The Supreme Court's *Bathurst* judgment

Mine (or minefield?) of guidance on contract construction

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"In our view the best judges of what is commercially realistic are the substantial commercial entities that entered into the Third Deed"[1]

1. Introduction

1.1. The Supreme Court's recent judgment in *Bathurst* may have delivered more than the parties bargained for. This landmark decision finally settles the law on two key aspects of the construction of written contracts.[2] All members of the Court have agreed on the approach to, (a) admissibility of extrinsic evidence in aid of interpretation, and (b) the test for implication of terms.

1.2. The guidance on extrinsic evidence is especially important. This aspect of the law was left in disarray after *Vector*[3] and *Gibbons*.[4] Neither judgment provided clear direction on the use of evidence of prior negotiations and subsequent conduct. However, the more liberal approach urged by Tipping J – his "touchstone" of relevance[5] – has now prevailed. The Supreme Court in *Bathurst* has ruled that all extrinsic evidence is prima facie admissible if it is relevant to the objective task of interpretation. This contrasts sharply with the more restrictive approach to admissibility preferred by the Court of Appeal.[6]

1.3. Should we be alarmed by the expansiveness of the Supreme Court's restatement? Will the courts be deluged with vast amounts of evidence, increasing the unpredictability and cost of contractual disputes? Several features of the judgment should provide some reassurance.

1.4. First, the Supreme Court has made it clear that extrinsic evidence will be rigorously scrutinised under ss 7 and 8 of the Evidence Act 2006 for relevance and probative value. It will not be a free-for-all. This is apparent in the Court's (again unanimous) approach to interpreting one of the two key provisions of the parties' contract. The extensive evidence adduced was, in the end, held to provide "little assistance". The meaning turned largely on the text.

1.5. Secondly, the judgment is notable for the hardline approach of the majority to the interpretation of the second key provision. On this the Court split three-two. The majority declined to "write in" an obligation which L&M, a large commercial entity, could "easily" have provided for but did not. The main focus was again on the text. As a consequence the High Court and Court of Appeal judgments ruling that Bathurst had to pay US$40 million to L&M were overturned. It

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1 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2021] NZSC 85 (***Bathurst***), at [250] per Glazebrook, O'Regan and Williams JJ.

2 In this paper I use the word "construction" in the broad sense of encompassing both the process of interpretation and the process of implication. The Supreme Court and Court of Appeal in *Bathurst* use the term in that way.

3 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 (***Vector***).

4 *Wholesale Distributors Ltd v Gibbons Holdings Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 (***Gibbons***).

5 *Vector*, above n 3, at [29].

6 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2020] NZCA 113. Kōs P (giving the reasons of the Court) thought that prior negotiations should be excluded, and subsequent conduct limited to mutual conduct.

was a harsh result for L&M, but that was the bargain it had struck. This robustness continues a trend which I discussed in my recent paper.[7]

1.6. Thirdly, Tipping J's approach in *Vector* to the admissibility of prior negotiations and subsequent conduct, although controversial, is the one the courts have most often applied since then.[8] Now it has been endorsed by a unanimous Supreme Court. In that sense there will not be drastic change at the coalface.

1.7. As for implication of terms, the Supreme Court has cleared up the confusion that followed Lord Hoffmann's pronouncements in *Belize*.[9] The Court has reaffirmed the "strict necessity" test, and the continuing role of the traditional *BP Refinery* conditions.[10] The judgment of the majority, who declined to imply a term to fix up the bargain, reinforces that in practice the threshold for implication remains a high one.

1.8. In this webinar I will examine the *Bathurst* judgment in some detail. What exactly does it decide, and what are its practical implications?

2. What was *Bathurst* about?

The facts

2.1. The principal setting of the dispute was the open-cast Escarpment mine, on the Denniston Plateau on the West Coast of the South Island. I come from a long line of Coasters, and am reliably informed that Denniston is a bleak, forbidding place. Its "black gold" reserves have been mined since the 1870s. For a long time the sole means of access was a notoriously steep railway incline, dubbed by locals as the "eighth wonder of the world". The frequency of overturned and runaway coal carts meant that some timorous Denniston inhabitants did not venture down "the Hill" for decades on end.

