



The interpretation of lesser words in insurance contracts: A matter of contextual commonsense?

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... The daily negotiations and property of merchants ought not to depend upon subtleties and niceties; but upon rules, easily learned and easily retained, because they are the dictates of commonsense, drawn from the truth of the case.†

This article discusses the manner in which lesser words are interpreted to invoke or exclude policy liability. It also deals with the circumstances in which the admission of pre-contractual negotiations may be appropriate to aid in the interpretive process.

1 Introduction

Much has been written about the doctrine of proximate cause in insurance law.¹ It is one of the most significant aspects in insurance law and litigation, as it deals with situations in which the insured may or may not be entitled to recover for a loss. The purpose of this article is to discuss those words and phrases which are used to invoke or exclude policy liability but do not require the consideration of proximate cause per se but do nevertheless, require a link between the loss and the event.² In this regard, they are termed as lesser words.

The first part of this article deals with a consideration of these words and phrases, their treatment in case law and the latter, with the manner in which they are interpreted. The consideration of this latter aspect necessarily touches on situations in which extrinsic evidence of pre-contract negotiations may be sought to be admitted and is so.

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† Lord Mansfield in *Hamilton v Mendes* (1761) 2 Burr 1198 at 1214; 97 ER 787.

1 M Davies, 'Proximate Cause in Insurance Law' (1996) 7 *ILJ* 135; G Pynt, 'The "causation inquiry": The law of negligence and insurance law' (2003) 14 *ILJ* 173; Text books and practitioners' manuals form a rich resource of materials in this area. In Australia some helpful sources are D Derrington and R Ashton, *Law of Liability Insurance*, 2nd ed, Lexis Nexis, 2005, pp 488–502; D St L Kelly and M Ball, *Principles of Insurance Law*, Lexis Nexis Butterworths 2001, para 8.0020.15 (Service 30); K Sutton, *Insurance Law in Australia*, LBC Information Services 1999, pp 1061–5. Two helpful and comprehensive texts from the United Kingdom are M Clarke, *The Law of Insurance Contracts*, 5th ed, Informa, London, Insurance Law Library, pp 788–92; J Lowry and P Rawlings, *Insurance Law Doctrines and Principles*, 3rd ed, Hart Publishing, 2005, pp 225–8. See also M Clarke, 'Insurance: The Proximate Cause in English Law' (1981) *CLJ* 284.

2 *Ibid*, Kelly and Ball, para 8.0020.25.

2 'Directly or indirectly'

The use of the word 'directly' as used in older cases, is clear enough in that damage or injury caused by certain specific events were meant to be covered. Hence the word 'directly' meant that it was used to 'exclude liability where injury or death was linked to some cause other than the accident'.³ Thus in *Fitton v Accidental Death Insurance Co*⁴ where cover was provided in respect of death resulting from various accidental injuries the stipulation in the policy was that the injury had to be 'the direct and sole cause of death'.

Death arising from other things such as hernia 'or any other disease or cause arising within the system of the insured before or at the time or following such accidental injury (whether causing death . . . directly or jointly with such accidental injury)' was excluded. The insured fell accidentally causing a strangulated hernia which resulted in his death. The court held that the insurers were liable to pay as the exclusion was applicable 'only where the hernia arises within the system'. In this situation it had been caused by the accident.⁵

In *Isitt v Railway Passengers Assurance Co*,⁶ the policy issued by the defendants covered the assured in the event that he sustained any injury caused by accident and should die from the effects of such injury within three months from the time that the accident took place. The injury sustained was a result of a fall causing dislocation of the shoulder. The assured was confined to his bedroom and died from pneumonia within a month from the date of the accident. It was held that he would not have died as and when he did had it not been for the accident. It was as a consequence of the accident that he suffered from pain and was rendered restless, unable to wear his clothing and unusually susceptible to cold. This susceptibility and the resultant fatal effects of the cold were attributable to the serious condition of health that he had been reduced to, by the accident. His death it was held was due to the 'effects of injury caused by accident' within the meaning of the policy.⁷

What of a situation where a clause seeks to exclude cover for a loss directly or indirectly caused by a particular means or event? Such a clause came up for consideration in *Spinney's (1948) Ltd v Royal Insurance Co Ltd*.⁸ The exclusion in various contents policies issued by the defendants in Beirut contained an exclusion clause, and the relevant wording of it was:

This insurance does not cover any loss or damage occasioned by or through or in consequence directly or indirectly of any of the following occurrences:

3 Lowry and Rawlings, above n 1, at 229.

4 [1864] 17 CB (NS) 122.

5 *Ibid.*, at 134, per Williams J.

6 [1889] 22 QBD 504.

