

Lecture 6: Implied Terms; Construction of Terms; Exclusion Clauses

Implied Terms: parties have not consciously included these terms in the formation of the contract

Under which circumstances will a Court imply a term into a contract?

- 1) **On the facts of the case** – we ask whether the particular facts and circumstances of the case justify or necessitate the implication of a term
- 2) **By operation of law** – we ask whether a term should be implied into a contract as a matter of law; Statute requirements/by way of common law
- 3) **Custom/usage** – we ask whether the way in which things are usually done in a particular trade or industry or market or locality would justify the implication of a term. A court will look at:
 - i. What type of contract is this?
 - ii. In what sort of market did this contract arise?
 - iii. In what sort of trade/industry did this contract arise; how are things normally done

General rule: Courts are reluctant to imply a term into a contract.

- They will only do so if certain threshold requirements are met (and this varies depending on the type of situation which arises).
- Courts do not want to be seen as “creating a contract.” They will generally be trying to enforce the contract that the parties themselves have formed.
- Implying a term into a contract can be potentially very intrusive. Traditionally, there have been constraints and limitations on courts to imply a term into a contract.
- The **onus** of convincing a court that a term should be implied rests with the party asserting that the term should be implied.

With contracts that appear to be comprehensive (i.e. written contracts) and follow a period of negotiation, esp. if there were legal parties involved in the drafting of these contracts, the implication of terms is rare. But it can happen.

Implication of terms on the facts of the case

- This is the most difficult situation for the implication of terms into contract. It really only occurs if the facts of the case are so strange that it warrants an implication of a term.
- In cases like this, the Court will only imply a term if the Court is satisfied that the term will give effect to the **presumed intention of the parties** (using an objective test, what the parties must have intended for the contract to do).

In order to decide whether to imply a term, courts tend to differentiate between contracts that are more formalized written contracts, and agreements that are less formalized.

Formal, written contracts

With formalized written contracts, the court will only imply a term if it is measured against the requirements set out below.

BP Refinery v Shire of Hastings (1977) 180 CLR 266

- Outlines the requirements for the implication of terms in written contracts.
- Originally, these requirements were thought of as essential.
- Over time, courts have become a little bit more flexible in the way they look at these requirements so that today you could say that they are “factors to be taken into account.”

Principles for the implication of terms on the facts of the case for written contracts:

- 1) **The implied term has to be reasonable and equitable** – we’re looking for the presumed intention of the parties: this has to be reasonable to both or all of the parties concerned.
 - a. To decide if this is reasonable and equitable, courts will consider and balance the **benefits** and the **burdens** of each party under the contract.
 - b. It’s less likely that the term will be implied if it clearly disadvantages one party against the other.
 - c. This is because a court will consider that the parties reasonably negotiated such an outcome, and that if one party were to be disadvantaged over the other, this would not reflect the presumed intention of both parties.
- 2) **The implied term must be necessary to give business efficacy to the contract** – courts ask: “would the contract be fully effective without this term?” If the contract is capable of **sensible operation** w/o this implied term, the term will probably not be implied.
 - a. The court is judging, how necessary is this term to achieve the overall aim of the contract? Can the aim of the contract be achieved without this term? If it can, it is less likely that it will be implied.
- 3) **The implied term must be obvious** – so obvious that it goes without saying
 - a. a court should be satisfied that both parties would probably have included this term had they put their minds to it.
 - b. The term will not be considered obvious if there are several possible terms that could be implied.
- 4) **The implied term must be capable of clear expression** – the party seeking to include the term must show that the term is not so wide/so imprecise/ so unclear that we either can’t get the words right or, more typically, that even when you get the words right, we’re not quite sure what the term is meant to achieve.
 - a. The onus is on the party seeking assertion of the implied term to come up with the wording of the term, and to make sure that it is clear and precise.
- 5) **The implied term must not contradict or be inconsistent with any express terms in the contract** – no term will be implied if there is already an express term which covers that field, no matter what it says. Courts will always give precedence to the express term, no matter how that term has been incorporated into the contract.

