise the reasonable person of the purpose and background of the transaction, which, in turn, informs the reasonable person as to the proper meaning of the disputed language.¹⁷⁶ Although, the distinction between looking at evidence of prior

¹⁶⁸ *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 [24] (Allsop P); *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 (Le Miere J). See also *Kimberley Securities v Esber* [2008] NSWCA 301 [5] (Allsop P and Macfarlan JA); *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290, 310 (Santow J).

¹⁶⁹ (2003) 198 ALR 442.

¹⁷⁰ *BP Australia Pty Ltd v Nyran Pty Ltd* (2003) 198 ALR 442 [34] (Nicholson J). This passage is cited with approval in a number of cases including: *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 [21] (Le Miere J); *Braystock Pty Ltd v Garland* [2004] NSWSC 874 [17] (Hamilton J); *Sunset Vineyard Management Pty Ltd v Southcorp Wines Pty Ltd* [2006] VSC 234 [60]-[62] (Hargrave J).

¹⁷¹ *BP Australia Pty Ltd v Nyran Pty Ltd* (2003) 198 ALR 442 [46] (Nicholson J). See also *Sampford IXL Pty Ltd v Whirlpool (Australia) Pty Ltd* [2009] VSC 335 [28]: 'These background circumstances may also include statements as to the intentions and objectives of the negotiating parties provided there is evidence that they concurred in these.'

¹⁷² *BP Australia Pty Ltd v Nyran Pty Ltd* (2003) 198 ALR 442 [34] (Nicholson J). See also *Supabarn Supermarkets Pty Ltd v Cotrell Pty Ltd (No 1)* [2014] ACTSC 11 [15]-[16] (Penfold J); *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [156], [158] (Beech J).

¹⁷³ *Sunset Vineyard Management Pty Ltd v Southcorp Wines Pty Ltd* [2006] VSC 234 [63]-[64] (Hargrave J).

¹⁷⁴ See for example *Cruise Oz Pty Ltd v AAI Ltd* [2015] QSC 215, in which Carmody J reinforced (at [23]) that 'the interpretation of a contract is not controlled by the intersecting subjective intentions of the parties.'

¹⁷⁵ *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 [26] (Le Miere J).

¹⁷⁶ With respect to this 'indirect' use of evidence of prior negotiations see further Ryan Catterwell, 'The "Indirect" Use of Evidence of Prior Negotiations in Contract Construction: Part of the Surrounding Circumstances' (2012) 29 *Journal of Contract Law* 183, particularly at 185-186.

negotiations as part of the surrounding circumstances and drawing an inference about what the contract means has been described as ‘a very fine line... so fine it almost vanishes.’¹⁷⁷ Consequently, Le Miere J cautioned in *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]*¹⁷⁸ that the surrounding circumstances ‘cannot be used to introduce by a side wind evidence of the subjective intention of the parties, since that is contrary to the objective theory of interpretation of contracts.’¹⁷⁹ But, in practice, I submit that this is precisely what occurs. Where evidence of the parties’ mutual actual intention is admissible in line with the second view, it is conceivable that it is used to draw an inference about the parties’ *actual* agreement contrary to the objective theory.

Overall, the extent to which evidence of prior negotiations are admissible as part of the surrounding circumstances is variable, and the precise use of admissible surrounding circumstances evidence is unclear. Ultimately, I argue that the different theories of contract operate at the core of the division.

(b) *Subject matter of the contract*

The scope of the subject matter exception is also uncertain. For example, the formulation of the exception is on occasion enlarged to permit the reception of mutually known facts from the parties’ prior negotiations ‘to identify the meaning of a descriptive term.’¹⁸⁰ A second example of the potential breadth of this exception is provided by *B & B Constructions*.¹⁸¹ President Kirby reasoned that the subject matter exception permitted recourse to evidence of prior negotiations in order to find the sense in which the parties used the disputed word.¹⁸² This reasoning, arguably, inverts the exception articulated in *Codelfa*. The conventional meaning of the disputed word is imbued with the subject

¹⁷⁷ *Excelsior Group Productions Ltd v Yorkshire Television Ltd* [2009] EWHC 1751 [25] (Flaux J); *Righi v Kissane Family Pty Ltd* [2015] NSWCA 238 [48] (Emmett JA, Ward and Gleeson JJA agreeing). See generally, Ryan Catterwell, ‘The “Indirect” Use of Evidence of Prior Negotiations in Contract Construction: Part of the Surrounding Circumstances’ (2012) 29 *Journal of Contract Law* 183.

¹⁷⁸ [2015] WASC 66.

¹⁷⁹ [2015] WASC 66 [18].

¹⁸⁰ *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* [2004] NSWSC 149 [182] (Einstein J); *Optus Vision Pty Ltd v Australian Rugby Football League Ltd* [2003] NSWSC 288 [11]; *GR Securities Pty Ltd v Baulkham Hills Private Hospital Ltd* (1986) 40 NSWLR 631, 636.

¹⁸¹ (1994) 35 NSWLR 227.

¹⁸² *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 237 (Kirby P).

matter of the prior negotiations, as opposed to the subject matter of the contract being informed by the prior negotiations.

The receipt of mutually known facts pursuant to this exception, and the purported enlargement of the exception in the above examples, is arguably consistent with the subjective theory of contract and purpose of interpretation being to give effect to the mutual actual intention of the parties. The proper interpretation is not that which is presumed by a detached observer, nor is it tempered by community values such as resultant unfairness to third parties, as directed by the objective theory.

(c) *The parties' common refusal*

The exception to the inadmissibility of evidence of prior negotiations where the parties are united in refusing to include a provision has been criticised by Lord Nicholls as a qualification to the rule that 'lets the cat out of the bag' and 'destroys the rationale for an absolute rule.'¹⁸³ In particular, I submit that it undermines the fundamental principle of objectivity in interpretation by enabling the content of the parties' legal rights and obligations under the contract to be determined by the parties' *actual* agreement to refuse to include a provision.