7 *Ibid.*, at 512–13 the direction to the jury that Willes J thought was appropriate in the circumstances was:

Do you think that the circumstances leading to the death, including the cold which caused the pneumonia, were the reasonable and natural consequences of the injury and of the conditions under which the assured had to live in consequence of the injury? If you find that no foreign cause intervened and that nothing happened except what was reasonably to be expected under the circumstances, you may and ought to find that the death resulted 'from the effects of the injury' within the meaning of the policy'.

See also Lowry and Rawlings, above n 1, at 229.

8 [1980] 1 Lloyd's Reports 406.

- (a) civil war;
- (b) civil commotion assuming the proportions of or amounting to a popular rising . . . insurrection, rebellion, . . .

Looting occurred in the plaintiff's premises causing loss. In order to recover from the insurers, Justice Mustill stated that the insured had to prove that the losses occurred independently of the existence of abnormal conditions outlined in the above exclusion clause. As they had failed to discharge this burden from the evidence that they had adduced at trial, the plaintiff's claims were dismissed.⁹

On the issue of proximate cause, the finding of fact was that it 'was quite clear that the draftsman has gone to great lengths to ensure that the doctrine of proximate cause does not apply'.¹⁰ Although it was not explained in any manner by the policy drafters, the thing to do according to Lord Mustill was to examine the nature of the policy, which in this case expressly insured against violent acts.¹¹ The finding of fact by the court was that the loss was occasioned 'indirectly (if not directly) by, through or in consequence of the civil commotion'.¹²

In *Oei v Foster and Eagle Star Insurance Co Ltd*,¹³ the insured's personal liability cover in a householder's and house owner's all-in policy contained an exclusion 'for injury or damage arising directly or indirectly from . . . ownership or occupation of any land or buildings'. In the course of the Fosters' occupation of the Oei home, Mrs Foster left a pan of fat on a heated cooker and caused a fire when she failed to turn off the cooker.

The finding of fact by Glidewell J was that an indirect cause of the damage was the occupation of the insured property by the Fosters and that the cooking of meals was an inevitable incident relating to their occupation.¹⁴ It was also pointed out that there need not be a 'sufficiently clear cause or connection between the occupation and damage'¹⁵ in order for the exclusion to apply which meant that the insurers successfully excluded liability in this instance. There was no need to consider the issue of proximate cause in the light of the word 'indirectly' appearing in the exclusion.

Australian cases have regarded the word 'indirectly' in a similar vein to the English cases in excluding cover. In *Mitor Investments Pty Ltd v General Accident Fire and Life Assurance Corporation Ltd and Australian Insurance Brokers (WA) Pty Ltd*,¹⁶ the plaintiff insured a two-storey hotel under a Fire and Special Perils Insurance policy and a Loss of Profits policy. The insured property was located on the bank of an inlet connected to the Koombana Bay.

The policies covered damage and loss caused by storm and/or tempest and by flood. The aspect of flood was defined in the policy by the following relevant words as 'the escape of water from the normal confines of any natural

⁹ Ibid, at 444–5.

¹⁰ Ibid, at 441.

¹¹ Ibid, at 442.

¹² Ibid.

¹³ [1982] 2 Lloyd's Law Reports 170.

¹⁴ Ibid, at 176.

¹⁵ Ibid.

¹⁶ [1984] 3 ANZ Insurance Cases 60-562.

or artificial watercourse . . . or lake, reservoir, canal or dam'.¹⁷ However, the policy excluded cover in respect of 'destruction or damage caused directly or indirectly by the sea'.¹⁸

Strong winds generated by Cyclone Alby drove the sea into Koombana Bay, causing a tremendous influx of sea water to enter the Koombana Inlet and flood the surrounding countryside. The ground floor of the hotel was flooded and the dance jetty was damaged by the force of the surging waters.

Damage to the hotel and its contents fell into three categories. The first was in respect of property above flood level such as the TV antenna and part of the roof. General Accident admitted liability for this category of damage as it had been caused by the storm and/or tempest. The second was property such as carpets and electrical installations within the hotel which sustained saturation damage. The third category of damage was the impact damage caused by the combined impact of water and wind upon outside structures such as the jetty, the decking of the jetty dance floor and the barbecue by the combined impact of water and wind as well.

