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The application of contracts

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Abstract

The application of a contract involves ascertaining whether the components of a contract term are met on the facts. It is a matter of categorisation or classification. There are at least three methods of categorisation: by criteria; by factor-balancing; and by analogy. The process of application is distinct from the processes that are engaged to define contract terms, including in particular interpretation. However, both the process of application and the process of interpretation address problems of linguistic indeterminacy, that is, cases where the words do not fit the facts. And these problems are usually resolved through interpretation; the relevant term is defined with such specificity that it is clear how it is to be applied. It is only when the court cannot define the term precisely that the court engages in categorisation or classification in a complex and meaningful way.

Keywords: application; construction; interpretation; classification; categorisation

Introduction

If I agree to buy 50kg of 'deluxe red apples' from you, and you deliver Red Delicious while I am expecting Pink Lady, a court has two options. It can interpret the contract so as to establish which type or types of red apple were objectively intended by the sale. Or it can simply apply the contract by categorising the facts: did you deliver apples that are both red and deluxe? That is to say, the court can resolve the problem of linguistic indeterminacy by either interpretation or application.

Much has been written about contract interpretation over recent decades. But remarkably little has been said, by judges or academics, regarding the application of contracts.[1] This is surprising considering that almost every contract dispute involves application of the contract: the contract terms must be defined and then applied to the facts to determine the dispute. This paper seeks to fill a void in this area. It analyses the nature of contract application by answering three fundamental questions. First, what is the goal in applying a contract? Secondly, how does one apply a contract? Thirdly, when is the process employed in practice?

In answer to the first question, the aim of contract application is to determine whether the components in a contract term are satisfied on the facts. Like legal rules, contract terms are applied by establishing whether the predicates or conditions in the term are met.

As regards the second question, the application of a contract involves categorisation or classification, that is, the process of determining whether a fact or facts fall within a particular class, quality, relation or other category. A contract is applied by categorising or classifying facts so as to determine whether the components in a contract term are met. There are at least three methods of categorisation: by criteria; by

[1] But see eg JW Carter *The Construction of Commercial Contracts* (Oxford: Hart Publishing, 2013) chs 15–18.

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factor-balancing; and by analogy or comparison. The appropriate method may depend on the categorisation task at hand. For example, if a class can be defined in terms of positive or negative properties, it may be appropriate to categorise by reference to criteria; if a category is demarked by conflicting indicia rather than criteria, factor-balancing may be suitable; and if the class is simply a description that cannot be deconstructed in terms of criteria or indicia, then one might categorise by analogy.

With respect to the third question, the process of application follows the definition of the term in question and the ascertainment of the facts to which the term is to be applied. However, the categorisation or classification process is rarely engaged in an overt or complex way. A key reason for this is because the application process and the interpretive process both address problems of linguistic indeterminacy, that is, cases where the words of the contract do not fit the facts. And most problems of linguistic indeterminacy are usually resolved through interpretation, that is, by ascertaining the reasonable person's understanding of what was objectively meant by the words in a contract. The relevant contract term is defined with such specificity that it is clear how it is to be applied to the facts. Ordinarily, it is only when the means to define the rule 'run out' that complex reasoning in terms of categorisation or classification is necessary. For example, the contract may refer to a broad normative or evaluative standard (such as reasonableness) or it may contain a subject matter description that cannot be defined in specific terms (eg the description of a chattel in a sale of goods). In these types of cases at least, courts often engage in categorisation or classification in a sophisticated way so as to resolve the problem.

This paper is doctrinal in nature. It is interpretative; it accepts the law as it is. It relies primarily on a review of case law to illustrate and explain the application process in action. However, the paper also utilises theoretical perspectives (both in law and beyond) to frame the doctrinal analysis. Legal jurisprudence, linguistics, philosophy, computer science and informatics are employed, in particular, to preface and explain the different methods of categorisation through which a contract is applied. The focus is the common law of contract as it has developed in England and other common law jurisdictions. The selection of cases analysed is unavoidably random; it is hard to find cases illustrating the application process in action using a systematic method.

One might think that, in a paper exploring how and in what circumstances a contract is applied, you would see a discussion regarding the concept of 'application' at the outset. However, the aim of this paper is, in effect, to define application as a judicial technique in the context of contract law.[2] That is to say, the aim is to define application in terms of *why* we apply contracts, *how* we apply contracts, and *when* we apply contracts. To put it differently, if you are asking 'what is application', then my answer is that it is a technique that serves a particular object in a particular way in particular circumstances. It is the process through which one ascertains whether the components of a contract term are met on the facts; it involves a process of categorisation by criteria, by factor-balancing, or by analogy. It can be contrasted with the process of interpretation through which one defines a term as a matter of objective intention and meaning.

The bulk of the analysis in this paper is set out in Sections 2 (the aim in application), 3 (the mechanics of application) and 4 (the scope for application). Before exploring the nature of application in detail, we need to examine what has been said about application and its relationship with interpretation and construction. That is the focus of Section 1, to which we now turn.

1. Construction, interpretation and application: terminology and concepts

Terminology in the common law of contract is notoriously messy. The area of application is no exception. In fact, the role of application in contract law has arguably been obscured by inaccurate

[2]The ideas advanced in this paper may well be applicable more broadly. It is not necessarily suggested that the application of contract terms is a unique form of rule application. A similar approach may apply in the application of legal rules or norms more generally. In the interest of brevity and by reason of the limits imposed in writing a single paper, this paper focuses on contract application as a means to explore these issues.

language and overlapping labels, in particular, with respect to construction and interpretation. Hence, the aim of this part of this paper is to briefly summarise terminological issues and outline common views regarding application and its place in contract law.

Application is commonly regarded as either part of interpretation or part of construction. For example, in *Casson v Ostley PJ Ltd*,[3] Sedley LJ stated: 'Interpretation … only happens when words are applied to facts'.[4] That said, it is generally understood that the application of a contract follows the ascertainment of what was meant by the words to be applied.[5] Hence, McMeel views 'construction disputes' as involving two phases: the first 'concerned with ascertaining the meaning of the contractual language', and the second involving 'the application of the rule to be found from the parties' language to the particular facts or circumstances'.[6] In similar terms, Carter sees 'construction' as consisting of three stages: the preliminary stage (eg identifying background); the meaning stage; and the application stage.[7] The application process is also often said to be part of, or tied up with, determining the 'effect' or 'legal effect' of a contract.[8] For example, Lewison describes 'interpretation' as involving 'the ascertainment of the words used by the parties and the determination, subject to any rule of law, of the legal effect of those words'.[9] And Lindley LJ remarked in *Chatenay v Brazilian Submarine Telegraph Co Ltd*:[10]

> The expression 'construction,' as applied to a document, at all events as used by English lawyers, includes two things: first, the meaning of the words; and, secondly, their legal effect, or the effect which is to be given to them.[11]

Despite the academic recognition that construction involves or necessitates application, leading judgments on interpretation and construction say very little about the application process.[12] For the most part, the notion that a contract needs to be applied is merely referenced by judges in England and other common law jurisdictions when engaging in the process of application itself.[13]

This paper draws a critical distinction between the process of application and the processes employed to define the terms in a contract.[14] The key techniques engaged in defining contract terms are

[3][2001] EWCA Civ 1013.

[4]Ibid, para [28] (Sedley LJ). See also F Pollock *A First Book of Jurisprudence for Students of the Common Law* (London: Macmillan, 1896) p 226; A Scalia and BA Garner *Reading Law* (Minneapolis: Thomson West, 2012) p 53.

[5]*Shore v Wilson* (1842) 9 Cl & F 355 at 555; 8 ER 450 at 528 (Parke B) (one must 'discover the meaning of the terms … [and] apply them to the facts').

[6]G McMeel *McMeel on the Construction of Contracts: Interpretation, Implication and Rectification* (Oxford: Oxford University Press, 2017) p 8.

[7]Carter, above n 1, p 7.

[8]See eg McMeel, above n 6, p 8. It is beyond the scope of this paper to analyse in detail what is meant by giving effect or legal effect to a contract. Beyond application of the contract, it is also said to involve issues of characterisation and the application of contract doctrine or 'external rules of law': Carter, above n 1, p 360; Lord Justice Lewison *The Interpretation of Contracts* (London: Sweet & Maxwell, 8th edn, 2024) p 27.

[9]Lewison, above n 8, p 28.

[10][1891] 1 QB 79 (CA).

[11]Ibid, at 85 (Lindley LJ).

[12]But see eg *Upper Hunter County District Council v Australian Chilling & Freezing Co Ltd* [1968] HCA 8, (1968) 118 CLR 429 at 436–437 (Barwick CJ); *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 995 (Lord Wilberforce) (Viscount Dilhorne, Lord Simon and Lord Kilbrandon agreeing) (HL) (*The Diana Prosperity*); *Wasa International Insurance Co Ltd v Lexington* [2008] EWCA Civ 15, [2008] Bus LR 1029 at [46] (Sedley LJ).