This intervention by the subjective theory generates further difficult distinctions. As McLauchlan posits: Where is the line to be drawn if there is evidence that the parties accepted a particular meaning? Is it admissible because such proof presupposes that the parties have rejected a different meaning?¹⁸⁴

(d) *The parties' private dictionary*

It is unsettled whether the scope of admissible material under this exception is limited to particular types of meaning that the parties may permissibly agree the contractual language should bear. The broad view, consistent with the subjective theory, is that this exception permits consideration of evidence of

¹⁸³ Lord Nicholls of Birkenhead, 'My Kingdom for a Horse: The Meaning of Words' (2005) 121 *Law Quarterly Review* 577, 584.

¹⁸⁴ DW McLauchlan, 'Common Assumptions and Contract Interpretation' (1997) 113 *Law Quarterly Review* 237, 242.

prior negotiations to establish that the parties intended that ambiguous language have a particular meaning (without apparent limitation).¹⁸⁵

Narrow views also operate. One is that the exception only permits the consideration of evidence where the parties used words in an unconventional sense and claim that the contract should bear a similar unconventional meaning.¹⁸⁶ Conversely, another view is that the exception does not support an agreement reached by the parties in the course of negotiations that contractual language should bear a special meaning which the word or phrase is not capable of bearing.¹⁸⁷ Both narrow views are more consistent with the objective theory and limited extent to which parties' intentions can govern the ascription of contractual obligations to themselves.

3 *The external influence of other contractual claims and principles of interpretation*

(a) *Slight distinctions between interpretation and other contractual claims*

Evidence of prior negotiations is admissible for rectification, estoppel, vitiating factor and formation purposes.¹⁸⁸ However, as Tipping J observed in *Gibbons Holdings*, there is 'some conceptual difficulty in adopting different evidential rules for those purposes on the one hand as against interpretation purposes on the other.'¹⁸⁹ In particular, the distinction between the various contractual claims can be slight. For example, the extent to which courts can permissibly correct errors or resolve inconsistencies in the contract by interpretation

¹⁸⁵ *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290, 309 (Santow J); *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* [2004] NSWSC 149 [182] (Einstein J); *Optus Vision Pty Ltd v Australian Rugby Football League Ltd* [2003] NSWSC 288 [71].

¹⁸⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [47] (Lord Hoffmann, Lord Walker expressly agreeing at [97].) The status of this limitation in Australia is unclear. Following *Chartbrook*, one appellate court noted the limitation espoused by Lord Hoffmann (*Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [103] (Warren CJ, Harper JA and Robson AJA)), while another case applied the exception without the limitation (*Queensland Power Co Ltd v Downer Edi Mining Pty Ltd* [71] (Chesterman J)). Further, the judgment of Kirby P in *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 236.

¹⁸⁷ *Trawl Industries v Effem Foods Pty Ltd* (1992) 27 NSWLR 326 (Clarke JA).

¹⁸⁸ See §II.A.2(b).

¹⁸⁹ *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [51] (Tipping J).

without trespassing upon the role of the equitable remedy of rectification is unclear.¹⁹⁰

This problem is compounded by the common practice of pleading another contractual claim such as rectification in the alternative to ensure that relevant evidence of prior negotiations is before the court.¹⁹¹ If evidence of prior negotiations is tendered in support of an alternative claim, the court must take care not to be influenced by that evidence in construing the contract unless it is admissible for that purpose (eg pursuant to an exception to the rule).¹⁹² Although, it is argued that, in practice, the judge will read and potentially be influenced by the evidence of prior negotiations tendered in support of an alternative claim, even if the alternative claim is not successful.¹⁹³ In fact, in *Chartbrook*, Baroness Hale conceded that it would not have been ‘quite so easy’ to reach the same conclusion as the majority on the proper construction of the contract if the House of Lords had not been ‘made aware’ of the relevant prior negotiations (which the majority ruled inadmissible).¹⁹⁴

*Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd*¹⁹⁵ provides another example of the difficulty in disentangling the permissible use of evidence of prior negotiations. In this case, there was a dispute as to: (1) the

¹⁹⁰ See for example *W & K Holdings (NSW) Pty Ltd v Laureen M* [49]. See further Andrew Burrows, ‘Construction and Rectification’ in A Burrows and E Peel (eds), *Contract Terms* (2007) 77; Gerard McMeel, ‘The Principles and Policies of Contractual Construction’ in A Burrows and E Peel (eds), *Contract Terms* (2007) 27, 35.

¹⁹¹ Bayley’s empirical study involved a questionnaire issued to barristers and solicitors in the United Kingdom and New Zealand, including both practitioners that specialise in litigious work and others classified by Bayley as ‘non-litigators’. Bayley found that 88% of litigators would plead another contractual claim in the alternative ‘to ensure that evidence of prior negotiations is admitted if it could influence a judge in interpreting a contract.’: J Edward Bayley, ‘Prior Negotiations and Subsequent Conduct in Contract Interpretation: Principles and Practical Concerns’ (2011) 28 *Journal of Contract Law* 179, 186. See also *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [35] (Lord Hoffmann); Lord Nicholls of Birkenhead, ‘My Kingdom for a Horse: The Meaning of Words’ (2005) 121 *Law Quarterly Review* 577, 578; Kirby P (as he then was) acknowledged this ‘legitimate forensic technique’ in *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 233 (Kirby P); *Arrale v Constain Civil Engineering Ltd* [1976] 1 Lloyd’s Rep 98, 101 (Lord Denning MR); V K Rajah, ‘Redrawing the Boundaries of Contractual Interpretation: From Text to Context to Pre-text and Beyond’ (2010) 22 *Singapore Academy of Law Journal* 513 [42].

¹⁹² *Bahr v Nicolay (No 2)* (1988) 164 CLR 604, 617-618; *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 233 (Kirby P).