General Accident denied liability under the policies for the saturation and impact damage. Their argument was that in respect of both categories of damage, the loss and damage had been caused directly or indirectly by the sea. The insured and the brokers argued, on the other hand, that the proximate cause of the damage was Cyclone Alby and that the damage was caused by the storm and tempest and not by the sea. This argument missed out a consideration of the words 'indirectly by the sea'. The saturation damage had no doubt, been caused by flood within the meaning of the policy. However, on the facts, it had been caused indirectly by the sea. Burt CJ stated that the word 'indirectly' could not be ignored.¹⁹

In respect of the impact damage to the jetty and for other items sustaining such damage, it was held that the damage was caused by a combination of sea water entering the inlet, driven in and disturbed by the storm. Therefore, the sea had indirectly caused the damage.²⁰

A common thread runs through the unsuccessful arguments in the consideration of the word 'directly'. In *Fitton*, cover was afforded for death, the sole cause of which was the injury arising from the accident. What was not considered was that the hernia was caused by the external injuries from the accident, that is to say, the effects of the accident. In *Issit*, death from the effects of such injury occurring within 3 months was covered and the pneumonia causing death was a direct effect of the accident. In such instances, it is suggested that Willes J's direction to the jury of the direct effect of injury without the intervention of an unrelated foreign cause is instructive.²¹

17 Ibid, at 78,388.

18 Ibid.

19 Ibid, at 78,392. Further, Burt CJ had this to say on the plaintiff's argument on saturation damage as well as the involvement of sea water:

That submission has the merit of simplicity but I am not persuaded that it should be accepted. It seems to me that the overwhelming cause of the saturation damage in terms of potency was the high level of the sea which caused the water of the sea to enter the inlet and I think that it was the sea in that condition which caused the damage.

20 Ibid, at 78,393.

21 See above n 7.

As for the word 'indirectly' in both *Oei* and *Mitor* the purport and effect of it was not considered by the unsuccessful parties. A consideration of the dominant cause was unnecessary as the use of the word 'indirectly' in an exclusionary sense did not require it.²²

3 'In connection with'

Of these words, Derrington and Ashton suggest that the nexus to the object that it is identified with is 'broad and imprecise'.²³ However, they state that it requires 'some discernible and rational link'.²⁴ Using this helpful guideline, the recent NSW Court of Appeal decision in *QBE Insurance Australia Ltd v Vasic*²⁵ is examined. This case is important in two aspects. First, in the interpretation of the words 'in connection with' and, second, the admission of extrinsic evidence in order to determine the rationale of the policy or the 'genesis' of it, as was the word used to describe it. The first part is dealt with in this section and the second aspect is dealt with below, in considering matters of policy interpretation.

The insured respondent Vasic owned a property in western New South Wales which was insured with the appellant under an indemnity policy in respect of the insured's legal liability to third parties for bodily injury and/or in connection with the activity of allowing licensed shooters onto her land for the purpose of shooting only. Fairey, the second respondent was the property manager employed by the owner. A licensed shooter and his son, both lawfully on the property, were staying in the shearers' shed when it accidentally caught fire. The son was badly burned. The question before the Court of Appeal was whether the insured should be indemnified by the appellant.

The coverage clause read as follows:

Covering the insureds for legal liability to third parties for bodily injury and/or property damage caused by an occurrence *in connection with* the insured's activity of allowing licensed shooters on their properties *for the purpose of hunting only*. (Emphasis added).

The insurer's submission was that no coverage was afforded under the above clause because the use of the word 'only' after the word 'hunting' tended to suggest that the occurrence should be causally and temporally related to hunting in order for coverage to be afforded. The particular act of sleeping

22 See also *Coxe v Employer's Liability Assurance Corporation Ltd* [1916] 2 KB 629 where a military officer insured under a life policy was killed in the course of walking along unlighted railway tracks during the war, having been collided into by a train. The exclusion in the policy was in respect of death 'directly or indirectly caused by, arising from, or traceable to . . . war'. Scrutton LJ stated at 635: 'while doing his military duties in that position of special danger he was killed by reason of that special danger which prevails at that particular place and to which he was exposed by reason of his military duties. In those circumstances I am unable to hold that the arbitrator could not reasonably find, as a matter of fact, that the death was indirectly caused by war'.

23 Derrington and Ashton, above n 1, pp 3-123, 227.

24 Ibid.

25 [2010] NSWCA 166; BC201004923.

overnight in the shearers' shed bore no such connection, they contended and hence there was no cover under the policy.²⁶

The respondents were also cross-claimants, submitted that the words 'in connection with' would include any other activities reasonably incidental to the related activities.²⁷

In holding for the respondents, Allsop P stated:

The coverage clause concentrates on coverage of an occurrence in connection with the defined activity. It is important to note that the defined activity relates to the conduct of the cross claimants in allowing licensed shooters on their properties for the expressed purpose. It does not relate to the particular conduct or activity of the licensed shooters whilst they are on the property.