2.2. In June 2010 L&M agreed to sell its coal mining rights to Bathurst. The written agreement was structured as a sale of L&M's shares in its subsidiary, Buller Coal Ltd, which owned these rights. Bathurst paid a purchase price of US$40 million -- a deposit of US$5 million, and a further US$35 million on settlement. Once certain levels of mining were reached Bathurst had to make two performance payments of US$40 million each. Bathurst also had to pay L&M royalties on its coal sales, in accordance with a tier of rates specified in a separate royalty deed.[11] The parties expected the main focus of the project to be the extraction of high quality coking coal for export.

2.3. Clause 3.4 of the agreement required Bathurst to make the first performance payment of US40 million when it had "shipped" the first 25,000 tonnes of coal from the site. It provided:

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7 Gillian Coumbe QC "Jumping off the page: the use of extrinsic material in the interpretation of contracts and statutes", paper presented at an ADLS seminar on 24 February 2021, at [1.3]-[1.4], [2.26]-[2.68], and [3.12]-[3.52]. This preceded *Bathurst*, but anticipated the Supreme Court's judgment

8 *Bathurst*, above n 1, at [74].

9 *Attorney-General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988 (***Belize***).

10 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR (PC) (***BP Refinery***).

11 The initial rate was 10%, but after the first performance payment was made would drop to 5% until the second performance payment was made, and would then drop to 1.75%.

> **Performance Payments**
> The Purchaser shall pay the Vendor or its nominee, to such bank account as the Vendor may direct in writing at least 5 Business Days before payment is due to be made:
> (a) US$40,000,000 within 30 days of the date on which the first 25,000 tonnes of coal has been *shipped from the Permit Areas*; and
> (b) US$40,000,000 within 30 days of the date on which the first one million tonnes of coal has been shipped from the Permit Areas;
> and the Purchaser shall immediately notify the Vendor of the occurrence of any event which gives rise to an obligation on the Purchaser to make a payment to the Vendor under clause 3.4. (Emphasis added)

2.4. Subsequently, in August 2012, the parties entered into a Third Deed amending the agreement to insert a new cl 3.10. This essentially allowed Bathurst to delay making the performance payments if it made the "relevant royalty payments":

> **Failure to make Performance Payments**
> For the avoidance of doubt, the parties acknowledge and agree that a failure by the Purchaser to make, when and as due, a Performance Payment, is not an actionable breach of or default under the Agreement for *so long as the relevant royalty payments continue to be made under the Royalty Deed*. (Emphasis added)

2.5. In October 2012 the price for coking coal collapsed. Bathurst continued to mine, extracting some 50,000 tonnes of coal. However, this was all inferior thermal coal. Most of the coal was trucked out and sold to a local cement works, Holcim, for domestic use. The rest was stockpiled within the permit area. In March 2016, as a result of the continuing fall in coking coal prices and the closure of Holcim, Bathurst announced that it was "mothballing" the mine, which it placed in "care and maintenance". Mining was suspended. Bathurst did not pay the initial performance payment of US$40 million (and instead bought a number of other coal mining interests). Bathurst continued to pay only nominal royalties on occasional sales of stockpiled coal. L&M brought proceedings to recover the first performance payment from Bathurst.

The contract construction issues

2.6. Three key issues of construction arose:

(a) First, what was the meaning of the words "*shipped from the Permit Areas*" in cl 3.4? L&M argued that they simply meant transported from the site by truck, which had occurred. Bathurst contended that the words should be given their literal meaning of exported by ship, which had not occurred.

(b) Secondly, what was the meaning of the words "*relevant royalty payments*" in cl 3.10? L&M argued that they meant payments based on an ongoing substantive level of coal production. Bathurst argued that they were only those required to be paid under the royalty deed. Since there was currently no mining, the royalties payable were either zero or minimal amounts from sales of the stockpiled coal.

(c) Thirdly, and as an alternative to (b), L&M contended that the Court should imply a term to the effect that Bathurst could only rely on cl 3.10 to delay making the first performance payment if it continued to make royalty payments based on *substantive* continuing levels of coal production.

