The Impact of Pre-Contractual Conduct on Contractual Interpretation

The Hon Justice Michael Sifris[1]

The importance of the written word

1 I would like to begin with a trite proposition, namely, the importance of the written word.

2 Most commercial contracts are in writing. Many are long and complex and follow lengthy negotiation and compromise. Usually there are multiple iterations and of course an endeavour to find the most suitable and precise language to record the agreement. This process necessarily follows where parties have chosen to create a **permanent record** of their consensus, a record often intended to last well beyond the engagement of those involved in creating the consensus.

3 It is not surprising therefore that reasons of principle and policy compel caution in relation to the revisitation and consideration of prior negotiations in particular and extrinsic evidence in general.

4 There is much common ground in the common law jurisdictions in relation to the admissibility of evidence of the actual subjective intentions of the parties and also evidence of the prior negotiations of the parties. Generally, this evidence is not admissible even if the language is ambiguous.

5 In *Codelfa Constructions Pty Ltd v State Rail Authority of New South Wales*,[2] and in relation to proof of actual intention Mason J said:

> … 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. [3]

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1 Justice of the Supreme Court of Victoria.
2 (1982) 149 CLR 337 (*Codelfa*).
3 Ibid 352.

6 In *Johnson Mathey Ltd v AC Rochester Overseas Corp*,[4] McLellan J said:

> It would be a serious threat to the stability of commercial relationships and dealings if parties who, after lengthy and intricate negotiations, deliberately recorded their agreement in permanent written form, were subject to the risk of having that permanent written record yield to the inherently less reliable evidence of oral statements made during the course of negotiation, given possibly many years after the event when witnesses may have become unavailable, and when memories may have faded or become distorted by subsequent occurrences and changing perceptions of self-interest.[5]

7 In the earlier case of *State Rail Authority of New South Wales v Heath Outdoor Pty Ltd*,[6] Kirby P said:

> … Too great a willingness by the courts to discern, in pre-contract negotiations, a basis for estoppel will have the effect of introducing a serious element of uncertainty into our law of contract. It may also encourage expensive litigation in which the terms of the writing are put to one side and the courts busily engaged … in a minute examination of the wilderness of pre-contract conversations. This may be a reason, at least in the case of written contracts which are accepted by the parties and are not varied or elaborated, to hold the parties to the applicable terms of such contracts and to limit carefully the development of the law of estoppel, lest it seriously undermine the adherence to bargains which are such an important feature of modern economic life.[7]

8 Although the starting point must be the actual words used by the parties it must be recognised that language may be ambiguous or capable of more than one meaning. Further and more importantly, language may be plain or clear but require context to give it its intended meaning, like technical or descriptive terms. A meaning that may appear to a court to be clear and unambiguous, may, given the relevant context, not be what a reasonable person aware of all the relevant circumstances would consider the parties intended their words to mean. Finally the use of plain or clear language may in certain cases lead to absurd results.

9 All of this raises the very important question with which we are concerned, namely the extent to which recourse may be had to the pre-contractual conduct of the parties particularly where the words they have used appear to be clear and unambiguous.

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4 [1990] 23 NSWLR 190.
5 Ibid 195.
6 (1986) 7 NSWLR 170.
7 Ibid 177.

10 To what extent is there a move away from literalism so that context, surrounding circumstances and extrinsic evidence may be admissible even if the language is clear and unambiguous? Is all language inherently textual?

The Problem Identified

11 In *Electricity Generation Corporation v Woodside Energy Ltd*,[8] the High Court of Australia reaffirmed the objective approach to the interpretation of contracts. The plurality said:

> 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."[9]

12 In *Thiess v Collector of Customs*,[10] the High Court of Australia dealt with the related area of statutory construction and held that the statutory text must be considered in its context which includes legislative history and extrinsic materials.

13 There is no reference in these passages to any requirement for ambiguity before recourse may be had to evidence of surrounding circumstances or extrinsic evidence.

14 In *Western Export Services Inc v Jireh International Pty Ltd,*[11] the High Court of Australia refused special leave to appeal on the basis that *Codelfa* remained binding authority. An unusual aspect of the case was that the High Court published short reasons for refusing special leave. The decision, although not binding as a matter of

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8 [2014] HCA 7.
9 Ibid [35] (French CJ, Hayne, Crennan and Kiefel JJ). Citations omitted.
10 (2014) 88 ALJR 514, 518 [22].
11 [2011] HCA 45 (*Jireh International*).

precedent,[12] has caused much concern and some criticism.[13] It is clear that direction was being given by the High Court to intermediate courts of appeal and trial courts. However, it is not easy to identify the precise direction being given.

15 In *Codelfa*, Mason J held that the true rule was that evidence of surrounding circumstances was only admissible if there was ambiguity or the language was susceptible of more than one meaning.[14]

16 In *Jireh International*, after referring to *Codelfa*, Gummow, Heydon and Bell JJ said:

> Acceptance of the applicant's submission, clearly would require reconsideration by this Court of what was said in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* 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.
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> 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.
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> 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.[15]

17 Although the trial judge in *Jireh International* although held that the language was not ambiguous and its application was not irrational or capricious, his Honour did not apply the unambiguous words but gave the language an interpretation which he considered was more commercial.