¹⁹³ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [35]; Lord Nicholls of Birkenhead, ‘My Kingdom for a Horse: The Meaning of Words’ (2005) 121 *Law Quarterly Review* 577, 585.

¹⁹⁴ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [99]. See also Paul S Davies, ‘Finding the Limits of Contractual Interpretation’ (2009) 61(4) *Lloyd’s Maritime and Commercial Law Quarterly* 420, 425.

¹⁹⁵ (2009) 261 ALR 501.

proper interpretation of the contract; (2) whether the contract was partly oral; and (3) whether there was misleading and deceptive conduct in the course of negotiations. Justice Finn said that evidence of the parties' prior negotiations admitted for the purpose of the second and third claims 'can result in the court obtaining an informed appreciation not only of the object and intent of the contract itself but also individual clauses of it.'¹⁹⁶ His Honour then said that where it is found that the contract is wholly written, to require the rule to be applied in the determination of the interpretation questions despite that informed appreciation 'does sit rather oddly with the concept of party autonomy.'¹⁹⁷ However, with respect, Justice Finn's approach sits rather oddly with the requisite distinctions between the purpose for which evidence of prior negotiations is used and the objective theory.

While it is relatively simple to distinguish between these contractual claims – and, therefore, the circumstances in which evidence of prior negotiations is admissible – in the abstract, the boundaries between each are less clear in practice. Adherence to the objective theory necessitates that judges assert a dichotomy of mind and disregard relevant evidence, which, as the above cases illustrate, is not always practicable.

(b) The operation of other principles of contract interpretation

Three other principles of contract interpretation can also influence the admissibility of evidence of prior negotiations. I argue that the divergent authority on the precise content and operation of each principle is also explicable by reference to the subjective and objective theories.

First, the perspective of the reasonable person, which frames the interpretive inquiry. Consistent with the objective theory, the reasonable person is informed by the 'language used by the parties in the contract, the circumstances addressed by the contract and the commercial purpose or objects to be secured by the contract' ascertainable by reference to the contract alone.¹⁹⁸

¹⁹⁶ *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [121] (Finn J).

¹⁹⁷ *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [121] (Finn J).

¹⁹⁸ *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [47]-[48] (French CJ, Nettle and Gordon JJ), citing (at fn 22) *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640, 656-657 [35]. Although, I note that the approach of French CJ, Nettle and Gordon JJ in *Mount Bruce Mining* differs from the passage cited in *EGC v Woodside* as the latter

The contracting parties are depersonalised.¹⁹⁹ Conversely, consistent with the subjective theory, the reasonable person is assumed to stand in the position of the parties,²⁰⁰ and is informed by *all* the background information that would have been reasonably available to the parties at the time of entering into the contract.²⁰¹

Secondly, the plain meaning rule, which restricts the admissibility of surrounding circumstances evidence to contradict the ‘plain meaning’ of contractual language.²⁰² Under the conception of the plain meaning rule consistent with the objective theory, it is not permissible to consider surrounding circumstances evidence in the determination of whether the text has a ‘plain meaning’, nor if the text is subsequently found to have a plain meaning. Consequently, irrespective of the rule, evidence of prior negotiations classified as part of the surrounding circumstances is inadmissible, unless the disputed language is determined to be susceptible of more than one meaning on the basis of the text and internal context of the contract alone.²⁰³ Conversely, under the formulation consistent with the subjective theory, it is permissible to consider evidence of prior negotiations that constitutes part of the surrounding circumstances both in determining whether the disputed language has a plain meaning and subsequently if the language is susceptible of more than one meaning. If the language is determined to have a plain meaning, evidence of prior negotiations that forms part of the surrounding circumstances is not used to establish the proper interpretation.

Thirdly, the ambiguity requirement, which restricts the admissibility of surrounding circumstances evidence if a threshold level of ‘ambiguity’ is not

does not (at least explicitly) state that a finding of ambiguity or susceptibility of more than one meaning is a prerequisite to consideration of the surrounding circumstances.

¹⁹⁹ *Wilson v Anderson* (2002) 213 CLR 401, 418 [8] (Gleeson CJ).

²⁰⁰ See for example *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451, 462; *Toll (FGCT) Pty Ltd v BNP Paribas* (2004) 219 CLR 165 [40]. See generally JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 128 [4-22.]

²⁰¹ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912, cited with approval in *Magbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181 [11] (Gleeson CJ, Gummow and Hayne JJ); *Byrnes v Kendle* (2011) 243 CLR 253 [98] (Heydon and Crennan JJ); *Mount Bruce Mining v Wright Prospecting Pty Ltd* (2015) 325 ALR 188 [120] (Bell and Gageler JJ).

²⁰² *Rosenhain v Commonwealth Bank of Australia* (1922) 31 CLR 46, 53; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 347 (Mason J).

²⁰³ See for example *Duoedge Pty Ltd v Simon Leong* [2013] VSC 36, in which evidence of the prior negotiations and other pre-contractual arrangements were not considered as an aid to construction as the language of the contract was found to have a plain meaning (at [22]-[23]).

identifiable in the disputed language.²⁰⁴ Like the plain meaning rule, the conception of the ambiguity requirement consistent with the objective theory proscribes consideration of relevant evidence of prior negotiations that form part of the surrounding circumstances, unless ambiguity is apparent by reference to the contract alone.²⁰⁵ Accordingly, relevant evidence of prior negotiations is only admissible if the contract is ambiguous.²⁰⁶ Conversely, consistent with the subjective theory, evidence of prior negotiations is admissible to (indirectly) establish ambiguity as part of the surrounding circumstances.²⁰⁷ If determined ambiguous, prior negotiations that form part of the surrounding circumstances are then unconditionally admissible and used to inform the reasonable person in determining the proper interpretation of the disputed language. If unambiguous, the surrounding circumstances evidence, including prior negotiations, is not subsequently used in the interpretation process.²⁰⁸

These issues flowing from the unclear formulation of the rule and exceptions are closely related to the unpredictable application of the rule. Where the boundaries of the rule and exceptions are unclear such that the content and function of the rule and exceptions vary, it can, in turn, manifest as uncertainty in the application of the rule. The reverse is also true: the continued unpredictable application of the rule, and approach to the admissibility and use of evidence of prior negotiations more broadly, can cloud the precise formulation of the rule. This interrelationship in mind, the examination of the application of the rule which follows focuses upon variant judicial application of the rule.