In my opinion, once it is established that the licensed shooters attend the property with the subjective purpose of hunting only, then there is no reason to limit coverage by reference to the activities of the licensed shooters rather than the cross claimants in allowing them onto the property.²⁸

Once it was established by the Court of Appeal, that it was the activity of the cross claiming respondents in allowing shooters onto the property that was covered and not the activities of the licensed shooters themselves, it was stated that it would not be unreasonable 'to contemplate that hunters who go to remote areas for hunting will need to stay on the properties where they are hunting'.²⁹ Therefore, the act of staying on the property was reasonably incidental to the act of hunting and this would be a more realistic interpretation of the words 'in connection with'.

The words 'hunting only'³⁰ were read in a way that the words restricted the type of activity that licensed shooters were permitted onto the land for. This was the defined purpose. The sensible, commercial construction of the wordings was the manner in which the words 'in connection with' were construed as stated above.³¹

Earlier authorities interpreting the words 'in connection with' also refer to the reasonably incidental nature of the activity in relation to the stated insured activity. In an administrative law case, *OurTown FM Pty Ltd v Australian Broadcasting Tribunal*³² the words 'in connection with', as used in a particular statutory provision were capable of describing 'a relationship with a contemplated future effect'. This related to the procedure that the tribunal in question had to observe 'in connection with' the granting of a licence. Applying this analogy to the *QBE* case discussed above, the act of the licensed shooters staying in the shearers' shed was 'in connection with' their prospective activity of hunting. The important thing to bear in mind is that there need not have been a causal relationship between the act of staying in the shearers' shed and that of hunting.

In *Drayton v Martin*³³ where an accountant's professional indemnity policy

26 Ibid, at [60] per Allsop P.

27 Ibid, at [59].

28 Ibid, at [62] and [63].

29 Ibid, at [64].

30 Ibid, at [66].

31 See above n 27.

32 (1987) 16 FCR 465 at 480 per Wilcox J; 13 ALD 740; 77 ALR 577.

33 [1996] 9 ANZ Insurance Cases 61-322.

was being interpreted, the question that had to be determined was whether advice given by an accountant as an investment adviser was ‘in connection with’ his practice as an accountant. The wording of the coverage clause was wide in that it extended to any loss arising from any claim in respect of any description of civil liability whatsoever in connection with his practice.³⁴

The insured’s evidence was that the services provided to the plaintiffs as an accountant, on one hand, and investment adviser, on the other, could not be disentangled. In short, the accounting records of the business, a tractor company, were discussed in the same breath as the performance of the business thus providing an inextricable interlink between the provision of accounting services and investment advice. Policy liability was held to engage for claims arising from the insured’s provision of services as an investment adviser. In these circumstances, it was held that the liability incurred by the insured to his client, as an investment adviser was in connection with his practice as an accountant.³⁵

In *HIH Casualty & General Insurance Ltd v Turner*,³⁶ the words ‘in connection with’ or words of similar import did not appear. What was covered was described by the words:

breach of professional duty as estate agents, land brokers, settlement agents, auctioneers, insurance agents (excluding insurance brokers), travel agents, business agents and stock and station agents.

The letter issued by the insured to the buyer was that the house was a sound building and a good one to buy. It was issued on the basis that the insured were general builders. It was held that there was no cover in such instance as the activity of general builders was not a listed activity in the variety of others which had been listed for coverage.³⁷ No related or logical link could be made between the activities listed and the insured’s representation as a general builder.

4 ‘Arising from or out of’

Although a link is required between the loss and the event, it is not a direct or proximate relationship such as that required by the use of the words ‘caused by’.³⁸ In *State Government Insurance Commission (SA) v Stevens Brothers Pty Ltd*³⁹ the issue before the High Court of Australia in the interpretation of a motor policy was whether the injuries arose out of the use of a compressor which fell within the definition of a motor vehicle for the purposes of the Motor Vehicles Act 1959 (SA) as amended. As the compressor was mounted on wheels and fitted with a tow-bar it fell within the definition of a ‘motor vehicle’ for the purposes of the said Act.

The relevant motor policy covered inter alia, bodily injury ‘to, any person caused by, or arising out of the use of, the vehicle’. An injury occurred to the

³⁴ Ibid, at 76,597.

³⁵ Ibid, at 76,599.

³⁶ [1998] 10 ANZ Insurance Cases 61–416.

³⁷ Ibid, at 74,670.

³⁸ See *Government Insurance Office of NSW v RJ Green & Lloyd Pty Ltd* [1966] 114 CLR 437 at 443; [1967] ALR 106; (1966) 39 ALJR 429; BC6600270 per Barwick CJ.

³⁹ [1984] 3 ANZ Insurance Cases 60–560.

person returning the compressor when the compressor was being lifted off the delivery truck by a crane. The tow-bar attached to the compressor, which had been caught by some portion of the back of the truck, was suddenly released due to the increased pressure brought to bear on it by the process of lifting the compressor.