[13]See eg *Electricity Generation Corpn v Woodside Energy Ltd* [2014] HCA 7, (2014) 251 CLR 640 at [49] (French CJ, Hayne, Crennan and Kiefel JJ). See further below, nn 35–38. Under American law, the process of construing a contract consists of an interpretation stage and a subsequent construction stage, with the latter involving the resolution of cases of vagueness or omission: see eg AL Corbin 'Conditions in the law of contract' (1918) 28 Yale Law Journal 739 at 741; MN Kniffin *Corbin on Contracts* (Charlottesville: LexisNexis, revsd edn, 1998) vol 5, p 8.

[14]A point sometimes made by judges when dealing with problems of application: see eg *Liberty Mutual Insurance Company Australian Branch t/a Liberty Specialty Markets v Icon Co (NSW) Pty Ltd* [2021] FCAFC 126 at [43] (Allsop CJ, Besanko and Middleton JJ) (*Liberty v Icon*).

interpretation, implication in fact, and common mistake rectification. Under the English common law of contract, interpretation is the process through which one ascertains what was objectively meant or intended by the words in a contract (ie the reasonable person's understanding of the words);[15] implication is the process through which one implies a term as a matter of presumed intention based on necessity or obviousness;[16] and rectification is a technique through which one rectifies a document in equity, in the case of common mistake, to accord with a common intention of the parties at the time of contracting.[17]

The process of application is distinct from these processes, albeit quite closely related. As defined in this paper, application is a technique that is engaged after a term has been defined. It is employed to ascertain whether the components of the term are met on the facts; it involves categorisation or classification.

The term 'construction' can be used broadly to encompass both the process of application and the techniques employed to define terms in a contract.[18] It is often used as an umbrella term to describe how one ascertains the 'legal effect' of a contract;[19] it can denote the 'holistic' process of 'attempting to understand the entire contractual relationship'.[20] For example, the Supreme Court of the United Kingdom has noted that implication in fact and interpretation, while 'different processes governed by different rules',[21] can be regarded as 'part of construction of the contract in a broad sense'.[22]

In addition to its use as an umbrella term, the term 'construction' is also commonly used interchangeably with 'interpretation' to refer to the interpretive process.[23] In the interests of conceptual clarity, this paper does not use the term in this way. Instead, this paper describes the process of ascertaining what was meant or intended by words in a contract as 'interpretation'. As already noted, this process is distinct from the process of application. Like interpretation and implication in fact, interpretation and application are 'different processes governed by different rules'.[24] Interpretation involves a search for meaning and intention; application involves categorisation and classification. With these definitional and conceptual issues resolved, we can begin our analysis of the nature of application, starting with the aim of the process.

2. The aim in application

The aim of contract application is to determine whether the components of a contract term are met on the facts. Contract terms, like legal rules, can be broken down into constituent components and the process of application is one through which it is determined whether the components are satisfied.

The law in general is often conceptualised in terms of rules that need to be applied.[25] These rules are typically formulated in logical deductive terms along the lines of 'if p, then q'. The process of application

[15]See eg *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619 at [15] (Lord Neuberger) (Lord Sumption, Lord Hughes and Lord Hodge agreeing).

[16]See eg *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742 at [14]–[32] (Lord Neuberger) (Lord Sumption and Lord Hodge agreeing) (*Marks and Spencer*).

[17]See eg *Tyne and Wear Passenger Transport Executive (t/a Nexus) v National Union of Rail, Maritime and Transport Workers* [2024] UKSC 37, [2024] 3 WLR 909 at [26]–[35] (Lord Leggatt and Lady Simler) (Lord Lloyd-Jones, Lord Sales and Lord Burrows agreeing).

[18]See McMeel, above n 6, pp 7–8 ('construction disputes'); Carter, above n 1, p 7 ('stages in construction').

[19]cf McMeel, above n 6, pp 7–8.

[20]C Mitchell *Interpretation of Contracts* (Oxford: Routledge Cavendish, 2nd edn, 2019) p 107.

[21]*Marks and Spencer* [2015] UKSC 72, [2016] AC 742 at [26] (Lord Neuberger) (Lord Sumption and Lord Hodge agreeing).

[22]*Marks and Spencer* [2015] UKSC 72, [2016] AC 742 at [76] (Lord Clarke).

[23]McMeel, above n 6, p 13; Mitchell, above n 20, p 108.

[24]Borrowed from *Marks and Spencer* [2015] UKSC 72, [2016] AC 742 at [26] (Lord Neuberger) (Lord Sumption and Lord Hodge agreeing) (discussing the distinction between interpretation and implication in fact).

[25]See eg HLA Hart *The Concept of Law* (Oxford: Oxford University Press, 3rd edn, 2012) (first published 1961); FF Schauer *Playing by the Rules* (Oxford: Oxford University Press, 1991); N MacCormick *Legal Reasoning and Legal Theory* (Oxford: Oxford University Press, 1994).

is one through which it is determined whether the predicate or predicates (p) are satisfied so that the legal consequences (q) follow. As Pollock postulated over a century ago:

> Every question of interpretation may be reduced ultimately to this form: Given a rule of law that conditions generically described as *A* produce a certain legal liability or other consequence *X*, does the specific fact or group of facts *n* fall within the genus *A*.[26]

More recently, MacCormick expressed the idea in similar terms:

> [A]ll legal rules … can … be recast in the form that if certain facts and circumstances obtain, a certain legal consequence is to follow … [In] canonical form *if p then q (p q)*, the symbol *p* stands for a proposition stipulating a set of operative facts, *q* for the legal consequence which is to follow.[27]

Hence, in this sense, the application of a legal rule involves establishing whether the 'operative facts' or 'factual predicate[s]' in a rule are met; it involves ascertaining whether 'the factual conditions triggering the application of the rule' are satisfied.[28]

Like the application of a legal rule, the application of a contract term involves determining whether its components are met. However, what exactly constitutes a 'term' of a contract is not entirely clear. For some, contract terms are akin to rules. For example, as has been noted by McMeel, the construction of a contract involves 'identifying in a document a *rule* for future cooperative behaviour from the language of the instrument, and then applying that *rule* to subsequent facts or situations'.[29] Nonetheless, there is an apparent difficulty with the conceptualisation of contracts in terms of rules because not all contract terms are expressed in logical deductive form; that is to say, they are not all 'rules' in the strict deductive sense. Contingent conditions or 'conditions precedent' are by nature expressed in deductive logic. Several other types of contractual provisions can also be cast in the form 'if p, then q', including exclusions of liability, termination clauses, agreed damages clauses, and so on. Yet many contract terms cannot be expressed in such a way. Some terms are merely statements of intention, such as a statement that the parties intend (or do not intend) an agreement to be binding as a contract.[30] Most simply take the form of an imperative statement or norm of conduct, such as 'party A must do X'.[31] Hence, rather than being framed as rules in the strict deductive sense, contract terms are more accurately understood as simply propositions of law agreed (or taken to be agreed) between the parties – propositions of law that govern the parties' contractual rights and obligations.[32] To put it differently, a contract term is a norm of conduct, statement of intention or imperative statement that forms part of the contractual agreement and governs the relationship between the parties.

Whatever the form of a contract term, the process of applying the term still involves determining whether its components are satisfied. Contracts refer to 'classes of ideas, actions, events, states of affairs, persons, and other things'.[33] Hence, in applying the contract, one must determine whether these classes are satisfied on the facts; one must establish whether the 'operative facts' in a term are met. A classic example is whether a chattel proffered on delivery satisfies a contractual description under a sale or hire contract.[34] Judges often grapple with these types of problems when seeking to resolve cases on

[26]Pollock, above n 4, p 226 (quoted in Scalia and Garner, above n 4, pp 54–55).

[27]MacCormick, above n 25, p 45.

[28]Schauer, above n 25, p 23. See also MacCormick, above n 25, p 45.

[29]McMeel, above n 6, p 5 (emphasis added).

[30]See eg *Rose & Frank Co v JR Crompton & Bros Ltd* [1925] AC 445 at 451 (Lord Phillimore) (HL) ('honour clause').

[31]This is because the primary legal consequences of late or defective performance are usually not expressed in the contract, but rather are the effect of contract doctrine. For example, if a party fails to perform an obligation in accordance with a contract term, the other party is entitled to relief at common law in the form of damages or specific relief.

[32]cf F Wilmot-Smith 'Term limits: what is a term?' (2019) 39 Oxford Journal of Legal Studies 705.

[33]SJ Burton *Elements of Contract Interpretation* (New York: Oxford University Press, 2008) p 9.

