

Construction of Contracts: The High Court's Approach

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Introduction

- 1 Sir Robert Goff (later Lord Goff of Chieveley) said in 1984 that 'if not the meat and drink, then at least the staple diet of the Commercial Court can be summed up in one word — "Construction".¹ That is no less true today, as commercial courts at all levels of the judicial hierarchy find themselves, with monotonous regularity, confronted with the task of deciding the legal effect of words that parties to an agreement have chosen to govern their contractual relationship. While there is no shortage of judgments on this topic from state and territory courts, it is the approach taken by the High Court that I wish to focus on today.
- 2 The High Court has handed down no fewer than 17 decisions touching on the construction of contracts since the year 2000. These decisions have canvassed dispute resolution mechanisms, exemptions from liability, the interaction between statutory and contractual construction, 'reasonable endeavours' clauses, indemnity clauses, implied duties, contracts between public bodies, and so on. Yet these developments have often been eclipsed by the fixation shared by practitioners, academics and (some) judges on the debate concerning the extent to which recourse may be had to evidence of surrounding circumstances in construing

* For personal reasons I was unable to deliver this paper. My colleague Justice François Kunc kindly agreed to step into the breach, and I am grateful to him for doing so.

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¹ Sir Robert Goff, 'Commercial Contracts and the Commercial Court' (1984) *Lloyd's Maritime and Commercial Law Quarterly* 382, 385.

contracts, in light of Mason J's 'true rule' in *Codelfa*. This is regrettable, as in my all too long experience, contract cases in real life do not often hinge on the distinction between ambiguous and plain language referred to in that rule.

3 However, since it remains a vexing issue, I will begin by advancing a view of the High Court's jurisprudence on the 'ambiguity gateway' that seeks to resolve some perceived inconsistencies between the various decisions. Once that is considered, I propose to revisit some of the other more orthodox principles of contractual construction, which although having received far less attention outside the courts in the last decade and a half, are certainly no less important. These include the objective theory of contract, the search for a 'commercial' construction, the commonsense approach, and the desirability of harmonious operation. As will be seen, principles such as these, which tend to focus far more on the internal content of a contract than the external context, are more frequently determinative of the construction of a particular contract than the inquiry into ambiguity.

4 I note in passing that some authorities treat ambiguity as having two different forms – patent ambiguity and latent ambiguity – although decreasingly so in modern times. Patent ambiguity is said to arise where ambiguity emerges from the language of the instrument, whereas latent ambiguity arises where there is ambiguity as to how the language is to be applied to the factual situation.² The distinction is an interesting one but does not need to be delved into for present purposes.

The relevance of surrounding circumstances to the construction of a contract

A. The correct approach

5 The question of whether – or more accurately, "to what extent" – evidence of surrounding circumstances is admissible as an aid to the construction of contracts is a still a live issue.

² Lewison and Hughes, *The Interpretation of Contracts in Australia* (LawBook, 2012) 348.

The inquiry begins – as it always does – with what Mason J (with whom Stephen and Wilson JJ agreed) said in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*:³

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

6 This statement of the ‘true rule’ appears to conflate two concepts. One is the admissibility of evidence. The other is the use to which that evidence may be put. Of course, those two concepts are interlinked. If “evidence” has no utility – may not be used for any relevant probative purpose – then it is irrelevant and, by s 56(2) of the *Evidence Act 1995* (NSW), inadmissible. I shall return to the concepts of admissibility and use.

7 The ‘true rule’ appears at first blush to ban any use of evidence of surrounding circumstances – which I will call ‘extrinsic evidence’ – when construing contracts, unless there is ambiguity in the language of the contract. However, as is clear from *Codelfa* itself, there are other bases on which extrinsic evidence can be admitted. Only two paragraphs before the statement of the ‘true rule’, Mason J affirmed his own earlier observation in *DTR Nominees Pty Ltd v Mona Homes Pty Ltd*⁴ that:

A court may admit evidence of surrounding circumstances in the form of ‘mutually known facts’ ‘to identify the meaning of a descriptive term’ and it may admit evidence of the ‘genesis’ and objectively the ‘aim’ of a transaction to show that the attribution of a strict legal meaning would ‘make the transaction futile’...

8 That statement makes clear that there are at least two other purposes for which extrinsic evidence can be admitted: (1) to identify the meaning of a descriptive term, and (2) to explain the genesis or aim of a transaction. However, the issue that is not made clear – and this has come to be known as the ‘internal tension’⁵ of Mason J’s judgment – is how those two admissibility purposes interact with the so-called ‘ambiguity gateway’.⁶ There are two possibilities. One is that they operate *cumulatively*, with the ambiguity gateway being a mandatory requirement in all cases, that must be satisfied before extrinsic evidence can be

³ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352.

⁴ (1978) 138 CLR 423, 429.

⁵ *Franklins v Metcash* (2009) 76 NSWLR 603, 664 per Campbell JA.

⁶ This term has never been authoritatively adopted by the High Court itself.

admitted for one of the other two purposes just mentioned. The other possibility is that they operate *disjunctively*, meaning that there are in total three separate purposes for which extrinsic evidence can be admitted:

- (1) To identify the meaning of a descriptive term;
- (2) To explain the genesis or aim of a transaction; or
- (3) To assist in the interpretation of ambiguous language.