Murphy, Wilson, Brennan and Deane JJ recognised the principle that the words 'arising out of' required a less proximate relationship of the injury to the relevant use of the vehicle than would have been the case by the use of the words 'caused by' and accordingly held that the injury arose out of the use of the compressor. In this regard, *Green & Lloyd*⁴⁰ was followed. As to whether the compressor was 'in use' Dawson J placed a wide meaning on this aspect by stating:⁴¹

it is being used within the meaning of the policy when it is being detached and placed in position after being towed, whether for use in the compression of air or to await further use.

The words 'arising out of' were construed in a broad sense in that at the time that the injury occurred, the compressor was being moved in a manner for which it was designed.⁴²

Further justification as to whether the compressor was in use was provided by Dawson J's reasoning that as it had been fitted with a loop in order for it to be lifted from the truck 'it was being used in the relevant sense whilst it was being lifted'.⁴³

In conclusion, the words 'arising out of' do not require a direct or proximate relationship but only some causal or consequential relationship between the act and the resultant damage or injury.⁴⁴

5 'In relation to' and 'In respect of'

In the case of *Trustees Executors and Agency Co Ltd v Reilly*⁴⁵ Mann CJ said:

The words 'in respect of' are difficult of definition, but they have the widest possible meaning of any expression intended to convey some connection or relation between the two subject-matters to which the words refer.

Mann CJ's description applies equally to the words 'in relation to'. In *Antico v C E Heath Casualty & General Insurance Ltd*⁴⁶ the appellant insured's argument was that under a Directors' and Officers' Legal Expenses Policy legal expenses incurred, or to be incurred by an insured, in resisting the insured's liability for loss or damage caused to a third party, were covered as they came about 'in respect of' the insured's liability. This argument was

40 See above n 38.

41 [1984] 3 ANZ Insurance Cases 60-560 at 78,379.

42 Ibid, at 78,376

43 Ibid, at 78,379.

44 *Dickinson v The Motor Vehicle Insurance Trust* (1987) 4 ANZ Insurance Cases 60-608 at 74,963 per Mason CJ, Wilson, Brennan, Dawson and Toohey JJ (HCA).

45 [1914] VLR 110 at 111; [1941] ALR 105.

46 [1996] 38 NSWLR 681 at 696; (1996) 125 FLR 270; 9 ANZ Ins Cas 61-304; BC9600040 per Kirby P.

upheld by Kirby P who stated that policies which provided cover for legal expenses were policies ‘in respect of the insured’s liability’.

In *State Government Insurance Office (Qld) v Crittenden*⁴⁷ the words ‘in respect of’ and ‘for’ could be used interchangeably to connote coverage under a motor policy for an insured’s legal liability to pay damages to a third party ‘for’ or ‘in respect of’ accidental bodily injury.⁴⁸ It was however acknowledged by Taylor J that the latter expression had a wider significance.⁴⁹ The appellant’s narrow construction was that liability was limited to a person or estate of a person suffering from accidental bodily injury. The High Court rejected this argument and held that a husband was entitled to damages for the loss of consortium of his wife owing to her injury caused to her by a person using a motor vehicle. Such damages would fall within the conception of ‘damages in respect of’ a motor vehicle.⁵⁰

The treatment of the words ‘in respect of’ in their wide interpretation is no different when they are considered in statutory interpretation. In *McDowell v Baker*⁵¹ the High Court of Australia had to interpret s 9A(1)(a) of the Worker’s Compensation Act 1916–1966 (Qld) which provided that the amount of common law damages that an employer would be legally liable to pay would be reduced by the amount of compensation payable under the Act ‘in respect’ of the injury in question. The amount payable was reduced accordingly by the High Court.

6 The admission of extrinsic evidence in *QBE v Vasic* and the current legal position relating to it

The insurers in *QBE v Vasic* attempted to adduce four documents in support of their case at first instance.⁵² These were:

1. The proposal form for the particular policy. The proposal described the business operations of the insured as farming and shooting. As the cover was in respect of ‘allowing licensed shooters on their properties for the purpose of hunting only’, it added nothing to the insurer’s case and was not admitted. Garling J at first instance held that the proposal was not part of the QBE policy.⁵³
2. The second document was a facsimile message from an underwriting agency (‘Concord’) to brokers (‘SSAA Brokers’). It was an offer of

47 (1966) 117 CLR 412; [1967] ALR 237; (1966) 40 ALJR 260; BC6600060.

