

# Ambiguity of a written contract in australia



**ASSIGN  
BUSTER**

Do you think that a written contract must be ambiguous before an Australian court may hear surrounding circumstances evidence?

In order to answer the question, I think it fit to discuss the principles for interpreting written commercial contracts.

### Principles of Interpretation

Interpretation of a written contract involves establishing the parties' bargain. This involves an understanding of express and unexpressed terms in contracts and is of the utmost importance as these interpretations will impact a party's legal rights and obligations.

An objective approach must always be used in the interpretation of a commercial contract and the meaning of terms determined by what a reasonable businessperson would have understood those terms to mean if it was in the position of the parties at the time the contract was made.[1]

The process of interpretation may require an investigation of the text, the context and the purpose of the transaction in order to establish the bargain between parties.[2]In the event that a contract is unambiguous, the process of interpretation may be concluded by an investigation of the text alone; however, this is not always possible or indeed the case, and the process of interpretation requires an understanding of the context, commercial purpose and object of the transaction.[3]

As to the question of text, the exact meaning of the words used and their legal effect on the parties must be established. The contract must be given its natural and ordinary meaning unless that meaning would create an

absurdity or inconsistency[4]. The interpretation of text may involve a review of the contract itself, the language used, including definitions and grammar, and maxims or canons of interpretation which, amongst others, include interpreting the contract document as a whole, giving effect to all parts of the contract, and precedence of special and terms and conditions over general provisions.

An investigation of the context of a transaction has been described as the ‘matrix of fact’[5]and it requires an understanding of the transaction’s genesis, background facts and ultimate purpose.

I will discuss below the admissibility of evidence of surrounding circumstances external to the contract.

### The Debate and Uncertainty

There has been considerable debate in Australian courts regarding the extent to which recourse may be had to evidence of surrounding circumstances in construing contracts, in light of Mason J’s ‘true rule’ in *Codelfa*.

Much controversy exists in Australian courts in relation to the decision in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales (Codelfa)* [6]and recent Australian High Court decisions, namely *Electricity Generation Corporation v Woodside Energy (Woodside)* [7] and *Mount Bruce Mining Pty Ltd v Wright Prospecting (Mount Bruce)* [8] in respect of the extent to which a court may hear evidence of surrounding circumstances evidence without there being ambiguity.

Perhaps as a consequence of the conflict raised in respect of Mason J's judgement in *Codelfa*, it is also arguable whether the judgment advocates a 'literal' (the text being dominant) or 'contextual' (requires background against which words are used) approach to contract interpretation.

*Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*

Is evidence of surrounding circumstances admissible in the interpretation of a contract without there being any ambiguity in the language of the contract?

A logical starting point for any inquiry as to the above question and the role of ambiguity as a possible 'threshold' or 'gateway' should start with that said by Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales (Codelfa)* :[9]

*" 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."*

At first glance, Mason J's true rule appears to affirm a common view and often cited reason by the judiciary that any use of evidence of surrounding circumstances to assist in the interpretation of a contract is strictly banned unless ambiguity can be shown in the language of the contract. This view supports the proposition of an 'ambiguity gateway'[10], that 'gateway' existing to condition the admissibility of evidence of surrounding circumstances where there is ambiguity.

## Codelfa – an alternative interpretation

An alternative interpretation lies in the suggestion that what in fact Mason J stated as the true rule at page 352 of *Codelfa* is in fact in unison with the rest of his analysis.

A careful review of Mason J's judgement (with whom Stephen and Wilson JJ agreed), specifically at pages 347 to 352 reveals that in the preceding paragraphs to the deliberation of the true rule, Mason J endorses and accepts the admissibility of evidence of surrounding circumstances to aid in the proper construction of a contract, as words are rarely ever isolated from the context in which they were set.[11] Mason J quotes from various passages of previous judgments, repeatedly emphasising the admissibility of whilst confirming that evidence of surrounding circumstances cannot be used for ascertaining a party's subjective intentions.

The true rule could therefore be interpreted as simply confirming Mason J's view that evidence of surrounding circumstances can in fact be admitted to:

1. Identify the meaning of a descriptive term;[12]
2. Clarify the genesis and purpose of the transaction;[13]and
3. Aid in clarifying ambiguous language in the contract[14]

so long as the surrounding circumstances are not used to contradict and change the plain meaning of the contract language used.