Codelfa Construction Pty Ltd v State Rail Authority of NSW (1982) 149 CLR 337

- Most well-known case applying these principles set out in *BP Refinery v Shire of Hastings*.

[FACTS]

- This case involved construction of the eastern-suburbs railway where the *Codelfa* company won the contract to do some of the excavation work for the State Rail authority
- The State Railway authority (being a statutory authority) was protected by statute; it was given a statutory immunity in certain circumstances including nuisance
- When constructing railways there is a lot of disruption to the world generally and the statutory authority is protected by law against nuisance claims
- Both parties assumed that that statutory authority would extend to any of the contracting parties to do that work
- Codelfa negotiated with SRA to do the work with this in mind - agreed to do excavation work non-stop in order to meet schedule
- Local residents in that area took action to stop some of the excavation work because it was disruptive; wanted to stop the work at night and on Sundays
- Residents won an injunction to do that – work could not proceed on a non-stop basis anymore.
- Codelfa was not protected by the SRA immunity; therefore work could not be done according to the schedule that they had formed
- Codelfa ended up finishing the work late. When it was all done, the Codelfa company claimed that they should have been paid more – saying that there should be an implied term to the effect that “we would be able to increase our costs because in the circumstances it cost us more to achieve what we had to contractually achieve.”

[HELD]

High Court refused to imply this term as requested by Codelfa:

- Had the parties put their minds to the possibility that the SRA’s statutory immunity did not extend to Codelfa, it was not obvious that the SRA would have agreed to pay the extra money
- it would have been more likely that other alternatives would have been explored and that the parties at that point would have negotiated further to cover their respective interests in such an eventuality
- This case illustrates that Courts will not imply a term just because it seems like a good idea, or just because it would solve the problems for one of the parties; they will only do so on an objective test that the subject of the term would have been agreed to by both parties as **necessary for the contract to achieve what the parties wanted to achieve.**

Attorney General of Belize v Belize Telecom Ltd [2009] 2 All ER 1127

- Privy Council decision – not obligated in Australia to follow this decision
- It is likely that the High Court may adopt what was said in this case.
- Court had to decide whether to imply a term into a company's Constitution.

Lord Hoffman: about the process of implication of terms

- Where a contract fails to expressly say what will happen if an event occurs, then basically nothing is to happen. [STARTING POINT].
- If the event that has occurred causes loss to one of the parties, then so be it. The loss lies where it falls.
- HOWEVER, it may be appropriate to imply a term where a reasonable observer understands that something should happen that will affect the rights of the parties: “this is what the contract must have been saying even though the parties have failed to say so expressly.”
- Where it is argued that a term should be implied into a contract, there is a question a Court must answer: would such a provision spell out in express words what the contract, read against the **relevant background**, would reasonably be understood to mean?
- The **implication of a term is not an additional term** to the contract; when you think of implying a term, you shouldn't be seen as “adding” to the contract, you are only spelling out what the contract means but fails to say.
- Referring to BP Refinery case – best regarded as not a set of independent tests each of which must be satisfied, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed term must spell out what the contract really means.

Shifts principles from “necessary” to “reasonable.”

Mediterranean Salvage & Towage Ltd v Seamar Trading & Commerce [2009] EWCA Civ 531

Crema v Cenkos Securities [2010] EWCA Civ 1444

The Moorcock (1889) 14 PD 64

[FACTS]

- Two parties agreed that a ship would be used for the purpose of unloading cargo - agreed that this particular ship would be moored in a particular place for the purpose of loading that ship with cargo
- They expressly agreed that that ship would be allowed to rest on the bottom of a river when the tide went out
- When the tide came back in, they let the ship come back to the particular place to continue loading the cargo
- Whilst the ship was resting on the bottom of the river, it was damaged

[HELD]

- Court of Appeal was prepared to imply a term to the effect that the owner of the jetty where the boat was moored would indemnify the owner of the ship in case the river bottom contained a risk to the bottom of the boat
- Court was saying that both parties must have intended that if they were happy to have the ship rest at the bottom of the river, surely both have agreed that the owner of the jetty would indemnify the owner of the boat
- NOT SURE IF SAME RESULT WOULD APPLY TODAY → BP Refinery case had not come to existence yet.

