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# ***TRUSTS SYMPOSIUM***

## **IMPLICATIONS OF CHARTBROOK LTD v PERSIMMON HOMES LTD FOR THE LAW OF TRUSTS**

***Presented By:***

**The Honourable Justice J D Heydon  
*High Court of Australia***

**18 February 2011**

**IMPLICATIONS OF CHARTBROOK LTD v**  
**PERSIMMON HOMES LTD FOR THE LAW OF TRUSTS**

**J D Heydon\***

In recent years an extraordinary amount of attention has been paid to contractual interpretation by judges and academic scholars. The contributions of academic scholars almost outnumber the sands of the seashore. A smaller but nevertheless unusually large quantity of extrajudicial writing has come from the pens of judges, in a fashion we have not seen since the early days of Lord Denning. In part this is due to the intense interest which has been stimulated by the line of cases from *Investors Compensation Scheme Ltd v West Bromwich Building Society (No 1)*<sup>1</sup> to *Chartbrook Ltd v Persimmon Homes Ltd*.<sup>2</sup> That interest is in turn due to Lord Hoffmann's brilliant expositions of the law, dripping with suave, glittering phrases.

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<sup>1</sup> [1998] 1 WLR 896 ("the ICS case"). *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 in fact narrowly preceded it.

<sup>2</sup> [2009] 1 AC 1101.

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The *Chartbrook* cases rest on a datum and go on to state a compromise. The datum is that contractual construction depends on finding the meaning of the language of the contract – the intention which the parties expressed, not the subjective intentions which they may have had, but did not express.<sup>3</sup> The compromise may be stated thus. Its first limb is that a contract means what a reasonable person having all the background knowledge of the "surrounding circumstances" which would have been available to the parties would have understood them to be using the language in the contract to mean.<sup>4</sup> But, on the other hand, its second limb is that evidence of pre-contractual negotiations between the parties is inadmissible for the purpose of drawing inferences about what the contract meant unless it demonstrates knowledge of "surrounding circumstances".<sup>5</sup>

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<sup>3</sup> *Deutsche Genossenschaftsbank v Burnhope* [1995] 1 WLR 1580 at 1587. See also *Rabin v Gerson Berger Association Ltd* [1986] 1 WLR 526 at 533.

<sup>4</sup> *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 at 1112 [14]. A fact known to one party but not reasonably available to the other cannot be taken into account: *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at 272 [49]. Gleeson CJ, Gummow and Hayne JJ agreed with this first limb of the *Chartbrook* compromise in *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181 at 188 [11]. See also *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 179 [40].

<sup>5</sup> *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 at 1117-1121 [33]-[42].

### 3.

The ultimate question which this paper seeks to examine is whether the *Chartbrook* compromise has any implications in relation to documents, conversations and other dealings alleged to create a trust. But before dealing with it, it is desirable to examine some features of and problems arising out of the *Chartbrook* compromise, for, so far as it applies to trusts, the same problems are likely to arise there.

#### **The datum of the Chartbrook compromise**

The datum in the *Chartbrook* cases finds a parallel in statutory and constitutional construction. In that regard there is relevance in some words of Charles Fried, former Solicitor-General of the United States, a cultured and acute legal thinker. He expressed scorn for the notion that "in interpreting poetry or the Constitution we should seek to discern authorial intent as a mental fact of some sort." He said: "we would not consider an account of Shakespeare's mental state at the time he wrote a sonnet to be a more complete or better account of the sonnet itself." He disagreed "with the notion that when we consider the Constitution we are really interested in the mental state of each of the persons who drew it up and ratified it." On that false notion, he said, the "texts of a sonnet or of the Constitution would be a kind of second-best; we would prefer to take the top off the heads of authors and framers – like soft-boiled

eggs – to look inside for the truest account of their brain states at the moment that the texts were created." He continued:<sup>6</sup>

"The argument placing paramount importance upon an author's mental state ignores the fact that authors writing a sonnet or a constitution seek to take their intention and embody it in specific words. I insist that words and text are chosen to embody intentions and thus replace inquiries into subjective mental states. In short, the text *is* the intention of the authors or of the framers."

That approach to constitutional construction is consonant with the approach to be found in s 109 of our Constitution. It provides in part: "When a law of a State is inconsistent with a law of the Commonwealth, the latter shall prevail ...." It does not say: "When what a law of a State was intended to say is inconsistent with what a law of the Commonwealth was intended to say, the latter shall prevail ...." That form of words was eschewed even though many of the cases on s 109 direct attention to what the *intention* of the Federal Parliament was in enacting a federal law said to be inconsistent with the law of a State. The form actually chosen for s 109 is not surprising. Soon after the Constitution came into force, in *Tasmania v The Commonwealth*, O'Connor J propounded a theory of statutory construction – and the Constitution is contained in an

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<sup>6</sup> "Sonnet LXV and the 'Black Ink' of the Framers' Intention" (1987) 100 *Harvard Law Review* 751 at 758-759 (emphasis in original). Fried attributes the reasoning to passages in R Dworkin's *Law's Empire* (The Belknap Press of the Harvard University Press, Cambridge, Massachusetts, 1986) at 54-57 and 359-365.

Imperial statute – which stressed the irrelevance of the subjective intention of legislators. The construction of the statute depended on its intention, but its intention was only to be gathered from the statutory words in the light of surrounding circumstances.<sup>7</sup> The last six words have similarities with the first limb of the *Chartbrook* compromise.

On this view, even if it were possible to establish the actual mental states of those drafting and voting for a Bill, the inquiry would be irrelevant. The correct approach is that of Mr Justice Holmes, who said only five years before O'Connor J: "we do not deal differently with a statute from our way of dealing with a contract. We do not inquire what the legislature meant; we ask only what the statute means."<sup>8</sup> In the words of the Seventh Circuit of the United States Court of Appeals: "Congress did not enact its members' *beliefs*; it enacted a text."<sup>9</sup> However, in recent times in England<sup>10</sup> and in New Zealand,<sup>11</sup> through similar common law

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<sup>7</sup> (1904) 1 CLR 329 at 358-359.

<sup>8</sup> "The Theory of Legal Interpretation" (1899) 12 *Harvard Law Review* 417 at 419.

<sup>9</sup> *Jones v Harris Associates LP* 527 F 3d 627 at 633 (2008) (emphasis in original).

<sup>10</sup> *Pepper v Hart (Inspector of Taxes)* [1993] AC 593 at 630-640.

<sup>11</sup> See J F Burrows, *Statute Law in New Zealand* (3rd ed, LexisNexis, Wellington, 2003) at 181-184.

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developments, and in Australia by statute,<sup>12</sup> extrinsic materials have been routinely examined to ascertain what the legislature meant. It is but one of several objections to that usually unprofitable course that it does not comply with Fried's approach.

Lord Hoffmann adopted an approach to statutory construction which is consistent with his approach to contractual interpretation. He described statutory construction as "the ascertainment of what ... Parliament would reasonably be understood to have meant by using the actual language of the statute."<sup>13</sup>

That approach is justifiable because contracts are "objective" rather than "subjective". They do not depend on actual mental agreement. Mr Justice Holmes said:<sup>14</sup>

"[P]arties may be bound by a contract to things which neither of them intended, and when one does not know of the other's assent....

[T]he making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs, – not on the parties' having

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<sup>12</sup> *Acts Interpretation Act* 1901 (Cth), s 15AB, and equivalents in some other jurisdictions.

<sup>13</sup> *R (Wilkinson) v IRC* [2005] 1 WLR 1718 at 1723 [17]. See also Lord Steyn: *R (Westminster City Council) v National Asylum Support Service* [2002] 1 WLR 2956 at 2958-2959 [5].

<sup>14</sup> "The Path of the Law" (1897) 10 *Harvard Law Review* 457 at 463-464 (emphasis in original).

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*meant* the same thing but on their having *said* the same thing."

In Australia, the objective theory of contractual obligation prevails, as it does elsewhere. The actual state of mind of either party is only relevant where one party relies on the common law defences of *non est factum* or duress; where misrepresentation is alleged; where one party is under a mistake and the other knows it;<sup>15</sup> where the contract is liable to be set aside by reason of equitable doctrines of undue influence, unconscionable dealing or other fraud in equity; where the equitable remedy of rectification is available; where a question of estoppel arises; or where there is a question whether the "contract" is a sham.<sup>16</sup>

The objective theory of contract is congruent with the principle of contractual construction stated in the *Chartbrook* line of cases. That principle concentrates on the meaning of the contractual words understood as reasonable persons in the position of the parties would understand them. It does not search for the actual meanings which the parties may have believed or intended their words to convey. Thus the Australian position is illustrated by what five

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<sup>15</sup> *Taylor v Johnson* (1983) 151 CLR 422 at 432.