48 Ibid, at 418–19 per Taylor J.

49 Ibid, at 417. See also *Trustees Executors & Agency Co Ltd v Reilly* [1914] VLR 110 at 111; [1941] ALR 105 where Mann CJ stated the following:

The words ‘in respect of’ are difficult of definition but they have the widest possible meaning of any expression intended to convey some connexion or relation between the two subject-matters to which the words refer.

50 Ibid, at 421 per Menzies J.

51 (1979) 144 CLR 413 at 419; 26 ALR 277; 53 ALJR 671; BC7900086.

52 *El Hayek v Vasic* [2010] NSWSC 634; BC201004036.

53 Ibid, at [24]. The authorities cited by Garling J in support of the proposition that a proposal was not part of an insurance policy were *Australian Provincial Assurance Association Ltd v Producers & Citizens Co-operative Assurance Co of Australia Ltd* (1932) 48 CLR 341; [1932] ALR 442; (1932) 6 ALJR 199; BC3200016 and *Deaves v CML Fire and General Insurance Co Ltd* [1979] 143 CLR 24 at 36 per Gibbs ACJ, 68 per Jacobs J; 23 ALR 539; 53 ALJR 382; BC7900045.

renewal which suggested inclusion of a number of terms, conditions and limitations on coverage which were not evident from the later documents relied on by the insurers. It was correctly held in the circumstances that it represented communication in the course of pre-contract negotiations and was not part of the QBE policy.

3. The third document which insurers contended was part of the QBE policy was one termed as both a Tax Invoice and a Renewal from SSAA Brokers to Robert Williams & Associates Pty Ltd (RWA). Neither SSAA Brokers nor RWA were parties to the QBE policy. Admittedly, RWA were the brokers for the insured but SSAA Brokers were not agents of the insurer. Thus any statement made by SSAA Brokers could not be made on behalf of the insurers. Similarly insurers would not be bound by any statement made by SSAA Brokers. Taking all the features of the document together, it was ruled at first instance that it was not part of the QBE policy.
4. The fourth document was a statement made by a Mr Low who was the Chief Executive of SSAA Brokers. He was regarded as an expert in this area of coverage. His statement was sought to be adduced to understand the 'aim and genesis'⁵⁴ of the QBE policy, which was that provision of cover in relation to liability to licensed shooters, excluded from public liability policies held by persons owning or operating rural properties. Such cover was termed as gap insurance as normal public liability policies would exclude cover for such shooting activities. Bearing in mind that SSAA Brokers were not the agents of the insurers involved and the statement was not in relation to the cover in question, the extrinsic evidence was held to be inadmissible at first instance as well as by the New South Wales Court of Appeal.

The basis of ruling that all the documents, were inadmissible was that they all tended to show the subjective understanding of one party 'by permitting or requiring the contract to be interpreted by reference to one party's knowledge only'.⁵⁵ This was particularly so in respect of documents two, three and four.

On the criterion for admission of such extrinsic evidence, Garling J at first instance, had drawn strict parameters in that the background knowledge had to be both the actual and mutual knowledge of the contracting parties. He emphasised that both parties must know of the factual background.⁵⁶ This narrow approach was however rejected by Allsop JA when he stated that:

The relevant circumstances in that process are those with which the reasonable person should be attributed in order that one objectively correct meaning can be ascribed to the text.⁵⁷

⁵⁴ [2010] NSWCA 166; BC201004923 at [14] per Allsop P.

⁵⁵ Ibid, at [22] per Allsop P.

⁵⁶ Ibid, at [34]. Garling J cites *Movie Network Channels Pty Ltd v Optus Vision Pty Ltd* [2010] NSWCA 111; BC201003145 at [97]–[106] per Macfarlan JA as authority for the proposition. See however Allsop P's comments above, in the Court of Appeal criticising the narrow approach.

⁵⁷ [2010] NSWCA 166; BC201004923 at [26].

The objective intention to be adopted in the course of the interpretive process outlined by Lord Wilberforce in *Reardon Smith Line v Hansen-Tangen*⁵⁸ was cited with approval by Allsop J. On the role of the court in the interpretive process Lord Wilberforce's description was as follows:

what the court must do must be to place itself in thought in the same factual matrix as that in which the parties were. All of these opinions seem to me implicitly to recognize that, in the search for the relevant background, there may be facts which form part of the circumstances in which the parties contract in which one, or both, may take no particular interest, their minds being addressed to or concentrated on other facts so that if asked they would assert that they did not have these facts in the forefront of their mind, but that will not prevent those facts from forming part of an objective setting in which the contract is to be construed.