CASE ILLIJA COULDN'T FIND IN TIME FOR LECTURE:

Correlative obligations:

- Lease between a tenant and a landlord which says that the tenant is to pay for certain outgoings including lighting to the common area car park.
- There was no lighting in the common area car park
- Landlord said that there was no express obligation that he was to provide lighting to the common area car park
- Court said this is a correlative obligation: if one party has an express obligation to pay for the lighting, then we are prepared to imply a term that the other party is to provide the lighting.

Informal, unwritten contracts

Courts have tended to opt for a more flexible approach than the BP Refinery criteria when it comes to informal/unwritten contracts. Courts must decide whether the *implication of a term is necessary for the reasonable or necessary operation of the contract*, taking into account any existing custom and usage → the implied term must be capable of clear expression and must not contradict any express term in the contract

Hawkins v Clayton (1988) 164 CLR 539

Byrne v Australian Airlines Ltd (1995) 185 CLR 410

Implication of terms by law

- In order for a court to imply a term as a matter of law, it's normally the case that a court will see if the contract can be placed within a recognized category or type of contract.
- Specifically in the common law, courts will ask if the contract belongs to a specific "class" of contracts and courts will give priority to policy concerns (i.e. those that are in the public interest) **rather than the presumed intention of the parties**.
- How could the public generally be affected by the course of this contract? (e.g. public policy would be adversely affected if agreements made in marriage were interfered with by the law).

Statute

- Very common for terms to be implied into contracts; certain types of contracts will include implied terms that are mandated by statute.
- For example, in consumer transactions, the contract needs to comply with the ACL - "goods be of acceptable quality/fit for the purpose etc.
- In some types of contracts, the parties may be free to expressly include the implication of statutory implied terms; generally only in commercial transactions where the Sale of Goods Act may apply → you cannot exclude provisions of the ACL.
- Sale of Goods Acts, Australian Consumer Law et al.

Common Law

Some types of contracts may have terms implied.

- Employment duties;

When you get a job, courts have been prepared to imply certain terms into employment contracts. E.g. that the employee will exercise due care and skill/ will follow lawful and reasonable instructions/ employers must provide a safe workplace.

- Implied term of cooperation
- Although many common law implied terms relates to particular types of contracts, some terms apply to ALL types of contracts. An implied term of cooperation does apply to all types of contracts.
- Each party is contractually bound to do all things necessary on their part to enable the other party to receive the benefit of the contract and not to prevent the fulfillment of an express term. You cannot sabotage the contract.

Butts v O'Dwyer (1952) 87 CLR 267

- Parties agreed to a contract of the sale of land subject to ministerial consent
- High Court implied a term that the transferor had to do all he could reasonably do to obtain the minister's consent.
- The transferor may have changed his mind and never went to get that consent, which was a breach of his duty to cooperate.
- Thus, Court implied a term of cooperation.

Implication of terms by custom and usage

- It is important for a court to look at the customs and practices/ the way things are done in a particular industry or trade etc and to imply a term into that contract on that basis.
- If there is some usage or custom that is there, the courts may take that if it is necessary for them to imply a term.

Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (1986) 160 CLR 226

[FACTS]

- Insurance policy - customer paid a premium directly to an insurance broker and the broker didn't pass the premium on
- The broker was bankrupted and when a customer made a claim on that insurance policy, the insurer said that because the premium was never paid, she was not insured.
→ Insurer took action to receive the premium which they never received
- Should the court imply a term that the insurer could only sue the broker in such a case and not the customer? This would be in favour of the customer's argument

→ there was no such practice or custom in the insurance industry (although some people did it that way, there was no clear evidence that this was an established practice or custom)

[HELD]

- The broker is the agent of the customer and thus the customer remained liable.

Evidence of custom and usage is a **question of fact**. You have to prove custom and usage as a matter of fact. Heavy onus of proof – the custom/usage must be virtually a notorious fact – must be so well known that the parties must have intended to include it as a term. However, it is not necessary to prove that it is universally accepted.