[34]See eg *The Diana Prosperity* [1976] 1 WLR 989 (sub-charter).

construction. They consider whether a particular clause is 'engaged' by the facts,[35] whether the language is 'apt' to 'encompass', 'include', 'cover' or 'exten[d] to' particular facts,[36] whether a 'reference fits' a particular object,[37] whether a particular thing falls 'within [the] words',[38] and so on. What is involved in determining whether the components of a contract term are met on the facts is the focus of the next part of this paper.

3. The mechanics of application

Contract application involves categorising or classifying facts to establish whether the components of a contract term have been satisfied. It turns on the categorisation or classification of facts to determine whether they fall within a particular 'class', 'quality', 'relation' or other category identified in the contract.[39] It involves '"subsum[ing]" particular facts under general classificatory heads'.[40] For example, one might need to determine: whether particular profits qualify as profits of a corporate group; whether conduct falls within the category of dishonest; whether a given loss amounts to consequential or indirect loss; whether a liability or loss qualifies as being caused by a particular occurrence; and so on. Hence, to borrow from the field of informatics, each instance of contract application involves 'a set of boxes … into which things [are] put to then do some kind of work',[41] the work being the ascertainment of whether the components of a contract term are met.

To understand the mechanics of applying a contract term, we need to understand how judges and lawyers categorise facts as part of the process; we need to understand how one categorises or classifies facts in determining whether a component in a contract term is met. That is the focus of this part of this paper. It analyses cases to illustrate the application process in action. It also borrows from theories of categorisation in other disciplines so as to preface and justify this doctrinal analysis.

There are at least three methods of categorisation in contract application.[42] First, there is categorisation by reference to constituent properties, that is, categorisation by reference to positive or negative criteria. Secondly, there is categorisation by factor-balancing, that is, categorisation by reference to conflicting indicia. And thirdly, there is categorisation by analogy, that is, categorisation by comparison with past cases or with similar objects that either do or do not fall within the class.

Depending on the nature of the case, one manner of categorisation may be more appropriate than another. For example, if a category is identifiable by positive or negative properties (such as whether or not a machine is in operation),[43] then categorisation by reference to criteria may be more suitable; if a category is defined not so much by criteria but by conflicting indicia (such as a normative standard like

[35] *Liberty v Icon* [2021] FCAFC 126 at [43] (Allsop CJ, Besanko and Middleton JJ).

[36] *Transocean Drilling UK Ltd v Providence Resources plc* [2016] EWCA Civ 372, [2016] 2 Lloyd's Rep 51 at [15], [17]–[18] (Moore-Bick LJ) (McFarlane and Briggs LJJ agreeing) (*The GSF Artic III*).

[37] *The Diana Prosperity* [1976] 1 WLR 989 at 999 (Lord Wilberforce) (Lord Simon and Lord Kilbrandon agreeing) (HL).

[38] *Southland Frozen Meat & Produce Export Co v Nelson Bros Ltd* [1898] AC 442 at 444 (Lord Herschell) (PC).

[39] Borrowed from G Williams 'Language and the law – II' (1945) 61 Law Quarterly Review 179 at 190 (discussing the law generally). This is not to be confused with the process of legal characterisation through which it is determined whether a set of facts satisfies a legal term in a doctrinal or statutory test: see further R Catterwell *Unified Approach to Contract Interpretation* (Oxford: Hart Publishing, 2020) pp 234–238. However, insofar as the application of a contract term turns on the application of a legal test (see further Section 4(c) below), the distinction between application and legal characterisation may not be so clear.

[40] Borrowed from Hart, above n 25, p 125 (discussing the application of legal rules).

[41] Borrowed from GC Bowker and SL Star *Sorting Things Out: Classification and Its Consequences* (Cambridge: MIT Press, 2000) p 10.

[42] Further methods of categorisation may be possible. For a different approach to the question of application, see Carter, above n 1, ch 15. Carter postulated three 'standards of application', being 'literal application' (where the words are applied literally), 'strict application' (where the words are given a narrow scope of application), and 'commercial application' (where the court employs various presumptions or preferences to arrive at a commercially sensible result): see Carter, above n 1, p 500. See also F Lieber *Legal and Political Hermeneutics, Or Principles of Interpretation and Construction in Law and Politics: With Remarks on Precedents and Authorities* (Boston: Charles C Little and James Brown, 1839) pp 77, 81.

[43] See below n 61.

'material breach'),[44] then factor-balancing may be more appropriate; and if the category is simply a description not readily capable of being broken down into criteria or indicia (such as an exclusion of consequential or indirect loss),[45] then reasoning by analogy can be employed. There is also scope for applying a combined or amalgamated approach.[46]

It could be argued that judges categorise simply as a matter of intuition or impression[47] – that classification is part of the 'mental work that produces impressions [and] intuitions … in silence in our minds'.[48] However, this explanation appears to be unsatisfactory, particularly considering that contract law seeks to secure commercial certainty,[49] albeit in a flexible and commercially sensible way.[50] It may be that, in some cases, judges categorise by reference to underlying biases or preferences.[51] This reflects the recognition in cognitive science and psychology that how we categorise may depend on moral or political choices[52] and that 'intuitive' decision-making may turn on underlying biases.[53] Whether this is an acceptable explanation for the process of categorisation in contract application is debatable. This paper does not adopt a position either way. Instead, it focuses on three methods of categorisation that can be explained in terms of logic and process, namely, categorisation by criteria, factor-balancing, and analogy.

(a) Categorisation by criteria

Perhaps the typical way one would understand categorisation in the application of contracts is that it turns on identifying the constituent properties or components of a class. That is, one establishes the properties or criteria of the components of a contract term and then one determines whether those properties or criteria are established on the facts.

Classification by reference to constituent properties is of course a fundamental cognitive activity. To take a simple example of a small child seeking to slip blocks into a shape-sorter, 'the infant must distinguish, among the features of the blocks, what matters (shape) and what does not (colour)'.[54] It is also a critical feature of legal reasoning. Statutes and contracts use definitions to identify the properties or

[44]See below n 80.

[45]See below n 93.

[46]For example, in law and technology, the 'nearest neighbour' approach has been developed as a means to automate reasoning by analogy with past cases. It involves 'measur[ing] the similarity or dissimilarity between the facts of the cases in terms of some metric … [and then] predict[ing] that a new case will have the same outcome as its closest neighbors': K Ashley *Artificial Intelligence and Legal Analytics: New Tools for Law Practice in the Digital Age* (Cambridge: Cambridge University Press, 2017) p 108.

[47]Construction and interpretation have been described in this way: see eg *John v Price Waterhouse* [2002] EWCA Civ 899 at [94] (Robert Walker LJ) ('intuitive (but not irrational)'); *Norwich Union Life Assurance Society v British Railways Board* [1987] 2 EGLR 137 at 138 (Hoffmann J) (Ch).

[48]D Kahneman *Thinking, Fast and Slow* (New York: Penguin, 2011) p 1.

[49]See eg *Pioneer Shipping v BTP Tioxide Ltd* [1982] AC 724 at 741, 743 (Lord Diplock) (Lords Fraser, Russell and Keith agreeing).

[50]See eg *Hillas & Co Ltd v Arcos Ltd* (1932) 43 Lloyd's Rep 359 at 367 (Lord Wright) (discussing interpretation).

[51]For example, in *The Diana Prosperity* [1976] 1 WLR 989, the House of Lords had to determine whether a vessel delivered by a disponent owner under a sub-charter matched the contractual description. The contract described the vessel as 'Newbuilding motor tank vessel called Yard No 354 at Osaka'. The dispute arose because the vessel that was delivered was built in a different yard (in Oshima) and it had a different yard number ('Oshima 004'). As a matter of interpretation, the House of Lords held that the vessel delivered merely needed to be *identifiable* as 'yard number 354 in Osaka'. Lord Wilberforce concluded that, 'as a matter of fact', the vessel delivered was so identifiable. In doing so, his Lordship emphasised that the upstream charters used the same description: see [1976] 1 WLR 989 at 999 (Lord Wilberforce) (Viscount Dilhorne, Lord Simon and Lord Kilbrandon agreeing). At the outset of his reasons, his Lordship also noted that the sub-charterer was opportunistically seeking to 'escape' the sub-charter due to a drop in the charter rate: see [1976] 1 WLR 989 at 993 (Lord Wilberforce) (Viscount Dilhorne, Lord Simon and Lord Kilbrandon agreeing).

[52]See Bowker and Star, above n 41.

[53]See A Tversky and D Kahneman 'Judgment under uncertainty: heuristics and biases' in D Kahneman et al (eds) *Judgment under Uncertainty: Heuristics and Biases* (Cambridge: Cambridge University Press, 1982).