18 In *Jireh International*, an Australian company (JI) entered a written agreement with an American corporation (WES) pursuant to which WES agreed to provide contract

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12 *North Ganalanja Aboriginal Corporation and Another v The State of Queensland and Others* (1996) 185 CLR 595, 643 (McHugh J).

13 See J W Carter, 'Context and Literalism in Construction' (2014) 31 JCL 100.

14 *Codelfa,* 352.

15 *Jireh International* [3]-[5]. Citations omitted.

negotiation assistance and logistical support to JI in aid of JI entering into a master franchise agreement with an American coffee shop franchisor to operate 'Gloria Jean's coffee shops' (GJGC). Clause 3 provided that remuneration payable to WES included a commission of five per cent of the 'ex-factory price' of products sold by Jireh to GJGC stores in Australia and other countries. Clause 3 was in the following terms:

> One of the primary goals of negotiations with GJGC CORP, is to establish JIREH INTERNATIONAL PTY LTD., or an associated entity, as a roaster/supplier of Gloria Jean's, or other branded coffees, teas and other products for sale in GJGC STORES in Australia and to GJGC Master Franchisees or GJGC STORES in other countries. For sales by JIREH INTERNATIONAL PTY LTD to GJGC STORES in Australia and to other countries, WES shall receive a commission of 5% of the ex-factory price of the coffees, teas and other products.

Relevantly, the first sentence of clause 3 refers to 'Jireh International Pty Ltd., *or an associated entity*' whereas the last sentence refers only to sales by 'Jireh International Pty Ltd'. The last sentence contained no reference to 'an associated entity'. In the event, sales were made to GJGC stores, not by JI, but by two other companies associated with it. WES claimed payment of commission on sales by those associated companies. At trial, it succeeded.[16]

19 Before construing clause 3, the trial judge referred to recent High Court authorities[17] and said:

> The meaning of words used in the Letter Agreement is to be determined by what a reasonable person would have understood them to mean. This requires consideration of the language used, the surrounding circumstances known to the parties, the purpose of the transaction and the objects which it was intended to secure.
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> A commercial contract should be given a business-like interpretation. The nature and extent of the commercial aims

16 *Western Export Services Inc v Jireh International Pty Ltd* [2010] NSWSC 622.

17 His Honour referred to *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* [2004] 219 CLR 165, 179; *International Air Transport Association v Ansett Australia Holdings Ltd (Subject to Deed of Company Arrangement) and others*[2008] HCA 3 [8]*; McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579, 589*; Codelfa,* 350 *; Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407 [19] and following*; Wilkie v Gordian Runoff Ltd* [2005] 221 CLR 522, 529*; Australian Broadcasting Commission v Australasian Performing Right Association Ltd* [1973] HCA 36, 109.

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> and purposes of the agreement or parts of it are part of the essential background circumstances.
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> The whole of the instrument has to be considered. Preference is given to a construction supplying a congruent operation to the various components of the whole of an instrument.
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> If the words used are unambiguous, the Court must give effect to them. If the language is open to two constructions, that will be preferred which avoids consequences which appear to be capricious, unreasonable, inconvenient or unjust.[18]

20 The trial judge referred extensively to the speech of Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd*,[19] in which his Lordship referred to and elaborated on the substance of his reasons in *Investors Compensation Scheme Ltd v West Bromwich Building Society*.[20] The trial judge then held that clause 3 was unambiguous and that, on the plain meaning of the words, there was no warrant to read in the words 'or an associated entity' into the last sentence of clause 3.[21] Nevertheless, he held that commission was payable on sales not only by Jireh International but also by its associated entities. His Honour said:

> The question is what the parties intended the phrase "sales by Jireh … to GJGC stores" to mean. The requirement for there to be a sale is satisfied, and GJGC stores is undoubtedly a short-hand expression for Jireh's Franchisees. The sales in question were made to GJGC stores under Jireh's franchise arrangements with them.
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> I do not consider that a reasonable person in the position of the parties would have understood the term "sales by Jireh … to GJGC stores" to include only sales by Jireh itself and to exclude sales to GJGC stores under Jireh's franchise arrangements where all that happens is that Jireh appoints a Preferred Supplier closely related to it to make the sales to the GJGC stores. Giving the term "sales to Jireh … to GJGC stores" a commercial and business-like operation, I think it comprehends sales to GJGC stores under Jireh's franchise arrangements with them by Jireh's Preferred Supplier acting where Jireh itself (but for the

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18 *Western Export Services Inc v Jireh International Pty Ltd* [2010] NSWSC 622 [285]-[288]. Citations omitted.

19 [2009] 1 AC 1101 (*Chartbrook*), 1112 [14].

20 [1998] 1 WLR 896 (HL) (*Investors Compensation Scheme*).

21 *Western Export Services Inc v Jireh International Pty Ltd* [2010] NSWSC 622 [290].