Incorporation by custom will not be possible if there is an express term in the contract which would contradict that custom and thus contradict the implication of a term on such a custom.

Implied terms of 'good faith'

- Category of their own- don't necessarily belong anywhere
- Courts have tried to grapple with this issue in the past couple of decades – no clear resolution in Australia.
- QUESTION: Is there a term implied in commercial contracts as a matter of law rather than fact that the parties will act in good faith?
 - One thing is to look at a particular contract and say that "in this particular contract on its facts, we think we are prepared to imply a term."
 - This differs with implied terms of good faith; we look if we should imply this term of good faith as a matter of law.
 - NSW courts are more inclined to imply such a term in commercial contracts whereas in other states, they have been less inclined. The High Court has avoided this issue. They had the opportunity to resolve this issue in the following case, but didn't take that opportunity up.

Royal Botanic Gardens & Domain Trust v South Sydney Council (2002) 186 ALR 289

In this case, Justice Kirby pointed out three issues that need to be resolved before it can be decided that a term of good faith can be implied into a contract:

- 1) **To what types of contracts will this apply?** If there is such a term of good faith, is this only referable to commercial contracts or to other kinds of contracts as well?
- 2) **What does the obligation/duty of good faith actually mean?** This needs to be more precise; has to have some specific meaning. One of the judges on this case elaborated upon this point in more detail outside of Court, saying that it:
 - a. Means that both parties are to **cooperate** to achieve the objectives of the contract (this duty exists anyway under implied duty of cooperation)
 - b. The parties have to act **reasonably** what circumstances should they act reasonably? Why should they act reasonably?
 - i. In some circumstances, when negotiating the price of goods, one of the parties may charge an “unreasonable amount” higher than market price to which the other party is happy to pay. Why should “reasonableness” stop the party from charging that much?
 - ii. What about the “freedom of contract?” To what extent should the state interfere with agreements and tell us what’s reasonable and what’s not reasonable?
 - c. That the parties are to adhere to **honest standards** of behaviour. What constitutes honest behaviour in what circumstance?

However, this is not law or should not really be taken into consideration because it was not deliberated upon during the proceedings.

- 3) **Can an implied term of good faith, whatever it is, be expressly excluded by the parties?** In commercial contracts, parties should be free to contract and free to exclude any requirement they want to (provide it is not against statute to remove such a requirement).

A duty of good faith will not routinely be implied into contracts as a matter of law, but it may be implied into contracts on the facts of the case.

Construction of Terms

- Very often a court will need to determine what the parties meant when they said what they said.
- This is an important topic on a practical sense; most issues that come to the Courts involve the construction of terms – what is meant by the terms?

Importance of legal drafting

- Requires skill and accuracy – good drafting usually comes with experience.
- Legal writing differs to literary writing; it's about limiting the possibilities/meanings of the words and the terms that are used (i.e. being precise and consistent with the meaning of words and terms).

Aim is to determine intention of parties

- The main objective is to be clear of the intentions of the parties in their pursuit of what they hope to get out of the contract → avoid the contract from being declared void for “uncertainty.”

Literal v ‘commercial’ approach to construction

- Literal: You read the term; and you say “this is what these words mean;” safest approach – the Courts do not have to “invent” what the terms meant.
- More recently, however, Courts are beginning to be more inclined to adopt a more “commercial” approach – interpreting the terms in such a way that a commercial party would construe those terms. This sometimes means avoiding too literal/technical an approach.

General principles of construction

- Meaning is subject to an objective test – looking at the words/text of a contract, and determining what a reasonable person in the same situation would take these words/text to mean. Put the words in the context of the facts; what is the purpose of this contract?
- Presumption parties did not intend an unreasonable result – Courts will try to avoid construing a term that would lead to a result that could be seen as unreasonable in the circumstances, and they would try to settle on a meaning that has a less clear, but reasonable result. HOWEVER, if it is clear from the words that the unreasonable result is actually what the parties intended, then the court will probably give effect to that intention.
- Courts will avoid finding inconsistencies in a contract – Many contracts have got inconsistencies all over the place, if Courts were actively looking for them, they could negate the whole contract, which of course is something the Courts try to avoid. In some circumstances, however, the inconsistency is so great that nothing can be done other than to negate the whole contract.