²⁰⁴ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 (Mason J). As to the meaning of 'ambiguity', see the conception established in cases such as *Hancock Prospecting Pty Ltd v Wright Prospecting Pty Ltd* [2012] WASCA 216 [77] (McLure P); *Cape Lambert Resources Ltd v MCC Australia Sanjin Mining Pty Ltd* [2013] WASCA 66 [108].

²⁰⁵ See for example *Brambles Holdings Ltd v Bathurst City Council* (2001) 53 NSWLR 153, 163 [24], citing *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 347-352 (Mason J).

²⁰⁶ See for example *Thundellara Ltd v Richmond (No 2)* [2013] WASC 392 [130] (Edelman J).

²⁰⁷ See for example *Velvet Glove Holdings Pty Ltd v Mount Isa Mines Ltd* [2011] QCA 312 [36(d)(i)], [103] (Philippides J, Fraser and White JJA agreeing).

²⁰⁸ See for example *Velvet Glove Holdings Pty Ltd v Mount Isa Mines Ltd* [2011] QCA 312 [103] (Philippides J, Fraser and White JJA agreeing).

B *Unpredictable judicial application*

In this section, I argue that judicial application of the rule is unpredictable. Moreover, I argue that this is primarily a function of judicial choice, capable of being framed by adherence to one theory of contract over another. As the Irish Law Reform Commission pertinently observed: ‘Judges have differed in their views as to how far one can go, in pursuit of purpose, beyond the literal meaning of a provision.’²⁰⁹

1 *Circumvention of the rule*

At a procedural level, the ‘usual practice’²¹⁰ of trial judges in Australia is to provisionally admit evidence of prior negotiations and later rule on its admissibility.²¹¹ That is, while the plain meaning rule and ambiguity requirement may ultimately influence the admissibility and use of evidence of prior negotiations as examined, trial judges initially receive the evidence subject to any such ensuing finding.

This practice arguably has a similar impact to pleading other contractual claims in the alternative: it brings potentially relevant evidence of prior negotiations before the court. For example, in *Red Hill Iron Ltd v API Management Pty Ltd*²¹² Beech J provisionally received evidence of prior negotiations, but upheld the objections to the evidence citing the classic exposition of the rule in *Codelfa*.²¹³ However, Beech J then considered the question of interpretation in light of the provisionally received evidence ‘[f]or the sake of completeness, in case [his Honour] was wrong in... ruling on these

²⁰⁹ Albeit in the (effectively equivalent) context of statutory interpretation. *Report on Statutory Drafting and Interpretation* (2000) [2.34]. In extra-judicial writing on the interpretation of statutes and contracts, Mason J (as he then was) referred to this finding as ‘probably an Irish understatement.’: Mason, *Towards a Grand Theory of Interpretation* p 102, fn 46.

²¹⁰ See for example *Thundellara Ltd v Richmond (No 2)* [2013] WASC 392 [127] (Edelman J).

²¹¹ Trial judges justify this practice on the basis that it can be difficult to confidently reject the receipt of extrinsic evidence without hearing the disputation arising from it. Further, by provisionally admitting such evidence, any error in the primary decision is remediable by an appellate court without the need for a retrial: *McCourt v Cranston* [2012] WASC 60 [25]-[26] (Pullin JA). While Edelman J referred to ‘the usual practice in this jurisdiction’ in *Thundelarra* [127], it is also the practice in other Australian jurisdictions. See for example *MCA International BV v Northern Star Holdings Ltd (Recs and Mgrs apptd)* (1991) 4 ACSR 719, 723 (Rogers CJ); *Ray Brooks Pty Ltd v NSW Grains Board* [2002] NSWSC 1049 [67].

²¹² [2012] WASC 323.

²¹³ *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [123], [150]-[164].

objections’, and concluded that the evidence ‘makes no difference’.²¹⁴ In my submission, in practice, provisionally admitting evidence of prior negotiations brings the evidence within the ambit of material considered by the judge, and has the potential to influence the proper construction conclusion.

Lord Nicholls extra-judicially observed that, where evidence of prior negotiations relevant to ascertaining the common mutual intention of the parties as to the meaning of disputed contractual language is adduced, English courts ‘have been ready to adopt the irresistibly sensible approach’,²¹⁵ being consideration of the evidence as an interpretive aid. This observation is similarly applicable to the approach of Australian courts.

*Convenience Stores Pty Ltd v Wayville Plaza Retirement Pty Ltd*²¹⁶ provides an example. In this case, there was evidence of prior negotiations comprised of three letters between representatives for the parties which evinced the plaintiff’s insistence upon the inclusion of certain restrictive covenants in the contract. Justice White provisionally admitted the evidence, but determined that it evidence was inadmissible as part of the surrounding circumstances because it reflected the subjective intentions of the plaintiff.²¹⁷ Accordingly, His Honour expressly stated that the correspondence was to be disregarded.²¹⁸ Extraordinarily, however, within the same paragraph White J noted ‘that the [c]ontract itself contains provisions from which it may be discerned that [the plaintiff] regarded the restrictive covenants as fundamental and that [the defendant] was aware of that attitude.’²¹⁹ With respect, this conclusion as to the proper construction of the contract appears convenient indeed in light of the evidence of prior negotiations before the court and absence of alternate reasoning.

Another example of the significant influence of evidence of prior negotiations in resolving questions of interpretation beyond that contemplated

²¹⁴ *Red Hill Iron Ltd v API Management Ltd* [2012] WASC 323 [165].