[54]S McEvoy 'Slot-thinking, or categorisation, in law and literature' (2011) 5 Law and Humanities 53 at 54.

parts of a word or phrase. And the law itself has been taxonomised, with varying degrees of success, by reference to the various properties of different areas of law.[55] Categorisation by reference to underlying properties has long been advocated by philosophers, including Aristotle, who proposed ten categories for classifying all things that can be the subject or the predicate of a proposition.[56] Classification based on properties was also embraced by prominent mathematicians and linguists in the late nineteenth and early twentieth centuries. For example, Frege is often credited with formulating the principle of 'compositionality', that is, the notion that the meaning of an expression is a function of the meaning of its parts.[57] Bertrand Russell employed the theory of types to explain numbers.[58] And Wittgenstein, in his early work, broke down the world in terms of 'facts', each of which is made up of 'objects' or 'things',[59] with a 'thing' only being distinguishable if it 'has properties which no other has'.[60]

Categorisation by reference to properties is suitable in contract application where the relevant component in a contract term constitutes a class that can be defined by criteria. The criteria can be positive or negative. For example, in *Arthur White (Contractors) Ltd v Tarmac Civil Engineering Ltd*,[61] the House of Lords considered whether a hirer of an excavator was liable to indemnify the owner of the excavator for a personal injury claim arising from use of the excavator. The owner supplied a driver to operate the excavator as part of the hire and it was a term of the hire that the hirer was responsible for 'all claims arising in connection with *operation* of [the excavator]' by the driver.[62] The driver had used the excavator to lift a section of piping and lower it into a deep trench. The driver attached the piping to the excavator bucket and raised it by the boom of the excavator. It was then decided that widening of the trench was necessary. The driver applied the brakes. The piping remained suspended in the air for a few minutes, until the brakes failed and the piping fell, seriously injuring an engineer on site. Among other points, the hirer argued that the excavator was not in 'operation' when the injury occurred, and hence the hirer was not responsible for the personal injury claim of the engineer. Lord Morris resolved this question by categorising or classifying the facts to determine whether the relevant component in the term was satisfied, namely, whether the excavator was in 'operation'. His Lordship ultimately rejected the hirer's argument, it appears, based on two criteria for what constituted 'operation of [the excavator]'. The first was positive: the excavator was in 'operation' if the engine was running, which it had been during the course of the accident. The second was negative: a mere 'temporary pause' did not deny the 'continuing operation' of the excavator.[63]

If the court is applying a broad normative standard agreed by the parties, the court may be able to assess whether or not conduct meets the standard by reference to criteria, some of which are established by authority in related areas. The decision of the High Court of Australia in *McCann v Switzerland Insurance Australia Ltd*[64] is a useful example. A law firm claimed under its professional indemnity insurance policy with respect to liability for loss of a client's funds. The money had been deposited for the purpose of purchasing what turned out to be a fictitious financial instrument. The partner who had arranged the transaction believed that the instrument existed, although he had of course never acquired such an instrument in the past. The funds were lost after the partner transferred the money, without

[55]For example, Birks proposed classifying areas of law by causative event: see eg P Birks 'Equity in the modern law: an exercise in taxonomy' (1996) 26 University of Western Australia Law Review 1.

[56]J Barnes *Complete Works (Aristotle)* (Princeton: Princeton University Press, 1991) ('Categories').

[57]See FJ Pelletier 'The principle of semantic compositionality' (1994) 13 Topio 11; R Cann *Formal Semantics* (Cambridge: Cambridge University Press, 1993) p 3.

[58]A Whitehead and B Russell *Principia Mathematica* (Cambridge: Cambridge University Press, 2nd edn, 1963).

[59]L Wittgenstein *Tractatus Logico-Philosophicus* (London: Kegan Paul, Trench, Trubner & Co Ltd, 1922) §1, §2.01.

[60]Ibid, §2.02331.

[61][1967] 1 WLR 1508 (HL).

[62]Emphasis added.

[63][1967] 1 WLR 1508 at 1515–1516 (Lord Morris). One could also reach the same conclusion, as a matter of interpretation, by adopting a broad interpretation rather than 'a narrow view … of the meaning' of the phrase: see [1967] 1 WLR 1508 at 1529 (Lord Pearson).

[64][2000] HCA 65, (2000) 203 CLR 579 (*McCann*).

security, to another bank for the purpose of purchasing the instrument. Critically, the partner had agreed a secret commission as part of the transaction. The insurer denied indemnity, relying on an exclusion in the policy for liability that was 'brought about by the dishonest or fraudulent act or omission' of a partner of the firm. One issue was the extent to which the partner had been dishonest.[65] Gleeson CJ, Gaudron, Kirby and Hayne JJ held that the partner's conduct as a whole in the transaction was dishonest,[66] citing a number of criteria, several of which were substantiated by authority in related areas, namely, criminal law, equity, and professional ethics. The criteria included: conduct is dishonest if it is in breach of fiduciary duty (the partner had preferred his personal interests over those of the client);[67] conduct is dishonest if it involves the concealment of knowledge or intention in circumstances requiring disclosure (the partner had failed to disclose his intention to make a profit and his lack of knowledge regarding the particular instrument);[68] a person acts dishonestly if the person uses means to deal with moneys that they know they have no right to use;[69] conduct is dishonest if it involves 'pretence and collusion in the conscious misuse of a power';[70] and a person acts dishonestly if they make payments in a manner that they know lacked authority.[71] In essence, the court applied the normative standard of 'dishonesty' by identifying criteria for dishonesty (rooted in related areas of law) and then determining whether those criteria were satisfied on the facts. This is a classical approach to classification based on criteria or properties.

(b) Categorisation by factor-balancing

Another way to rationalise categorisation in contract application is that it is a matter of balancing a variety of factors to draw an inference regarding the correct classification in a given case. That is to say, a contract term is applied by weighing and balancing factors to determine whether the components of the term are met on the facts.

On a granular level, factor-balancing involves four steps, although not always explicitly recognised: (i) identify the options being considered; (ii) identify the factors in support of each option; (iii) perform an 'evaluative assessment' of each option (ie a determination of 'how intensely each option deserves to be favoured in light of each factor, relative to other options'); and (iv) determine the 'relative importance to be accorded to each factor when combining assessments across factors'.[72] In essence, the process turns on inductive, rather than deductive, logic. In deductive logic, a premise or premises establish an alleged proposition absolutely,[73] whereas, with inductive reasoning, the premise or premises establish the alleged proposition in terms of likelihood.[74] In factor-balancing, we use inductive logic to assess the relative strength of each factor and, in turn, to make the relevant determination as a matter of probability.

Factor-balancing is common in legal reasoning. Statutory and doctrinal tests often simply state matters that must be taken into account in reaching a conclusion, leaving the rest of the work to be done

[65]Another key issue was interpretive: did the liability or the loss need to be brought about by the dishonest conduct?

[66](2000) 203 CLR 579 at [17] (Gleeson CJ), [61]–[62] (Gaudron J), [88] (n 88) (Kirby J), [121], [138] (Hayne J).

[67]Ibid, at [17] (Gleeson CJ), [138] (Hayne J).

[68]Ibid, at [62] (Gaudron J), [121] (Hayne J) (both citing *Peters v The Queen* [1998] HCA 7, (1998) 192 CLR 493 (a criminal case)).

[69]Ibid, at [88] (n 88) (Kirby J) (citing *Peters v The Queen* (1998) 192 CLR 493).

[70]Ibid, at [88] (n 88) (Kirby J) (citing *Latec Investments Ltd v Hotel Terrigal Pty Ltd* [1965] HCA 17, (1965) 113 CLR 265 (a case of equitable fraud)).

[71]Ibid, at [88] (n 88) (Kirby J) (citing *ex p Lenehan* [1948] HCA 45, (1948) 77 CLR 403 (a case regarding application for admission as a solicitor)).

[72]These four steps were identified by Lauritsen researching in law and technology: M Lauritsen 'On balance' (2015) 23 Artificial Intelligence and Law 23 at 27.

[73]For example, all humans are mortal; Socrates is human; therefore, Socrates is mortal: see I Copi et al *Introduction to Logic* (New York: Routledge, 14th edn, 2011) p 26.