> interposition of a Preferred Supplier), Jireh itself would have sold.[22]

21 Accordingly, the trial judge preferred an interpretation of the clause that gave it 'a commercial and business-like operation' to one which appeared to be demanded by the actual words it contained. Although the trial judge referred to *Codelfa*,[23] he did not refer to the statements of Mason J 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' and that evidence is inadmissible 'to contradict the language of the contract when it has a plain meaning'.[24]

22 The New South Wales Court of Appeal allowed an appeal.[25] In doing so, Macfarlan JA noted that the trial judge had found the language of clause 3 referred unambiguously only to Jireh and not to its associated companies, but that he had held that commission was payable on sales by those associated companies as that was required in order to give the clause 'a commercial and business-like operation'. His Honour said:

> In my view the primary judge erred in taking this approach. So far as they are able, courts must of course give commercial agreements a commercial and business-like interpretation. However, their ability to do so is constrained by the language used by the parties. If after considering the contract as a whole and the background circumstances known to both parties, a court concludes that the language of a contract is unambiguous, the court must give effect to that language unless to do so would give the contract an absurd operation. In the case of absurdity, a court is able to conclude that the parties must have made a mistake in the language that they used and to correct that mistake. 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.[26]

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22 Ibid [298]-[299].
23 Ibid [286].
24 *Codelfa* 352.
25 *Jireh International Pty Ltd v Western Export Services Inc* [2011] NSWCA 137.
26 Ibid [55].

Accordingly, there was 'no warrant for departing from the unambiguous terms of clause 3'.[27]

23 This paper argues that reconsideration by the High Court is taking place and indeed commenced well before *Jireh International* and probably at the beginning of this century with *McCann v Switzerland Insurance Australia Ltd.*[28]

24 Is ambiguity – whatever that means – a pre-condition to resorting to surrounding circumstances or extrinsic evidence as suggested in *Codelfa* and *Jireh International,* despite some reconsideration and momentum by the High Court and intermediate courts of appeal to the contrary? Are the decisions reconcilable? Are we asking the correct questions? Are the problems more academic than real? Is strict literalism a thing of the past?

25 The critical area of difficulty, undoubtedly, is where clear, plain and seemingly unambiguous words lead to an uncommercial (or not necessarily the best commercial result) but not absurd result. Absurd results are often dealt with differently (see below). This can cause great difficulty. The words may not be ambiguous or susceptible of more than one meaning but the result may not have been intended by the parties. Are they bound by the language they have used simply because the words are clear and unambiguous, whatever the result, because of strict adherence to the objective theory of contract?

26 Should the presumed intention of the parties be judged only by the words they use, however clear and unambiguous? Should we not be concerned with what the contract means or more particularly what the parties meant? Can meaning always be confined to specific words, even precise and unambiguous words.

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27 Ibid [64].

28 (2000) 203 CLR 579 (*McCann*).

Is there a move away from the 'true rule' in *Codelfa* and literalism?

27 Notwithstanding the clear message delivered in *Jireh International* there was, both before *Jireh International* and after, a move away from literalism and 'the true position' articulated by Mason J in *Codelfa* in 1982, more than 30 years ago.

28 Over the last decade, the High Court has on several occasions, made use of 'surrounding circumstances' to resolve questions of interpretation. However, in each of the cases, ambiguity was obvious. In one case, the High Court reiterated that the judgment of Mason J in *Codelfa* remained authoritative. However, in the 30 or so years since *Codelfa* was decided, there have been dicta in the Full Federal Court and Court of Appeal in Victoria to the effect that courts were justified in having reference to 'surrounding circumstances', and not only in cases of ambiguity, although each of these cases involved ambiguity.

29 In *Franklins Pty Ltd v Metcash Trading Ltd*,[29] the New South Wales Court of Appeal expressed the unanimous view that there was no longer any requirement to show ambiguity before surrounding circumstances could be admitted in order to construe the contract. Allsop P said:

> These cases are clear. The construction and interpretation of written contracts is to be undertaken by an examination of the text of the document in the context of the surrounding circumstances known to the parties including the purpose and object of the transaction and by assessing how a reasonable person would have understood the language in that context. There is no place in that structure, so expressed, for a requirement to discern textual, or any other, ambiguity in the words of the document before any resort can be made to such evidence of surrounding circumstances.[30]

30 The relevant High Court authorities referred to by Allsop P in *Franklins* and other High Court authority prior to *Jireh International* are compelling and appear, for the most part, not to require ambiguity before recourse may be had to surrounding circumstances. Some of the relevant authorities are examined briefly below.

31 In *McCann*, Gleeson CJ said:

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29 [2009] NSWCA 407 (*Franklins*).
30 [2009] NSWCA 407 [14].

> A policy of insurance, even one required by statute, is a commercial contract and should be given a businesslike interpretation. 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.[31]

32 In *Royal Botanic Gardens and Domain Trust v South Sydney City Council,*[32] the High Court considered a lease ambiguous and resolved the issue of construction by referring to various circumstances including that both parties were public authorities, the land was public land and the parking facility had been constructed at the lessees' expense. The Court's attention was drawn to the speech of Lord Hoffmann in *Investors Compensation Scheme*. The majority said:

> … 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* 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*.[33]

33 In *Maggbury Pty Ltd v Hafele Australia Pty Ltd,*[34] Gleeson CJ, Gummow and Hayne JJ referred to the principle articulated by Lord Hoffman in *Investors Compensation Scheme*, that the interpretation of a written contract involved

> … 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.

and noted that 'knowledge' may include matters law (as well as fact).[35]

34 In *Pacific Carriers Ltd v BNP Paribas,*[36] the High Court without any reference to the 'true rule' observed :

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31 *McCann*, 589 [22].
32 (2002) 240 CLR 45 (*Royal Botanic*).
33 Ibid 62-63 [39]. Citations omitted.
34 [2001] 210 CLR 181.
35 Ibid 188 [11], citing Lord Hoffman in *Investors Compensation Scheme*, 912.
36 [2004] 218 CLR 451 *(Pacific Carriers)*.