²¹⁵ Lord Nicholls of Birkenhead, ‘My Kingdom for a Horse: The Meaning of Words’ (2005) 121 *Law Quarterly Review* 577, 584. See also Hugh Collins, ‘Objectivity and Committed Contextualism in Interpretation’ in Sarah Worthington (ed), *Commercial Law and Commercial Practice* (Hart Publishing, 2003) 189, 197.

²¹⁶ [2012] SASC 14.

²¹⁷ *C Convenience Stores Pty Ltd v Wayville Plaza Retirement Pty Ltd* [2012] SASC 14 [172], citing (at [174]) *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 (Mason J).

²¹⁸ *C Convenience Stores Pty Ltd v Wayville Plaza Retirement Pty Ltd* [2012] SASC 14 [176].

²¹⁹ *C Convenience Stores Pty Ltd v Wayville Plaza Retirement Pty Ltd* [2012] SASC 14 [176].

by the rule is provided by *Wentworth Shire Council v Bemax Resources Limited*.²²⁰ The meaning of “adjustments” was in issue. In the course of pre-contractual negotiations, a representative of the defendant sent an email to a representative of the plaintiff, which referred to a particular method of adjustment. Justice Rein reasoned that the email was relevant ‘because it makes clear what “adjustments” the parties had in mind’, and, perceived in this sense, ‘it is a piece of correspondence between the parties which explains what adjustments were contemplated by the clause in the [contract] and hence is material to which regard can be had’.²²¹ That is, the correspondence clearly indicated what the parties had *intended* to agree, and, consequently, it could be used to explain the meaning of the term now embodied in the contract and the subject of dispute. No exception to the rule or other authority is cited in support of this direct use of the evidence of prior negotiations to explain the meaning of the disputed language.

Finally, in *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd*,²²² the Court of Appeal of Victoria unanimously decided that, while the trial judge referred to evidence of prior negotiations properly characterised as inadmissible evidence of the parties’ subjective intentions, ‘he can hardly be criticised for doing so as the parties conducted their case by including such evidence in their affidavits without objection and by placing reliance on that evidence.’²²³ It was also said that, irrespective of the fact that the trial judge impermissibly referred to inadmissible evidence, ‘the judge’s conclusions are amply supported by the admissible evidence.’²²⁴

Each of the above cases illustrates the opaque and altogether difficult reasoning used to circumvent the rule and consider relevant evidence of prior negotiations. Moreover, they exemplify judicial adherence to the subjective theory over the objective theory, as the court seeks to give effect to the parties’ mutual *actual* intent.

²²⁰ [2013] NSWSC 1047.

²²¹ *Wentworth Shire Council v Bemax Resources Limited* [2013] NSWSC 1047 [55] (Rein J).

²²² [2015] VSCA 286.

²²³ *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd* [2015] VSCA 286 [107]-[108].

²²⁴ *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd* [2015] VSCA 286 [108].

2 *Rigid application of the rule*

Quite contrarily to circumvention of the rule, there are also instances in recent contract interpretation cases of rigid application of the rule and correspondingly narrow conceptualisation of the exceptions.

*Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd*²²⁵ is an instructive example. In the course of prior negotiations, the manager represented to the developer that it would employ a director of nursing and provide respite care accommodation. This was evinced by a commercial proposal, council submissions, architectural plans, and the testimony of several officers of the developer. The trial judge considered the evidence of prior negotiations as part of the surrounding circumstances,²²⁶ and found that the duties of the manager in the contract included, and were understood by the parties to include, those obligations.²²⁷ However, in a unanimous decision of the Court of Appeal of Victoria, the developer's contention that the evidence of prior negotiations was part of the objective surrounding circumstances was rejected.²²⁸ This was primarily because the evidence fell within the rule and could not be used as an interpretive aid.²²⁹ The Court concluded that the *text* of the contract when read together with other relevant contracts as a whole did not oblige the manager to provide the services.²³⁰ Further, the developer's estoppel by convention claim was unsuccessful,²³¹ and no claim for rectification was raised.

Chartbrook provides a further example.²³² The primary judge found that the ordinary meaning of the disputed language pointed towards the

²²⁵ (2012) 37 VR 486.

²²⁶ *3143 Victoria St Doncaster Pty Ltd v Retirement Services Australia (RSA) Pty Ltd* [2010] VSC 317 [7]-[12] (Pagone J).

²²⁷ *3143 Victoria St Doncaster Pty Ltd v Retirement Services Australia (RSA) Pty Ltd* [2010] VSC 317 [13] (Pagone J).

²²⁸ *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [114]-[115] (Warren CJ, Harper JA and Robson AJA).

²²⁹ *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [115] (Warren CJ, Harper JA and Robson AJA).

²³⁰ *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [123] (Warren CJ, Harper JA and Robson AJA).

²³¹ *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [135]-[139] (Warren CJ, Harper JA and Robson AJA).

²³² Although an English case, it is arguably reflective of the rigid application of the rule in Australia, particularly because the most recent High Court discussion of the rule in *Byrnes v Kendle* (2011) 243 CLR 253 [98] n 133 (Heydon and Crennan JJ) is centred on this authority.

construction contended by Chartbrook.²³³ The majority in the Court of Appeal dismissed the appeal, as there was ‘nothing unclear, uncertain or ambiguous’ about the disputed language.²³⁴ Lord Collins, dissenting on the proper construction of the contract, said that the evidence of prior negotiations before the Court ‘points very strongly in favour of [Persimmon’s contention as to the proper] construction, and if there were no limitations on its admissibility it would not fall short of being determinative on the construction issue.’²³⁵ On appeal, the House of Lords found in favour of Persimmon. Lord Hoffmann, delivering the leading judgment, reasoned that the proper construction of the contract was ascertainable by reference to the text, context and purpose of the contract.²³⁶ His Lordship maintained that it was impermissible for the evidence of prior negotiations to be used in aid of construction.²³⁷

The inflexible application of the rule in both cases is arguably grounded in the objective theory of contract and attendant ascription of contractual obligations by the law.²³⁸

C *Uncertain foundation*

1 *The parol evidence rule*

The parol evidence rule is, or at least was, conceptually and historically distinct. In particular, the scope of application, exceptions and justification of the rule and parol evidence rule differ. The parol evidence rule excludes extrinsic evidence (*including* evidence of prior negotiations) that ‘adds to, varies or contradicts’ the written terms of a contract.²³⁹ Interpretation is the logically antecedent process of determining the terms of the contract, which cannot then

²³³ *Chartbrook Limited v Persimmon Homes Limited* [2007] 1 All ER (Comm) 1083 (Briggs J).