<sup>16</sup> Matthew Conaglen, "Sham Trusts" (2008) 67 *Cambridge Law Journal* 176 at 178, 182 and 193.



justices of the High Court said in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*:<sup>17</sup>

"It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe."

Thus on the one hand, the first limb of the *Chartbrook* compromise affords a wide avenue for material indicating what the words mean. On the other hand, the second limb bans material designed purely to show what the words were *intended* to mean – and a prime instance of that material is pre-contractual negotiations. This can be seen most clearly by looking at how the rejected argument in the *Chartbrook* case was put. That rejected argument was that all pre-contractual negotiations should be examined, not just those pointing to surrounding circumstances in the mutual contemplation of the parties. The argument purported to accept that contractual construction was an objective process, and that

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<sup>17</sup> (2004) 219 CLR 165 at 179 [40]. That is, what would the first party have led a reasonable party in the position of the other party to believe the first party intended, whatever the first party actually intended: Lord Hoffmann, "The Intolerable Wrestle With Words And Meanings" (1997) 114 *South African Law Journal* 656 at 661; *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at 272 [51]. See also *Gissing v Gissing* [1971] AC 886 at 906; *Ashington Piggeries Ltd v Christopher Hill Ltd* [1972] AC 441 at 502; *Pioneer Shipping Ltd v BTP Tioxide Ltd* [1982] AC 724 at 736; *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at 462 [22].

evidence of what one party intended should not be admissible. But other parts of the argument undercut that approach. Mr Christopher Nugee QC submitted: "The 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*."<sup>18</sup> It would have been revolutionary to have accepted that argument.

### **The application of the Chartbrook compromise**

Those who have supported the *Chartbrook* compromise have seen it as applying well beyond commercial contracts. Thus Lord Hoffmann has supported his approach by appealing to "the way we interpret utterances in everyday life."<sup>19</sup> His principal ally, Lord Steyn, selected as the "starting point" the proposition that "language in all legal texts conveys meaning according to the circumstances in which it was used."<sup>20</sup>

The *Chartbrook* compromise has been applied in many contractual fields. For example, it has been applied to the

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<sup>18</sup> [2009] 1 AC 1101 at 1108 (emphasis added).

<sup>19</sup> *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 at 774.

<sup>20</sup> *R (on the application of Westminster City Council) v National Asylum Support Service* [2002] 1 WLR 2956 at [5]; [2002] 4 All ER 654.

construction of contracts for the carriage of goods by sea;<sup>21</sup> bills of lading;<sup>22</sup> settlement agreements;<sup>23</sup> general releases;<sup>24</sup> and insurance policies.<sup>25</sup> It has been extended outside the construction of contracts to the construction of notices to terminate a lease.<sup>26</sup> In the first case in which he propounded the *Chartbrook* compromise, a case about a notice to terminate a lease, Lord Hoffmann overruled earlier cases, not only on notices to terminate a lease, but also on the construction of wills.<sup>27</sup> In relation to wills he dealt with the rule that extrinsic evidence to contradict an unambiguous reference to a person or thing was inadmissible. He went through a process which "demotes the rule" from a strict rule "to the common sense proposition that in a formal document such as a will, one does not lightly accept that people have used the wrong words."<sup>28</sup>

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<sup>21</sup> *Dairy Containers Ltd v Tasman Orient Line CV* [2005] 1 WLR 215.

<sup>22</sup> *Homburg Houtimport BV v Agrosin Private Ltd ("The Starsin")* [2004] 1 AC 715.

<sup>23</sup> *Oceanbulk Shipping and Trading SA v TMT Asia Ltd* [2010] 4 All ER 1011 (SC).

<sup>24</sup> *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251.

<sup>25</sup> *Zeus Tradition Marine Ltd v Bell ("The Zeus V")* [1999] 1 Lloyd's Rep 703.

<sup>26</sup> *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749.

<sup>27</sup> *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 at 776-780.

<sup>28</sup> *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 at 778.

Since then principles relevant to the construction of patents have been invoked as illustrations of the *Chartbrook* compromise and as the basis for its reformulation. Originally the *Chartbrook* compromise was said to turn on the background knowledge reasonably available to the *parties* to a contract. In 2003, in *The Starsin*, it was said to turn on what was reasonably available to the *addressees*:<sup>29</sup>

"The interpretation of a legal document involves ascertaining what meaning it would convey to a reasonable person having all the background knowledge which is reasonably available to the person or class of persons to *whom the document is addressed*. A written contract is *addressed* to the parties; a public document like a statute is *addressed* to the public at large; a patent specification is *addressed* to persons skilled in the relevant art, and so on."

In *The Starsin*, in working out what a bill of lading meant to its addressees, Lord Hoffmann took into account several matters which he said were "common general knowledge".

In patent law there is a doctrine that the construction of a patent must be affected by how its addressee reads it. Its addressee is a reasonably skilled practitioner of the craft involved in

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<sup>29</sup> *Homburg Houtimport BV v Agrosin Private Ltd ("The Starsin")* [2004] 1 AC 715 at 754 [73] (emphasis added). *The Starsin* was followed in *Dairy Containers Ltd v Tasman Orient Line CV* [2005] 1 WLR 215 at 220 [12] (PC).

the particular industry or art. The construction which the addressee will adopt will be affected by "common general knowledge" – the knowledge which the addressee is presumed to know as part of his or her equipment as a reasonably skilled practitioner.<sup>30</sup> There is another doctrine: a patent will be held invalid for obviousness, if the skilled addressee, taking into account common general knowledge in that field, would view any differences between what was already known or used and the alleged invention as being obvious.<sup>31</sup> There is a third doctrine: a patent will be treated as having sufficiently described the manner in which the invention is to be performed if the skilled addressee would be adequately guided by it in the light of common general knowledge.

In *The Starsin* Lord Hoffmann transplanted the concept of "common general knowledge" to another area. The area is that of construing bills of lading in relation to the funding by letter of credit of sales of goods carried by sea.<sup>32</sup>

He was speaking of a transaction having the following structure. Goods are sold by a seller to a buyer and transported to

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<sup>30</sup> *British Ore Concentration Syndicate Ltd v Minerals Separation Ltd* (1908) 26 RPC 124; Lord Hailsham, *Halsbury's Laws of England*, vol 35 (4<sup>th</sup> ed, London, Butterworths, 1981) para 521.

<sup>31</sup> Lord Hailsham, *Halsbury's Laws of England*, vol 35 (4<sup>th</sup> ed, London, Butterworths, 1981) paras 492-495.

<sup>32</sup> [2004] 1 AC 715 at 754-757 [72]-[85].

the buyer by the owner or charterer of a ship. A bill of lading is issued. It functions as a receipt for the goods, a document of title to them, and evidence of the contract of carriage. The seller may wish to finance the contract of sale, ie get the price, by obtaining an advance from a bank by way of letter of credit on production of the bill of lading. Lord Hoffmann was concerned with the question of who the carrier under a contract of carriage was. The problem arose because the front of a bill of lading stated that the carrier was one person, but more complicated contractual terms and conditions on the back suggested that the carrier was another person. Lord Hoffmann held that the front of the document overrode the back.

He reached this conclusion by the following route.

1. The interpretation of a legal document involves ascertaining what meaning it could convey to a reasonable person having all the background knowledge which is reasonably available to the person or class of persons to whom the document is addressed.
2. A bill of lading is (inter alia) a document of title. It is drafted with a view to being transferred to third parties absolutely, or by way of security for advances to finance the underlying transaction.

3. It is common general knowledge that advances to finance the underlying transaction are frequently made by letter of credit.
4. It is also common general knowledge that the bill of lading is ordinarily one of the documents which must be presented to the bank before payment can be obtained.
5. It is also common general knowledge, shared by the reasonable reader of the bill of lading, that the bill of lading is addressed not only to the shipper and consignee named on the bill, but to a potentially wide class of persons including merchants and bankers which have issued letters of credit.
6. It is common general knowledge that bankers do not examine the contractual terms on the back of a bill of lading.
7. It is common general knowledge that bankers almost invariably issue letters of credit in the terms of the International Chamber of Commerce Uniform Customs and Practice for Documentary Credit. Article 23 provides that banks will accept a document which appears on its face to indicate the carrier's name, and provides that banks will not examine the terms printed on the back.
8. A banker will know that on some questions of interpretation he or she will need to consult a lawyer to examine the complex

terms and conditions on the back of the bill of lading. But the banker will expect to find out certain essential things without legal assistance – such as the identity of the carrier.