It is suggested that it is the background knowledge that parties were aware of or ought to have been aware of, which forms the basis for the *contextual commonsense* approach that the court adopts in arriving at an objective decision. What needs to be taken into account in exercising this contextual commonsense is crisply expressed by Allsop P in the case of *Franklins Pty Ltd v Metcash Trading Ltd*. He states:

The construction and interpretation of written contracts is to be undertaken by an examination of the text of the document in the context of the surrounding circumstances known to the parties, including the purpose and object of the transaction and by assessing how a reasonable person would have understood the language in that context.⁵⁹

It is in relation to giving effect to the 'purpose and object' of the contract that the court needs to be armed with all the knowledge that a 'reasonable person' would have been armed with in order to reach an objective meaning on matters of interpretation. It is for this reason settled law in Australia that extrinsic evidence may be adduced to ascertain the meaning of words in a contract, although there is no ambiguity to clarify.⁶⁰ Therefore Mason J's need for ambiguity in order for surrounding circumstances to be admissible is no

58 [1976] 3 All ER 570; [1976] 1 WLR 989 at 996–7; [1976] 2 Lloyd's Rep 621 where Lord Wilberforce stated:

It is often said that, in order to be admissible in aid of construction, these extrinsic facts must be within the knowledge of both parties to the contract, but this requirement should not be stated in too narrow a sense. When one speaks of the intention of the parties to the contract, one is speaking objectively — the parties cannot themselves give direct evidence of what their intention was — and what must be ascertained is what is to be taken as the intention which reasonable people would have had if placed in the situation of the parties. Similarly when one is speaking of aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have had in mind in the situation of the parties. It is in this sense and not in the sense of constructive notice or of estopping fact that judges are found using words like 'knew or must be taken to have known'.

See also *ibid*, at [28] of Allsop P's judgment.

59 [2009] NSWLR 407 at [14].

60 See N B Rao, 'The admission of pre-contract negotiations in the construction and interpretation of insurance contracts' (2009) 20 *ILJ* 145 at 150–4 and also the cases of *Ray Brooks Pty Ltd v NSW Grains Board* (2002) Aust Contract R 90-155; [2002] NSWSC 1049; BC200206679 at [66]; *Lion Nathan Australia Pty Ltd v Coopers Brewery Ltd* (2005) 223 ALR 560; 56 ACSR 263; [2005] FCA 1812; BC200510636 at [78]; *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451; 208 ALR 213; [2004] HCA 35; BC200404838 at [22];

longer good law.⁶¹ Mason J stated this in relation to the workings of the parol evidence rule. The justification for this change is dealt with below.

7 Circumstances in which extrinsic evidence is admitted and how objectivity is determined

The starting point would be to re-iterate why the extrinsic evidence in *QBE v Vasic* which the insurers sought to introduce was rejected at first instance as well as by the NSW Court of Appeal. It was because such extrinsic evidence was regarded as tending to re-introduce the subjective understanding of one party only by reference to its peculiar knowledge. An introduction of such subjective aims or intentions would not assist in ascertaining the genesis or purpose of the contract in such circumstances.⁶²

Had the evidence that was sought to be admitted, related to a shared understanding of the parties or what reasonable people would have had in mind as to the object or commercial purpose of cover, then it would have been more readily received.⁶³ On the issue of subjective knowledge and the objective approach (using ‘what the reasonable person would have wanted to know’ approach), Allsop P had this to say:

The reasonable person may be taken to know of things that go beyond those that the parties thought to be important or those to which there was actual subjective advertence by the parties by the parties. Further, the circumstances may include such things as the legal context of the transaction, especially if a market is involved.⁶⁴

In deciding on the issue of coverage the appellate court in *QBE v Vasic* stated that it was ‘a commercial contract to be read in its totality, commercially and sensibly’.⁶⁵ In essence the use of contextual commonsense approach is nothing more than the admission of extrinsic evidence ‘so long as it is relevant, reasonably available to all contracting parties and relates to a clear and obvious context’.⁶⁶ A similar expression to this is found in *Franklins Pty Ltd v Metcash Trading Ltd* where Allsop P reasoned:

Toll (FGCT) Pty Ltd v Alphafarm Pty Ltd (2004) 219 CLR 165; 211 ALR 342; [2004] HCA 52; BC200407463 at [40]; *International Air Transport Association v Ansett Holdings Ltd* (2008) 234 CLR 151; 242 ALR 47; [2008] HCA 3; BC200800357 at [8], [53]. In *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 264 ALR 15; [2009] NSWCA 407; BC200911627 Allsop P continues in the same paragraph [14]:

There is no place in that structure, so expressed, for a requirement to discern textual, or any other, ambiguity in the words of a document before any resort can be made to such evidence of surrounding circumstances.

61 See *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337 at 352; 41 ALR 367; 56 ALJR 459; BC8200083 where Mason J stated: ‘The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning.’