²³⁴ *Chartbrook Limited v Persimmon Homes Limited* [2008] EWCA Civ 183 (Rimer LJ, Tuckey LJ agreeing).

²³⁵ Similarly, as mentioned above, on appeal in the House of Lords Baroness Hale said (at [99]) that it would it would not have been ‘quite so easy’ to reach the same conclusion as the majority on the proper construction of the contract if the House of Lords had not been ‘made aware’ of the relevant prior negotiations (which the majority ruled inadmissible): *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [99].

²³⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [6]-[25] (Lord Hoffmann).

²³⁷ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [28], [42] (Lord Hoffmann).

²³⁸ PS Atiyah, *Rise and Fall of Contract* (Clarendon Press, Oxford, 1979) 734; Hugh Collins, *The Law of Contract* (Butterworths, 3rd ed, 1997) 206-207.

²³⁹ Cf JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 254-5 [8.16]. See also Sir Kim Lewison and David Hughes, *The Interpretation of Contracts in Australia* (Thomson Reuters, 2012) [3.10].

be varied or contradicted.²⁴⁰ Accordingly, the rule applies to exclude evidence of prior negotiations in the former process of interpretation, and the parol evidence rule operates to exclude extrinsic evidence in the latter process. Further, as opposed to the exceptions to the rule, latent ambiguity in the contract text operates as an exception to the parol evidence rule.²⁴¹ In addition, while evidence of prior negotiations was historically excluded by the parol evidence rule for the purpose of adding to, subtracting from or varying the contract, the modern exclusion of evidence of prior negotiations from the process of interpretation pursuant to the rule is only traceable to *Prenn v Simmonds*.²⁴²

However, the distinction between the rule and the parol evidence rule is less clear in Australia.²⁴³ This lack of clarity is arguably rooted in *Codelfa*. Justice Mason observed that the parol evidence rule did *not* traditionally deny resort to extrinsic evidence for the purpose of interpretation.²⁴⁴ But then his Honour said that the parol evidence rule ‘has often been regarded as prohibiting the use of extrinsic evidence for [the purpose of interpretation]’,²⁴⁵ and concluded that ‘the object of the *parol evidence* rule’ was to exclude evidence of prior negotiations inadmissible in aid of construction.²⁴⁶ Accordingly, there is arguably authority for the subsequent conflation of the rule and parol evidence rule in Australian cases.²⁴⁷ Despite this, by reason of

²⁴⁰ A Corbin, *Corbin on Contracts* (West Publishing Co, 1st rev ed, vol 3, 1960) 543, 579; *Yoshimoto v Canterbury Gold International Ltd* [2001] 1 NZLR 523 [73] (Thomas J) citing D W McLauchlan, ‘The Plain Meaning Rule of Contract Interpretation’ (1996) 2 *New Zealand Business Law Quarterly* 80, 87.

²⁴¹ *Goldus Pty Ltd v Australian Mining Pty Ltd* [2015] SASC 32 [39] (Parker J); *Canberra Hire Pty Ltd v Koppers Wood Products Pty Ltd* [2013] ACTSC 162 [203] (Refshauge J). See also Ryan Catterwell, ‘The “Indirect” Use of Evidence of Prior Negotiations in Contract Construction: Part of the Surrounding Circumstances’ (2012) 29 *Journal of Contract Law* 183, 184.

²⁴² Yihan Goh, ‘A Wrong Turn in History: Re-examining the Exclusionary Rule Against Prior Negotiations in Contract Interpretation’ (2014) *Journal of Business Law* 360, 360-364; V K Rajah, ‘Redrawing the Boundaries of Contractual Interpretation: From Text to Context to Pre-text and Beyond’ (2010) 22 *Singapore Academy of Law Journal* 513 [19].

²⁴³ JW Carter, *Construction of Commercial Contracts* (Hart Publishing, 2013) 260 [8-22].

²⁴⁴ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 347 (Mason J).

²⁴⁵ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 347 (Mason J).

²⁴⁶ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 (Mason J).

²⁴⁷ See for example *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [89], [113], [115] (Warren CJ, Harper JA and Robson AJA); *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* (2009) 261 ALR 501 [118] (Finn J); *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 242-246 (Mahoney

the fundamentally different scope of application, I maintain that the ‘the rule’ is properly regarded as distinct from the parol evidence rule.

Alternately, Carter questions: ‘If the parol evidence rule does not restrict the use of context in construction, what rule does?’²⁴⁸ As identified by Yihan and other scholars, practical and policy grounds justify the independent ‘rule’.²⁴⁹

2 *Principle and policy considerations*

There are five arguments of principle and practical policy commonly advanced singly or cumulatively in support of the rule in both cases and commentary.²⁵⁰ As will be seen in the overview of each argument that follows, the essence of the justification for the rule is concern over the consequences of *not* maintaining the rule, and, hence, using evidence of prior negotiations as an interpretive aid.