2.7. To resolve these construction issues a startling amount of evidence was produced, over a 2½ week trial. There were 15 witnesses in total, including five independent experts. Bathurst argued

that the Court's focus should be on the *external context* of cl 3.4 but the *wording* of cl 3.10. L&M argued the reverse. Both "wanted to have it both ways".[12]

The High Court and Court of Appeal rulings

2.8. In the High Court Dobson J held that "shipped" in cl 3.4 meant simply "transported".[13] The first performance payment had therefore been triggered. The Court of Appeal agreed.[14] Export coking coal was not the project's exclusive focus. An objective observer, "cognisant of context", would not conclude that the contractual words were "merely a mangled description of export tonnages".[15]

2.9. In relation to cl 3.10, Dobson J held that the wording contemplated an alternative money flow to the payment of the performance payment. Payment of only minimal royalties made no commercial sense from L&M's perspective. The "relevant royalties" were therefore to be interpreted as referring to "the level of royalties calculated in accordance with the royalty deed that become payable on a *reasonable* level of production from the permit areas".[16] As no mining was being conducted Bathurst could not rely on cl 3.10 and Dobson J made a declaration that the US$40 million was due and payable.

2.10. Again the Court of Appeal agreed. As Kos P put it, the amendment did not entitle Bathurst to "place a US$40 million debt on ice, indefinitely"[17] while mining ceased and merely nominal royalties were paid in respect of sales from a stockpile. That would have made "no commercial sense".[18] However, the Court of Appeal interpreted cl 3.10 as requiring a different level of coal production. The "relevant royalty payments" meant royalties from "*continuing* mining and sales at a level *not materially less* than had resulted in the US$40 million payment being triggered in the first place".[19]

2.11. In relation to the third issue, implication, Dobson J said that in the alternative he would have implied a term that to rely on cl 3.10 Bathurst had to continue paying royalties at the higher rate on a *substantive* volume of coal. Yet another formulation. The Court of Appeal saw no need to address that argument, given its ruling on the interpretation of cl 3.10.

2.12. In my earlier paper I said I would be surprised if the Supreme Court took a different view of the meaning of cl 3.4. However, I thought that cl 3.10 was open to more possibilities. So it has turned out. The Supreme Court unanimously agreed with the Court of Appeal on cl 3.4 but was divided on the interpretation of cl 3.10, with the majority (Glazebrook, O'Regan and Williams JJ) taking a harder line and disagreeing with the Court of Appeal. The majority also rejected an implied term. The $US40 million judgment in favour of L&M was overturned.

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12 As observed by Glazebrook J in the *Bathurst* Transcript, [2020] NZSC Trans 25, p 49.
13 *L&M Coal Holdings v Bathurst Resources Ltd* [2018] NZHC 2127.
14 *Bathurst* CA, above n 6.
15 *Bathurst*, CA, above n 6 at [60] per Kós P (giving the reasons of the Court).
16 *Bathurst HC*, above n 13, at [30] per Dobson J.
17 *Bathurst*, CA, above n 6, at [93].
18 *Bathurst*, CA, above n 6, at [96].
19 *Bathurst*, CA, above n 6, at [96].

3. The Supreme Court's restatement of the principles governing admissibility of extrinsic evidence

The core principles before *Bathurst*

3.1. Before *Bathurst*, the Supreme Court had clearly signalled that the general principles of contract interpretation, as set out in the majority judgment in *Firm PI*,[20] must now be regarded as settled.[21] In its leave judgment in *Bathurst* the Court confirmed that it would "not be revisiting" those principles".[22] These core principles, as far as they go, are as follows.

(a) ***Test is objective***. The interpretation exercise is an objective one. The aim is to ascertain "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".[23] This objective meaning is "taken to be that which the parties intended".[24]

The objective approach excludes a purely subjective inquiry into the individual (and uncommunicated) intentions or belief of each party. No one would argue otherwise. What *Firm PI* did not clarify was the extent to which the objective approach can have regard to *objective evidence* of the actual (subjective) mutual intentions of the parties as revealed in prior negotiations. The *Firm PI* objective test was formulated as one of 'pure' presumed intention, not actual intention,[25] something given significant emphasis by the Court of Appeal in *Bathurst.*

(b) ***Exercise is contextual***. The interpretive task is "contextual". In statutory interpretation it is called "purposive". Whatever the label, it encompasses text, context and purpose. The interpretation process involves an examination of the language used (text) in the immediate contractual clause and in the contract document as a whole (internal context), informed by the surrounding circumstances known or reasonably available to both parties (external context).