- Presumption in favour of business common sense – courts will generally favour what a reasonable objective commercial will see what the contract is purporting to say. However, just because one of the parties has agreed to do something that a reasonable party would not agree to do, this doesn't mean that a Court will not enforce such a term, especially if that term is clear.
- Presumption parties intended technical use of words – where technical words or phrases are used in a contract, there is a presumption that the parties intended to use those words according to their technical meaning. This presumption can only be rebutted on clear evidence that both parties did not intend that that be the case.

Phoenix Commercial Enterprises v City of Canada Bay Council [2010] NSWCA 64

Parol Evidence Rule

- The Parol Evidence rule has two limbs: exclusionary limb and the constructionary limb.
 - The **exclusionary** limb decides whether a statement or a promise is incorporated as an express term to the contract; rule states that Courts cannot take extraneous matters into account in order to subtract from or vary the terms of a written contract.
 - The **construction** limb deals with the exclusion of extraneous evidence insofar as that evidence would assist a Court in interpreting or construing a contract as a whole, or a term in that contract. This limb says: in determining what the contract or words in the contract means, the **Parol Evidence rule stops us from taking matters outside of the contract to determine what those terms mean.**

[PROBLEMS OF THE PAROL EVIDENCE RULE]

- Excluding evidence of prior negotiations
 - Courts prefer to let the contract speak for itself.
 - Australian courts have generally applied this rule strictly. In order to decide what a contract says or means, you don't look to what the other parties said to each other before the contract was formed.
 - We can look to what the parties said and did during negotiations to decide whether a contract was formed and in order to decide whether something was expressly included in a contract; but now we are concerned with what the contract means – we don't look at what the parties had said to each other beforehand in order to decide what the meaning of a particular phrase/word is.
 - The British courts have been more flexible; however Australian courts have enforced the rule more strictly on the basis that prior negotiations between the parties mostly reveal what the parties intended to achieve, not what they actually agreed on.
- Excluding evidence of post-contractual conduct
 - Just as we shouldn't look at what the parties said to each other before the contract was formed in order to understand what the contract means, we also should not look at what the parties did after the contract was formed to understand what the contract means.

- Judicial opinion differs on this topic and the High Court has not ruled to clarify what should be done – should we or should we not look to the conduct of the parties after the formation of the contract to determine the meaning of the contract?
- If you look at the conduct of the parties after the contract was formed, this can distort the truth, distorting what the contract really means.

Hide & Skin Trading Pty Ltd v Oceanic Meat Traders Ltd (1990) 20 NSWLR 310

- ***Look at this case***

Exceptions to the Parol Evidence Rule

- Clarifying ambiguities – where words have several and separate obvious meanings – “English History Teacher”
- Identifying subject matter
- Identifying parties – if the parties had the same name

Classification of Terms

Termination v rescission

Rescission (going back to the beginning)/ termination: going forward.

Conditions

A condition is basically an **essential term**; one that goes to the root of the contract. If you breach a condition, you will not only be able to sue for damages, but you may also be able to terminate the contract as a whole.

Tramways Advertising Pty Ltd v Luna Park Ltd (1938) 38 SR(NSW) 633

Associated Newspapers Ltd v Bancks (1951) 83 CLR 322

Warranties

Warranties are non-essential terms to which an injured party can obtain damages, but they will not be able to terminate the contract.

Bettini v Gye [1876] 1 QBD 183

Intermediate terms

Unsure whether the terms are conditions or warranties.

Construction of Exclusion Clauses

Breach, incorporation, construction

- Does this exclusion clause limit liability? Or is it a big mess to which nobody understands what it means?
- Historically, courts were suspicious of exclusion clauses. They didn't particularly like them and often tried to deny a party from exercising their right to operate as per the exclusion clause.
- Today, Courts are not as hostile and exclusion clauses are readily used in commercial contracts. Courts will give effect to a valid exclusion clause even if it has harsh consequences as long as it is incorporated properly and it means what it says it means.