(a) *The objective approach*

Maintaining the rule is said to uphold the objective approach to the interpretation of contracts.²⁵¹ It is reasoned that evidence of prior negotiations is often ‘drenched in subjectivity’²⁵² and adduced purely to show what the words were intended to mean.²⁵³

JA); *Righi v Kissane Family Pty Ltd* [2015] NSWCA 238 [46] (Emmett JA, Ward and Gleeson JJA agreeing). See also JW Carter, *The Construction of Commercial Contracts* (Hart Publishing, 2013) [8-23]; Carter, Peden and Tolhurst, *Contract Law in Australia* (LexisNexis, 5th ed, 2007) [12-09].

²⁴⁸ JW Carter, ‘Context and Literalism in Construction’ (2014) 31 *Journal of Contract Law* 100.

²⁴⁹ Yihan Goh, ‘A Wrong Turn in History: Re-examining the Exclusionary Rule Against Prior Negotiations in Contract Interpretation’ (2014) *Journal of Business Law* 360; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [34] (Lord Hoffmann).

²⁵⁰ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 [99] (‘practical utility’ of the rule). See also JW Carter, ‘Context and Literalism in Construction’ (2014) 31 *Journal of Contract Law* 100, 119. In particular, this thesis adopts the distinction between principle and policy contended by Catherine Mitchell in ‘Contract Interpretation: Pragmatism, Principle and the Prior Negotiations Rule’ (2010) 26 *Journal of Contract Law* 134, 140-142.

²⁵¹ Lord Nicholls of Birkenhead, ‘My Kingdom for a Horse: The Meaning of Words’ (2005) 121 *Law Quarterly Review* 577, 588.

²⁵² *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [38] (Lord Hoffmann), cited with approval *Phoenix Commercial Enterprises Pty Ltd v City of Canada Bay Council* [2010] NSWCA 64 [30].

²⁵³ *Byrnes v Kendle* (2011) 243 CLR 253 (Heydon and Crennan JJ) [99]; Lord Bingham of Cornhill, ‘A New Thing Under the Sun? The Interpretation of Contract and the ICS Decision’ (2008) 12 *Edinburgh Law Review* 374, 389.

But this argument conflates the objective task of giving effect to the mutual actual intention of the parties and the illegitimate exercise of searching for and seeking to give effect to the subjective intention of the parties.²⁵⁴ As Lord Hoffmann and numerous other jurists and commentators have conceded: consideration of evidence of prior negotiations in the process of interpretation is not inconsistent with the objective approach.²⁵⁵

(b) *Unhelpfulness*

In *Prenn v Simmonds*, Lord Wilberforce justified the exclusion of prior negotiations on the basis that ‘such evidence is unhelpful.’²⁵⁶ This flows from the primacy of the final contract under the objective theory,²⁵⁷ and the lack of utility or difficulty in appealing to the inherently fluid process of negotiation, in which the parties’ positions are commonly changing and divergent.²⁵⁸ However, the completeness of this reasoning is difficult in light of the use of evidence of prior negotiations as part of the surrounding circumstances²⁵⁹ and the acceptance in civil law systems that the intentions of the parties as evinced in the course of negotiations may be relevant in deciding the proper interpretation of the contract.²⁶⁰ It is not suggested that all evidence of prior negotiations is helpful in the interpretive exercise, but, to the extent that it is not, there is ‘no need for a special rule to exclude irrelevant evidence.’²⁶¹

²⁵⁴ *Wholesale Distributors v Gibbons Holdings Ltd* [2008] 1 NZLR 277 [114] (Thomas J).

²⁵⁵ Lord Nicholls of Birkenhead, ‘My Kingdom for a Horse: The Meaning of Words’ (2005) 121 *Law Quarterly Review* 577, 583; A Burrows, ‘Construction and Rectification’ in A Burrows & E Peel (eds), *Contract Terms* (2007) 77, 82–3.

²⁵⁶ *Prenn v Simmonds* [1971] 1 WLR 1381, 1384 (Lord Wilberforce), cited with approval in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 [99] (fn 86); *Canberra Hire Pty Ltd v Koppers Wood Products Pty Ltd* [2013] ACTSC 162 [200] (Refshauge J).

²⁵⁷ Sir Johan Steyn, ‘To What Extent May Evidence Control Language?’ (1988) 41(1) *Current Legal Problems* 23, 28–9

²⁵⁸ *Prenn v Simmonds* [1971] 1 WLR 1381, 1384; *Britoil plc v Hunt Overseas* [1994] CLC 561, 573 (Hobhouse LJ); *Terravision Pty Ltd v Black Box Control Pty Ltd [No 2]* [2015] WASC 66 [37] (Le Miere J); Richard Calnan, *Principles of Contractual Interpretation* (Oxford University Press, 2013) 18.

²⁵⁹ For example, in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 (at [33]), Lord Hoffmann said that evidence of prior negotiations is, prima facie, ‘potentially relevant background.’

²⁶⁰ See generally Catherine Valcke, ‘On Comparing French and English Contract Law – Insights from Social Contract Theory’ (16 January 2009) Social Science Research Network <<http://ssrn.com/abstract=1328923>>.

²⁶¹ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [32].

(c) *Certainty*

Consistent with the objective theory, the exclusion of prior negotiations is also said to promote certainty and predictability in the enforcement of contractual promises.²⁶² The argument is that excluding evidence of prior negotiations prevents or limits disputes in relation to what the parties had intended to achieve by the contract by limiting the scope of background from which inferences can be drawn to displace the conventional meaning of the contract.²⁶³ Moreover, it follows from the conviction that ‘it is appropriate and just for the parties to be bound to the natural and ordinary meaning of the agreement to which they have signified their assent.’²⁶⁴

(d) *Time and cost considerations*

The rule is also justified on the basis that it lessens the time and cost expended in negotiating the contract, receiving legal advice on contract interpretation issues, and the litigation of disputes.²⁶⁵ In relation to the negotiation process, to admit prior negotiations may encourage parties to make self-serving statements or establish a paper trail in the hope that it would influence the construction which the courts will give to the contract.²⁶⁶ It is also said that to admit ‘voluminous’ evidence of prior negotiations would increase the time and cost of providing legal advice and adjudicating disputes, as the interpretive agent is required to construe the additional material and the scope of factual and legal debate is enlarged.²⁶⁷ The broader public interest in the efficient utilisation of court resources is also cited.²⁶⁸

²⁶² *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [37]; Hon JJ Spigelman, ‘From Text to Context: Contemporary Contractual Interpretation’ (2007) 81 *Australian Law Journal* 303, 323.