> 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. The letters of indemnity were, and were intended by NEAT and BNP to be, furnished to Pacific. 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 Construction 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*:
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> > '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.'[37]

35 In *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*,[38] the High Court said:

> … 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.[39]

36 In *Wilkie v Gordian Runoff Ltd*,[40] the plurality applied Gleeson CJ's statement in *McCann*[41] in giving the disputed clauses of an insurance policy, as a commercial contract, a 'businesslike interpretation'.

37 In *IATA v Ansett Australia Holdings Limited,*[42] the plurality said:

> 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

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37 Ibid 461-462 [22], citing Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 WLR 989, 995-996.

38 [2004] 219 CLR 165 *(Toll)*.

39 Ibid 179 [40].

40 [2005] 221 CLR 522 *(Wilkie)*.

41 See paragraph 31 above, cited in *Wilkie* 528-529 [15].

42 [2008] 234 CLR 151.

> 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 it meaning. … [43]

38 In *MBF Investments Pty Ltd v Damien Nolan,*[44] the Victorian Court of Appeal said:

> There was, for many years, a lively debate as to when a court could have regard to the circumstances surrounding the making of a contract in the course of construing one of its terms. More recently, that debate appears to have been resolved.[45]

39 In *Lion Nathan Australia Pty Ltd v Coopers Brewery Ltd,*[46] Finn J said:

> Until very recently there has been considerable controversy as to whether in the interpretation of contracts evidence of surrounding circumstances was admissible only if it first appeared that the language of the contract was ambiguous or whether it is admissible at the outset for the purpose of ascertaining the meaning of contractual language in its context ...
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> ...
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> it must now be accepted that the meaning of [a] commercial contract is to be construed objectively by reference to what it conveys to a reasonable person ... This normally 'requires consideration not only of the text of the documents, but also the surrounding circumstances known to [the parties], and the purpose and object of the transaction'] .... …[47]

40 On appeal, that analysis was approved by the Full Federal Court.[48] Weinberg J (as his Honour then was) said:

> … In effect the High Court has determined that, at least when construing commercial contracts, the 'surrounding circumstances' or 'factual matrix' may be taken into account. This is so in all cases, even if the words at issue are not ambiguous, or susceptible of more than one meaning. …[49]

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43 Ibid 160 [8].

44 [2011] VSCA 114 [197].

45 Ibid [197]. In its review of the High Court authorities regarding the need for ambiguity in order to consider extrinsic factors, the court referred to Mason J's statement in *Codelfa*, that surrounding circumstances are to be taken into account only when the language in dispute was ambiguous or susceptible to more than one meaning. The court commented that this view has been rejected (as illustrated in the subsequent authorities reviewed) (in footnote 202).

46 (2005) 56 ACSR 263 (*Lion Nathan*).

47 Ibid 276-277 [77] –[78], citing *Pacific Carriers* 461-462 [22], see paragraph 34 above.

48 *Lion Nathan Australia Pty Ltd v Coopers Brewery Ltd* (2006) 156 FCR 1.

49 Ibid 11 [46].

41 In *Gardiner v Agricultural and Rural Finance Pty Ltd*,[50] the New South Wales Court of Appeal accepted Finn J's analysis in *Lion Nathan* as correct.

42 The courts in England and New Zealand seem to have dispensed with any need for ambiguity before having regard to surrounding circumstances and extrinsic evidence in the interpretation of a written contract. They have regarded themselves as able to dispense with the meaning compelled by the words where they consider that 'something must have gone wrong with the language'.[51]

43 From this brief review it is apparent that *Jireh International* does not sit well with the not insubstantial developments in the law in this particular area both in Australia and to a far greater extent in England and New Zealand. However, it is submitted that the problem is more academic than real. Further, as pointed out in most of the cases ambiguity was obvious.[52]

Post *Jireh International*

44 It will be recalled that *Jireh International* emphasised that the law was, as stated by Mason J in *Codelfa*, as follows:

> 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.
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> Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious knowledge of them will be presumed.
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> It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are admissible. But in so far as they consist of statements and actions of the

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50 [2007] NSWCA 235 *(Gardiner)*[13]. The reasoning of Finn J had earlier been approved by that same court in *Ryledar Pty Ltd v Euphoric Pty Ltd* [2007] NSWCA 65; (2007) 69 NSWLR 603, 626 (Tobias JA), 655-6 (Campbell JA).

51 See *Chartbrook* 1112 [14] and *Investors Compensation Scheme,* 913 in England and *Ansley v Prospectus Nominees Unlimited* [2004] 2 NZLR 590, 600 [36] in New Zealand.

52 Also there is a danger in extracting any general principle. Regard must always be had to the precise issues before the court.