9 This second possibility is consistent with later High Court authorities, while the first possibility appears not to be. In addition, and also in his discussion directly preceding the ‘true rule’, Mason J approved the following statement of principle by Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen*:⁷

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... Similarly when one is speaking of aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have in mind in the situation of the parties.⁸

10 Combining that restriction with the second sentence of the ‘true rule’, we reach the further conclusions that *Codelfa* expressly prohibits the use of extrinsic evidence:

- (4) To contradict the language of the contract when it has a plain meaning; or
- (5) To establish subjective intentions of the parties, even where shared by both parties.⁹

11 Therefore, an open view of *Codelfa* is that it prescribes three distinct purposes for which extrinsic evidence can be “admitted”, and two prohibited purposes for which it cannot be “used” (I turn in a moment to the concepts of “admissibility” and “use”). I will call these the First, Second, Third, Fourth and Fifth Purposes respectively. Before I explain why this is the best view, there is a critique that needs to be dealt with.

⁷ [1976] 3 All ER 570.

⁸ *Codelfa* (1982) 149 CLR 337, 351.

⁹ See further the Hon Kevin Lindgren AM QC, ‘The Ambiguity of “Ambiguity” in the Construction of Contracts’ (2014) 38 *Australian Bar Review* 153.

12 The framework that I have just given effectively splits the ‘true rule’ in half, treating the existence of ambiguity as a basis for admissibility, and the existence of a plain meaning as a bar against the use of extrinsic evidence to contradict it. It might be retorted that these are simply two sides of the same coin: either the language is ambiguous, and you can admit the evidence, or it is plain, and you cannot. However as Leeming JA succinctly noted in *Mainteck Services Pty Ltd v Stein Heurtey SA*:¹⁰

[W]hether contractual language has a ‘plain meaning’ is (a) a conclusion and (b) a conclusion which cannot be reached until one has had regard to the context.

13 On this view, extrinsic evidence is always provisionally admissible (compare *Evidence Act 1995* (NSW), s 57) to answer the preliminary question of whether ambiguity exists.¹¹ If ambiguity is found to exist, then the evidence becomes admissible unconditionally to assist in the interpretation of that ambiguous language. Whereas if the preliminary inquiry reveals that the language is plain, the extrinsic evidence can go no further in illuminating its meaning (and, clearly, it would not need to anyway).¹²

14 The difficulty is primarily terminological. For both aspects of the rule the word ‘admissible’ is used, although in respect of the five Purposes just stated, I am treating it as meaning ‘useable’, with evidentiary admissibility being an anterior question that logically precedes any application of the ‘true rule’. As Campbell JA noted in *Franklins Pty Ltd v Metcash Trading Ltd*:¹³

¹⁰ [2014] NSWCA 184.

¹¹ The technique of provisionally admitting extrinsic evidence is indeed a widespread practice in many courts. See, eg, *McCourt v Cranston* [2012] WASCA 60, [36] (per Pullin and Newnes JJA).

¹² Professor John Carter expresses this same distinction in slightly different language: ‘To ask what raw material may be used to construe a contract raises a distinction between, on the one hand, evidence which is necessarily admissible as an aid to construction and, on the other hand, evidence which may not be used. The former includes evidence of context, and the latter is regulated by the exclusionary rule. It is useful to use terminology which reflects that distinction... A very good reason for distinguishing the various stages in construction is that the admissible raw material varies. Evidence which is inadmissible as an aid to construction may be admissible in application of the contract... [I]n the preliminary stage of construction the admissible evidence depends on what is in issue. In so far as the terms of the contract are at issue, the evidence is at large, and therefore includes material which would be inadmissible in construction’: John W Carter, *The Construction of Commercial Contracts* (2013, Hart Publishing) [1-21].

¹³ (2009) 76 NSWLR 603, 667.

The word 'admissible' is itself ambiguous, even when used in a legal context. It can refer to a rule of evidence, under which, if evidence is not admissible, it is neither received nor considered by the court. Alternatively, it can mean that evidence that is not 'admissible' is evidence that is not legitimately able to be used by a court in some particular reasoning process.

15 Since the 'true rule' is directed at the probative purpose of the evidence (that is, whether or not it can shine light on the meaning of words), rather than, by its terms, the reception of evidence, it is clear that 'admissibility' in the true rule means 'admissible... in some particular reasoning process', or synonymously, 'useable' or 'applicable'.

16 In short, and to re-iterate, *Codelfa* shows that extrinsic evidence is always admissible in the evidentiary sense; that is, courts may always allow its reception. It is then admissible in the usage sense for the first three of the five Purposes I have mentioned (that is, (1) to define a descriptive term, (2) to explain the genesis of a transaction, or (3) to resolve ambiguity), but is inadmissible in the usage sense for the other two Purposes (that is, (4) to contradict plain language, or (5) to prove subjective intentions).

17 I will now demonstrate how this view accords with, and reconciles any apparent inconsistencies contained in, the subsequent High Court authorities on the issue.

B. Reconciliation with High Court authorities

18 The High Court has handed down nine judgments¹⁴ since the year 2000 dealing expressly with construction of contracts.

(1) In the first, *Maggbury Pty Ltd v Häfele Australia Pty Ltd*, the majority held that:

Interpretation of a written contract involves, as Lord Hoffmann has put it: "the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract."¹⁵

The words 'having all the background knowledge' affirm that extrinsic evidence of the relevant background can and should be received at first instance. The words 'would

¹⁴ Although one of these was a refusal to grant special leave to appeal, rather than a final determination.

¹⁵ (2001) 210 CLR 181, 188 per Gleeson CJ, Gummow and Hayne JJ, citations omitted.

convey to a reasonable person' invoke the objective theory of contract and affirm the proposition that such evidence, once admitted, may only be *used* for confined interpretative purposes, and in particular, cannot be used for the Fifth Purpose, that is, to establish the subjective intentions of parties.