62 [2010] NSWCA 166; BC201004923 at [22]–[25] per Allsop P.

63 See above n 61 for the cases on contextual interpretation and the admission of extrinsic evidence.

64 [2010] NSWCA 166; BC201004923 at [35].

65 *Ibid.*, at [39].

66 *Zurich Insurance v B-Gold* [2008] 3 SLR 1029 at 1097 per VK Rajah JA in the Court of Appeal in Singapore.

The evidence, to be admissible, must be relevant to a fact in issue, probative of the surrounding circumstances known to the parties or of the purpose or object of the transaction, including its genesis, background, context and market in which the parties are operating.⁶⁷

What is reasonably available to all contracting parties means that information which a reasonable person in the relevant market would have considered as helpful information in determining scope of cover and the meaning of words which in turn would assist in arriving at an objective decision. Stephen Smith describes an objective approach in the following way:

It is orthodox law that courts interpret contractual terms not by seeking the subjective or 'inner' intentions of the contracting parties, but rather by asking how the terms would have been reasonably or 'objectively understood'.⁶⁸

How is this objectivity achieved? A good description comes from Justice Oliver Wendell Holmes when he stated:

Thereupon we ask, not what this man meant, but what those words would mean in the mouth of a normal speaker of English, using them in the circumstances in which they were heard.⁶⁹

Stephen Smith sums it up best when he states that the meaning of a word is gauged by what it would be reasonably understood to mean as opposed to what the speaker intended it to mean.⁷⁰ There is a greater emphasis on what a reasonable person would have understood a word or phrase to mean as opposed to the intention of the parties, unless of course, parties have a clear shared understanding.⁷¹

8 Conclusion

A summary of the key things to consider in interpreting the lesser words discussed is as follows:

1. In considering the word 'directly' the use of the 'but for' test is useful. For instance in the case of *Fitton*, but for the accidental fall

67 (2009) 264 ALR 15; [2009] NSWCA 407; BC200911627 at [24].

68 *Contract Theory*, Clarendon Law Series, Oxford University Press, 2007 Reprint, p 271. See also *Deutsche Genossenschaftsbank v Burnhope* [1995] 4 All ER 717 at 724; [1995] 1 WLR 1580; [1996] 1 Lloyd's Rep 113 per Lord Steyn:

It is true the objective of the construction of a contract is to give effect to the intention of the parties. But our law of construction is based on objective theory. The methodology is not to probe the real intention of the parties but to ascertain the contextual meaning of the relevant contractual language . . . The question therefore resolves itself in a search for the meaning of language in its contractual setting. It may only be inferred from the language used by the parties, judged against the objective contextual background.

69 'The Legal Theory of Interpretation' (1899)12 *Harvard L Rev* 417.

70 Above n 68, p 273. Smith adds at the same page in discussing Wittgenstein's observations: 'words are used for communication, and communication requires shared or public meanings.'

71 See G McMeel, *The Construction of Contracts: Interpretation, Implication and Rectification*, 1st ed, Oxford University Press, 2007, p 79 where the example provided by the author is the first principle of interpretation stated by Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98; [1998] 1 WLR 896 at 912; [1997] CLC 1243 commences with the words: 'Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person'.

the herniated condition of the insured would not have occurred. Therefore, the accident was covered.

2. As to the word 'indirectly' it is important to bear in mind that it specifically excludes the need to consider the doctrine of proximate cause.
3. The words 'in connection with' require some discernible link between the loss and the event giving rise to it. In *QBE v Vasic* for instance it was reasonable for hunters to stay on the property, it being in a remote area, the act of staying was 'in connection with' the activity of hunting.
4. With regard to the words 'arising from or out of' no direct or proximate relationship is required between the loss and the event giving rise to it.
5. In respect of the words 'in relation to' and 'in respect of', there only needs to be some connection between the loss and the event giving rise to it.

With regard to the admission of extrinsic evidence of pre-contract negotiations, the cases⁷² show that judges have moved somewhat from a formalistic, rigid application of the parol evidence rule to shut out such extrinsic evidence, particularly where such extrinsic evidence assists them in the understanding of the surrounding circumstances leading to the formation of the contract.

Mitchell states that 'it is rare, and arguably impossible, for a judge to give a completely acontextual interpretation of the words of a contract'.⁷³ This can only be viewed as a positive development in this area of the law.⁷⁴

⁷² See above n 60.

⁷³ C Mitchell, *Interpretation of Contracts*, Routledge-Cavendish, 2007, p 94.

⁷⁴ Not for a moment is it being suggested that the subjective unexpressed views of a party should be admissible. This would open the floodgates to perhaps irrelevant material which would as a necessary consequence, lengthen the litigation process.