> parties which are reflective of their actual intentions and expectations they are not receivable. The point is that such statements and actions reveal the terms of the contract which the parties intended or hoped to make. They are superseded by, and merged in, the contract itself. The object of the parol evidence rule is to exclude them, the prior oral agreement of the parties being inadmissible in aid of construction, though admissible in an action for rectification.
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> Consequently when the issue is which of two or more possible meanings is to be given to a contractual provision we look, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties' presumed intention in this setting. 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.[53]

45 According to the Court in *Jireh International*, and despite a move away from text and literalism, *Codelfa* remains the law and all Australian courts are bound to follow it. This moderate chastisement from the High Court of Australia follows a move away from literalism in England and New Zealand, much of which has been embraced by the High Court of Australia, and indeed even by Mason J in *Codelfa*.

46 Since *Jireh International* there have been a number of interesting decisions as referred to below.

47 In *Westfield Management Limited v AMP Capital Property Nominees,*[54] the plurality, without reference to *Jireh International* said:

> … Interpretation of a written agreement ***may*** involve consideration of the background knowledge available to the parties at the time of the contract, which may include matters of law including relevant legislation. Here it may be taken that the Agreement was drafted with the knowledge that the scheme was governed by the provisions of Ch 5C. Its recitals acknowledge that it is a scheme for the purposes of the Corporations Law. No provision of the Agreement can be seen to exclude the possibility of the scheme being brought to an end by the exercise of voting rights under s 601NB. To the contrary, cl 18 would appear to intend to preserve rights such as those given by s 601NB.[55]

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53 *Codelfa* 352.
54 [2012] HCA 54.
55 Ibid [36]. Emphasis added.

48 There are two important matters that restrict the impact of *Jireh International* and indeed the true rule as stated in *Codelfa*. The first involves a proper reading of *Codelfa*, and not simply the 'true rule' passage. The second involves an assessment of what may properly be regarded as ambiguous, a word itself of relative imprecision.[56]

49 Much has been written about the difficulties associated with the 'true rule' and its inconsistency with earlier passages in the judgment of Mason J.[57]

50 Prior to stating the 'true rule' Mason J referred to observations of Lord Wilberforce in various cases including *Prenn v Simmonds*[58] where Lord Wilberforce discussed what fell within the term 'surrounding circumstances'. Mason J said:

> … It was held that, although evidence of prior negotiations and the parties' intentions, and *a fortiori* the intentions of one of the parties, ought not to be received, evidence restricted to the factual background known to the parties at or before the date of the contract, including evidence of the 'genesis' and objectively of the 'aim' of the transaction, was admissible. Considered in the light of this evidence 'profits' meant 'consolidated profits'.[59]

51 Mason J also referred to what he, together with Stephen and Jacobs JJ had said in *DTR Nominees Pty Ltd v Mona Homes Pty Ltd*:[60]

> 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 the transaction to show that the attribution of a strict legal meaning would 'make the transaction futile' …[61]

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56 Both matters are referred to in recent articles of great insight and clarity by The Hon Kevin Lindgren AM OC ('The Ambiguity of 'Ambiguity' in the Construction of Contracts' (2014) 38 ABR 153), and the Hon Justice Kenneth Martin 'Contractual Construction: Surrounding Circumstances and the Ambiguity Gateway' (2013) 37ABR 118.

57 See *Lindgren* (supra, fn 646), *Martin* (supra fn 64) and *Carter* (supra fn 15).

58 [1971] 1 WLR 1381 (*Prenn*).

59 *Codelfa* 348.

60 (1978) 138 CLR 423.

61 Ibid 429.

52 Mason J also, immediately prior to stating 'the true rule' referred (at page 351) to his judgment in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* where he referred to and applied *Prenn*.[62]

53 Neither Lord Wilberforce nor Mason J refer to ambiguity as a basis to admit evidence of surrounding circumstances. Indeed, Lord Wilberforce acknowledged that even those written instruments with plain and clear words were not made in a vacuum, and that it was proper to have regard to the matrix of facts. This would not include pre-contractual discussions or the actual intention or expectation of the parties because of the parol evidence rule and the objective theory of contract.

54 Mason J did not explain how, after making extensive reference to the admissibility of extrinsic evidence and significant developments in the law in this regard, he progressed to the 'true rule'. Sir Anthony, writing extra-judicially, has acknowledged that the 'true rule' was expressed 'imperfectly'. In *Minerology Pty Ltd v Sino Iron Pty Ltd*,[63] Edelman J referred to Sir Anthony's acknowledgment[64] as follows:

> Although the meaning of the words used by Mason J in *Codelfa* is a matter for posterity, it is noteworthy that Sir Anthony Mason subsequently said that the 'idea I was endeavouring to express in *Codelfa*, albeit imperfectly' was that 'the extrinsic materials are receivable as an aid to construction, even if, as may well be the case, the extrinsic materials are not enough to displace the clear and strong words of the contract. Sir Anthony considered that subsequent decisions of the High Court of Australia, including the decision of *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* had taken this broad approach. …[65]

55 Reading *Codelfa* as a whole, it is tolerably clear that Mason J accepted that extrinsic evidence is admissible, not only if the language is ambiguous or capable of more than one meaning but also where it is necessary to give meaning to plain language, such as descriptive terms. This would include the genesis and aim of the transaction but not the subjective intention of the parties.

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62 (1979) 144 CLR 596, 605-606, cited in *Codelfa* 351.
63 [2013] WASC 194 (*Minerology*).
64 Sir Anthony Mason, 'Opening Address' (2009) 25 JCL 1, 3.
65 *Minerology* [121]. Citations omitted.

