Dispute Resolution Update

Are "reasonable endeavours" in the eye of the obligor?

*Electricity Generation Corporation v Woodside Energy Ltd; Woodside Energy Ltd v Electricity Generation Corporation [2014] HCA 7*

**WHAT YOU NEED TO KNOW**

- The High Court has held, in construing a "reasonable endeavours" obligation in a supply contract, that the obligor is able to take into account its own commercial interests, including its interests in supplying to an alternative party for a higher price.
- Perhaps more significantly, the High Court has, in construing the contract, emphasised the need to consider surrounding circumstances and context and may have departed from the more restrictive rejection of those matters as an aide to interpretation following the denial of the Court of special leave to appeal from the NSW Court of Appeal's decision in *Jireh*.

**WHAT YOU NEED TO DO**

- This decision highlights the importance of carefully drafting reasonable endeavours clauses. Where it is commercially acceptable, it would be prudent for an obligee to seek to include express, specific and objective boundaries on the obligor's conduct.

The High Court has recently considered the extent of parties' obligations in "reasonable endeavours" clauses in *Electricity Generation Corporation v Woodside Energy Ltd; Woodside Energy Ltd v Electricity Generation Corporation [2014] HCA 7 (Verve v Woodside)*. This decision was on appeal from the Western Australian Court of Appeal.

**Background**

The High Court considered a long term gas sale agreement (GSA) requiring various sellers (Sellers) to provide to Electricity Generation Corporation, trading as Verve Energy (Verve), a maximum daily quantity (MDQ) of gas.

Clause 3.3(a) of the agreement also required the Sellers to use "reasonable endeavours" to make available to Verve a supplemental maximum daily quantity (SMDQ) of gas. Under clause 3.3(b) of the agreement, the Sellers were able to take into account all "relevant commercial, economic and operational matters" in considering whether they were "able" to supply SMDQ.

The supply of gas in Western Australia was significantly reduced following an explosion at Apache's gas plant at Varanus Island, leading to a significant increase in the market price for gas. The Sellers considered they were unable to supply Verve with SMDQ at the contract price. Instead, the Sellers offered to supply Verve with the same amount of gas at the market price, being a higher price than that which was specified in the GSA.

The issue for the Court was whether the Sellers had breached their obligation under the GSA to use reasonable endeavours to supply Verve with SMDQ. This was a question of contractual construction, considering the relationship between clauses 3.3(a) and 3.3(b).
**The decision**

The focus of this case was not really the scope of reasonable endeavours obligations, but the meaning of clause 3.3(b) of the GSA and, in particular, the words "all commercial, economic and operational matters".

A 4:1 majority of the High Court held that the matters that could be considered by the Sellers' in determining their ability to supply SMDQ included the market conditions occasioned by the Apache incident and the fact the Sellers could obtain a price for the gas that significantly exceeded the price for SMDQ under the GSA. In doing so, the majority effectively accepted that the Sellers were not "able" to supply SMDQ for the purposes of clause 3.3(b) if the Sellers determined that it was not in their business interests to do so.

Justice Gageler, in dissent, considered that the requirement to use "reasonable endeavours" to supply SMDQ imposed an objective standard that could not be overridden by the Sellers' subjective desire to maximise profits.

His Honour considered that the Sellers' right to "take into account all relevant commercial, economic and operational matters" was directed to assessing the Sellers' capacity to supply SMDQ, not their willingness to do so. Were it otherwise, his Honour considered the reasonable endeavours obligation would be left without practical content and the price fixed by the GSA for SMDQ meaningful only if the Sellers considered it to their commercial advantage to accept that price.

**Implications of the decision**

**Contract drafting**

An obligation to use reasonable endeavours to bring about a contractual object is an obligation which requires a value judgment, on which minds might differ. Accordingly, while "reasonable endeavours" is a familiar formulation in commercial contracts, there will always be scope for argument as to whether steps taken by the obligor to fulfil the obligation are reasonable in all of the circumstances.

An additional level of uncertainty is created if, as here, the parties add a further general qualification to the obligation to use reasonable endeavours.

The procedural history of Verve v Woodside demonstrates the uncertainty that can flow from the use of general language in a contract. The Sellers were successful before a well respected judge at first instance, unsuccessful before three highly regarded members of the Western Australia Court of Appeal and finally achieved success with the majority decision of the High Court.

The differing views of the various judges who considered this case demonstrates the latitude that the words used in clause 3.3(b) of the GSA gave to the Court in construing the clause.

Given this uncertainty, to the extent it is commercially possible, it would be prudent for obligees to seek to impose unqualified obligations wherever possible. Where it is necessary to accept a reasonable endeavours obligation, it would be preferable for this to be qualified by specific and objective criteria. By expressly providing clear boundaries to the obligation, the uncertainty faced by Verve and the Sellers in this case may be avoided or at least reduced.

There may be reasons, commercial or otherwise, that a negotiating party is prepared to accept more general qualifications on a contractual obligation. It may be the best deal the party can obtain in the circumstances or there may be perceived benefits to the inherent flexibility provided by vague contractual language. In either case, it is important to be clear about what is sought to be achieved and why.

**Contractual interpretation**

Although the High Court only briefly considered contractual interpretation, all 5 members of the High Court reaffirmed the objective approach to the interpretation of contracts.

In its discussion of contractual interpretation, the High Court made no mention of its refusal to grant special leave to appeal in *Western Exports Services Inc v Jireh International Pty Ltd [2011] HCA 45 (Jireh)*. In Jireh, the High Court stressed that the 'true rule' was as stated by Mason J in *Codelfa v State Rail Authority of New South Wales (1982) 149 CLR 337 (Codelfa)* that a Court is only to have regard to surrounding circumstances if the language is ambiguous or susceptible of more than one meaning, but not where the language has a plain meaning. This has been referred to as the 'ambiguity gateway'.

While not a binding precedent, the effect of the High Court’s comments in Jireh has been to cause lower Courts to restrict the consideration of surrounding circumstances known to both parties (including, for example the consideration of the commercial purpose of a transaction) by a strict application of the ambiguity gateway.
Despite the wide acceptance of the meaning of Jireh, aspects of that decision were difficult to reconcile with other authority. In particular, the High Court in Jireh did not consider there was any inconsistency between its interpretation of Codelfa and the decision in Pacific Carriers Ltd v BNP Paribas (2004) 218 CLR 451 (Pacific Carriers). In Pacific Carriers, the High Court held that an appreciation of the commercial purpose of the agreement, a knowledge of the origins of the transaction, the background and factual context, and the market, is required by the court to interpret a contract, without first making an express finding that the clause in question was ambiguous.

Perhaps significantly, the majority in Verve v Woodside stated (at [35]):

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\text{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.}
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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 [2009] EWC A Civ 636 at [28], 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” (emphasis added).

In support of this statement of principle, the majority not only referred to both Pacific Carriers and Codelfa, but also to several United Kingdom authorities that take a more expansive approach to the use of surrounding circumstances than seemed to be advocated by the High Court in Jireh.

The majority made no express finding that the language of clause 3.3 of the GSA was ambiguous. Further, the majority made no reference to Jireh or the decisions of intermediate appellate courts that have applied a restrictive approach to the use of surrounding circumstances following Jireh. It is therefore not clear whether the majority adopted the ‘true rule’ in construing clause 3.3 of the GSA, or were seeking to reintroduce a broader approach to the use of surrounding circumstances to interpret contracts.

While the question remains uncertain, Verve v Woodside may be a signal that the High Court will release the restrictions hitherto thought to have been imposed by Jireh should it be called upon to expressly consider that case in the future.