(c) ***Text has primacy***. While context is a necessary element of the interpretive process, the text remains centrally important.[26] If the language in issue, construed in the context of the contract as a whole, has an ordinary and natural meaning, that will be "a powerful, albeit not conclusive", indicator of what the parties meant. As a corollary to this, the majority in *Firm PI* emphasised that the "ordinary and natural meaning" of the text should not be challenged on the basis of commercial absurdity except in the "most obvious and extreme of cases".[27]

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20 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 (***Firm PI***).

21 *New Zealand Air Line Pilots' Association Inc* v *Air New Zealand Ltd* [2017] NZSC 111 (***NZALPA***), at [71] per Arnold, O'Regan and Ellen France JJ; *Savvy Vineyards 4334 Ltd v Weta Estate Ltd* [2020] NZSC 115 (***Savvy Vineyards***), at [24] per Winkelmann CJ, Glazebrook, O'Regan and Ellen France JJ.

22 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2020] NZSC 73, at [1](a).

23 *Firm PI*, above n 20, at [60] per Arnold, O'Regan and Ellen France JJ, quoting Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* (***ICS***) [1998] 1 WLR 896 (HL), at 915.

24 At [60].

25 The majority in *Firm PI* referred to Lord Hoffmann's wholly presumptive formulation in *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988 ("***Belize***") at [16] (which referred in turn to his formulation in *ICS*).

26 *Firm PI*, above n 20, at [63] per McGrath, Glazebrook and Arnold JJ.

27 At [93] per McGrath, Glazebrook and Arnold JJ.

(d) ***No ambiguity requirement***. It is not necessary to identify an ambiguity in the text before looking at the surrounding circumstances.[28] Interestingly, however, in several recent cases, the Supreme Court has in fact seen no need to refer to the external context, even as a cross-check, where the meaning is "crystal clear",[29] or "clear" with "no ambiguity".[30]

The approach to extrinsic evidence before *Bathurst*

3.2. The majority in *Firm PI* said that there is "no conceptual limit" on what can be regarded as the "background" reasonably available to the parties at the time of the contract, provided it is "background that a reasonable person would regard as relevant".[31] That must mean relevant to the objective assessment of meaning. Thus, a broad test of relevance determined what extrinsic evidence could be looked at as part of the factual matrix.[32]

3.3. However, a key issue that did not arise for consideration in *Firm PI* was the extent to which the Court could look at evidence of prior negotiations and subsequent conduct.

Prior negotiations -- the uncertainty left by Vector

3.4. Prior negotiations include earlier drafts of the contract, and communications between the parties in the course of negotiations. It can also extend to evidence of the content of oral negotiations.[33]

3.5. The 'exclusionary rule' that limits the use of evidence of prior negotiations as an aid to interpretation of written contracts is long standing. It was reaffirmed by the House of Lords in *Prenn v Simmonds*[34] and again in *Chartbrook*.[35] It is still the position in England, and in Australia. The Supreme Court revisited the issue in *Vector*. There was, however, no common rationale. The issue remained unsettled.

3.6. Abolition of the exclusionary rule "did not command majority support" in *Vector*[36] but some significant exceptions were recognized by the different judges:

(a) ***Objective background facts exception***. It is well-established that evidence of prior negotiations may be relevant to proving objective background facts (or whether particular facts were known to one or both parties, if that is disputed), as part of the factual matrix.[37] That may include, for example, the genesis of the transaction, its commercial object, and the market in which the parties are operating. The line between identifying the factual matrix and relying on such evidence to show what the parties intended can be a fine one.