56 The second point is of extreme importance. Whatever the effect of *Codelfa* and the 'true rule' resort to surrounding circumstances, as described is clearly available in the event of ambiguity or if the language is susceptible of more than one meaning.

57 Ambiguity has and will no doubt continue to be given a broad definition thus permitting recourse to the surrounding circumstances or extrinsic evidence as may be relevant and permitted.

58 As the authorities demonstrate, although ambiguity embraces a number of different situations, as a concept it may be different to the concept of language being susceptible of more than one meaning. The reference to both concepts was intended by Mason J to mean that 'the gateway should be wide enough to admit extrinsic material which is capable of influencing the meaning of words of the contract'.[66]

59 Ambiguity may appear from the document itself – this is patent ambiguity. However, ambiguity may be latent. This means that the ambiguity will not be apparent and indeed the language may appear plain and clear and on its face unambiguous. This usually occurs in the case of names or descriptive terms. Only by the reception of evidence does the true meaning become obvious. This exception was recognised in *Codelfa*.

60 In *Manufacturers' Mutual Insurance Ltd v Withers*,[67] McHugh JA said:

> … [F]ew, if any, English words are unambiguous or not susceptible of more than one meaning or have a plain meaning. Until a word, phrase or sentence is understood in the light of the surrounding circumstances, it is rarely possible to know what it means. …[68]

61 In *Gardiner*, Spigelman CJ regarded the phrase 'susceptible of more than one meaning' as widening the gateway beyond grammatical ambiguity. According to Spigelman CJ it was sufficient if the meaning was 'for any reason doubtful'.[69]

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66 Sir Anthony Mason, 'Opening Address' (2009) 25 JCL 1, 3.
67 (1988) 5 ANZ Ins Cases 60-853.
68 Ibid 75-343.
69 *Gardiner* [12].

62 In *McGrath v Sturesteps*,[70] Bathurst CJ said:

> In considering this issue it is important to bear in mind the extent to which the context and surrounding circumstances can be used as an aid in the construction of a written agreement. Whilst it is correct in my opinion that context and the surrounding circumstances known to both parties can be taken into account even in cases where there is an absence of apparent ambiguity that does not permit the Court to depart from the ordinary meaning of the words used by the parties merely because it regards the result as inconvenient or unjust.
>
> This does not mean that there are not exceptional cases where, to use the words of Lord Hoffmann, something has clearly gone wrong with the language so as to interpret it in accordance with the ordinary rules of syntax makes no commercial sense. In such a case, in my opinion, a court is entitled to depart from the ordinary meaning to give effect to what objectively speaking the parties intended.[71]

63 In *McCourt v Cranston*,[72] the Western Australian Court of Appeal having reviewed the authorities,[73] and noting the reference in *Jireh International* that the High Court is yet to reconsider *Codelfa*, Pullin JA said:

> Usually, the meaning of 'ambiguous' is taken to include 'open to various interpretations': see *Macquarie Dictionary*, but by using the phrase 'ambiguous or susceptible of more than one meaning' perhaps Mason J wished to emphasise that not only a contract open to more than one meaning would allow in evidence of surrounding circumstances but also one where the contract is merely 'difficult to understand'. Once evidence of surrounding circumstances is allowed in, the restrictions on such evidence are clear. Evidence of subjective opinions are not admissible, nor is evidence of negotiations; the surrounding circumstances have to be objective facts and they have to be known to both parties.
>
> …
>
> … it would be wise for trial judges, in cases where a party reasonably contends that the contract is ambiguous or susceptible of more than one meaning and there is relevant evidence of objective relevant surrounding circumstances known to both parties or objective evidence of the aim or object of the transaction, to allow that evidence in provisionally, even if the trial judge considers that his or her likely conclusion will be to reject the argument of the party contending that the agreement is ambiguous or susceptible of more than one meaning.[74]

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70 [2011] NSWCA 315.
71 Ibid [17]-[18]. Citations omitted.
72 [2012] WASCA 60 (*McCourt v Cranston*).
73 Referring to *Pacific Carriers*, *Toll* and *Royal Botanic*.
74 *McCourt v Cranston* [24] and [26].

64 In *Hancock Prospecting Pty Ltd v Wright Prospecting Pty Ltd*,[75] McLure P said:

> The word 'ambiguous', when juxtaposed by Mason J with the expression 'or susceptible of more than one meaning', means any situation in which the scope or applicability of a contract is doubtful: *Bowtell v Goldsbrough, Mort & Co Ltd* (1905) 3 CLR 444, 456-457. Ambiguity is not confined to lexical, grammatical or syntactical ambiguity.
>
> Moreover, the extent to which admissible evidence of surrounding circumstances can influence the interpretation of a contract depends, in the final analysis, on how far the language of the contract is legitimately capable of stretching. Generally, the language can never be construed as having a meaning it cannot reasonably bear. There are exceptions (absurdity or a special meaning as the result of trade, custom or usage) that are of no relevance in this context.
>
> Further, on my reading of *Codelfa*, pre-contractual surrounding circumstances are admissible for the purpose of determining whether a term is implied in fact. That may be because the stringent test for the implication of a term in fact excludes any possibility of an implied term contradicting the express terms.[76]