9. Since bankers construe bills of lading as meaning that the person named on the front as carrier is the carrier, and since the bill of lading cannot mean one thing to a banker and another to a consignee or assignee, what is said on the front prevails over what is said on the back.

It will have been noticed that in Lord Hoffmann's chain of reasoning he said that five matters of fact are common general knowledge. He put them in a series of bald assertions. Perhaps his reasoning rests on even more assertions of this kind which are not expressly and baldly labelled "common general knowledge", but are implied. Reliance on common general knowledge in patent law depends on evidence about what it is. There was no evidence of, or other information about, the common general knowledge to which Lord Hoffmann appealed before the House of Lords (except for step 7). The recourse to "common general knowledge" of the type Lord Hoffmann made raises uneasy suspicions about whether he was construing a contract made by the parties or making for them a different contract he thought they ought to have made, and about whether he was conjuring up materials for doing so out of fairly thin air. That is one general concern about the *Chartbrook* compromise.



### Did Lord Wilberforce work a fundamental change?

Lord Hoffmann did not claim to have created the *Chartbrook* compromise. In the *ICS* case<sup>33</sup> he said that there had been a "fundamental change" in the law, but that it had been effected by the speeches of Lord Wilberforce in *Prenn v Simmonds*<sup>34</sup> in 1971 and *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* in 1976.<sup>35</sup> He said that this had been insufficiently appreciated. He said that the judges of the 18<sup>th</sup> and 19<sup>th</sup> centuries adopted an approach which:<sup>36</sup>

"was far more literal and less sensitive to context than ours today. Courts were reluctant to admit what was called 'extrinsic evidence', that is to say, evidence of background which would put the language into context. This reluctance has to do with a number of factors which are now of purely historical interest, such as trial by jury, under which the construction of documents was treated as a matter of law for the judge, the incompetence of the parties and persons interested to give evidence, the fact that most documents which came before the courts were deeds prepared by lawyers and a general feeling that the less the court took account of extrinsic evidence, the more predictable would be the construction which it gave to the document."

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<sup>33</sup> *Investors Compensation Scheme Ltd v West Bromwich Building Society (No 1)* [1998] 1 WLR 896 at 912.

<sup>34</sup> [1971] 1 WLR 1381.

<sup>35</sup> [1976] 1 WLR 989.

<sup>36</sup> *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at 274 [54].

Whether or not that is true of the 18<sup>th</sup> century, it is much less true of the 19<sup>th</sup>.

The true authorship of the *Chartbrook* compromise does not in fact lie with Lord Wilberforce. Lord Wilberforce did not so much work a fundamental change as revive ideas which had been current in the 19th century but had perhaps since become overlooked – something which quite often happens in the common law.

Thus in 1842 in *Shore v Wilson*,<sup>37</sup> Erskine J, speaking in the context of wills, can be seen propounding the "modern" doctrine:

"[I]t is always allowable, in order to enable the Court to apply the instrument to its proper object, to receive evidence of the circumstances by which the testator or founder was surrounded at the date of the execution of the instrument in question, not for the purpose of giving effect to any intention of the writer not expressed in the deed, but for the purpose of ascertaining what was the intention evidenced by the expressions used; to ascertain what the party has said; not to give effect to any intention which he has failed to express."

In 1877 in *Lewis v Great Western Railway Co*<sup>38</sup> Brett LJ said:

"Now I apprehend that, in order to construe a written document, the Court is entitled to have all the facts relating to it and which were existing at the time the

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<sup>37</sup> (1842) 9 Cl & Fin 355 at 512-513; 8 ER 450 at 513.

<sup>38</sup> (1877) 3 QBD 195 at 208 (emphasis added).

written contract was made, and *which were known to both parties*. Certain facts existing at a time when a written contract is made are sometimes customs of trade, or the ordinary usages of trade; sometimes the course of business between the parties; sometimes they consist of a knowledge of the matter about which the parties were negotiating; the Court is entitled to ask for those facts, to enable it to construe the written document; not simply because they are customs of trade, or the course of business between the parties, but because they are facts which were existing at the time, and which have a relation to the written contract, and which are things *which must be taken to have been known* by both parties to the contract."

In the same year, 1877, Lord Moncreiff, the Lord Justice Clerk, said it was an elementary rule of contractual construction that "the Court [is] entitled, in reading this contract, to be placed in the position of the parties to it, by ascertaining the surrounding circumstances".<sup>39</sup> Lord Ormidale said the same later in 1877.<sup>40</sup> So did Lord Moncreiff a second time.<sup>41</sup> He additionally favoured including "communings", that is, negotiations; but with that last extension removed, in 1878 Lord Blackburn approved these approaches on appeal.<sup>42</sup> That was no surprise, since in 1877 in *River Wear Commissioners v Adamson*<sup>43</sup> Lord Blackburn had said it was necessary to see "what the circumstances were with reference to which the words were used, and what was the object, appearing

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<sup>39</sup> *Baird's Trustees v Baird and Co* (1877) 4 R 1005 at 1017.

<sup>40</sup> *Buttery & Co v Inglis* (1877) 5 R 58 at 68.

<sup>41</sup> *Buttery & Co v Inglis* (1877) 5 R 58 at 64.

<sup>42</sup> *Inglis v Buttery & Co* (1878) 3 App Cas 552 at 576-577.

<sup>43</sup> (1877) 2 App Cas 743 at 763.

from those circumstances, which the person using them had in view; for the meaning of words varies according to the circumstances with respect to which they were used."

In 1891 Lord Inglis, the Lord President, said that in construing a contract "the Court [is] quite entitled to avail [itself] of any light [it] may derive from such evidence as will place [it] in the same state of knowledge as was possessed by the parties at the time that the contract was entered into."<sup>44</sup> In 1910 the Earl of Halsbury applied Lord Blackburn's words.<sup>45</sup> In 1933 Lord Russell of Killowen<sup>46</sup> and in 1935 Lord Wright<sup>47</sup> took the same approach.

There then appears to have followed a period in which these approaches fell from favour, or at least from view, until Lord Wilberforce revived them in 1971.

Lord Wilberforce placed some reliance on Judge Cardozo's decision in *Utica City National Bank v Gunn*.<sup>48</sup> Judge Cardozo did

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<sup>44</sup> *Bank of Scotland v Stewart* (1891) 18 R 957 at 960 (Lords Adam and Kinnear concurring).

<sup>45</sup> *Butterley Co Ltd v New Hucknell Colliery Co Ltd* [1910] AC 381 at 382.

<sup>46</sup> *Hvalfangerselskapet Polaris A/S v Unilever Ltd* (1933) 46 Ll L Rep 29 at 40.

<sup>47</sup> *Inland Revenue Commissioners v Raphael* [1935] AC 96 at 142-143.

<sup>48</sup> 118 NE 607 at 608 (1918).

not refer to the English and Scottish cases just described, and what he said was not reconcilable with everything in them. But he did state the doctrine enunciated by Lord Wilberforce. He only cited a passage from Wigmore<sup>49</sup> and a passage from Sir James Fitzjames Stephen's *A Digest of the Law of Evidence*.<sup>50</sup> The latter work – a work of considerable influence – was published in 1876 – just before the spate of Anglo-Scottish cases in 1877 and 1878 to which reference has just been made. It is a sign of how well-settled the *Prenn v Simmonds* doctrine was by then. Each of those great scholars stated wide principles corresponding with the modern law. Once Judge Cardozo had blessed their formulations, the wider doctrine was assured of a secure future. Judge Cardozo's decision was a particularly striking one in that it widened the liability of a guarantor from liability for not only future loan renewals (as the document suggested) but past renewals as well (because of surrounding circumstances): this is different from the normal strict approach to guarantees.

At all events, whether Lord Wilberforce's "fundamental change" lay in fresh creation or revival of forgotten ideas, its provenance is lengthy and well-established.

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<sup>49</sup> See now J H Wigmore, *Evidence in Trials at Common Law*, (Chadbourn rev), vol 9 (Little, Brown and Co, Boston, 1981) [2470].

<sup>50</sup> (Macmillan and Co, London, 1876), Arts 91(5) and (6).

**To whom is the relevant meaning to be conveyed?**

There are two aspects of proposition (1) in the *ICS* case I wish to comment on. Proposition (1) is:

"Interpretation is the ascertainment of the meaning which the document would convey to a *reasonable person* having all the background knowledge *which would reasonably have been available to the parties* in the situation in which they were at the time of the contract.<sup>51</sup>

The first point concerns "the reasonable person" (and a similar issue arises in relation to proposition (2) in the *ICS* case). The second point concerns the question of knowledge.