(b) ***Private dictionary exception***. The parties may have adopted an agreed definition of a word or phrase. It may be a meaning which is "linguistically impossible (for example, black

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28 *Firm PI*, above n 20, at [61] per McGrath, Glazebrook and Arnold JJ.
29 *Lakes International Golf Management Ltd v Vincent* [2017] NZSC 99, at [28] per William Young J.
30 *Savvy Vineyards*, above n 21, at [26]-[29] per Winkelmann CJ, Glazebrook, O'Regan and Ellen France JJ.
31 *Firm PI*, above n 20, at [60] per McGrath, Glazebrook and Arnold JJ.
32 See the full discussion of the factual matrix in Jumping off the page", above n 7, at [3.1]-[3.52].
33 *Bathurst* above n 1, at [69] per Winkelmann CJ and Ellen France J.
34 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL), at p 1384 per Lord Wilberforce.
35 *Chartbrook v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 3 WLR 267 ("***Chartbrook***").
36 David McLauchlin "The Continuing Confusion and Uncertainty over the Relevance of Actual Mutual Intention in Contract Interpretation" (2021) 37 Journal of Contract Law 25 at 32, 36.
37 *Vector*, above n 3, at [67], [70] & [73] per McGrath J, at [13] &[14] per Blanchard J, at [151] per Gault J (who agreed with Blanchard J), at [27], [29] per Tipping J. See *Chartbrook*, above n 35, at [27] per Lord Hoffmann.

means white), or represents a specialised or generally unfamiliar usage".[38] The exception was confined in *Chartbrook* to situations where the words are used in "an unconventional sense". [39] It does not apply where the negotiations merely show a choice between two competing meanings.

(c) ***Subject matter of the contract exception***. The negotiations may clarify the subject matter of the contract, where that is in doubt. Blanchard J (with whom Gault J agreed) recognised this exception in *Vector*.[40] This could also be regarded as part of the wider "objective background facts" exception in (a) above.

3.7. In addition, prior negotiations (and subsequent conduct), are of course admissible in support of rectification and estoppel by convention. However, these are not exceptions to the exclusionary rule, but rather sit outside it.

3.8. Tipping J's approach in *Vector* went further than merely recognising exceptions to the exclusionary rule. He proposed that in determining whether to allow evidence of "surrounding circumstances" – including the factual matrix, negotiations, or subsequent conduct – "relevance" should be the "touchstone", in accordance with s 7 of the Evidence Act. He said:[41]

> The key point is that extrinsic evidence is admissible if it tends to establish a fact or circumstance capable of demonstrating objectively what meaning both or all parties intended their words to bear.

This, he said, included evidence derived from the negotiations of any "objectively apparent consensus" between the parties. He regarded objective evidence of the parties actual mutual intent as compatible with the objective approach to interpretation. Tipping J's broad relevance test would subsume the exceptions in paragraphs [3.6](b) and (c) above, and would effectively abolish the exclusionary rule. As the Supreme Court noted in *Bathurst*, Tipping J's approach has been the one most often applied by the courts since *Vector*.[42]

3.9. The Supreme Court in *NZALPA* appeared (almost as an aside) to approve Tipping J's approach, drawing a distinction between the parties' "inadmissible subjective individual intentions" and the parties' "objectively apparent consensus".[43] However, as I said in my earlier paper, a more definitive statement of the Supreme Court's view was still needed.

3.10. Given the lack of certainty it is not entirely surprising that the Court of Appeal in *Bathurst* decided to state its own, more restrictive, position on this question. The Court rejected the use of prior negotiations, saying that:[44]

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38 *Vector*, above n 20, at [36] per Tipping J.

39 *Chartbrook*, above n 35, at [43]-[47] per Lord Hoffmann.

40 *Vector*, above n 3, at [13]-[14] per Blanchard J, at [151] per Gault J (agreeing with Blanchard J). In *Codelfa Construction Pty Ltd v State Rail Authority of NSW* [1982] HCA 24; (1982) 149 CLR 337 Mason J also recognised as an exception (at [25]) evidence showing that the parties were "united in rejecting" a certain meaning. This would allow words deleted from a written contract prior to its execution to be looked at.

41 *Vector*, above n 3, at [31] per Tipping J, and also at [19], [21], [27]-[30].

42 It was described by McLauchlan, above n 36 p 35, as "the most influential of the five judgments" in *Vector*. A clear example of its application by the High Court is the judgment of Asher J in *i-Health Ltd v iSoft NZ Ltd* HC Auckland, CIV-2006-404-7881, 8 September 2010.

43 *NZALPA*, above n 21, at [86] and fn 122 per Arnold, O'Regan and Ellen France JJ, and at [140] and fn 150 per William Young J.

44 *Bathurst*, CA, above n 6, at [41] per Kós P. See the comments of David McLauchlin "A new conservatism in contract interpretation" [2020] NZLJ 273 (Part 1) and [2020] NZLJ 312 (Part 2).