[74]For example, most corporate lawyers are conservative; A is a corporate lawyer; therefore, A is (probably) conservative: see Copi et al, ibid, p 26.

through balancing the various factors. For example, in contract law, interpretation,[75] frustration[76] and remoteness[77] have been conceptualised in terms of factor-balancing. The process is perhaps best exemplified by analysing interpretation. The various factors (ie potential meanings, background, purpose, etc) act as indicators of intention, and the strength of each factor is established through inductive inference; one considers the degree to which each relevant factor reinforces a conclusion regarding what the parties objectively meant by the words in the contract.[78]

Categorisation by factor-balancing is appropriate in contract application where a component in a contract term can be defined by reference to conflicting indicia. For example, whether a charterer of a vessel has breached a warranty that it would only carry between 'safe' berths or ports is determined by reference to 'factors', including the past history of the relevant port, the frequency (if any) of the event, the degree of foreseeability of the event (or combination of events), and the severity of the event.[79] Likewise, in determining whether a party has committed a 'material breach' giving rise to a power to terminate under an express termination clause, courts take into account a range of factors, such as the nature of the breach, its consequences, the breach in the context of the agreement, the guilty party's explanation for the breach, and the consequences of holding that the agreement was terminated or that it continues.[80] That is to say, the court determines whether a component in a contract term is satisfied through weighing and balancing competing factors.

(c) Categorisation by analogy

A simpler alternative in terms of explaining categorisation in contract application is that it involves reasoning by analogy or comparison. In some instances, we determine whether the components of a contract term are satisfied by drawing analogies with comparable cases and objects.

Categorisation by analogy can be understand in a number of ways. On one view, it is essentially a matter of identifying patterns or inferring conclusions from examples. One identifies the same pattern or patterns in a particular object and a class of objects, and thereby categorises the object as falling within the class. Categorisation by pattern recognition is remarkably common in everyday life. Most people do it each day without thinking. It is fundamental to the machine learning algorithms that power many modern applications; through machine learning, a machine is trained to automatically categorise unseen data by recognising patterns in training data.[81] It is also one way to explain the jurisprudential system of precedent; that is, one 'treat[s] like cases alike' by identifying 'material likeness'.[82] To put it in terms of logic, categorising by analogy involves 'using examples in the process of inferring a conclusion from a set of premises'.[83]

Categorisation by analogy can also be understood, in rudimentary terms, as turning on a more simplistic comparison between the facts under consideration and objects that do and do not fall within

[75]See eg *Driver v War Service Homes Commissioner (No 2)* [1924] VLR 535 at 542 (Cussen ACJ) (VSC); *John v Price Waterhouse* [2002] EWCA Civ 899 at [94] (Robert Walker LJ).

[76]See eg *Edwinton Commercial Corporation v Tsavliris Russ (Worldwide Salvage & Towage) Ltd* [2007] EWCA Civ 547 at [111] (Rix LJ).

[77]See eg D McLauchlan 'Remoteness re-invented?' (2009) 9 Oxford University Commonwealth Law Journal 109 at 133 (remoteness).

[78]Catterwell, above n 39, p 110.

[79]*Gard Marine and Energy Ltd v China National Chartering Co Ltd* [2017] UKSC 35, [2017] 1 Lloyd's Rep 521 at [38] (Lord Clarke) (Lord Sumption, Lord Mance, Lord Hodge and Lord Toulson agreeing) (endorsing the reasoning of the Court of Appeal) (*The Ocean Victory*).

[80]See eg *Gallaher International Ltd v Tlais Enterprises Ltd* [2008] EWHC 804 (Comm) at [764] (Clarke J). See further R Gibson 'Termination of contract for breach' (PhD thesis, University of Queensland, 2023).

[81]Ashley, above n 46, pp 236–237.

[82]See generally C Webb 'Treating like cases alike: principle and classification in private law' in A Robertson and HW Tang (eds) *The Goals of Private Law* (Oxford: Hart Publishing, 2009) p 215.

[83]S Brewer 'Exemplary reasoning: semantics, pragmatics, and the rational force of legal argument by analogy' (1996) 109 Harvard Law Review 923 at 934.

the relevant class. This is similar to prototype theory, a theory of categorisation in psychology and cognitive science.[84] The theory arguably derives from Wittgenstein's work on 'family resemblance', which involved categorisation by reference to 'a complicated network of similarities overlapping and criss-crossing'.[85] The fundamental idea underpinning prototype theory is that, based on a prototype example of a member of a category, one can reason by gradients in terms of items that fall within the category.[86] For example, a sparrow may constitute a prototype example of a bird, while an ostrich is at the periphery.[87] Likewise, to borrow from Hart, a motor-car clearly qualifies as a vehicle while a bicycle does not.[88] Prototype theory was advanced as a simpler and more accurate rationalisation of how people categorise in real life – one that reflected the fact that we often classify items and objects with less cognitive effort than a properties-based approach suggests.[89] Glanville Williams described a similar way of 'controlling words', namely, by identifying 'the lower-order referent' or the 'real object in which the quality is conceived as inhering'.[90] Reasoning in this way is particularly appropriate in classifying 'basic' objects,[91] such as colours.[92]

It is appropriate to categorise by analogy in contract application when points of comparison are available. Sometimes judges resort to past cases dealing with similar words and similar facts to identify points of comparison, such as in determining whether an exclusion of consequential or indirect loss captures a particular liability.[93] But resort to precedent is not strictly necessary. For example, in *Thames Valley Power Ltd v Total Gas & Power Ltd*,[94] Christopher Clarke J concluded that a sharp rise in the price of gas did not qualify as 'force majeure' under a gas supply agreement (which would automatically discharge the contract). His Honour noted that the facts before him were not the paradigm case of force majeure where a supplier had 'become unable' to supply gas. Nor was it a situation where the supplier would be physically unable to supply in future (which was still not sufficient to establish force majeure). Rather, the case was two steps removed from force majeure in that it had simply become 'uneconomic' to supply gas. Hence, reasoning by analogy with a paradigm example, there was no force majeure.[95] One can see similar reasoning at play in the application of express contractual duties to negotiate or otherwise act in good faith, with judges reasoning by reference to typical examples of both good faith (such as honesty)[96] and bad faith[97] (eg threatening a breach of contract).[98] Points of comparison are used to guide the process through which one determines whether a component in a contract term is met. The contract is applied by analogy.[99]

[84]See further BG Slocum *Ordinary Meaning: A Theory of the Most Fundamental Principle of Legal Interpretation* (Chicago, University of Chicago Press, 2015) ch 5.

[85]L Wittgenstein *Philosophical Investigations* (Oxford: Basil Blackwell, 2nd edn, 1958) pp 31–32.

[86]See E Rosch 'Principles of categorization' in E Rosch and BB Lloyd (eds) *Cognition and Categorization* (Hillsdale: Lawrence Erlbaum, 1978); E Rosch 'Natural categories' (1973) 4 Cognitive Psychology 328.

[87]R Charnock 'Hart as contextualist? Theories of interpretation in language and the law' in M Freeman and F Smith (eds) *Law and Language: Current Legal Issues Volume 15* (Oxford: Oxford University Press, 2013) p 128 at p 131.

[88]Hart, above n 25, p 126. See further ibid, p 131.

[89]cf E Rosch et al 'Basic objects in natural categories' (1976) 8 Cognitive Psychology 382 at 384.

[90]Williams, above n 39, at 183.

[91]cf Rosch et al, above n 89.

[92]Rosch (1973), above n 86, at 329.

[93]See eg *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2007] BLR 235 at [20] (Sedley LJ) (CA).

[94][2005] EWHC 2208 (Comm), [2006] 1 Lloyd's Rep 441.

[95]Ibid, at [50] (Christopher Clarke J).

[96]See eg *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* [2010] WASCA 222, (2010) 41 WAR 318 at [64]–[65] (Murphy JA) (*Strzelecki*).

[97]See eg *Strzelecki* (2010) 41 WAR 318 at [98] (Murphy JA).

[98]See eg *United Group Rail Services Ltd v Rail Corpn NSW* [2009] NSWCA 177, (2009) 74 NSWLR 618 at [73] (Allsop P).

[99]It may be that many cases of classification by analogy can also be understood in terms of classification by criteria or factor-balancing. However, classification by analogy is distinct in the sense that examples and points of comparison are used in the process.

4. The scope for application

The process of categorisation or classification involved in applying a contract is rarely engaged in a complex and overt way. This is partly because the application process is only engaged after one has both ascertained the facts to which the term is to be applied[100] and also defined the term itself.[101] More fundamentally, it is because both the application process and the interpretive process address cases of linguistic indeterminacy, that is, cases where it is not clear how a contract term applies on the facts. And these problems are usually in practice resolved through interpretation. The relevant term is defined with such specificity that application of the contract is rendered straightforward. As a result, the application process is usually only engaged in a meaningful way when it is not possible to define the term precisely. In these cases at least, judges must classify or categorise the facts in detail so as to resolve the dispute. Before turning to these cases, we must analyse the concept of linguistic indeterminacy and why it is that interpretation (and not application) is usually engaged to determine problems of linguistic indeterminacy.