Darlington Futures Ltd v Delco Australia Pty Ltd (1986) 161 CLR 500

Ordinary and natural meaning

Nature of the contractual relationship

Contra proferentum rule

- When you're looking at an exclusion clause and deciding what it means, you should look to the ordinary and natural meaning of the words.
- Once the meanings of the ordinary and natural meaning of the words have been established, you put those words in the circumstances/context of the case – including the nature of the contractual relationship between the parties.
- Then, we apply the *contra proferentum* rule – in cases where there is an ambiguity, the Court reads the exclusion clause saying “it could mean this, but it could also validly mean that, which meaning should we give it?”
- You give it the meaning which goes against the party relying on the exclusion clause.

By using these principles, Courts have found in favour of parties to exclude their liability where the wording is clear, and where the parties are in a commercial relationship even where there is an inequity of bargaining power.

Photo Production Ltd v Securicor Transport Ltd [1980] AC 827

[FACTS]

- Two commercial entities; one company had premises and they engaged in a security company to protect those premises at night.
- Securicor sent a security officer to look after the factory; it was a cold night and the security officer lit a fire to keep warm - burnt down the factory
- the company wanted to be compensated but the security company said they had an exclusion clause in the contract
- Court looked at the words used: “Securicor would not be responsible under any circumstances for any loss occasioned by one of its employees *unless the employee's actions could have been foreseen or avoided by due diligence of Securicor*”

- Courts said that the actions of the employee were clearly outside the contemplation of Securicor and that because the action was so far outside the scope of the contract, that exclusion clause (even though it had harsh consequences) was accepted.
- Photo Production should not have accepted such a wide exclusion clause.

TO DETERMINE IF/HOW THE EXCLUSION CLAUSE IS APPLIED:

- You look at the exclusion clause and look at the words in their ordinary and natural meaning
- Look at the relationship between the parties & the factual background to determine what it says
- Use the contra proferentum rule (resolve ambiguities by giving it the meaning that goes against the interest of the party relying on the clause)
- Negligence rule.

Negligence rule

- If you are trying to limit your liability for negligence, then you have to be careful.
- You can limit your liability for breach of contract, but you cannot limit your liability for breach of tort.
- To limit liability for negligence, you have to be very, very precise.

Canada Steamship Lines Ltd v The King [1952] AC 192

- In the exclusion clause, you've got to expressly refer to negligence or expressly refer to a term which is wide enough to include negligence such as "under no circumstances/loss/however it's caused" etc.
- However, if your term is so wide, then it will not exclude liability.
- Other expressions you use will not exclude liability unless it is wide enough to exclude liability on other grounds → in that case those other grounds will be incorporated as the exclusion clause, not negligence.

Four corners rule

- "scope of the contract rule" – an exclusion clause can only exclude liability if the conduct that is being excluded is within the scope of the contract
- the conduct to which you are trying to exclude your liability for must be authorised/contemplated by the contract within the four corners of the contract

Council of the City of Sydney v West (1965) 114 CLR 481

[FACTS]

- West takes his car, to park in the car park of the Sydney City Council
- he got a ticket which said, "when you present your ticket, you will get your car back"
- It also had an exclusion clause which protected the car park from liability for any loss, howsoever any loss/damage/injury may arise or be caused
- Court found that this exclusion clause was properly incorporated

- West came back to pick his car up, but it was gone; a thief broke into the car, drove it down to the checkout
- The operator at the checkout let out the thief with the car
- The clause however did not apply to limit the liability of the car park because the clause purported to exclude liability for an act that was not authorised or contemplated by the contract and was outside of the scope of the contract
- **You can only exclude liability if you are excluding liability for something that is reasonably something you had to do under the contract.**
- One of the judges said, if it was valet parking for example, if the car park was authorised to take your car to move it in place A to place B, then in moving the car they smashed it, then the exclusion clause would be valid and protect the car park against that kind of damage because moving the car from place A to place B was within the scope of the contract.

Exclusion clauses and Statute

Australian Consumer Law s 64

Generally speaking, where statute excludes the operation of exclusion clauses, the exclusion clause is void.