> The contract is the governing instrument and must be made to yeield a solution. Notably that solution is not reached by looking at prior negotiations – perhaps the best evidence of actual intention, yet inadmissible in interpretation.

3.11. However, subsequently, in *Kaimai Properties*, the Court of Appeal seemed to retreat.[45] Kós P commented that there was nothing in the evidence to suggest "an objective common intention" between the former landowner and the Trust to qualify the covenant boundaries.[46] This seems implicitly to accept that such evidence might be admissible, but there was no further comment on the issue.

3.12. There was clearly a need for the Supreme Court to settle this question in the *Bathurst* appeal, especially in light of the position taken by the Court of Appeal in *Bathurst*.

Subsequent conduct – the uncertainty left by Gibbons

3.13. Traditionally the common law has excluded evidence of subsequent conduct in aid of interpretation of contracts.[47] That exclusionary rule still applies in England and Australia. However, in the Supreme Court's judgment in *Gibbons*[48] a majority of four judges favoured admissibility. As in *Vector* there was an unhelpful divergence of views about what kind of conduct could be looked at. Two judges (Anderson and Tipping JJ) thought the conduct had to be shared or mutual. Thomas J, however, considered that unilateral conduct could be relevant if inconsistent with the interpretation that party was advancing in court. The question was left open.

3.14. Subsequently, in *Vector*, Tipping J revised his position. As stated above, he suggested that his broad relevance standard should apply equally to subsequent conduct and prior negotiations.

3.15. Again, this lack of a clear position from the Supreme Court has resulted in inconsistencies of approach in the courts below.[49]

3.16. The Court of Appeal in *Bathurst* preferred the view that the conduct had to be mutual. Kós P said that even if unilateral conduct was admissible, it "may well command little weight". It may show only that party's "subjective understanding", or indicate a "merely mistaken perspective of obligation".[50]

The Supreme Court's clarification in *Bathurst*

In relation to the core principles

3.17. The Supreme Court largely reaffirmed the core principles set out above, including the primacy of the text, and the need for caution in invoking "commercial common sense". The members of the Court all acknowledged that judges are not the best arbiters of commerciality.[51]

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45 *Kaimai Properties v Queen Elizabeth the Second National Trust* [2021] NZCA 10.
46 At [46], per Kós P (giving the reasons of the Court).
47 *James Miller & Partners v Whitworth Street Estates (Manchester) Ltd* [1970] AC 583; *L Schuler AG v Wickman Machine Tools Ltd* [1974] AC 235.
48 *Gibbons*, above n 4.
49 "Jumping off the page", above n 7 at [3.62]-[3.67].
50 *Bathurst*, CA, above n 6, at [63] per Kós P.
51 *Bathurst*, above n 1, at [45] per Winkelmann CJ and Ellen France J, and at [250] and fn 236 per Glazebrook, O'Regan and Williams JJ.

3.18. However, the Court went further than *Firm PI* (and *ICS*) and clarified that the courts can, consistently with the objective approach, also have regard to objective evidence of the parties' actual mutual intention in discovering their "true" bargain. This will be discussed below.

A single test of relevance

3.19. The Supreme Court swept away what was left of the exclusionary rules relating to prior negotiations and subsequent conduct. The Court articulated a single approach to the admissibility of all extrinsic evidence based on *relevance*. This broad test applies equally to the factual matrix (which the Court labels "commercial context and purpose"), prior negotiations, and subsequent conduct. It subsumes the exceptions set out in paragraph [3.6] above.

3.20. The Court emphasised that admissibility "is determined by the laws of evidence"[52] and so relevance is to be assessed under s 7 the Evidence Act 2006, in light of the substantive law of contract. Under s 7(3) evidence is relevant in a proceeding if it "has a tendency to prove or disprove anything of consequence to the determination of the proceeding". The Court blended the wording of s 7 of the Evidence Act with the *Firm PI* objective approach to interpretation, and restated the test of admissibility as: follows[53]

> …evidence is prima facie admissible if it has a tendency to prove or disprove anything of consequence to determining the meaning the contractual document would convey to a reasonable person having all the background knowledge reasonably available to the parties in the situation they were in at the time of the contract.

