CONSTRUCTION OF COMMERCIAL CONTRACTS

Need to know

- Commercial contracts in Australia are given an objective, businesslike construction on the assumption that the parties intended to produce a commercial result. The meaning of commercial contracts is established by considering the language used in the context of the contract as a whole, the surrounding circumstances and the commercial purpose or objects to be secured by the contract.
- The courts take a broad approach to the admission of evidence of the surrounding circumstances known to the parties in interpreting commercial contracts. However there remains an unresolved question as to whether such evidence is admissible to construe a contractual provision if it has not first been established that the provision is ambiguous. In practice, courts regularly find such ambiguity exists, enabling the evidence to be adduced without the question being addressed.
- The *contra proferentem* rule of construction by which the words of a contract are construed against a party proffering them remains a valid rule of construction in Australia. However this is used only as a last resort where there remains ambiguity in a contractual term after the application of text-based and context-based principles of construction. In practice, resort to the rule is rare.
- No special rules apply to the interpretation of exclusion clauses, limitation clauses or insurance policies. These are interpreted in accordance with the general principles above. However standard clauses in insurance policies may have been given a particular judicial interpretation which will ordinarily prevail. Statute may also impact the construction or effectiveness of exclusion clauses, limitation clauses and clauses in insurance policies.
- A rule of strict construction applies to contracts of guarantee or indemnity (but not including indemnity insurance policies). This means that a doubt as to the construction of a provision in a contract of guarantee or indemnity should be resolved in favour of the surety or indemnifier.

1 How are commercial contracts construed in Australia?

The principles relating to the construction or interpretation of commercial contracts in Australia have been stated and re-stated in a number of High Court cases, most recently in *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7; (2014) 251 CLR 640 (**Woodside**) and *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37; (2015) 256 CLR 104 (**Mount Bruce**).

In short, the rights and liabilities of parties under contracts in Australia are determined *objectively* by reference to the contract's *text*, *context* (meaning the entire text of the contract as well as any contract, document or statutory provision referred to in the text of the contract) and *purpose*.

An exposition of these principles of interpretation can be drawn from *Woodside* and *Mount Bruce*, and from earlier High Court cases cited with approval in those cases (including *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* [2004] HCA 52; 219 CLR 165, *Pacific Carriers Ltd v BNP Paribas* [2004] HCA 35; 218 CLR 451 and *International Air Transport Association v Ansett Australia Holdings Limited* [2008] HCA 3; (2008) 234 CLR 151) as follows:

- an objective approach is adopted in determining the rights and liabilities of parties to a contract. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations;
- 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 *commercial* contract is to be determined by what a reasonable *businessperson* would have understood those terms to mean;
- establishing that meaning 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;
- 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; and
- a commercial contract is to be construed so as to avoid it making commercial nonsense or working commercial inconvenience.

These same principles of construction will also apply when a commercial agreement is embodied in a deed rather than merely in a contract: *MBF Investments Pty Ltd v Nolan* [2011] VSCA 114.

2 Contra proferentem rule

The *contra proferentem* rule of construction provides that the words of an instrument should be taken most strongly against the party proffering them: see *Wilkie v Gordian Runoff Ltd* [2005] HCA 17; 221 CLR 522.

This rule was of considerable historic importance, particularly in the interpretation of exclusion clauses. However, while the rule remains able to be applied to *any* contractual term in appropriate

cases, it is now well settled, certainly outside the area of contracts of guarantee (dealt with in section 5 below), that the rule is one of last resort, applying only when ambiguity remains after all other avenues of construction have been exhausted: *Beefeater Sales International Pty Ltd v MIS Funding No 1 Pty Ltd* [2016] NSWCA 217; see also *Chubb Insurance Company of Australia Limited v Robinson* [2016] FCAFC 17and *GL Nederland (Asia) Pty Ltd v Expertise Events Pty Ltd* [1999] NSWCA 62.

In practice, the courts rarely resort to the contra proferentem rule and prefer to resolve questions of interpretation by the application of ordinary principles: see eg *Finch v Telstra Super Pty Ltd* [2010] HCA 36; (2010) 242 CLR 254 and *Wilkie v Gordian Runoff Ltd* [2005] HCA 17; 221 CLR 522.

Nonetheless the rule may still be applied in appropriate cases: see eg *JP Morgan Australia Ltd v Consolidated Minerals Pty Ltd* [2011] NSWCA 3. The parties can contract out of the contra proferentem rule: *G L Nederland (Asia) Pty Ltd v Expertise Events Pty Ltd* [1999] NSWCA 62. Some difficulties with the scope and application of the rule are further considered in *North v Marina* [2003] NSWSC 64.

3 Construction of exclusion clauses and limitation clauses

The general rules of construction set out above apply to exclusion clauses: *Selected Seeds Pty Ltd v QBEMM Pty Limited* [2010] HCA 37; (2010) 242 CLR 336.

In the leading case of *Darlington Futures Ltd v Delco Australia Pty Ltd* [1986] HCA 82; (1986) 161 CLR 500 the High Court held that "the interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the contract, and, where appropriate, construing the clause contra proferentem in case of ambiguity."

The same principles apply to the construction of limitation clauses: *Darlington Futures Ltd v Delco Australia Pty Ltd* [1986] HCA 82; (1986) 161 CLR 500 at [16].