(2) Second, in *Royal Botanical Gardens and Domain Trust v South Sydney City Council*, the majority held:

In his judgment, Fitzgerald JA referred to well-known passages in the judgment of Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* respecting the admissibility of evidence of surrounding circumstances to assist in the interpretation of a written contract if the language be ambiguous or susceptible of more than one meaning... In a context such as cl 4(b), to specify a particular matter to which a party may have regard without expressly stating either that it is the only such matter or, to the contrary, that the specification does not limit the generality of the matters to which regard may be had is likely to result in ambiguity. It does so in the present case. The resolution of the ambiguity requires the application of settled principles of construction.

This paragraph explicitly affirms that extrinsic evidence may be used for the Third Purpose, that is, to resolve ambiguity. However, nothing in it suggests that this is the only purpose for which extrinsic evidence may be used. Rather, it is simply invoked as a relevant purpose in the present case. The majority continues:

In *Codelfa*, Mason J (with whose judgment Stephen J and Wilson J agreed) referred to authorities which indicated that, even in respect of agreements under seal, it is appropriate to have regard to more than internal linguistic considerations and to consider the circumstances with reference to which the words in question were used and, from those circumstances, to discern the objective which the parties had in view. In particular, an appreciation of the commercial purpose of a contract: "presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating." Such statements exemplify the point made by Brennan J in his judgment in *Codelfa*: "The meaning of a written contract may be illuminated by evidence of facts to which the writing refers, for the symbols of language convey meaning according to the circumstances in which they are used."¹⁶

This paragraph confirms that the Third Purpose is not the only basis for admissibility. It does that by specifically citing the passage in *Codelfa* that establishes the Second Purpose, and by affirming the Second Purpose directly ('the objective which the parties had in view' and 'the genesis of the transaction').

The relevant passage finishes with the following:

¹⁶ (2002) 240 CLR 45, 52–53, per Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ, citations omitted.

... Two further matters should be noticed. First, reference was made in argument to several decisions of the House of Lords, delivered since *Codelfa* but without reference to it. Particular reference was made to passages in the speeches of Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society [No 1]* and of Lord Bingham of Cornhill and Lord Hoffmann in *Bank of Credit and Commerce International SA v Ali*, in which the principles of contractual construction are discussed. It is unnecessary to determine whether their Lordships there took a broader view of the admissible “background” than was taken in *Codelfa* or, if so, whether those views should be preferred to those of this Court. Until that determination is made by this Court, other Australian courts, if they discern any inconsistency with *Codelfa*, should continue to follow *Codelfa*.¹⁷

This paragraph references English authorities which may admit of a more liberal use of extrinsic evidence than that outlined in *Codelfa*. The **Court** does not adopt the approach taken in these authorities. Instead, it ultimately affirms *Codelfa* as the authoritative statement of principle in Australia.

In short, this decision confirms the Second and Third Purposes as bases for the admissibility of extrinsic evidence in the construction of contracts.

(3) Third, in *Pacific Carriers Ltd v BNP Paribas* the Court unanimously held:

What is important is not Ms Dhiri’s subjective intention, or even what she might have conveyed, or attempted to convey, to NEAT about her understanding of what she was doing... Pacific did not know what was going on in Ms Dhiri’s mind, or what she might have communicated to NEAT as to her understanding or intention. The case provides a good example of the reason why the meaning of commercial documents is determined objectively: it was only the documents that spoke to Pacific. The construction of the letters of indemnity is to be determined by what a reasonable person in the position of Pacific would have understood them to mean. That requires consideration, not only of the text of the documents, but also the surrounding circumstances known to Pacific and BNP, and the purpose and object of the transaction. In *Codelfa Constructions Pty Ltd v State Rail Authority of NSW*, Mason J set out with evident approval the statement by Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen*:

“In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.”¹⁸

This passage affirms that extrinsic evidence cannot be used for the Fifth Purpose, that is, to establish subjective intentions of parties. It also affirms that such evidence can be used for the Second Purpose, that is, to establish the ‘purpose and object of the transaction’ and ‘the genesis of the transaction’.

¹⁷ *Codelfa*, at 62–3.

¹⁸ (2004) 218 CLR 451, 461–2 per Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ (citations omitted).

(4) Fourth, in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*, the Court unanimously held:

A striking feature of the evidence at trial, and of the reasoning of the learned primary judge, is the attention that was given to largely irrelevant information about the subjective understanding of the individual participants in the dealings between the parties. Written statements of witnesses, no doubt prepared by lawyers, were received as evidence in chief. Those statements contained a deal of inadmissible material that was received without objection. The uncritical reception of inadmissible evidence, often in written form and prepared in advance of the hearing is to be strongly discouraged. It tends to distract attention from the real issues, give rise to pointless cross-examination and cause problems on appeal where it may be difficult to know the extent to which the inadmissible material influenced the judgment at first instance.

In *Codelfa Construction Pty Ltd v State Rail Authority of NSW*, Mason J observed:

“We do not take into account the actual intentions of the parties and for the very good reason that an investigation of those matters would not only be time consuming but it would also be unrewarding as it would tend to give too much weight to these factors at the expense of the actual language of the written contract.”