As to the first point, proposition (1) is a sound expression of the principle in the case of a document addressed to the world, or addressed to that part of the world composed of persons skilled in a particular art, like a patent. But in the field of contract, the doctrine stated in proposition (1) may be better stated thus: "Interpretation is the ascertainment of the meaning which the document would convey taking account of the background knowledge of the parties, and assuming they were acting reasonably." The point is that it

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<sup>51</sup> *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912 (emphasis added).

does not matter what any reasonable person would think. All that matters is what a court would think, and what it thinks depends on what the contracting parties themselves would reasonably think. A contractual dispute can arise when one party propounds a particular construction which another denies. For the court, one test is: would the words and conduct of the first party have led a reasonable person in the position of the second party to believe that the contractual promise was as the first party contends? It does not matter what *any* reasonable person would think, only the parties. The point was well put in the Scottish contract book, *Gloag on Contract*, as quoted by Lord Reid in *McCutcheon v David MacBrayne Ltd*:<sup>52</sup> "The judicial task is not to discover the actual intentions of each party; it is to decide what each was reasonably entitled to conclude from the attitude of the other." Perhaps proposition (1) is structured in this respect to allow for the position of assignees, for the possibility of novation, and for the possibility of third parties like insurers or bankers relying on the contract.

**Known information, or information which is reasonably available to be known?**

Proposition (1) in the *ICS* case used the expression "background knowledge which would reasonably have been available

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<sup>52</sup> [1964] 1 WLR 125 at 128, quoting from the second edition at 7.

to the parties". There is a distinction between knowledge which was *available* to the parties, and knowledge which they actually *had*. The relevant principle has often been stated in terms not of availability but of actual knowledge. These are almost always just passing references, not attending to the present distinction or its possible significance. It is thus dangerous to place excessive reliance on them. As Lord Hoffmann said: "The remarks of judges, however general, have to be read in context no less than the general words of contractual documents."<sup>53</sup> The references must be qualified in that light, but they are numerous. One example is Lord Inglis in *Bank of Scotland v Stewart*.<sup>54</sup> Others include Lord Wright in *Inland Revenue Commissioners v Raphael*,<sup>55</sup> Lord Wilberforce in *Prenn v Simmonds*,<sup>56</sup> Lord Bingham in *Bank of Credit and Commerce International SA v Ali*,<sup>57</sup> the High Court of Australia in *Toll's case*,<sup>58</sup> and Moore-Bick LJ in *Ravennavi SpA v New Century Shipbuilding Co Ltd*.<sup>59</sup>

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<sup>53</sup> *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at 273 [52].

<sup>54</sup> (1891) 18 R 957 at 960.

<sup>55</sup> [1935] AC 96 at 143 ("facts known to the parties").

<sup>56</sup> [1971] 1 WLR 1381 at 1385 ("factual background known to the parties").

<sup>57</sup> [2002] 1 AC 251 at 259 [8] ("all the relevant facts ... so far as known to the parties").

<sup>58</sup> (2004) 219 CLR 165 at 179 [40].

<sup>59</sup> [2007] 2 Lloyd's Rep 24 at 27.



On the other hand, contrary instances are legion. Thus Staughton LJ, although a determined foe of the *ICS* doctrine, considered that recourse could be had to "surrounding circumstances [which] must have been known, or *reasonably capable of being known*, to both parties at the time when the contract was made."<sup>60</sup> He also spoke of "what the parties *must have had in mind*". Brett LJ had spoken similarly in 1877, for after referring to what was "known to both parties", he spoke of: "things which *must be taken to have been known* by both parties to the contract."<sup>61</sup> Now the words "must have had in mind" could simply refer to a circumstantial inference. If it is likely that the parties had a circumstance in mind, the court may the more readily infer that they actually did have it in mind.<sup>62</sup> But other formulations exclude

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<sup>60</sup> "How Do the Courts Interpret Commercial Contracts?" (1999) 58 *Cambridge Law Journal* 307-308 (emphasis added).

<sup>61</sup> *Lewis v Great Western Railway Co* (1877) 3 QBD 195 at 208 (emphasis added).

<sup>62</sup> Thus in *Manufacturers' Mutual Insurance Ltd v Withers* (1988) 5 ANZ Ins Cas 75,336 at 75,343 McHugh J said: "evidence of surrounding circumstances will generally be admissible if it is known to both parties or sufficiently notorious to be presumed to be within their knowledge." Similarly, in *Zeus Tradition Marine Ltd v Bell ("The Zeus V")* [1999] 1 Lloyd's Rep 703 at 706-707, Colman J said expert evidence of particular linguistic usages or practices may be admissible "simply because, having regard to the considerations which people in the market could be expected to have in mind in relation to transactions of that particular kind, it is to be inferred that the parties to the transaction in question would probably have had the same considerations in mind when they agreed on the actual words or phrases used."

this and go further. In *Reardon Smith Line Ltd v Yngvar Hansen-Tangen ("The Diana Prosperity")*<sup>63</sup> Lord Wilberforce said Brett LJ was not speaking of constructive notice or an estoppel. Instead he was held to have been speaking of facts which reasonable persons would have known even if one or both of the parties did not have those facts in the forefront of their minds. In New Zealand the expression "knowledge which *would reasonably have been available* to the parties" has been favoured.<sup>64</sup>

Judge Cardozo gave some support to this. In the *Utica* case<sup>65</sup> he said of the defendant's state of knowledge: "the purpose of the transaction can hardly have been unknown. The slightest inquiry would have revealed it." Yet it is possible not to know something even though the slightest inquiry would have revealed it.

In 2005 Lord Bingham appeared to support the view that knowledge was not necessary. He said: "There may reasonably be attributed to the parties to a contract such as this such general commercial knowledge as a party to such a transaction *would ordinarily be expected to have*".<sup>66</sup>

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<sup>63</sup> [1976] 1 WLR 989 at 996-997.

<sup>64</sup> *Potter v Potter* [2003] 3 NZLR 145 at 156 [31]-[32] (emphasis added).

<sup>65</sup> 118 NE 607 at 608 (1918).

<sup>66</sup> *Dairy Containers Ltd v Tasman Orient Line CV* [2005] 1 WLR 215 at 220 [12] (emphasis added).

Some support for the way proposition (1) in the *ICS* case is formulated can be found in the fact that one background fact is often the law,<sup>67</sup> and it is not necessary that the parties actually know the law: they are assumed to do so.<sup>68</sup> But that may be a *sui generis* phenomenon.

Sir Kim Lewison has questioned these latter approaches: "if the facts were unknown they cannot have played any part in forming the presumed intention which is embodied in the contract."<sup>69</sup> That is, the contract is the *parties'* contract; what that is depends on *their* mutual knowledge; taking into account what they are *expected* to know but did not in fact know is to *make another* contract, not *construe their* contract.

Thus some critics are concerned that a test unrelated to actual knowledge widens the court's power to make for the parties a contract which it thinks just, even though the grounds for thinking that the parties actually made it are slender.

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<sup>67</sup> *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at 269 [39]; *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2002) 210 CLR 181 at 188 [11].

<sup>68</sup> Lewison, *The Interpretation of Contracts* (Sweet & Maxwell, London, 2007) at 128-131 [4.06].

<sup>69</sup> *The Interpretation of Contracts* (Sweet & Maxwell, London, 2007) at 108 [3.14].

A further question is whether, if the test turns on the facts each party knew, it should require further that the facts be facts which each party knew the other party knew. A related question is whether, if the test turns on what parties are expected to know, it should include as an element: "what each party might reasonably have expected the other to know". Thus in *Bank of Scotland v Dunedin Property Investment Co Ltd*<sup>70</sup> Lord Kirkwood approved a formulation of Staughton LJ's – "facts which both parties would have had in mind and known that the other had in mind at the time when the contract was made."<sup>71</sup> The strength of this approach is that it is consistent with a search for the parties' "presumed *mutual* intention", which is one way of putting the inquiry into interpretation. Lord Wilberforce in *Prenn v Simmonds*<sup>72</sup> spoke of "mutually known facts", which may be different from facts which each party individually happened to know. Similar words have been used in New Zealand: "mutual contemplation of the parties".<sup>73</sup>

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<sup>70</sup> 1998 SC 657 at 670.