(a) Problems of linguistic indeterminacy

The concept of linguistic indeterminacy can be framed in a number of ways.[102] For the purpose of this paper, it describes the circumstance where ambiguity or vagueness in contractual language make it unclear how a contract term is to be applied.[103] In short, linguistic indeterminacy arises when 'the words fall short of the facts'.[104] It occurs when 'the information [provided] is [not] sufficiently specific to answer the question, or questions, directing one's inquiry'.[105]

Problems of linguistic indeterminacy are remarkably common in law and in contracts. As Hart argued in *The Concept of Law*, the 'open texture' of language means that there will always be 'hard cases' at the penumbra of a legal rule.[106] Glanville Williams also remarked that 'not merely some but all words are capable of occasioning difficulty in their application',[107] citing the following examples:

> [I]s an album a 'book'? Is a bicycle a 'carriage'? Is a flag a 'document'? Is a flying-boat a 'ship or vessel'? Are household goods 'money'? Is ice-cream 'meat'? Is sandstone a 'mineral'? And so on.[108]

Cases on contract are replete with examples of linguistic indeterminacy. For example, the question might be: whether an excavator is in 'operation' when it is stationary and the brakes have been applied, yet the engine is running;[109] whether a dispute as to contract invalidity is caught by an arbitration clause;[110] whether the insolvency of a shipbuilder triggered a refund guarantee issued in relation to a shipbuilding

[100]See eg *The Diana Prosperity* [1976] 1 WLR 989 at 995 (Lord Wilberforce) ('When it comes to ascertaining whether particular words apply to a factual situation or, if one prefers, whether a factual situation comes within particular words, it is undoubtedly proper, and necessary, to take evidence as to the factual situation').

[101]See eg EA Farnsworth '"Meaning" in the law of contracts' (1967) 76 Yale Law Journal 939 at 942 ('[I]f the seller sells wood as 'braziletto', a court may be called upon to decide whether it is in fact braziletto or peachum. But such questions of fact, which concern truth, arise only after questions of law, which concern the expectations of the parties, have been answered: Was the seller bound to deliver braziletto rather than peachum?'). See also MacCormick, above n 25, p 67; *Upper Hunter County District Council v Australian Chilling & Freezing Co Ltd* [1968] HCA 8, (1968) 118 CLR 429 at 436–437 (Barwick CJ).

[102]See T Endicott 'Linguistic indeterminacy' (1996) 16 Oxford Journal of Legal Studies 667 at 669–670.

[103]cf Endicott, ibid, at 669.

[104]*Casson v Ostley PJ Ltd* [2001] EWCA Civ 1013 at [29] (Sedley LJ).

[105]S Soames 'What vagueness and inconsistency tell us about interpretation' in A Marmor and S Soames (eds) *Philosophical Foundations of Language in the Law* (Oxford: Oxford University Press, 2011) p 31 at p 32 (describing vagueness). See also *Life Insurance Co of Australia Ltd v Phillips* [1925] HCA 18, (1925) 36 CLR 60 at 78 (Isaacs J); Carter, above n 1, p 621 ('ambiguity in application').

[106]Hart, above n 25, pp 127–128.

[107]Williams, above n 39, at 181.

[108]Ibid, at 189.

[109]See *Arthur White (Contractors) Ltd v Tarmac Civil Engineering Ltd* [1967] 1 WLR 1508 (HL).

[110]*Fiona Trust & Holding Corpn v Privalov* [2007] UKHL 40, [2007] Bus LR 1719.

contract;[111] whether loss or damage arising from self-reporting regulatory non-compliance falls within the scope of an indemnity in a share sale agreement;[112] and so on. At least as a matter of principle, these problems can be resolved through either the process of application or the processes engaged to define contract terms, in particular, interpretation.

(b) The resolution of linguistic indeterminacy through interpretation

Interpretation is the process through which one ascertains the reasonable person's understanding of what was meant by the words in a contract. Problems of linguistic indeterminacy are usually resolved through this process.[113] The relevant contract term is defined through interpretation so as to 'mak [e] express provision for the particular difficulty that has arisen'.[114] The process of application and the process of interpretation remain distinct. It is simply that, in the interpretive process, the term is defined with such specificity that the application process is rendered straightforward.

Beyond the mere fact that a term is interpreted before it is applied, there are at least two reasons why linguistic indeterminacy is usually resolved through interpretation rather than application. The first is that the facts to which the contract is to be applied impact the process of interpretation. In particular, the consequences of competing interpretations are taken into account when interpreting the contract. As Lord Reid famously stated in *L Schuler AG v Wickman Machine Tool Sales Ltd*:[115]

> The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear.[116]

One must take into account potential consequences in interpreting a contract and one can only establish those consequences by looking at the facts to which the contract is to be applied.[117] Because the facts of the dispute are before the court in interpreting the contract, the court can address linguistic indeterminacy through interpretation.

The second and most fundamental reason why problems of linguistic indeterminacy are usually resolved through interpretation rather than application is the flexibility inherent in the interpretive process. As Bix remarks in the broader context of legal interpretation, '[t]he decision whether a rule applies to a particular situation often turns on the meaning – on delimiting the range of meanings – of a general term'.[118] Likewise, for MacCormick, ambiguity in a legal rule is effectively determined by 'choosing between rival versions of the rule'.[119] Of course, to borrow from Wittgenstein, each 'interpretation' of a rule is effectively 'the substitution of one expression of the rule for another'.[120] But the legal process of interpretation is typically guided by the reasonable person. Scalia described this as the 'Fair

[111] *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900.

[112] *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, [2017] AC 1173.

[113] cf *Casson v Ostley PJ Ltd* [2001] EWCA Civ 1013 at [30] (Sedley LJ); McMeel, above n 6, p 5 ('In practice most disputes which have to be resolved by resort to the technique of interpretation are not problems about the meanings of words or ones which require familiarity with grammatical niceties. Rather, they are problems about the application of the language of a contract to the (perhaps unexpected) events which subsequently transpired and form the core of the dispute between the parties').

[114] Borrowed from G Williams 'Language and the law – III' (1945) 61 Law Quarterly Review 293 at 301.

[115] [1974] AC 235 (HL).

[116] Ibid, at 251 (Lord Reid). See also *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619 at [22] (Lord Neuberger) (Lord Sumption, Lord Hughes and Lord Hodge agreeing).

[117] It may be that the facts are ascertained first and then the relevant term is defined: cf Carter, above n 1, pp 7, 8. However, the term itself impacts the facts to be ascertained, so it may not be appropriate to break down the process in this way.

[118] B Bix *Law, Language and Legal Determinacy* (Oxford: Oxford University Press, 1995) p 7.

[119] MacCormick, above n 25, p 67.

[120] Wittgenstein, above n 85, p 81.

Reading Method': 'determining the application of a governing text to given facts on the basis of how a reasonable reader, fully competent in the language, would have understood the text at the time it was issued'.[121] Hence, for Scalia, Hart's classic 'chestnut' of whether a bicycle is prohibited in a park by reason of a sign prohibiting 'vehicles' is resolved by defining the rule as a matter of interpretation or intention so that it is clear that bicycles are not caught by the rule.[122]

A similar approach applies in the interpretation of a contract. The court arrives at the reasonable person's understanding of what was meant by the words by considering the meaning of the words, the contract as a whole, the background, the objects served by the contract, and the consequences of the competing interpretations.[123] But the court does so bearing in mind the facts to which the contract is to be applied. Take the seminal case of *Prenn v Simmonds*.[124] Mr Prenn had agreed to sell shares in a company that he had recently acquired, RTT Ltd, to an employee of a subsidiary of that company, Dr Simmonds. The share sale was relevantly conditional upon the 'aggregate profits of RTT' exceeding a certain threshold over a four-year period. The difficulty was that, on the facts that transpired, the profits of RTT Ltd did not exceed the threshold, while the profits of the RTT group did exceed the threshold. The House of Lords had to determine whether the share sale condition was satisfied so as to establish whether Dr Simmonds was entitled to an order for specific performance of the contract for sale of the shares. The share sale condition merely referred to the profits of 'RTT' without clearly specifying whether the profits needed to be those of RTT Ltd or the RTT group.[125] Hence, there was a problem of linguistic indeterminacy: did 'RTT' encompass only RTT Ltd or did it also extend to the RTT group? The House of Lords determined the case as a matter of interpretation. Properly interpreted, the share sale condition only required that group profits exceed the threshold. By inference drawn from the contract as a whole, the background and the purpose of the transaction, it was clear that the parties, by agreeing the share sale condition, had objectively intended a share sale that was conditional upon group profits exceeding the prescribed amount.[126] Through interpretation, the lexical ambiguity in the term 'RTT' was resolved such that it was apparent, when applying the contract, that the share sale condition was met: group profits clearly exceeded the threshold. The myriad cases on interpretation provide numerous examples of contracts being interpreted so as to resolve linguistic indeterminacy and thereby make it clear how the contract must be applied. To put it plainly, to the extent possible, linguistic indeterminacy is usually in effect addressed through interpretation rather than application, that is, as a matter of objective intention rather than through categorisation or classification.[127]

(c) The resolution of linguistic indeterminacy through application

It becomes necessary to resolve linguistic indeterminacy through application when the means to define a contract term 'run out'.[128] That is to say, in some instances, it is not possible to define the term with sufficient specificity such that it is clear how the term should be applied. In at least these cases, one must categorise or classify the facts in detail so as to resolve the dispute. By way of example, categorisation or classification is often necessary in the circumstances outlined below.[129]

[121]Scalia and Garner, above n 4, p 33.