This Court, in *Pacific Carriers Ltd v BNP Paribas (20)*, has recently reaffirmed the principle of objectivity by which the rights and liabilities of the parties to a contract are determined. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe. References to the common intention of the parties to a contract are to be understood as referring to what a reasonable person would understand by the language in which the parties have expressed their agreement. The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction.¹⁹

The first paragraph in that passage admonishes the primary judge for uncritically allowing evidence of the subjective intentions of parties. This affirms again that extrinsic evidence cannot be used for the Fifth Purpose of proving the subjective intentions of parties (and if it was evidence that served that purpose alone, it should not have been received). The second paragraph makes this same point again by reference to what Mason J said in *Codelfa*. The third paragraph picks up and rephrases the statements from *Pacific Carriers v BNP Paribas* which, as we have seen, affirmed that extrinsic evidence cannot be used for the Fifth Purpose (establishing subjective intentions), but can be used for the Second Purpose (establishing the purpose and object of the transaction).

(5) Fifth, in *Wilkie v Gordian Runoff Ltd*, the majority held:

¹⁹ (2004) 219 CLR 165, 177–9, per Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ (citations omitted).

In *McCann v Switzerland Insurance Australia Ltd*, after observing that, as a commercial contract, a policy of insurance should be given a businesslike interpretation, Gleeson CJ added:

“Interpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure.”²⁰

It is clear here that the Court may inform itself of the ‘objects which [a contract] is intended to secure’, again an affirmation that extrinsic evidence can be used for the Second Purpose (to establish the genesis or aim of a transaction).

(6) Sixth, in *International Air Transport Association v Ansett Australia Holdings Ltd*, Gleeson CJ stated that:

In giving a commercial contract a businesslike interpretation, it is necessary to consider the language used by the parties, the circumstances addressed by the contract, and the objects which it is intended to secure. An appreciation of the commercial purpose of a contract calls for an understanding of the genesis of the transaction, the background, and the market. This is a case in which the Court’s general understanding of background and purpose is supplemented by specific information as to the genesis of the transaction. The Agreement has a history; and that history is part of the context in which the contract takes its meaning.²¹

The majority stated that:

The task of construction is to be approached in the manner described as follows by Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*:

“This Court, in *Pacific Carriers Ltd v BNP Paribas*, has recently reaffirmed the principle of objectivity... [The third paragraph already extracted at (4) above continues in full].”²²

The passage from Gleeson CJ conjures up his own statements in *McCann v Switzerland Insurance* affirming the use of extrinsic evidence for the Second Purpose of establishing the purpose and object of a transaction. His Honour twice re-affirms that purpose, with the dicta, ‘calls for an understanding of the genesis of a transaction’, and even more explicitly, ‘the Court’s general understanding... is supplemented by specific information as to the genesis of the transaction’. The majority judgment breaks no new ground by simply citing *Toll v Alphapharm*, which, it will be recalled, affirms that extrinsic evidence cannot

²⁰ (2005) 221 CLR 522, 528–9, per Gleeson CJ, McHugh, Gummow and Kirby JJ (citations omitted).

²¹ (2008) 234 CLR 151, 160 per Gleeson CJ (citations omitted).

²² (2008) 234 CLR 151, 174, per Gummow, Hayne, Heydon, Crennan and Kiefel JJ.

be used for the Fifth Purpose (establishing subjective intentions), but can be used for the Second Purpose (establishing the purpose and object of the transaction)

(7) Seventh, in *Byrnes v Kendle*, the plurality held:

Contractual construction. The approach taken to statutory construction is matched by that which is taken to contractual construction. Contractual construction depends on finding the meaning of the language of the contract – the intention which the parties expressed, not the subjective intentions which they may have had, but did not express. A contract means what a reasonable person having all the background knowledge of the “surrounding circumstances” available to the parties would have understood them to be using the language in the contract to mean. But evidence of pre-contractual negotiations between the parties is inadmissible for the purpose of drawing inferences about what the contract meant unless it demonstrates knowledge of “surrounding circumstances”. And in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* this Court said:

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

One reason why the examination of surrounding circumstances in order to decide what the words mean does not permit examination of pre-contractual negotiations is that the latter material is often appealed to purely to show what the words were intended to mean, which is impermissible.²³

This is an orthodox restatement of the rule that extrinsic evidence may not be used for the Fifth Purpose (to establish subjective intentions of parties), as well as another affirmation that Courts must nonetheless start their inquiry by receiving ‘all the background knowledge of the “surrounding circumstances” available to the parties’.

(8) Eighth, in *Western Export Services Inc v Jireh International Pty Ltd*, three judges of the High Court, in refusing special leave to appeal, said:

[1] [Macfarlan JA] found error in principle in the reasons of the primary judge... :

[55] ... A court is not justified in disregarding unambiguous language simply because the contract would have a more commercial and businesslike operation if an interpretation different to that dictated by the language were adopted.

His Honour added that the primary judge appeared... :

... to have acted on the basis that the provision would make more sense from a commercial point of view if it were construed as the primary judge did construe that provision.

²³ (2011) 243 CLR 253, 284–5, per Heydon and Crennan JJ (citations omitted).

[2] ... The applicant in this Court refers to [*Franklins v Metcash*] and to *MBF Investments Pty Ltd v Nolan* as authority rejecting the requirement that it is essential to identify ambiguity in the language of the contract before the court may have regard to the surrounding circumstances and object of the transaction...

[3] Acceptance of the applicant's submission, clearly would require reconsideration by this Court of what was said in [*Codelfa*] by Mason J, with the concurrence of Stephen J and Wilson J, to be the "true rule" as to the admission of evidence of surrounding circumstances. Until this Court embarks upon that exercise and disapproves or revises what was said in *Codelfa*, intermediate appellate courts are bound to follow that precedent. The same is true of primary judges, notwithstanding what may appear to have been said by intermediate appellate courts.