3.21. The Court explained that the term "prima facie" is used because even if the evidence is relevant it may still be inadmissible under s 8 or one of the Act's other exclusionary provisions. Under s 8(1)(b), for example, evidence may be excluded if its probative value is outweighed by the risk that it will "needlessly prolong the proceeding". The Court stressed that s 8 "will often be relevant to a court's task in determining admissibility".[54] It provides a means of keeping out material that is unhelpful or only marginally relevant, and discouraging excessive amounts of evidence.

3.22. The framing of the approach in terms of a single test of relevance is not really surprising. That was already the standard for the factual matrix. Extending it to prior negotiations and subsequent conduct endorses Tipping J's approach, and continues the liberalising path taken in *Vector* and *Gibbons.* It is a bold forward step, and, at least at present, a specifically New Zealand one.

3.23. What is surprising, and may be controversial, is the extent to which the Court has treated the Evidence Act, and s 10 in particular, as dictating this approach. Of course, the admissibility of any evidence actually adduced at trial – whether in aid of interpretation or otherwise – must meet the requirements of the Evidence Act. That has always been the case, although the Australian courts have tended to focus on this more than the New Zealand courts.[55]

3.24. But at what point is the Evidence Act engaged? Where exactly is the line between the substantive law of contract interpretation (which is outside s 10) and the law of evidence? As the Supreme

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52 At [56].
53 At [62].
54 At [64].
55 The detailed discussion of the provisions of the Evidence Act 1995 (NSW) in *Cherry v Steele-Park* [2017] NSWCA 295, (2017) 96 NSWLR 548 provides a good illustration of this.

Court accepts, the determination of the core principles – including the objective approach –is a substantive law issue. But surely it is also open to the Court to decide, as a matter of general principle, to what extent it is legitimate to use as an aid to contract interpretation, prior negotiations or subsequent conduct? This is arguably a matter of the substantive law of contract, not the law of evidence. [56] Historically the exclusionary rules, and the exceptions, have been treated as substantive law, formulated on "pragmatic grounds".[57]

3.25. However, the Supreme Court is clear as to the approach. Sections 7 and 8 are now the "touchstones" for all admissibility issues, using the "objective standard for contract interpretation as the standard against which relevance and probative value must be measured". Whether or not this 'abdication' to the Evidence Act will lead to any difficulties in practice remains to be seen. A potential issue may be that the Evidence Act provisions do not apply in every forum where a question of contract interpretation may arise.[58]

Specific guidance

3.26. The Court has provided specific guidance as to how its reformulated approach can be applied to the various categories of extrinsic evidence. These are described as "indications" only of the likelihood of admission under the Evidence Act, not "hard and fast rules".

Prior negotiations

(a) Evidence will continue to be irrelevant and inadmissible to the extent that it proves only one party's subjective intention or belief as to the meaning of the words, or what their undeclared negotiating stance was at the time.[59]

(b) If however, there is objective evidence of a prior common consensus or mutual understanding, that will be relevant, and subject to s 8, admissible. The intention needs to be communicated, but need not be express on both sides:[60]

> Logically, the party who claims to have communicated their intention would have to be able to point to something – even if just silence (in circumstances where a reply might be expected) – on the part of the other party to bring that intention into the realm of mutual understanding.

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56 V K Rajah (Justice of Appeal, Supreme Court of Singapore), "Redrawing the boundaries of contractual interpretation: from text to context to pre-text and beyond", paper delivered at the 15th Malaysian Law Conference, 30 July 2010, 10-12.

57 *Chartbrook*, above n 35. at [34] per Lord Hoffmann. In Singapore, where (unlike here) the Evidence Act (Cap 97, 1997 Rev Ed) expressly addresses contract interpretation, the courts have still added a substantive requirement that the evidence must relate to a "clear and obvious" context. They continue to exclude prior negotiations, and appear not to regard that as an issue dictated by the Act. See *Sembcorp Marine Ltd v PPL Holdings Ltd* [2013] SGCA 43 (***Sembcorp***).

58 By virtue of ss 4 and 5, the Evidence Act only applies to proceedings in the District Court, High Court and Supreme Court. Other legislation may or may not make the rules of evidence in the Act applicable to other tribunals. See eg *Keach v RetroCar.co.nz – Reference No MVD 171/2021* [2021] NZMVDT 140, at [13] and fn 1.