65 In *Saraceni v Mentha (No 2)*,[77] regarding whether ambiguity is required in order to consider evidence of surrounding circumstances, Corboy J followed *Jireh International* (and *Codelfa*). However, Corboy J adopted the statements of Pullin JA in *McCourt v Cranston* indicating a broad understanding of 'ambiguity'.[78]

66 Accordingly, Corboy J found that as the Deed was 'open to various interpretations', the evidence of the commercial circumstances addressed by the documents and of its purpose was admissible in construing the Deed, and that this was consistent with *Codelfa* and *Jireh International*.[79]

67 In *Current Images Pty Ltd v Dupack Pty Ltd*, Bathurst CJ said that what was required was 'uncertainty or ambiguity'.[80]

68 In *Red Hill Iron Ltd v API Management Pty Ltd*,[81] Beech J, of the Supreme Court of Western Australia, recently observed as to the breadth of the concept of ambiguity:

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75 [2012] WASCA 216.
76 Ibid [77]-[79].
77 [2012] WASC 236 [100].
78 Ibid [99], citing *McCourt v Cranston* [24], see paragraph 63 above.
79 Ibid [100].
80 [2012] NSWCA 99[116].

> It should be noticed that a broad concept of ambiguity may apply in this context. … Moreover, as Pullin JA pointed out in *McCourt v Cranston* it is enough if the instrument is 'susceptible of more than one meaning'. See in this regard Spigelman JJ, 'From Text to Context: Contemporary contractual interpretation' (2007) 81 *Australian Law Journal* 322-337.[82]

69 In *Mineralogy*, Edelman J said:

> … it has been held on a number of occasions that the concept of ambiguity may involve a situation 'whenever the [manifested] intention of the parties is, for whatever reason, doubtful'. …[83]

70 In *Cape Lambert Resources Ltd v MCC Australia Sanjin Mining Pty Ltd*,[84] McLure P said:

> All of the issues of contractual construction that figure prominently in this case stem from ambiguity in the contractual text for *Codelfa* purposes, if ambiguity means any situation in which the scope or applicability of a contract is, for whatever reason, doubtful.[85]

71 It is also not without relevance to note that there have been many cases where clear and unambiguous words have, as a matter of construction, been ignored.

72 In *National Australia Bank Ltd v Clowes*,[86] the borrowers agreed to give a 'first ranking mortgage … over … [the property]'. The borrowers were not the registered proprietors of the property, which was a flat. Rather, they owned shares which gave them an entitlement to use and occupy the flat. As a matter of construction the plain meaning was ignored and the contract was construed as a mortgage over the shares. At [34]-[38] Leeming JA[87] said:

> In my view, the Bank's submission should be accepted because of the Bank's first point. In my opinion this is a clear case where the literal meaning of the contractual words is an absurdity, *and* it is self-evident what the objective intention is to be taken to have been. Where both those elements are present, as here, ordinary processes of contractual construction displace an absurd literal meaning by a meaningful legal meaning. As this Court observed in *Westpac Banking Corporation v Tanzone Pty Ltd*, the principle is premised upon absurdity, not ambiguity, and is available even where, as here, the language is unambiguous.

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81 [2012] WASC 323.
82 Ibid [119]. Citations omitted.
83 *Minerology* [127].
84 [2013] WASCA 66.
85 Ibid [108].
86 [2013] NSWCA 179 (*Clowes*).
87 McColl and Macfarlan JJA agreed with Leeming JA.

The applicable principles are conveniently found in *Noon v Bondi Beach Astra Retirement Village Pty Ltd*, where Giles JA said, with the agreement of Macfarlan JA:

> "The process of construction may bring a marked divergence from the text. In *Wilson v Wilson* 'John' was read as 'Mary' in a will. In *Fitzgerald v Masters* 'inconsistent' was read as 'consistent' in a contract for sale. As a recent illustration in *McHugh Holdings Pty Ltd v Newtown Colonial Hotels Pty Ltd* 'lessor' was read as 'lessee' in a lease. This is often because a mistake is obvious on the face of the instrument and in *Chartbrook Ltd v Persimmon Homes Ltd* Lord Hoffmann, with whom Lords Hope, Rodger and Walker and Baroness Hale relevantly agreed, accepted that there must be a clear mistake on the face of the instrument and it must be clear what correction ought to be made in order to cure the mistake. But in *Fitzgerald v Masters* at 437 it was explained 'the rejection of repugnant words, the transposition of words and the supplying of omitted words' is a consequence of 'the rule that the intention of the parties is to be ascertained from the instrument as a whole and that this intention when ascertained will govern its construction'. Ascertaining the intention of the parties, of course, is in accordance with the principles of contract construction abovementioned."

In the same case, Young JA referred at [179] to Brereton J's decision in *Saxby Soft Drinks Pty Ltd v George Saxby Beverages Pty Ltd* in which the word "shorter" was read as "longer".

This principle is distinct from rectification in equity. As Lord St Leonards said in *Wilson v Wilson*:

> "Now it is a great mistake if it is supposed that even a Court of Law cannot correct a mistake, or error, on the face of an instrument: there is no magic in words. If you find a clear mistake, and it admits of no other construction, a Court of Law, as well as a Court of Equity, without impugning any doctrine about correcting those things which can only be shown by parol evidence to be mistakes - without, I say, going into those cases at all, both Courts of Law and of Equity may correct an obvious mistake on the face of an instrument without the slightest difficulty."