[4] The position of *Codelfa*, as a binding authority, was made clear in the joint reasons of five Justices in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* and it should not have been necessary to reiterate the point here.

[5] We do not read anything said in this Court in *Pacific Carriers Ltd v BNP Paribas; Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd; Wilkie v Gordian Runoff Ltd* and *International Air Transport Association v Ansett Australia Holdings Ltd* as operating inconsistently with what was said by Mason J in the passage in *Codelfa* to which we have referred.²⁴

Paragraph [1] implicitly approves Macfarlan JA's proposition that a Court is not justified in 'disregarding unambiguous language'. So much is uncontroversial, and confirms that extrinsic evidence cannot be used for the Fourth Purpose, that is, to contradict the plain language of a contract. Paragraphs [2] and [3] are the most problematic, and appear to imply that ambiguity is a pre-requisite to admissibility of extrinsic evidence in all cases. However, their Honours go on to say in paragraphs [4] and [5] that nothing in *Codelfa* operates inconsistently with the post-*Codelfa* authorities already explored in this speech.

This difficulty can be resolved in one of two ways. One is to recall the distinction between evidentiary admissibility and usage admissibility²⁵ highlighted in *Mainteck* and *Metcash*, and to read the words 'have regard to' in paragraph [3] as meaning 'use or rely upon' rather than 'receive into evidence'. This view casts *Jireh* as affirming the use of extrinsic evidence for the Third Purpose, that is, to resolve an already identified ambiguity, rather than as demanding ambiguity as a pre-requisite to the *reception* of extrinsic evidence.

²⁴ (2011) 282 ALR 604, per Gummow, Heydon and Bell JJ.

²⁵ Or as Professor John Carter has called it elsewhere, 'procedural admissibility' and 'substantive admissibility'.

The other way to resolve the difficulty in *Jireh* is to ignore the decision entirely, noting as many elsewhere have done that it is not a binding precedent, and that it was handed down after only 37 minutes of argument and 11 minutes of deliberation. The doctrine of precedent means that a court is bound by the *ratio decidendi* of any decision made by court to which an appeal from the first court directly lies. However such a decision must dispose of the dispute in a final way, which a refusal to grant special leave does not – rather, it leaves the decision of the court below it untouched.²⁶

In either case, it is certainly not reason enough to now treat *Codelfa* as imposing a mandatory ambiguity gateway for the reception of extrinsic evidence in all cases.

(9) Ninth, and finally, in *Electricity Generation Corporation v Woodside Energy Ltd*, the majority held:

Both Verve and the Sellers recognised that this Court has reaffirmed the objective approach to be adopted in determining the rights and liabilities of parties to a contract. The meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean. That approach is not unfamiliar. As reaffirmed, it will require consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract. Appreciation of the commercial purpose or objects is facilitated by an understanding “of the genesis of the transaction, the background, the context [and] the market in which the parties are operating”. As Arden LJ observed in *Re Golden Key Ltd*, unless a contrary intention is indicated, a court is entitled to approach the task of giving a commercial contract a businesslike interpretation on the assumption “that the parties ... intended to produce a commercial result”. A commercial contract is to be construed so as to avoid it “making commercial nonsense or working commercial inconvenience”.

This passage delivers us back to familiar territory by affirming, once again, that the Court may always have at its disposal extrinsic evidence to be used for the Second Purpose, that is to identify ‘the genesis of the transaction’, which feeds into an understanding of ‘the commercial purpose or objects to be secured by the contract’.

²⁶ The Hon Sir Anthony Mason, ‘The Use and Abuse of Precedent’ 1988) 4 *Australian Bar Review* 93, 96–97, citing *Blackore v Linton* [1961] VR 374, 380; *Mihaljevic v Longyear (Australia) Pty Ltd* (1985) 3 NSWLR 1. A related consequence flowing from the doctrine of precedent is that while intermediate appellate courts are bound directly and exclusively by High Court precedents, trial judges are also bound by their own intermediate appellate courts, and if they perceive a conflict between their appellate court and the High Court, are bound to follow the appellate court: See further *Hasler v Singtel Optus Pty Ltd* (2014) 87 NSWLR 609, 631.

19 This concludes the journey through the High Court's nine recent pronouncements on the use of extrinsic evidence to construe contracts. I have endeavoured to show that there is a clear reading of Mason J's statements in *Codelfa* that is capable of being reconciled with all subsequent High Court authorities. I accept that it is not only the possible reading of *Codelfa*,²⁷ or even necessarily the best reading of *Codelfa* from a policy perspective, but it appears to be the reading that most convincingly harmonises these otherwise disparate authorities.

Beyond the gateway

20 The issue of ambiguity dealt with, I turn now to some of the other principles of contractual interpretation that are more often relied upon in the daily caseload of commercial courts. I propose to consider these through the lens of two worked examples: *Electricity Generation Corporation v Woodside Energy*²⁸ and *Westfield Management v AMP Capital Property Nominees*.²⁹ Although these cases are not known for their extended discussions of high principle in relation to the construction of contracts, both are instructive examples of the construction process in action. Perhaps it is because the principles involved are now thought to be so ingrained in the psyche of legal practitioners that courts less frequently feel the need to signpost what it is they are doing: for instance, judges will less often expound on the virtue of reading the text closely, when simply doing so themselves will exemplify the point and resolve the dispute at hand more efficiently.