In summary and based on the above, the true rule is better interpreted as meaning that evidence of surrounding circumstances is admissible when the language is ambiguous.

## Electricity Generation Corporation v Woodside Energy Ltd

The case involved an obligation by one of the parties to use ‘reasonable endeavours’ and the High Court confirmed that reasonable endeavours are not absolute or unconditional in nature and stated that some contracts expressing an obligation to use reasonable endeavours contain “their own internal standard of what is reasonable, by some express reference relevant to the business interests...”[15] This meant that *Woodside* recognised the fluid nature of ‘reasonable endeavours’ which would inherently require an investigation of all background facts and thereby allowing or even requiring the inclusion of evidence of surrounding circumstances.

Whilst the High Court did not directly address the controversy surrounding the true rule it has recognised the objective approach to contract interpretation and affirmed the ‘mandatory’[16] nature of the requirement to consider the text used and the surrounding information, as well as the context and genesis of the transaction, including the market conditions in which the parties are operating.[17]

Construing a commercial contract so as to avoid it “*making commercial nonsense*” and intended for the contract to “*produce a commercial result*” . [18] I interpret this statement as confirming that all relevant information is admissible, will require consideration and therefore does not rule out evidence of surrounding circumstances to either resolve or establish an ambiguity.

## Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd

The most recent authority of the High Court dealing with admissibility of evidence, delivered in 2015. It was common ground that the contract was ambiguous and the judgment did not directly tackle or resolve the ‘ambiguity gateway’ question.[19] Instead, it reiterated previously agreed contract interpretation approaches that include reference to objective background information, setting and context in order to interpret a commercial contract “ *so as to avoid it making commercial nonsense or working commercial inconvenience* “. [20]

Judgments made confirm that the ‘commercial purpose’ of a transaction is a primary consideration of contract interpretation. It reveals that whilst, the ‘ambiguity gateway’ question was not directly resolved, it nevertheless reaffirms that resolution of ambiguity may be achieved by reference to all background surrounding circumstances.

The judges affirmed that nothing in their deliberation was intended to state any departure from the law as set out in *Codelfa* and *Woodside* . [21]

## Conclusion

*Codelfa* made an authoritative statement which, properly construed, illustrates a contextual interpretation of contracts in which, beyond the simple grammatical interpretation of words devoid of context, the interpretation of the contract is informed by evidence of surrounding circumstances and an interrogation of the context and relevant background to find the objective purpose of the transaction.

I regard *Woodside* and *Mount Bruce* decisions as being consistent with Mason J's true rule and overall judgment in *Codelfa* (with whom Stephen and Wilson JJ agreed) as well as Brennan J's views and judgment<sup>[22]</sup> in the same case. The supposed requirement in *Codelfa* which prevents the admission of evidence of surrounding circumstances unless there is ambiguity, the so called 'ambiguity gateway' has not been confirmed by the High Court.

An alternative interpretation of *Codelfa* also reconciles with the decisions in *Woodside* and *Mount Bruce*.

Mason L's comments in *Codelfa* where he stated that a distinction between reliance on surrounding circumstances to raise or resolve an ambiguity is perhaps more apparent than real<sup>[23]</sup> may shed light in respect of where Australian law is or should be heading in respect of admission of evidence of surrounding circumstances.

Finally, until the High Court affirms its position it will no doubt lead to continuing controversy.

Word count 1520

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[1] *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 35

[2] *Ibid*

[3] *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37 at 47



[4] Sir Kim Lewison – David Hughes, *The Interpretation of Contracts in Australia*, Thomson Reuters, 2012, 5

[5] See *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37 at 108 and *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 351

[6] *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337

[7] *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640

[8] *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37

[9] *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352

[10] Daniel Reynolds, 'Construction of Contracts after *Mount Bruce Mining v Wright Prospecting*' (2016) 90 *Australian Law Journal* 190

[11] *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347-352

[12] *Ibid* at 351

[13] *Ibid*

[14] *Ibid* 352 – refer to Mason J's true rule statement

[15] *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 41-43

[16] See mandatory requirement “ it will require consideration...” in *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 35

[17] *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 35

[18] *Ibid*

[19] See *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37, at 52, 113 and 118

[20] *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37 at 50-51

[21] *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37 at 52

[22] *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 401

[23] *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 350