<sup>71</sup> Quoting *Scottish Power plc v Britoil (Exploration) Ltd* [1997] TLR 616. See also per Staughton LJ in *Youell v Bland Welch & Co* [1992] 2 Lloyd's Rep 127 at 133 ("circumstances ... known to both parties, and ... what each might reasonably have expected the other to know").

<sup>72</sup> [1971] 1 WLR 1381 at 1384.

<sup>73</sup> *Potter v Potter* [2003] 3 NZLR 145 at 156 [34].

**Can the background be examined if there is no ambiguity?**

Another matter of controversy is whether it is necessary that the contract be ambiguous before recourse is had to surrounding circumstances. In *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* Mason J said:<sup>74</sup>

"The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning."

This is now the most striking formal difference between English and Australian law: ambiguity is not a precondition under the *ICS* tests, even though it is far from clear that this accords with *Prenn v Simmonds*. Yet it is plain that Mason J did not think *Prenn v Simmonds* was inconsistent with his position.

There are numerous judges, before and after the *Codelfa* case and the *ICS* case, who have spoken to the same effect as Mason J. In 1918 there were Lord Atkinson<sup>75</sup> and Lord Shaw:<sup>76</sup> indeed Mason

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<sup>74</sup> (1982) 149 CLR 337 at 352.

<sup>75</sup> *Great Western Railway and Midland Railway v Bristol Corporation* (1918) 87 LJ Ch 414 at 419 ("ambiguous, susceptible of more than one meaning").

J's formulation was taken directly from that of Lord Atkinson. In 1976 Stephenson LJ said that antecedent negotiations are only available "to clarify ambiguity".<sup>77</sup> Saville J said the same in 1988.<sup>78</sup> In 1997 Saville LJ permitted resort to surrounding circumstances only where the actual language was ambiguous, meaningless or nonsensical.<sup>79</sup> Others in this category are three judges of the New South Wales Court of Appeal in 2003.<sup>80</sup> There are also Scottish<sup>81</sup> and New Zealand<sup>82</sup> cases to the same effect.

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<sup>76</sup> *Great Western Railway and Midland Railway v Bristol Corporation* (1918) 87 LJ Ch 414 at 424-425 (cf Lord Wrenbury at 429).

<sup>77</sup> *Arrale v Costain Civil Engineering Ltd* [1976] 1 Lloyd's Rep 98 at 104.

<sup>78</sup> *Vitol BV v Compagnie Europeene des Petroles* [1988] 1 Lloyd's Rep 574 at 576.

<sup>79</sup> *National Bank of Sharjah v Dellborg* [1997] EWCA Civ 2070: otherwise what he said is most fully set out by Lord Bingham of Cornhill, "A New Thing Under the Sun? The Interpretation of Contract and the ICS Decision" (2008) 12 *Edinburgh Law Review* 374 at 382-383.

<sup>80</sup> *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2003] NSWCA 74 at [44].

<sup>81</sup> *Buttery & Co v Inglis* (1877) 5 R 58 at 66-68 per Lord Ormidale. On appeal Lord Blackburn agreed: *Inglis v Buttery & Co* (1878) 3 App Cas 552 at 576-577. See also *Bovis Construction (Scotland) Ltd v Whatlings Construction Ltd* 1994 SC 351 at 357 per Lord Hope, the Lord President.

<sup>82</sup> *Blakely and Anderson v de Lambert* [1959] NZLR 356 at 367 per F B Adams J; *Eastmond v Bowis* [1962] NZLR 954 at 959 per Richmond J; *Quainoo v NZ Breweries Ltd* [1991] 1 NZLR 161 at 165 per Hardie Boys J; *Masport Ltd v Morrison Industries Ltd* (unreported, NZCA, 31 August 1993), quoted in *Benjamin Developments Ltd v Robt Jones (Pacific) Ltd* [1994] 3 NZLR 189 at 196; *WEL Energy Group Ltd v Electricity Corporation of New Zealand Ltd* [2001] 2 NZLR 1 at 9 [23] per McGechan J

But there are cases the other way. The New Zealand position now is that ambiguity is not necessary.<sup>83</sup> There are old authorities supporting this. In 1842 Erskine J said that surrounding circumstances could be examined "even where the words are in themselves plain and intelligible".<sup>84</sup> In 1877 in *Buttery & Co v Inglis*<sup>85</sup> Lord Moncreiff said it was "trite law – so trite that I do not think it necessary to quote authority on the subject – that in all ... mercantile contracts, whether they be ambiguous or unambiguous, whether they be clear and distinct or the reverse, the Court [is] entitled to be placed in the position in which the parties stood before they signed." Recently the New South Wales Court of Appeal has denied the need for ambiguity.<sup>86</sup>

Whatever the intellectual merits of what Mason J said, his statement is Australian law until the High Court says otherwise. However, the New South Wales Court of Appeal gave several

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(approved by the Court of Appeal on appeal at 18 [31]) and *Potter v Potter* [2003] 3 NZLR 145 at 156 [34].

<sup>83</sup> *Ansley v Prospectus Nominees Unlimited* [2004] 2 NZLR 590 at 600-601 [36].

<sup>84</sup> *Shore v Wilson* (1842) 9 Cl & Fin 355 at 512; 8 ER 450 at 513.

<sup>85</sup> (1877) 5 R 58 at 64.

<sup>86</sup> *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* (2009) 261 ALR 382 at 384-385 [1]-[4] and 406-407 [112]-[113] and *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15 at 24-25 [14]-[18], 29 [42], 33 [63] and 70-86 [239]-[305].

reasons for believing that Mason J did not state Australian law. Among them were the following. One was that he contradicted this position in other parts of his judgment. That is not so. Another was that later intermediate appellate courts have stated the law inconsistently with what he said. But since Stephen and Wilson JJ agreed with him, the opinion of Mason J was the opinion of the majority, and it is not for later intermediate appellate courts to overrule High Court majorities. Apart from anything else, to do so creates extraordinary difficulties for trial judges. The Court of Appeal rightly took no point that Mason J's opinion was not part of the ratio. Even if it had been a dictum, as in some senses it may be, a "dictum" of that kind is not to be ignored by other Australian courts. Another reason given was that later High Court cases deny what Mason J said. Strictly speaking they do not deny it, the statements are summary ones, the point seems neither to have been argued nor to have been crucial, and the *Codelfa* case was not in terms overruled – and it is unlikely that a case as important and as heavily relied on as the *Codelfa* case, which is perused by many Australian lawyers each day, would be impliedly overruled. A further reason given is that the *ICS* case is against Mason J. That is true. His test is not incorporated in the crucial propositions. But in *Royal Botanic Gardens and Domain Trust v South Sydney Council*<sup>87</sup> the High Court said, in effect, that until there had been full argument in

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<sup>87</sup> (2002) 240 CLR 45 at 62-63 [39].



the High Court on any differences between the *ICS* case and the opinions of Mason J in the *Codelfa* case, Australian courts should apply the latter.

On one view, Mason J's test creates no barrier at all. Normally a contract which is the subject of litigation is in some sense "susceptible of more than one meaning". If not, there would be no litigation about it. Further, as McHugh J contended, with perhaps some exaggeration, "few, if any, English words are unambiguous or not susceptible of more than one meaning or have a plain meaning".<sup>88</sup> But it would seem that the test has some content, and requires more than a merely arguable second meaning.

Critics of Mason J's test point out that every piece of language may depend for its comprehension on matters of context, and that if a court is debarred from examining the background unless there is an ambiguity, it may fail to give the contract the construction which that background reveals to be preferable to that which it appears unambiguously to bear on its face. Defenders of Mason J would point to this as a necessary sacrifice, which probably only applies in exceptional cases, in order to avoid the evils which flow from having excessive resort to the background.

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<sup>88</sup> *Manufacturers' Mutual Insurance Ltd v Withers* (1988) 5 ANZ Ins Cas 75,336 at 75,343.

Lord Hoffmann has given the following explanation of what Mason J said:<sup>89</sup>

"It is not a rule of evidence but a substantive rule of construction. It means that whatever the background, you cannot give the language a meaning which, as a matter of conventional syntax and dictionary usage, it cannot reasonably bear. You cannot say that the parties must have made a mistake of syntax or used the wrong words. The language must be ambiguous in the sense that [the words] can, in the particular context, have been used in the sense for which one of the parties is contending. If that is not the case, the background becomes irrelevant and, for that reason, turns out to be inadmissible."