21 For all the airtime that the issue of external context still receives in academic journals, law firm publications, occasional High Court pronouncements and extra-curial speeches by judges (and accepting that I am now adding to that volume of literature), the vast majority of cases involving the construction of contracts are determined by orthodox principles of interpretation,

²⁷ Another approach is to adopt a very broad view of 'ambiguity', such that the threshold will be met in virtually all cases. See, eg, *South Sydney Council v Royal Botanic Gardens* [1999] NSWCA 478; *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235. However this approach, in my view, tends to abolish the effect of the 'true rule' altogether, rather than incorporate it into a comprehensive approach.

²⁸ (2014) 251 CLR 640.

²⁹ (2012) 247 CLR 129.

which for the most part, focus far more on the internal content of a contract than the external context.

22 Although these principles will no doubt be familiar to this audience, I will rehearse some of them briefly by way of refresher. The construction of a commercial contract requires the ascertainment of the meaning (not just the dictionary definitions) which the words of the contract would convey to a reasonable businessperson with the knowledge of the contracting parties.³⁰ That process involves identifying the meaning of the words used, and then giving effect to that meaning within the context of the contract construed as a whole.³¹ In so doing, courts should take a commonsense approach³² in striving to give the contract an interpretation that avoids absurdity and in which all the parts of the contract are given effect and operate harmoniously together.³³ The search is for the objective intention of the parties, which as we have seen, is discoverable partly by reference to the genesis, aim and background of the transaction (as well any common assumptions), but which must always yield to the actual words the parties chose to express their intention.³⁴

23 The distinction between the dictionary definition of a word and its legal meaning is not often well understood. While dictionaries can be used as an aid to identifying the conventional meaning of a word,³⁵ they are no substitute for the interpretative process. Nor is the legal meaning of the words used in a contract merely the sum of the individual meanings of the words used, ascertained from dictionaries.³⁶ Justice Holmes once famously said that words are but 'the skin of a living thought'.³⁷ It is the thoughts themselves (regarded objectively) that courts must ascertain and apply.³⁸

³⁰ *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451, 461–2 [22]; *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640.

³¹ *Australian Broadcasting Commission v Australasian Performing Rights Association* (1973) 129 CLR 99, 109.

³² *Gollin & Co Ltd v Karenlee Nominees Pty Ltd* (1983) 153 CLR 455 at 464.

³³ *Ibid.*

³⁴ *Franklins Pty Ltd v Metcash Trading* (2009) 76 NSWLR 603, [19]–[23].

³⁵ *House of Peace Pty Ltd v Bankstown City Council* (2000) 48 NSWLR 498, [28].

³⁶ *Provincial Insurance v Consolidated Wood* [1991] 25 NSWLR 541, 559.

³⁷ *Towne v Eisner* (1918) 245 US 418, 425.

³⁸ *Provincial Insurance v Consolidated Wood* [1991] 25 NSWLR 541, 559.

A. Electricity Generation Corporation v Woodside Energy Ltd

24 It was by application of precisely the principles just summarised that the High Court reached the outcome that it did in *Electricity Generation Corporation v Woodside Energy Ltd*.³⁹ That case involved a contract for sale of gas between Electricity Generation Corporation, trading as Verve Energy (the Buyer), and Woodside Energy (the Sellers). Verve was a statutory corporation and the major generator and supplier of electricity to an area of Western Australia that included Perth. The Sellers operated gas plants and sold gas.

25 Clause 3.2 of the contract obliged the Sellers to make available to Verve a maximum daily quantity of gas (MDQ). If Verve indicated on a particular day that it required more than the MDQ, cl 3.3 further obliged the sellers to 'use reasonable endeavours' to make extra gas available up to a supplemental maximum daily quantity (SMDQ). On 3 June 2008, an explosion at a gas plant operated by an unrelated company caused a reduction of 30-35% in the overall supply of natural gas to the Western Australian market, causing an increase in the market price. The next day, the Sellers informed Verve that they would no longer supply SMDQ at the price nominated in the contract, but that they would be prepared to sell that amount to Verve at the prevailing market price under a new contract.

26 The question was, did cl 3.3 permit the Sellers to refuse to sell SMDQ to Verve in the circumstances just described?

27 The relevant portion of the contract was as follows (with contested language italicised):

3.3 Supplemental Maximum Daily Quantity

(a) If in accordance with Clause 9 ('Nominations') the Buyer's nomination for a Day exceeds the MDQ, the Sellers *must use reasonable endeavours* to make available for delivery up to an additional 30TJ/Day of Gas in excess of MDQ ('Supplemental Maximum Daily Quantity' or 'SMDQ').

(b) In determining whether they *are able to supply SMDQ on a Day*, the Sellers may take into account all relevant commercial, economic and operational matters and, without limiting those matters, it is acknowledged and agreed by the Buyer that nothing in paragraph (a) requires the Sellers to make available for delivery any quantity by which a nomination for a Day exceeds MDQ where any of the following circumstances exist in relation to that quantity:

³⁹ (2014) 251 CLR 640.

(i) the Sellers form the reasonable view that there is insufficient capacity available throughout the Sellers' Facilities (having regard to all existing and likely commitments of each Seller and each Seller's obligations regarding maintenance, replacement, safety and integrity of the Sellers' Facilities) to make that quantity available for delivery;

(ii) the Sellers form the reasonable view that there has been insufficient notice of the requirement for that quantity to undertake all necessary procedures to ensure that capacity is available throughout the Sellers' Facilities to make that quantity available for delivery; or

(iii) where the Sellers have any obligation to make available for delivery quantities of Natural Gas to other customers, which obligations may conflict with the scheduling of delivery of that quantity to the Buyer.