True it is that that principle requires a very strong level of conviction that a mistake has been made. To use the language of Dixon CJ and Fullagar J in *Fitzgerald v Masters*, it must be "clearly necessary in order to avoid absurdity or inconsistency", and, as this Court said in *Miwa Pty Ltd v Siantan Properties Pty Ltd*, the test of absurdity is not easily satisfied. But that demanding test is in my view satisfied in this case. The principle is not confined to linguistic errors such as "inconsistent" being read as "consistent" or "shorter" being read as "longer". The principle extends to obvious conceptual errors, such as "lessor" being read as "lessee" as in *McHugh Holdings Pty Ltd v Newtown Colonial Hotel Pty Ltd*, or words denoting a mortgage of company title flat being read as a mortgage of the shares in the company which entitle their

> owner to that flat. In all those cases, it is perfectly clear what legal meaning is to be given to the literally absurd words.[88]

73 Leeming JA was at pains to point out that the principle was based on absurdity and not ambiguity. Of course if there was ambiguity there would be no difficulty on the authorities in examining the surrounding circumstances. However, there was no ambiguity. But what precisely is absurdity? Where does uncommerciality end and absurdity begin? *Clowes* was a clear case, as was *Westpac Banking Corporation v Tanzone Pty Ltd*,[89] a case referred to by Leeming JA.[90] However, to highly experienced business people dealing with sophisticated concepts and transactions evidenced by documentation a strange and perhaps unintended commercial result may be equally absurd, as in *Clowes*.[91]

74 Although absurdity may be different, the point is that courts of high authority have been prepared to disregard the clear and unambiguous meaning of words. Is there a difference in principle when dealing with uncommercial results? Should there be?[92]

Some concluding remarks

75 The main difficulty presented by *Jireh International* relates to the admission of extrinsic evidence where the language has a 'plain meaning'. However, if the apparent clear words require meaning or have a meaning that is doubtful, difficult to understand or is disputed (or is absurd) relevant extrinsic evidence is admissible.

76 Of course extrinsic evidence is admissible in other contexts such as claims for rectification, allegations of a collateral contract, claims that a contract is a sham[93] and other recognised exceptions. However, in relation to the interpretation of contracts, there must be something wrong with the plain meaning or meaning needs to be

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88 Ibid [34]-[38]. Citations omitted.

89 [2000] NSWCA 25 (*Tanzone)*. In *Tanzone*, a literal reading of a rent review clause would have produced an increase in rent so extravagant so as to be absurd.

90 *Clowes* [34].

91 However it should be conceded that these types of documents are invariably not in the category of clear and unambiguous.

92 It is obviously easier to determine the presumed intention of the parties in the case of absurdity which involves a clear mistake. But this may be a question of degree not principle.

93 See *Equuscorp Pty Ltd v HGT Investments Pty Ltd* (2005) 218 CLR 472, 486.

given to the plain language such that it could not be said to represent the intention of the parties. However, it is important to remember that in cases involving the interpretation of contracts there arises a point beyond which the text's meaning cannot be extended, no matter how much background evidence is raised.

Summary

77 If there is **ambiguity** in the language used by the parties **extrinsic evidence** is permitted.

- **Ambiguity** itself lacks precision and although a broad view has been taken by the courts, it is not ambiguity in the abstract, but whether the asserted ambiguity is 'outside the array of meanings that the language reasonably bears under the circumstances'.[94]
- **Extrinsic evidence** does not include the subjective or actual intention of the parties and generally does not include (by way of a direct aid) the prior negotiations of the parties.[95]

78 If there is no ambiguity in the language used by the parties extrinsic evidence is permitted in England and New Zealand. Since *Jireh International* the position in Australia is doubtful.

79 In Australia, if there is no ambiguity in the language used by the parties extrinsic evidence is permitted –

- Where the result would be absurd.
- To give meaning and necessary context to the language.
- If the meaning makes no commercial sense.

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94 Professor Steven Burton, *Elements of Contract Interpretations* (2009) 138-139 cited by Wilson J in *Vector Gas Limited v Bay of Plenty Energy Limited* [2010] NZSC 5 [120] (*Vector Gas*).

95 This evidence may be available to establish circumstances and context but not as a direct aid to construction. There is a debate about the desired ambit of this exclusion. Why are discussions and correspondence that evidence the external manifestations of the parties pre-contract inconsistent with the objective theory of contract? (See *Vector Gas* [122]-[130] (Wilson J)).

80 The critical area is where the language used by the parties is clear and the ordinary meaning does make commercial sense, but one party asserts a meaning that makes more commercial sense and contends that such meaning reflects the presumed intention of the parties. On the authority of *Codelfa* extrinsic evidence would not be permitted. This would not include the facts and matters known to both parties. In England and New Zealand extrinsic evidence would be permitted. The result may well be the same.[96]

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[96] In *Bank of Credit and Commerce International v Ali* [2002] 1 AC 251, 269 Lord Hoffmann said:

> … the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage: "we do not easily accept that people have made linguistic mistakes particularly in formal documents". I was certainly not encompassing a travel through "background" which could have made a reasonable person think that the parties must have departed from conventional usage.