A related idea is the idea that the background cannot be used "to construct a contract which does not properly reflect the language employed". The words are those of Mummery LJ. He also said that it was wrong to construct "from the context alone a contract that the parties in their respective situations might have made", but which their language suggested that they did not make.<sup>90</sup>

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<sup>89</sup> "Interpretation of Contracts" (a paper delivered at Queenstown, New Zealand, as part of the Banking and Financial Services Law Association Conference) at 5. Another is given in J J Spigelman, "From Text to Context: Contemporary Contractual Interpretation" (2007) 81 *Australian Law Journal* 322 at 326.

<sup>90</sup> *Commerzbank AG v Jones* [2003] EWCA Civ 1663 at [24]. See also at [21]: "It is not the function of the court to substitute for the agreement of the parties what it thinks would have been the sensible commercial agreement for the parties to have made."

A key question is whether Mason J's test, perhaps modified, has significant merit as a restriction on an undesirably extensive recourse to background.

One cannot think about contractual interpretation for long without thinking of the thousands of litigants who either want to get into court, or want to have their cases which are in court heard by a judge, but cannot. They may be persons charged with crime but not on bail: for many of them may be, if not innocent, at least persons who will be eventually acquitted (as contrasted with those who are on bail, who may be less eager for an expedited hearing). Though this is less of a problem in New Zealand, they may be people who were badly injured in traffic or industrial or other accidents. They may be people whose claim to refugee status has been denied by the government. They may have any one of an innumerable range of civil claims, whether they relate to breaches of public law, commercial law, property rights or even the law of contract. They may be powerless people at the mercy of the State and powerful organisations which feel able to abuse their power and ride roughshod over them because they know the likelihood of speedy judicial intervention is slight. One key barrier stopping them from getting to a judge is the slowness with which problems turning on contractual construction are now heard, compared with the position 40 or 50 years ago.

This is bad, not only for litigation generally, but for commercial litigation in particular. A commercial court is supposed to be a piepowder court. The merchants come in, stamp the dust off their boots, and want a speedy answer. Commercial health – the health of individual traders and the health of the economy as a whole – depends on the velocity of the circulation of money. Those who owe money should pay it speedily. Those who do not owe it are entitled to a judgment removing doubt about that point. Many transactions and businesses are interconnected. Much legal process is instituted or defended unmeritoriously, in the knowledge that the court's delays can be exploited to deny justice. These abuses of legal process are massive in scale.

In 1877 Lord Gifford memorably said: "The very purpose of the written contract was to exclude disputes inevitably arising from the lubricity, vagueness, and want of recollection, or want of accurate recollection, of mere oral conversations occurring in the course of negotiations more or less protracted."<sup>91</sup> And three centuries earlier Popham CJ said:<sup>92</sup>

"it would be inconvenient, that matters in writing made by advice and on consideration and which finally import the certain truth of the agreement of the parties should

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<sup>91</sup> *Buttery & Co v Inglis* (1877) 5 R 58 at 70.

<sup>92</sup> *Countess of Rutland's Case* (1604) 5 Co Rep 25b at 26a-26b; 77 ER 89 at 90.

be controlled by averment of the parties to be proved by the uncertain testimony of slippery memory."

The goal of excluding disputes of this kind from litigation is thwarted by recourse to the same material in order to discover the background.

In logic one cannot fault the broad structure of the *Chartbrook* compromise – no evidence of prior negotiations unless they reveal background facts. Nor is it inconsistent with authority. But is the condition of modern commercial litigation such as to compel reconsideration of the compromise? Is it a doctrine which was sound in simpler times but which now has adverse consequences too great to permit its survival?

The justification for the *Chartbrook* ban on negotiations flows from the practical detriments that would flow from letting in negotiations – in particular the peculiarly subjective nature of negotiations. Lord Hoffmann pointed, with respect in a totally convincing fashion, to the evils that have attended the reception of background materials in construing legislation,<sup>93</sup> and similar evils flow from admitting negotiations.

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<sup>93</sup> *Chartbrook Ltd v Persimmon Homes Ltd* [2009] AC 1101 at 1119 [38].

The trouble is that the *Chartbrook* compromise is so liberal as to invite parties to prepare and tender negotiation material in the hope that all or part of it will be admitted as background material. To that is added the fact that cases involving contractual construction often involve other issues calling for recourse to negotiations – estoppel, misrepresentation, mistake, and equitable and statutory unconscionable conduct.

A cynic might say that greater love hath no managing partner than this – that large scale commercial litigation against a loyal and valued client will break out. Even if most managing partners do not experience that emotion, there are obvious points to be made about the bulk of commercial litigation involving analysis of contractual background – excessive discovery, huge tenders of ill-digested documents and often the preparation of diffuse witness statements which engender prolix cross-examination.<sup>94</sup> Some people deny that the courts have been inundated by background material merely in order to understand contractual context.<sup>95</sup> I respectfully disagree.

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<sup>94</sup> There is also the problem of how a lawyer invited to advise a client before litigation is instituted is to assemble the relevant background knowledge, unassisted by the coercive pressures employed by an adversary of his client in litigation itself: Alan Berg, "Thrashing Through the Undergrowth" (2006) 122 *Law Quarterly Review* 354 at 358.

<sup>95</sup> Lord Bingham of Cornhill, "A New Thing Under the Sun? The Interpretation of Contract and the *ICS* Decision" (2008) 12 *Edinburgh Law Review* 374 at 387-388.

To adopt the words of Rolfe B from another context:<sup>96</sup> "If we lived for a thousand years instead of about sixty or seventy, and every case were of sufficient importance, it might be possible, and perhaps proper, to throw a light on matters" in this way. But we do not live for a thousand years. Some of the evils in question do not flow merely from rules of law. They flow from a combination of subtle rules of law designed to ensure individual justice as much as possible, from procedural rules designed to give the fullest possible hearings to parties, and from changed business practices involving the generation of enormous quantities of material through the photocopier and the computer.

Commercial litigation is running off the rails. Something has gone wrong. Perhaps the only real solution in the short term is greater discrimination on the part of legal practitioners as to what points are taken, and much more economy and discipline on the part of the courts in permitting recourse to background. This may have to be backed up by special indemnity costs orders and a certain amount of judicial brutality of a kindly variety. But one technique may be to employ at least a form of Mason J's thinking: not to look at the real detail of the background unless there is an ambiguity on the face of the contract read with the obvious background, or there

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<sup>96</sup> *Attorney-General v Hitchcock* (1847) 1 Ex 91 at 105; 154 ER 38 at 44.

is real weight in the contention that the contract has two possible meanings.

In the *Chartbrook* case the House of Lords excluded evidence of negotiations even though in a few cases injustice would be caused by this course. The same reasoning might support a form of Mason J's test. To restrict access to the background may cause some injustice in a relatively small number of individual cases, but it would have broader advantages.

Further questions arise. One is whether *Prenn v Simmonds* and now the *Chartbrook* cases have contributed to the parlous state of modern commercial litigation. Another question is whether, even if *Prenn v Simmonds* has not itself contributed to that state of affairs, and however sound it is in principle, its application in complicated modern conditions has proved too time-consuming compared to its utility in a simpler past, when commercial life was less cumbersome, when business machines were fewer, and when legal services were delivered on a professional rather than a commercial/industrial basis. A further question is whether the courts should seek to curb the parties' enthusiasm for seeking to rely on background facts and seek instead to encourage the wider use of recitals, thus moving the background facts into the foreground.



### The Chartbrook compromise and trusts: general

Does the *Chartbrook* compromise apply to trusts? The question arises because the *Chartbrook* compromise has been said to involve an abandonment of the traditional "rules of construction" that applied in the past. In the *ICS* case Lord Hoffmann said: "Almost all the old intellectual baggage of 'legal' interpretation has been discarded."<sup>97</sup> In particular, he said that while it was unusual, even in the 19<sup>th</sup> century, for commercial documents to be interpreted according to the rules of construction, those rules continued to dominate the construction of wills and deeds. Now wills and deeds are very common tools for the creation of trusts, and a change in the rules of construction that apply to them could be a significant matter.

The question of whether the *Chartbrook* compromise applies to trusts in Australia is an open one, not only because a rule for contract does not necessarily apply in trust law, but also because in *Royal Botanic Gardens and Domain Trust v South Sydney City Council*<sup>98</sup> the High Court said that if Australian courts detected any inconsistency between *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*<sup>99</sup> and the *Chartbrook* cases, they

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<sup>97</sup> [1998] 1 WLR 896 at 912.

<sup>98</sup> (2002) 240 CLR 45 at 62-63 [39].

<sup>99</sup> (1982) 149 CLR 337 at 352.

should continue to follow the *Codelfa* case until the High Court had examined the matter. It is thus possible that not everything said in the *Chartbrook* cases will be accepted in Australia.