(c) The Sellers have no obligation to supply and deliver Gas on a Day in excess of their obligations set out in Clauses 3.2 and 3.3 in respect of MDQ and SMDQ respectively.⁴⁰

28 The crucial issue of construction was the relationship between the Sellers' obligation in cl 3.3(a) to 'use reasonable endeavours' to make SMDQ available for delivery, and the Sellers' entitlement under cl 3.3(b), in determining whether they were 'able to supply SMDQ' on any particular day, to 'take into account all relevant commercial, economic and operational matters'.

29 Verve contended that once it had requested the supply of SMDQ, cl 3.3 obliged the Sellers to use reasonable endeavours to make the nominated quantity available for delivery. The role of cl 3.3(b), it contended, was to illuminate when that obligation would arise, by allowing the Sellers to consider 'relevant commercial, economic and operation matters' in determining whether they were 'able' to supply the SMDQ: that is, whether they had the *capacity* to do so, rather than whether they *wished* to do so.

30 The Sellers advanced a different construction, arguing that the obligation to supply SMDQ under cl 3.3(a) could not be considered in isolation from the 'logically anterior question' arising in cl 3.3(b), which was whether they were able to supply the gas, having regard to the 'relevant commercial, economic and operation matters', which refer necessarily to the circumstances as they exist on a particular day. The fact that they could now get a higher

⁴⁰ *Woodside* (2014) 251 CLR 640, 651–2 (per French CJ, Hayne, Crennan and Kiefel JJ).

price for their gas on the open market was an economic matter the Sellers argued they were entitled to take into consideration.

31 The High Court read these provisions in favour of the Sellers, finding that cl 3.3 did not oblige them to supply SMDQ to Verve where doing so would be in conflict with their own business interests. It reached that conclusion using the orthodox principles of contractual construction I described earlier. In particular, it strove to find a construction that enabled the various provisions to operate harmoniously, and which accorded with the purpose or aim of the transaction.

32 A harmonious reading was achieved by holding that the requirement to use a 'reasonable' standard of endeavours was conditioned by the Sellers' express right to take into account 'relevant commercial, economic and operational matters', a phrase which, when viewed compendiously, included matters affecting the Sellers' business interests. Such a reading was confirmed by the subsequent non-exhaustive list of examples the Sellers were specifically entitled to take into account, which were not confined to considerations related to 'capacity'. The word 'able' in cl 3.3(b), therefore, should not have been read narrowly as referring only to capacity, but rather, as referring to the Sellers' ability, having regard to their capacity *and their business interests*, to supply SMDQ. These matters, in turn, provided the 'internal standard of reasonableness' by which the obligation to 'use reasonable endeavours' is measured.⁴¹

33 It can be seen that this reading gave each word of the contract meaningful work to do, and furthermore, was consistent with the 'chief commercial purpose and objects' of the contract, which was to create two separate regimes for the sale of gas. One (the MDQ regime) ensured that each year, Verve would receive a guaranteed minimum amount of gas for which the Sellers would receive a guaranteed sale at a set price. The other (the SMDQ regime) would provide for the further sale of gas between the parties as desired, but without obliging Verve

⁴¹ *Woodside* (2014) 251 CLR 640, 660–2 (per French CJ, Hayne, Crennan and Kiefel JJ). See, by contrast, Justice Gageler's dissent, which held that interpreting cl 3.3(b) in this way rendered the obligation in cl 3.3(a) 'elusive, if not illusory'.

to purchase, nor obliging the Sellers to make the gas available (except to the extent of its qualified obligation to make reasonable endeavours to do so where able).

34 This reading was also consistent with the surrounding circumstances known to both parties at the time of entering the contract, which included the fact that the Sellers sold and supplied gas to customers and buyers in the market other than Verve, that some essential services depend on gas supply, and that the prevailing market price of gas at any particular time may be greater (or less) than the nominated price in the contract. I hasten to note that these surrounding circumstances confirmed, rather than determined, the proper construction of the contract in this case, which reflects the reality that contractual interpretation is, in the main, primarily determined by reference to internal content.

*B. Westfield Management Ltd v AMP Capital Property Nominees Ltd*⁴²

35 *Westfield v AMP* is an even clearer example of ordinary principles of contractual construction in action. The Karrinyup Regional Shopping Centre was the principal asset of the KSC Trust. The KSC Trust was a unit trust and a managed investment scheme under Ch 5 of the *Corporations Act 2001* (Cth). One-third of the units of the Trust were held by Westfield, while the other two-thirds were held by AMP. The latter wanted the unitholders to pass a resolution under s 601NB of the Act directing the trustee to wind up the scheme. A consequence of a winding-up would be the sale of the Shopping Centre and the distribution of the proceeds of sale between the unitholders. Westfield opposed the sale, and argued that AMP was not entitled to vote in favour of a winding-up motion without Westfield's written consent.

36 The relevant provisions of the contract were as follows:

10.1 (a) [The Trustee], in its capacity as responsible entity of the KSC Trust, shall not sell the [Shopping Centre] or any substantial part thereof, without the written consent of the Unitholders.

(b) On completion of the sale of the [Shopping Centre], or if part of the [Shopping Centre] has already been sold, the completion of the sale of the remainder of the [Shopping Centre], [the Trustee], in its capacity as responsible entity of the KSC Trust, shall thereupon determine the Trust unless otherwise directed by the Unitholders.

⁴² (2012) 247 CLR 129.

...

16.2 Each and all of the Unitholders mutually agree that they will so exercise their respective voting rights as unitholders under the Trust Deed so as to most fully and completely give effect to the intent and effect of the provisions of this deed.”

37 Westfield contended that under these provisions, a unitholder who exercised voting rights under s 601NB of the Act would contravene cl 16.2 of the contract if so doing would result in the sale of the Shopping Centre without the written consent of all the unitholders, contrary to cl 10.1(a).