[122]Ibid, p 36.

[123]See eg *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619 at [15] (Lord Neuberger) (Lord Sumption, Lord Hughes and Lord Hodge agreeing).

[124][1971] 1 WLR 1381 (HL).

[125]The term 'RTT' was defined to mean RTT Ltd. However, the term was also used elsewhere in the agreement to refer to the RTT group.

[126]For a more detailed explanation of how the interpretive question was resolved, see Catterwell, above n 39, pp 111–114.

[127]But note *Arthur White (Contractors) Ltd v Tarmac Civil Engineering Ltd* [1967] 1 WLR 1508 (HL) (discussed in Section 3 (a) above).

[128]Borrowed from Bix, above n 118, p 25 (discussing legal rules generally).

[129]To be clear, there is certainly overlap between the different categories analysed in the following paragraphs and the categories are not meant to be exhaustive.

The first situation is where a term contains a broad normative or evaluative standard, such as reasonableness, fairness, necessity, and so on.[130] In rare cases, the contract indicates how the standard is to be met, such as in *Electricity Generation Corpn v Woodside Energy Ltd*,[131] where a gas supply contract detailed how a 'reasonable endeavours' obligation was to be satisfied. In many cases, however, one must simply ascertain whether the standard has been met without any further guidance drawn from the contract or party intention. For example, in *McCann*,[132] the High Court of Australia determined whether particular conduct was 'dishonest' (for the purpose of establishing liability under an insurance policy) by reference to criteria for establishing dishonest conduct.[133]

The second circumstance in which one often needs to categorise or classify facts in some detail is where a term contains a subject matter description. After the subject matter has been defined as a matter of interpretation, one must determine whether the description is met on the facts.[134] In some cases, the subject matter can only be defined in broad terms. This was the case in *The Diana Prosperity*.[135] A sub-charter of an unbuilt vessel described the vessel by reference to a particular yard or hull number. However, the vessel delivered was built at a different yard from that specified in the sub-charter. The sub-charter was ultimately interpreted such that the vessel merely needed to be *identifiable* as being built at the yard specified in the contract. The court then had to determine whether the vessel delivered was so identifiable. That is to say, the question became 'simply whether, as a matter of fact, it [could] fairly be said that – as a means of identification – the vessel was Yard No. 354 at Osaka Zosen or "built by Osaka Shipping Co. Ltd. and known as Hull No. 354 until named"'.[136]

The third type of case commonly necessitating categorisation or classification is where a contract term includes a technical word or phrase or a complex concept, whether it be legal, scientific or based on a custom or trade.[137] If the word or phrase bears a complex or technical meaning, the court may need to categorise or classify the facts in a sophisticated way so as to apply the contract. 'Force majeure' clauses are a simple example.[138] Clauses excluding liability for 'consequential' or 'indirect' loss are a more prominent illustration. In some cases, the question of application is straightforward because the contract defines what amounts to 'consequential' or 'indirect' loss[139] or it is clear from the contract as a whole that the phrase should bear a particular meaning.[140] However, in other cases, English courts have construed such clauses, in light of the test for remoteness of loss,[141] as not excluding liability if it naturally arises from the breach in question.[142] This leaves significant work to be done in categorising the facts so as to establish whether the loss is excluded.[143]

The fourth situation often giving rise to complex reasoning in terms of categorisation or classification is where a term contains a causation element or link. This problem commonly arises in the construction

[130]cf Williams, above n 39, at 182–183 ('good', 'bad', 'honest', 'dishonest', 'material', 'proximate').

[131][2014] HCA 7, (2014) 251 CLR 640.

[132][2000] HCA 65, (2000) 203 CLR 579.

[133]See further Section 3(b) above.

[134]See eg *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396, [2016] 1 CLC 712 (question whether particular electric motors were the subject of an exclusive supply agreement).

[135][1976] 1 WLR 989.

[136][1976] 1 WLR 989 at 999 (Lord Wilberforce) (Viscount Dilhorne, Lord Simon and Lord Kilbrandon agreeing). See further, above n 51.

[137]See eg *Gard Marine and Energy Ltd v China National Chartering Co Ltd* [2017] UKSC 35, [2017] 1 Lloyd's Rep 521 (a 'safe port' warranty in a charterparty, while not a 'term of art', bears a complex meaning that leaves several matters to be determined as a matter of application). See further text at n 79 above.

[138]See eg *Thames Valley Power Ltd v Total Gas & Power Ltd* [2006] 1 Lloyd's Rep 441 (discussed in Section 3(d) above).

[139]See eg *The GSF Artic III* [2016] EWCA Civ 372, [2016] 2 Lloyd's Rep 51.

[140]See eg *Star Polaris LLC v HHIC-Phil Inc* [2016] EWHC 2941 (Comm), [2016] 1 Lloyd's Rep 203.

[141]*Hadley v Baxendale* (1854) 9 Ex 341 at 354–355; 156 ER 145 at 151 (Alderson B).

[142]See the discussion of the authorities by O'Farrell J in *2 Entertain Video Ltd v Sony DADC Europe Ltd* [2020] EWHC 972 (TCC) at [226]–[232].

[143]See eg *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] BLR 235 at [20] (Sedley LJ) (CA) ('it does not automatically tell one on which side [of] the line a case falls').

of insurance policies and commercial indemnities and releases. For example, policies of insurance often contain a range of causation elements,[144] including with respect to whether a particular loss or injury was caused during the policy period or caused by a particular factor or factors[145] and whether liability is excluded from cover because it arises out of, or was based on, or was brought about by, a particular occurrence.[146] Commercial indemnities and releases also contain similarly complex causation links.[147] Of course, the causation test may be clarified through interpretation.[148] However, the test that results often still requires the resolution of difficult causation questions, such as whether a particular cause is a 'proximate cause' under an insurance policy[149] or whether a cause is an 'effective cause' under an indemnity.[150] These types of cases do not depend 'to any great extent on matters of linguistic meaning and how the words used would be understood by an ordinary member of the public'; what is in issue is 'the legal effect of [the contract], as applied to a particular factual situation'.[151] That is to say, these cases turn on categorising or classifying the facts rather than any search for objective intention.

The fifth scenario frequently necessitating classification or categorisation in complex terms is where a contract term needs to be applied to unforeseen circumstances. Sedley LJ described the problem in *Casson v Ostley PJ Ltd*:[152]

> [T]he parties have simply and understandably not even thought about the event which has now caused a problem … and the courts have only the now insufficient words on the page to fall back on.[153]

Of course, even in this situation, the relevant term is often construed such that it is clear how it should be applied to the facts.[154]

The sixth type of case commonly giving rise to the need to classify or categorise facts in a rigorous and detailed way is where the court must define a contract term broadly so as to accord with the objective intention of the parties. For example, in *The Antaios*,[155] a termination clause providing a power to terminate for 'any breach' was construed such that it only gave rise to a power to terminate for 'repudiatory breach'.[156] Adopting this approach, the breach in question had to be classified to determine whether it was 'repudiatory'.

It is these types of cases that necessitate complex reasoning in terms of categorisation or classification; it is these types of cases where the application process is engaged in a meaningful way. One resorts to

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[144]See generally *Financial Conduct Authority v Arch Insurance (UK) Ltd (Hiscox Action Group intervening)* [2021] UKSC 1, [2021] AC 649 (*FCA v Arch Insurance*).

[145]See eg *Durham v BAI (Run Off) Ltd* [2012] UKSC 14, [2012] 1 WLR 867 (insurance cover for disease 'contracted' or 'sustained' during policy period).

[146]See eg *AIG Australia Limited v Kaboko Mining Ltd* [2019] FCAFC 96 (exclusion of cover for loss 'arising out of, based upon or attributable to the actual or alleged insolvency' of the insured).

[147]See eg W Courtney *Contractual Indemnities* (Oxford: Hart Publishing, 2014) pp 60–68 ('Causation or connection').

[148]See eg *Durham v BAI (Run Off) Ltd* [2012] UKSC 14, [2012] 1 WLR 867; *FCA v Arch Insurance* [2021] UKSC 1, [2021] AC 649.