In *Gosper v Sawyer* Mason and Deane JJ said:<sup>100</sup>

"The origins and nature of contract and trust are ... quite different. There is however no dichotomy between the two. The contractual relationship provides one of the most common bases for the *establishment* or implication and for the *definition* of a trust."

It would therefore not be surprising if the *Chartbrook* compromise had a role to play in relation to trusts, both in England and Australia.

The *Chartbrook* compromise can have two possible applications. One is to the question whether there is a trust at all. The other is to the question of what its terms are – a related question, because whether there is a trust depends on the terms of the transaction. The possible dual application of the *Chartbrook* compromise is supported by the use by Mason and Deane JJ of the words "establishment" and "definition" in the last passage quoted.

In *Inland Revenue Commissioners v Raphael*, in 1934, Lord Wright had no doubt that elements of what is now the *Chartbrook*

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<sup>100</sup> (1985) 160 CLR 548 at 568-569 (emphasis added).

approach applied to both "establishment" and "definition". He said, speaking of a failed attempt to settle property on trust:<sup>101</sup>

"the Court, while it seeks to give effect to the intention of the parties, must give effect to that intention as expressed, that is, it must ascertain the meaning of the words actually used. There is often an ambiguity in the use of the word 'intention' in cases of this character. The word is constantly used as meaning motive, purpose, desire, as a state of mind, and not as meaning intention as expressed. The words actually used must no doubt be construed with reference to the facts known to the parties and in contemplation of which the parties must be deemed to have used them: such facts may be proved by extrinsic evidence or appear in recitals: again the meaning of the words used must be ascertained by considering the whole context of the document and so as to harmonize as far as possible all the parts: particularly words may appear to have been used in a special sense, which may be a technical or trade sense, or in a special meaning adopted by the parties themselves as shown by the whole document. Terms may be implied by custom and on similar grounds. But allowing for these and other rules of the same kind, the principle of the common law has been to adopt an objective standard of construction and to exclude general evidence of actual intention of the parties; the reason for this has been that otherwise all certainty would be taken from the words in which the parties have recorded their agreement or their dispositions of property."

In *Gissing v Gissing* Lord Diplock, too, reflected the *Chartbrook* approach. He made it plain that a trust between spouses could be inferred from the conduct of the parties. He said:<sup>102</sup>

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<sup>101</sup> [1935] AC 96 at 142-143.

<sup>102</sup> [1971] AC 886 at 906.

"the relevant intention of each party is the intention which was reasonably understood by the other party to be manifested by that party's words or conduct notwithstanding that he did not consciously formulate that intention in his own mind or even acted with some different intention which he did not communicate to the other party. On the other hand, he is not bound by any inference which the other party draws as to his intention unless that inference is one which can reasonably be drawn from his words or conduct."

Among the conduct relevant to inferring the trust was "what spouses said and did which led up to the acquisition of a matrimonial home". He referred to financial aspects of the transaction by which the matrimonial home was purchased, and the financial contributions of the parties as relevant to the inquiry. These are a type of "background circumstances".

There is an Australian case, *Eslea Holdings Ltd v Butts*, decided before the modern *Chartbrook* line of cases, in which "commercial necessity" was held relevant to the inferring of a trust. It was a case where guarantees were held on trust, and the relevant "commercial necessity" turned on the scope of the business which the party guaranteed was engaging in.<sup>103</sup> Mason CJ and Wilson J followed that approach when they said in 1988 in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*:<sup>104</sup>

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<sup>103</sup> (1986) 6 NSWLR 175 at 189-190.

<sup>104</sup> (1988) 165 CLR 107 at 121 (emphasis added).

"the courts will recognise the existence of a trust when it appears from the language of the parties, construed in its context, including the *matrix of circumstances*, that the parties so intended. We are speaking of express trusts, the existence of which depends on intention. In divining intention from the language which the parties have employed the courts may look to the *nature of the transaction* and the *circumstances, including commercial necessity*, in order to infer or impute intention: see *Eslea Holdings Pty Ltd v Butts*."

The reference to "matrix of circumstances" is plainly a reference to the decisions of Lord Wilberforce relied on in the *Chartbrook* line of cases. Similarly, Deane J said that where it was said that a contract had created a trust of a promise, the contractual terms had to be construed "in context".<sup>105</sup>

Two years later, Priestley JA said in *Walker v Corboy* that in deciding whether an agent for the sale of farm produce was a trustee of the proceeds or whether he and the principal stood only in the relationship of debtor and creditor, it was necessary to evaluate the "circumstances" and "background".<sup>106</sup> He cited a decision of Sir George Jessel MR in which, in deciding against the existence of trust or equitable duties, he took into account the nature of one party's business which was necessarily known to the others.<sup>107</sup> And Meagher JA said that in deciding whether there was a trust, it was

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<sup>105</sup> (1988) 165 CLR 107 at 148.

<sup>106</sup> (1990) 19 NSWLR 382 at 385-386.

<sup>107</sup> *Kirkham v Peel* (1880) 43 LT 171 at 172.

necessary to look not only at "the particular provisions of the agreement of the parties", but also "the whole of the circumstances attending the relationships between the parties".<sup>108</sup>

The following year, Gummow J twice said that the relevant intention to create a trust "is to be inferred from the language employed by the parties in question and to that end the court may look also to the nature of the transaction and the relevant circumstances attending the relationship between them."<sup>109</sup>

In England the *Chartbrook* principle has been applied to the construction of trust deeds controlling pension funds – first in the language of Lord Wilberforce's "matrix of fact",<sup>110</sup> later without that reference. In that area one relevant aspect of the background is the fiscal background,<sup>111</sup> and the practice and requirements of the tax

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<sup>108</sup> *Walker v Corboy* (1990) 19 NSWLR 382 at 397.

<sup>109</sup> *Re Australian Elizabethan Theatre Trust; Lord v Commonwealth Bank of Australia* (1991) 30 FCR 491 at 503; *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1991) 101 ALR 363 at 370. *Walker v Corboy* and *Re Australian Elizabethan Theatre Trust* were followed in *Di Petro v Official Trustee in Bankruptcy* (1995) 59 FCR 470 at 484.

<sup>110</sup> *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 at 1610; [1991] 2 All ER 513 at 537.

<sup>111</sup> *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 at 1610-1611; [1991] 2 All ER 513 at 537; *National Grid Co plc v Mayes* [2001] 2 All ER 417 at 423-424 [18]-[20].

authorities at the relevant time.<sup>112</sup> Another relevant aspect is that the beneficiaries under a pension scheme are usually not volunteers, but have rights with contractual and commercial origins in their contracts of employment which they pay for by their service and contributions.<sup>113</sup> Another relevant aspect is common practice in the field of pension schemes generally, as evinced in the evidence of actuaries and textbooks by practitioners in the field.<sup>114</sup>

In 2000 Gaudron, McHugh, Gummow and Hayne JJ said that even if "the language employed by the parties ... is inexplicit", the court can infer an intention to create a trust "from other language used by them, from the nature of the transaction and from the circumstances attending the relationship between the parties."<sup>115</sup>

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<sup>112</sup> *Stevens v Bell* (unrep, English CA, 20 May 2002), quoted in *Ansett Australia Ground Staff Superannuation Plan Pty Ltd v Ansett Australia Ltd* (2002) 174 FLR 1 at 56-57 [216].

<sup>113</sup> *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 at 1610; [1991] 2 All ER 513 at 537; *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589 at 597; [1991] 2 All ER 597 at 605-606.

<sup>114</sup> *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 at 1611; [1991] 2 All ER 513 at 537-538; *Stevens v Bell* (unrep, English CA, 20 May 2002).

<sup>115</sup> *Associated Alloys Pty Ltd v CAN 001 452 106 Pty Ltd (in liq)* (2000) 202 CLR 588 at 605 [34]. In *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35 at 77 [281] the *Chartbrook* principles of contractual construction were applied to an inquiry into whether a fiduciary relationship founded on a contract existed.

Neither in England nor in Australia has the application of the *Chartbrook* compromise to trusts been analysed with the sophistication devoted in England to its application in contractual construction. However, there seems little doubt that in both English and Australian law the surrounding circumstances are material to the question whether there was an intention to create a trust. Since the question of whether a trust exists and the question of what its terms mean are closely related, the surrounding circumstances must be material to that question as well.