38 The High Court unanimously rejected that argument, for the simple reason that cl 10.1(a) was directed only to a sale of trust property while the trust was still on foot, and had no application to the kind of resolution proposed to be voted upon by AMP. This is clear because cl 10.1(a) prohibited a ‘sale’ without the ‘written consent of the unitholders’. A sale of that description could only take place before the trust is terminated, because after termination, there would no longer be any unitholders. Similarly, cl 10.1(b) required the trustee to determine the trust after a ‘sale’, so that a ‘sale’ of that description, too, was one that could only take place while the trust was on foot.

39 Two other arguments advanced by Westfield also failed. It argued that it could be inferred from the contract taken ‘as a composite or as a whole’ that the parties expected the trust to ‘endure for quite a long time’. However it could point to no language sufficiently specific to demonstrate this, and in such an absence, the Court was reticent to imply a duty on the unitholders to ensure that the trust endure for some specified period of time.

40 Westfield also pointed out that the contract contained no provisions for how a sale of the Shopping Centre would be conducted, and argued for an inference that such a sale was therefore not possible. However, the absence of such machinery provisions says nothing about the possibility of sale generally, and in any case, the argument was irreconcilable with the fact that cl 10.1 specifically contemplated a sale of the Shopping Centre during the currency of the trust with the unitholders’ consent.

41 In reaching the conclusion it did, the Court recalled that ‘the duty of a court in construing a written contract is to endeavour to discover the intention of the parties from its words, and this requires consideration of the whole of the agreement between them’.⁴³ The case clearly demonstrates the primacy of text and internal context in construing contracts. When surrounding circumstances were considered, it was in the form of the ‘legal background’ to the contract, which was drafted with knowledge of the fact that the scheme would be governed by Ch 5C of the *Corporations Act*. This was expressly acknowledged by the recitals to the contract. Therefore, the fact that no provision of the contract could be seen to exclude the possibility of the scheme being brought to an end by the exercise of voting rights in s 601NB of the Act served to confirm the interpretation adopted by the High Court. Again, we see external context confirming, rather than determining, the proper construction of the contract.

Conclusion

42 In case there is any uncertainty, I am not saying that external context cannot be determinative of the construction of a contract in certain cases. Indeed, external context was arguably the central consideration in the interpretation of the contract in *Royal Botanical Gardens and Domain Trust v South Sydney City Council*. However, experience suggests that such cases are few and far between. Furthermore, even in such cases, external context can still go no further than to illuminate, rather than obliterate, the language used. Therefore, legal practitioners who develop the skill of slowly and thoroughly reading contracts with one eye on the specific words chosen, and the other eye on the organising logic and internal structure of the contract at large, will rarely find that they have wasted their time.

⁴³ Westfield at 139–40 per French CJ, Crennan, Kiefel and Bell JJ, citing *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99 at 109 per Gibbs J.

Appendix: Handout for Attendees

The second section of this speech deals with two cases on the construction of contracts in some detail. The relevant portions of those contracts are extracted here.

1. *Electricity Generation Corporation v Woodside Energy* (2014) 251 CLR 640 (emphasis in judgment)

3.3 Supplemental Maximum Daily Quantity

(a) If in accordance with Clause 9 ('Nominations') the Buyer's nomination for a Day exceeds the MDQ, the Sellers *must use reasonable endeavours* to make available for delivery up to an additional 30TJ/Day of Gas in excess of MDQ ('Supplemental Maximum Daily Quantity' or 'SMDQ').

(b) In determining whether they *are able to supply SMDQ on a Day, the Sellers may take into account all relevant commercial, economic and operational matters and, without limiting those matters*, it is acknowledged and agreed by the Buyer that nothing in paragraph (a) requires the Sellers to make available for delivery any quantity by which a nomination for a Day exceeds MDQ where any of the following circumstances exist in relation to that quantity:

(i) the Sellers form the reasonable view that there is insufficient capacity available throughout the Sellers' Facilities (having regard to all existing and likely commitments of each Seller and each Seller's obligations regarding maintenance, replacement, safety and integrity of the Sellers' Facilities) to make that quantity available for delivery;

(ii) the Sellers form the reasonable view that there has been insufficient notice of the requirement for that quantity to undertake all necessary procedures to ensure that capacity is available throughout the Sellers' Facilities to make that quantity available for delivery; or

(iii) where the Sellers have any obligation to make available for delivery quantities of Natural Gas to other customers, which obligations may conflict with the scheduling of delivery of that quantity to the Buyer.

(c) The Sellers have no obligation to supply and deliver Gas on a Day in excess of their obligations set out in Clauses 3.2 and 3.3 in respect of MDQ and SMDQ respectively.

2. *Westfield Management Ltd v AMP Capital Property Nominees Ltd* (2012) 247 CLR 129

10.1 (a) [The Trustee], in its capacity as responsible entity of the KSC Trust, shall not sell the [Shopping Centre] or any substantial part thereof, without the written consent of the Unitholders.

(b) On completion of the sale of the [Shopping Centre], or if part of the [Shopping Centre] has already been sold, the completion of the sale of the remainder of the [Shopping Centre], [the Trustee], in its capacity as responsible entity of the KSC Trust, shall thereupon determine the Trust unless otherwise directed by the Unitholders.

...

16.2 Each and all of the Unitholders mutually agree that they will so exercise their respective voting rights as unitholders under the Trust Deed so as to most fully and completely give effect to the intent and effect of the provisions of this deed.