[149]See *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350 at 369–371 (Lord Shaw) (HL); *FCA v Arch Insurance* [2021] UKSC 1, [2021] AC 649 at [162]–[170] (Lord Hamblen and Lord Leggatt) (Lord Reed agreeing).

[150]One example of how causation links in commercial indemnities are defined through interpretation: see eg *Arthur White (Contractors) Ltd v Tarmac Civil Engineering Ltd* [1967] 1 WLR 1508 at 1516 (Lord Morris) (HL). See further Courtney, above n 147, p 61.

[151]*FCA v Arch Insurance* [2021] UKSC 1, [2021] AC 649 at [162] (Lord Hamblen and Lord Leggatt) (Lord Reed agreeing) (discussing proximate cause).

[152][2001] EWCA Civ 1013.

[153]Ibid, at [29] (Sedley LJ).

[154]See eg *Laundy Hotels (Quarry) Pty Ltd v Dyco Hotels Pty Ltd* [2023] HCA 6, (2023) 97 ALJR 194 (a sale of business contract requiring that the vendor 'carry on the Business in the usual and ordinary course' up until settlement was construed as only requiring that the vendor act lawfully – this made it clear that the vendor had not breached the contract by reason of government shutdowns during the coronavirus pandemic). See also *Bromarin AB v IMD Investments Ltd* [1999] STC 301 at 311 (Chadwick LJ) (CA).

[155]*The Antaios* [1985] AC 191 (HL).

[156]Ibid, at 200–201, 205 (Lord Diplock) (Lord Keith, Lord Scarman, Lord Roskill and Lord Brandon agreeing).

categorisation or classification only after attempts to define the relevant term with further precision have failed. Of course, some judges and lawyers may be inclined to draw more from objective meaning or intention than others, and vice versa, such that a question resolved by some as a matter of interpretation is resolved by others as a matter of categorisation.[157] Critically, what ultimately distinguishes the process of application from the process of interpretation is that the latter is guided by the pursuit of objective intention or meaning in defining the relevant term, whereas the former is rooted in the categorisation or classification of the facts.

Conclusion

This paper has sought to bring some clarity to what is involved in the application of contracts by defining the process in terms of its objects, its mechanics and its use in practice. In essence, contract application is a process through which one classifies or categorises facts to establish whether the components of a contract term are met. There of course remain lingering uncertainties regarding the process. Three are worthy of particular mention.

The first is whether the application of a contract term is properly to be characterised as a question of law or a question of fact. This is obviously important in the context of appeals.[158] The interpretation of a wholly written contract is said to involve a question of law.[159] Perhaps due to the close connection between interpretation and application, questions of application (at least in the case of contracts reduced to writing) have been addressed in a similar way on appellate review.[160] That said, the characterisation of questions of application as questions of law may not simply be a matter of the close connection between interpretation and application. If the process of application is understood as one of categorisation or classification, it is arguably proper to regard questions of application as questions of law. One engages in a factual enquiry by ascertaining the facts to which the contract is to be applied. But then one resolves a question of law (at least in the case of wholly written contracts) by determining whether the components of the relevant contract term are satisfied on those facts.

The second point of uncertainty is related: to what extent does precedent impact the application process? Precedent is often said to play a limited role in the interpretation of contracts.[161] For example, it may only be relevant if the language and context are the same,[162] if the meaning is settled,[163] or in the case of a contract using standard language, such as a building and construction contract.[164] In contract application, the role of precedent appears to be similarly limited. It plays a role in categorisation by analogy with past cases.[165] And it may impact categorisation by criteria[166] and factor-balancing[167] in so far as prior authority indicates relevant criteria or factors, as the case may be.

The third and perhaps most critical issue with the way in which contract application is understood in this paper relates to its limited role in practice. When faced with linguistic indeterminacy in a contract dispute, one often has two choices: interpret and define the term so as to resolve the problem; or categorise the facts to determine the dispute. As this paper has demonstrated, courts tend to resolve such

[157]See eg above, n 63.

[158]For example, in the context of appeals from arbitral awards, s 69 of the Arbitration Act 1996 allows judicial review on questions of law but not questions of fact.

[159]By contrast, the interpretation of contracts not in writing is said to involve a question of fact: *Thorner v Major* [2009] UKHL 18, [2009] 1 WLR 776 at [82] (Lord Neuberger).

[160]See Section 3 above.

[161]See eg *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 at 256 (Lord Morris) (HL).

[162]See eg *Re Calf & Sun Insurance Office* [1920] 2 KB 366 at 382 (Atkin LJ) (CA).

[163]See eg *Akici v L R Butlin Ltd* [2005] EWCA Civ 1296, [2006] 1 WLR 201 at [24] (Neuberger LJ) ('standard phrases in standard contexts').

[164]See eg *Beaufort Developments (NI) Ltd v Gilbert-Ash (NI) Ltd* [1999] 1 AC 266 at 274 (Lord Hoffmann) (HL); *MT Højgaard A/S v E.ON Climate & Renewables UK Robin Rigg East Ltd* [2017] UKSC 59, [2017] Bus LR 1610 at [37]–[44] (Lord Neuberger).

[165]See above, n 93.

[166]See eg *McCann* (2000) 203 CLR 579 (discussed in Part 4.A above).

[167]See above, nn 79 and 80.

problems by stretching meaning and intention through interpretation, rather than by categorising or classifying facts as a matter of application. One might reasonably wonder why this is the case. A perhaps superficial answer is based on the notion that the cornerstone of the common law of contract is the principle of freedom of contract – 'the idea that the content of the parties' contractual obligations is a matter of choice for the parties, rather than imposed by the law'.[168] So as to further freedom of contract, to the extent possible, courts should resolve problems of linguistic indeterminacy by reference to the objective intentions of the parties, even if by inference. The difficulty with this justification is that, if the basis for inferring party intention is tenuous and unconvincing, it is hard to see how such an approach actually advances freedom of contract. Objective intention and linguistic meaning are not necessarily more certain tools than categorisation and classification.

It may be that courts are reluctant to embrace categorisation or classification as a means to resolve linguistic indeterminacy because of the view that words do not have acontextual meanings. That is to say, for some, words 'do not have a "meaning" of their own'; '[t]hey do not have a "meaning" independently of the person who utters them or the person who hears them'.[169] On this view of meaning, contract application is guided by objective intention. Any criteria or properties of a component of a contract term, or factors that bear upon establishing whether a component is satisfied, are established as a matter of objective intention: what the parties objectively intended by the words. However, this position denies the concept of semantic autonomy, that is, the notion that words 'carry meaning independent of the communicative goals on particular occasions of the users of those symbols'.[170] At a basic level, words must have objectively-identifiable abstract meanings in order for communication to be effective.[171] Without a shared understanding of such meanings between audience and speaker, an audience cannot understand what a speaker says.[172] On one view, it is by tapping into this common reservoir of objectively-identifiable abstract meanings that one categorises or classifies in applying a contract; it is how one identifies the criteria, factors or points of comparison that bear on the application process.

Further study of how we categorise or classify facts to apply a contract is certainly warranted. It may assist in understanding why judges and lawyers tend to interpret away problems of linguistic indeterminacy rather than deal with them through categorisation or classification. Indeed, further investigation in this area presents a range of potential benefits. Outside of doctrinal legal studies, it may assist in research analysing how we can automate legal reasoning. Beyond contract, it may help enhance our understanding of how statutes and other written instruments are applied. Focusing solely on contracts, it may result in a greater inclination amongst judges and lawyers to resort to categorisation or classification, at least in a more overt manner. It may mean that problems of linguistic indeterminacy that are currently resolved as a matter of intention can actually be resolved by classification. With development, the application process may offer a more certain and logical basis upon which to resolve such cases than a tenuous determination that the contract means X or the contract means Y. Time will tell. In the meantime, those faced with cases of linguistic indeterminacy (where intention and meaning do not readily present an answer) should consider whether classification by criteria, factor-balancing or analogy is appropriate. Each basis for classification has a robust foundation in legal jurisprudence and more broadly in linguistics, mathematics and philosophy. This foundation may provide the cognitive framework necessary to categorise rather than interpret.

[168]M Raczynska and PS Davies 'Freedom of contract and terms affecting freedoms' in PS Davies and M Raczynska (eds) *Contents of Commercial Contracts: Terms Affecting Freedoms* (Oxford: Hart Publishing, 2020) p 1 at p 1.

[169]D Nicholls 'My kingdom for a horse: the meaning of words' (2005) 121 Law Quarterly Review 577 at 578–579. See also S Fish 'There is no textualist position' (2005) 42 San Diego Law Review 629 at 635; D McLauchlan 'Contract interpretation: what is it about?' (2009) 31 Sydney Law Review 5 at 18.

[170]Schauer, above n 25, p 55.

[171]Ibid, p 57.

[172]cf Mitchell, above n 20, pp 8–9.

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