There is one fundamental respect in which the *Chartbrook* cases are valuable in Australia. That lies in the datum on which they are based – that what matters for contractual purposes is not the subjective states of mind of the parties, but the "intention" expressed in their contract. The same is true for trusts. The passage from Lord Wright quoted earlier establishes that. The following observation of Sir George Jessel MR does as well:<sup>116</sup>

"The settlement is one which I cannot help thinking was never intended by the framer of it to have the effect I am going to attribute to it; but, of course, as I very often say, one must consider the meaning of the words used, not what one may guess to be the intention of the parties."

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<sup>116</sup> *Smith v Lucas* (1881) 18 Ch D 531 at 542.



Similarly, Conaglen has said:<sup>117</sup>

"it should be emphasised ... that, although trusts *can* be settled by way of unilateral declaration over the settlor's own property, by far the more common method of creating trusts is for the settlor to transfer property to a third party who agrees to hold that property on trust. The court's focus when construing the terms of that bilateral arrangement is on the objective meaning that those terms would convey to a reasonable person, just as it is when construing contractual arrangements."

The question is what the settlor or settlors did, not what they intended to do. That truth tends to be obscured by constant repetition of the need to search for an "intention to create a trust". That search concerns one of the three "certainties" – what Dixon CJ, Williams and Fullagar JJ called in *Kauter v Hilton*:<sup>118</sup>

"the established rule that in order to constitute a trust the intention to do so must be clear and that it must also be clear what property is subject to the trust and reasonably certain who are the beneficiaries."

But when the expression "intention to create a trust" is used, the usage refers to an intention to be extracted from the words used, not a subjective intention which cannot be extracted from those words.

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<sup>117</sup> Matthew Conaglen, "Sham Trusts" (2008) 67 *Cambridge Law Journal* 176 at 181.

<sup>118</sup> (1953) 90 CLR 86 at 97.

As with contracts, subjective intention is only relevant in relation to trusts when the transaction is open to some challenge or some application for modification – an equitable challenge for mistake or misrepresentation or undue influence or unconscionable dealing or other fraud in equity, an application for modification by reason of some estoppel, a challenge based on the non est factum or duress defences, an allegation of illegality,<sup>119</sup> an allegation of "sham",<sup>120</sup> or a claim for rectification. But subjective intention is irrelevant both to the question of whether a trust exists and to the question of what its terms are.<sup>121</sup>

The sound justifications for limiting access to pre-contractual negotiations referred to above<sup>122</sup> apply equally to negotiations before trusts: in both cases the court is not concerned with "the real intentions of the parties, but with the outward manifestations of those intentions".<sup>123</sup> Where contracts are concerned, there is a public and private interest in matters being speedily determined

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<sup>119</sup> *Nelson v Nelson* (1995) 184 CLR 538.

<sup>120</sup> Matthew Conaglen, "Sham Trusts" (2008) 67 *Cambridge Law Journal* 176.

<sup>121</sup> See Scott and Fratcher, *The Law of Trusts*, 4<sup>th</sup> ed (1987), vol 1 at 248-249 [23] and at 284-285 [25.2].

<sup>122</sup> See above, page 35 at nn 91 and 92.

<sup>123</sup> *Taylor v Johnson* (1983) 151 CLR 422 at 4218 per Mason ACJ, Murphy and Deane JJ.

without recourse to every detail of the negotiations. That is true of inter vivos trusts as well. Where testamentary trusts are concerned, the subjective intentions will be those of the testator before executing the will, and that may have happened so long before death that the evidence has disappeared or become unreliable.

### **The Chartbrook compromise and trusts: third party problems**

One difficulty which exists in relation to contract may also exist in relation to trusts. In contract there is perhaps, at least in some applications, a fundamental difference between examining what a contract conveys to a reasonable person having the background knowledge reasonably available to the *parties*, and what it conveys to a reasonable person having all the background knowledge reasonably available to the *addressees* of the document. It will be recalled that the first proposition was advanced in the *ICS* case, and the second was advanced in *The Starsin*. Lord Hoffmann said that a contract is addressed to the parties. That is an understandable but curious usage: an addressee of a document usually receives it from someone else, and persons who draft and adhere to a document are not usually seen as addressing it to themselves. But even if parties to a contract are to be seen as its addressees, contracts can be assigned or charged or novated or otherwise shown to third parties, like banks or customers or suppliers or insurers. Hence the class of addressees is much wider than the parties. The background knowledge reasonably available

to the parties may be quite different from that which is reasonably available to other addressees. What is within the common knowledge of the parties may not be within the common knowledge of other addressees. The parties may have private dealings through which they gain mutual knowledge (for example, of each other's business affairs), or at least a mutual opportunity to gain that knowledge. Other addressees of the contract may not have the same knowledge of the parties' affairs as the parties did; and they may not know other matters, or have the opportunity to learn of them.

A similar problem exists with trusts. In the case of family trusts, the background known to the settlor, and if the settlor enters a covenant to hold property on trust, the background known to the settlor and the other parties to the covenant such as the trustees, could be important.<sup>124</sup> It would include matters like the financial position of the settlor, and members of the family, and their relationships. But if that knowledge of the background points in one direction, will the outcome be affected by the fact that the knowledge of other addressees is different? The knowledge of beneficiaries, agents appointed by the trustees, banks, insurers of trust property, and persons who may take assignments of a

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<sup>124</sup> See (eds) John Mowbray, Lynton Tucker, Nicholas Le Poidevin, Edwin Simpson and James Brightwell, *Lewin on Trusts*, 18<sup>th</sup> ed, (2008) at 203 [6-08].

beneficial interest under the trust may be very different from that of the settlor and others party to the creation of the trust. In the case of a superannuation trust or other trust intended for the benefit of employees of a large company, if beneficiaries are addressees, the class of addressees will be enormous. And the executives responsible for setting it up may number more than a few.

It may be that in the particular case of a bill of lading, because of its function as a document of title, it was appropriate to identify the class of addressees as the House of Lords did in *The Starsin*. But it may be that for trusts the class of addressees should be much less wide than might be suggested by *The Starsin*. It may be that the class should simply be limited to the settlor and those who are parties to any covenant by which the trust was established.

Chief Justice Spigelman has presented arguments against over-reliance on the background known to the parties.<sup>125</sup> The reasoning rests on the fact that contracts often come into the hands of and are used by third parties – perhaps with greater frequency than in the past. He considers that too much weight is given in contractual interpretation to the background shared by the parties (of which third parties may know very little) and too little weight is given to the fact that the third parties are likeliest to rely, and

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<sup>125</sup> J J Spigelman, "From Text to Context: Contemporary Contractual Interpretation" (2007) 81 *ALJ* 322 at 334-336.

perhaps only rely, on the words used in the contract. His plea is not that more weight be given to what addressees know or are taken to know, but that less weight be given to what parties know. His fundamental point is that certainty is significant, not only for the parties but for third parties.

A similar concern has been expressed by Saville LJ in *National Bank of Sharjah v Dellborg*:<sup>126</sup>

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

Finally, Alan Berg, a solicitor, has pointed to the need for the approach of the courts to interpretation to correspond with the way

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<sup>126</sup> Unreported, English CA (Civil Division), 9 July 1997, quoted by J J Spigelman, "From Text to Context: Contemporary Contractual Interpretation" (2007) 81 *ALJ* 322 at 337.

a lawyer asked to give speedy advice would approach interpretation, and often circumstances create the need for advice to be given extremely urgently. His point is that the lawyer will not necessarily know much about the background, particularly if the transaction is complex and not reasoned, and the lawyer was not personally involved in drafting or negotiating the transaction. He said:<sup>127</sup>

"for a commercial contract, the correct approach is to ask what methods of interpretation the parties, as businessmen and not as jurists, may realistically be taken to have intended should be used, having regard to two assumptions: (i) the parties cannot have intended that their contract would mean one thing to a court and something else to a lawyer asked to advise about it; and (ii) the parties must have had in mind the possible need, at some future point, to obtain legal advice without delay. On that approach, the parties may reasonably be taken to have intended that the admissible background should be limited to the sort of facts likely to be readily available to a lawyer asked to advise in circumstances in which a decision has to be taken without delay as to the course of action to be taken under the contract."

Obviously the third party problem could arise as sharply with trusts as it could with contracts.

### **Conclusions**

One conclusion is that the *Chartbrook* compromise rests on competing ideas, and the competition between those ideas was

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<sup>127</sup> "Thrashing Though the Undergrowth" (2006) 122 *Law Quarterly Review* 354 at 362.

taking place at least 150 years ago. A second is that elements of the *Chartbrook* compromise for contracts have been applied to trusts both in England and Australia. A third is that the elegance with which the *Chartbrook* compromise has been stated masks very difficult problems which remain to be resolved conclusively and satisfactorily.





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