²⁶³ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 [98]-[99]; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [37] (Lord Hoffmann); *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227, 243 (Mahoney JA).

²⁶⁴ *Cruise Oz Pty Ltd v AAI Ltd* [2015] QSC 215 [24] (Carmody J).

²⁶⁵ Sir Anthony Mason, ‘Themes and Tensions Underlying the Law of Contract’ in Geoffrey Lindell (ed) *The Mason Papers: Selected Articles and Speeches by Sir Anthony Mason* (The Federation Press, 2007) 296, 301.

²⁶⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [38]; O Ben-Shahar, ‘The Tentative Case Against Flexibility in Commercial Law’ (1999) 66 *University of Chicago Law Review* 781, 783; A W Katz, ‘The Economics of Form and Substance in Contract Interpretation’ (2004) 104 *Columbia Law Review* 496, 517.

²⁶⁷ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [35], [41]; Kirby; *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 [99]; C Staughton, ‘How Do the Courts Interpret Commercial Contracts?’ (1999) 58 *Cambridge Law Journal* 303, 307; Lord

This argument overlooks the usual practice of provisionally admitting evidence of prior negotiations and the reality that evidence of prior negotiations is admissible pursuant to other contractual claims, which are frequently pleaded in the alternative to bring the evidence before the court irrespective of the rule.²⁶⁹

(e) *Third parties*

Finally, the rule is also justified on the basis that consideration of evidence of prior negotiations would be unfair to a third party, such as an assignee of the contract or secured creditor, who must understand and abide by the written contract without cognisance of what transpired in the negotiation process.²⁷⁰

As against this, there is recent judicial recognition of the minimal risk that third parties will be adversely impacted, particularly in light of the contextual approach to interpretation that permissibly operates.²⁷¹ Furthermore, it is questioned '[w]hy 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'.²⁷²

D *Summary*

In this Part I established that the boundaries of the rule and exceptions are unclear, and the judicial application of the rule is unpredictable. I argued that the lack of clarity is influenced by unstated adherence to one theory of contract over another in contemporary contract interpretation. That is, judges can be seen as 'acting out of fidelity to what they perceive as their role and the requirements of contract law'.²⁷³

Bingham of Cornhill, 'A New Thing Under the Sun? The Interpretation of Contract and the ICS Decision' (2008) 12 *Edinburgh Law Review* 374, 389-390; Alan Berg, 'Thrashing Through the Undergrowth' (2006) 122 *Law Quarterly Review* 354, 360.

²⁶⁸ *Cruise Oz Pty Ltd v AAI Ltd* [2015] QSC 215 [24] (Carmody J).

²⁶⁹ See above §IV.A.3(a).

²⁷⁰ *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 (Giles JA); *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* (2012) 37 VR 486 [105].

²⁷¹ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 [40]; D W McLauchlan, 'Contract Interpretation: What Is It About?' (2009) 31 *Sydney Law Review* 5.

²⁷² *Yoshimoto v Canterbury Gold International Ltd* [2001] 1 NZLR 523 [81] (Thomas J).

²⁷³ Catherine Mitchell, 'Entire Agreement Clauses: Contracting Out of Contextualism' (2006) 22 *Journal of Contract Law* 222, 235.

Where the objective theory of contract underlies contract interpretation decisions, the actual intention of the parties, and, in turn, evidence of prior negotiations, is afforded a comparatively narrow role. In addition, the admissibility of evidence of prior negotiations is restricted by the operation of other principles of interpretation that reinforce the centrality of the text of the contract, namely, the ambiguity requirement and plain meaning rule. In contrast, where the judicial approach to interpretation is consistent with the subjective theory, evidence of prior negotiations is afforded a greater role through broad conceptions of the exceptions, more limited application of other principles of interpretation, and, where necessary to give effect to the parties' actual common intention, circumvention of the rule.

V CONCLUSION

The approach to the admissibility and use of evidence of prior negotiations in the interpretation of commercial contracts is influenced by judicial adherence (whether unstated or otherwise) to an objective or subjective theory of contract. For this reason, I submit that the admissibility and use of probative evidence of prior negotiations in the process of contract interpretation, such as in the example of A and B, is unclear.

In Part II, I established that the orthodox position in Australia is that, pursuant to the rule, evidence of prior negotiations is inadmissible in the process of interpreting written commercial contracts for the purpose of drawing inferences about what the contract meant, unless an exception applies. In Part III, I explained the basal influence of the underlying theory of contract. In Part IV, I established that the boundaries of the rule are unclear and judicial application of the rule is unpredictable. I argued that the divergence in authority and approach is influenced by adherence to one theory of contract over and another.

Under the objective theory of contract the court is concerned with policy considerations and communal standards of responsibility, rather than the parties' actual agreement. In such circumstances, the admissibility and use of evidence of prior negotiations, including that of A and B, is more likely to be restricted by rigid application of the rule, narrow construction of the exceptions and other principles of contract interpretation. In contrast, under the subjective theory, there is greater deference to the actual intent and autonomy

of the parties, and the function of the court is more passive. Consequently, evidence of prior negotiations, such as that of A and B, is afforded a greater role through broad conceptions of the exceptions, more limited application of other principles of interpretation, and, where necessary to give effect to the parties' actual common intention, circumvention of the rule.

I submit that the oft-cited objective theory of contract does not explicate the admissibility and use of evidence of prior negotiations in modern Australian contract interpretation cases. Whilst differing conceptions of the appropriate balance between party autonomy and the law operate, the law relating to the admissibility and use of evidence of prior negotiations as an interpretive aid will remain unclear.