The effectiveness of exclusion or limitation clauses may be impacted by statute. Most notably, clauses which purport to exclude *all* liability for breaches of statutory prohibitions on misleading or deceptive conduct have been held to be ineffective for public policy reasons: *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (No 1)* (1988) 39 FCR 546.

However it is still an open question whether the same approach will apply to clauses which seek to *limit* but not exclude such liability: see *Omega Air Inc v CAE Australia Pty Ltd* [2015] NSWSC 802 and the cases cited at [31]; cf *Olivaylle Pty Ltd v Flottweg GMBH & Co KGAA (No 4)* [2009] FCA 522.

4 Construction of insurance contracts

The general rules of construction set out above also apply to insurance contracts. These are commercial contracts and should be given a businesslike interpretation: *CGU Insurance Ltd v Porthouse* [2008] HCA 30; (2008) 235 CLR 103; *Chubb Insurance Company of Australia Ltd v Robinson* [2016] FCAFC 17; *Todd v Alterra at Lloyds Ltd* [2016] FCAFC 15; *Allianz Australia Insurance Ltd v Inglis* [2016] WASCA 25.

However, particular phrases or clauses which appear in standard form in insurance policies have often been given a particular judicial interpretation. That interpretation will ordinarily prevail, unless the policy provides otherwise.

For example, a condition requiring that an insured "take reasonable precautions" may be read down as requiring only that the insured avoid recklessness: *Legal & General Insurance Australia Ltd v Eather* (1986) 6 NSWLR 390; *Horsell International Pty Ltd v Divetwo Pty Ltd* [2013] NSWCA 368.

Further, the parties contractual obligations may be impacted by statute (eg the *Insurance Contracts Act 1984* (Cth), which cannot be contracted out of: see s 52).

5 Strict construction of contracts of guarantee or indemnity

An exception to the ordinary rules of contractual construction set out above applies in the case of contracts of guarantee or indemnity. It is a settled principle that these are strictly construed. This means that a doubt as to the construction of a provision in a contract of guarantee or indemnity should be resolved in favour of the surety or indemnifier: *Bofinger v Kingsway Group Limited* [2009] HCA 44; (2009) 239 CLR 269; *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* [1987] HCA 15; (1987) 162 CLR 549; *Andar Transport Pty Ltd v Brambles Ltd* [2004] HCA 28; (2004) 217 CLR 424.

While these principles apply to contracts of indemnity, they do not apply to contracts of indemnity *insurance*: *Todd v Alterra at Lloyds Ltd* [2016] FCAFC 15. As noted above, the general rules of construction apply to these contracts.

It is not entirely clear whether the rule of strict construction in relation to guarantees or indemnities reflects an elevation of the *contra proferentem* rule over the other rules of text-based and context-based construction, or whether it arises independently from the historical position of the surety as a vulnerable person: see *Todd v Alterra at Lloyds Ltd* [2016] FCAFC 15 at [34]. However the rule is firmly established by the High Court decisions cited above.

6 Is there an "ambiguity gateway" to the admissibility of evidence of the surrounding circumstances?

Although *Woodside* and earlier cases confirmed the admissibility of evidence of surrounding circumstances in court proceedings to determine a question of contractual interpretation, there remains an unresolved question as to whether there is a threshold hurdle to be mounted before recourse is available to such evidence.

Specifically, that hurdle concerns whether ambiguity must *first* be shown in a contract itself before a court can refer to evidence of the surrounding circumstances.

Intermediate courts of appeal have divided on this so-called "*ambiguity gateway*" issue post *Woodside* as follows:

- The NSW Court of Appeal and the Full Federal Court have held that ambiguity **is not** required before there is recourse to surrounding circumstances evidence: see eg *Mainteck Services Pty Ltd v Stein Heurtey SA* [2014] NSWCA 184, *Newey v Westpac Banking Corporation* [2014] NSWCA 319 and *Stratton Finance Pty Limited v Webb* [2014] FCAFC 110;

- The Full Court of the Supreme Court of South Australia has also held that evidence of surrounding circumstances is admissible without stating a gateway qualification (albeit that the issue was not specifically addressed): see *Pilton Holdings Pty Ltd v Essential Beauty Franchising (WA) Pty Ltd* [2015] SASCFC 88 at [65];

- By contrast, the WA Court of Appeal has held that ambiguity **is** required before there is recourse to surrounding circumstances: see eg *Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd* [2014] WASCA 164 and *KWS Capital Pty Ltd v Love* [2015] WASCA 237; and

- The Queensland and Victorian Courts of Appeal have noted the disagreement at the intermediate appellate court level but expressed no view on it because they found that the contract in question was, in any event, ambiguous: see *Jakeman Constructions Pty Ltd v Boshoff* [2014] QCA 354; *Grocon Constructors (Victoria) Pty Ltd v APN DF2 Project 2 Pty Ltd* [2015] VSCA 190 and *Apple and Pear Australia Ltd v Pink Lady America LLC* [2016] VSCA 280.

Ultimately resolution of this issue is a matter for the High Court. In three separate joint judgments in *Mount Bruce*, the seven members of that Court acknowledged that the ambiguity gateway issue was what Bell and Gageler JJ described as an "*important question on which intermediate courts*

of appeal are currently divided", but did not resolve the question. This was because the parties had agreed that ambiguity existed.

In practice, trial courts seem to fairly regularly find that there is ambiguity in a contract so that the issue of a gateway falls away. Recourse is then had to evidence of surrounding circumstances in accordance with the principles in *Woodside* set out above.