59 *Bathurst*, above n 1 at [75]. See the discussion of what constitutes subjective intent in "Jumping off the page", above n 7, at [3.70]-[3.77].

60 At [76].

As mentioned above, this focus on evidence of actual mutual intention places takes New Zealand away from the Lord Hoffmann's *ICS* formulation, which entertains only presumed intention, and (other than for limited exceptions) precludes reference to prior negotiations.[61]

(c) In relation to specialised meanings, the "private dictionary" principle presumably falls away, as it will be subsumed in (b) above. An "unconventional" meaning is no longer a requirement "because relevance and probative value are now the touchstones for admissibility".[62]

(d) The admissibility of evidence to show that the parties understood a word to carry a particular meaning within a profession, trade or industry "is now also to be determined by applying the Evidence Act". Objectively ascertainable evidence, which could include words or conduct showing that the parties understood words to carry that meaning at the time of the contract, will be relevant, subject to s 8.[63]

(e) The reality is that often the issue in contention in the litigation is not one which the parties contemplated (in this case Bathurst ceasing mining), and so it will not have been addressed, expressly or by necessary implication, in the prior negotiations.

Subsequent conduct

(f) Again, subsequent conduct that evidences one party's subjective intention or belief is irrelevant and inadmissible.

(g) Subsequent conduct need not necessarily be mutual. However, non-mutual conduct is more likely to be relevant to a claim for estoppel.[64]

(h) In assessing the relevance of subsequent conduct, it must not be forgotten that the court is interpreting the contract at the time it was made.[65]

(i) As with prior negotiations, evidence of subsequent conduct will not often be relevant. Courts and commentators have often emphasized how rarely subsequent conduct is of any assistance,

(j) Where the subsequent conduct does cross the s 7 relevance threshold, s 8 will be especially important.[66] Care will be needed to assess the probative value of the evidence. The Court gave two examples of "problematic evidence" that may be barred under s 8:

(i) The first is conduct that occurs after the actual dispute has arisen. This is very unlikely to be admissible as "by then the parties will have retreated into their respective corners, and their conduct may well be self-serving". Its admission is

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61 Lord Hoffmann states in *ICS*, above n 23, that "the law does not require judges to attribute to parties an intention that they plainly could not have had." But he is not referring to actual intention, but to the need to presume an intention that accords with commercial common sense. They "plainly could not have intended" a commercially absurd outcome.

62 *Bathurst*, above n 1, at [81].

63 At [83].

64 At [89].

65 At [89].

66 At [90].

likely to add to time and cost, especially in light of the inevitable calling of rebuttal evidence.[67]

(ii) The second is conduct of executives of corporate parties who had no prior involvement in negotiating the contract and no knowledge of its background. "This evidence will not be probative if their actions do not represent the views of the relevant corporate party at the time the contract was formed."[68]

Factors that may limit reference to external context

3.27. The Supreme Court has reaffirmed that some factors, which are "themselves contextual", will limit the extent to which the Court is willing to look at evidence of the external context. The Court specifically referred to the interests of third parties in the context of registered covenants.[69] The interests of third parties will also arise with company constitutions, and commercial contracts that are likely to be relied on by a banker, investor or creditor. In addition the courts have signalled that extrinsic evidence may have a more limited role in the case of standard form contracts, long term contracts, and incorporated society rules.[70]

3.28. How do these factors fit within the new *Bathurst* formulation? Presumably, given they are themselves contextual, they will be part of the admissibility inquiry under the Evidence Act. But there are also substantive principles that will shape what is relevant, as indicated in the *Green Growth* case.[71]

4. The Supreme Court's restatement of the principles governing implication of terms

The uncertainty after *Belize*

4.1. Until Lord Hoffmann's pronouncements in the Privy Council's judgment in *Belize*[72] the test for implication of 'terms in fact' was settled. The New Zealand courts applied the traditional test in *BP Refinery*.[73] These five conditions (which may overlap) had to be met:

> (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract; (3) it must be "so obvious that it" goes without saying"; (4) it must be capable of clear expression, and (5) it must not contradict any express terms of the contract.

4.2. Rightly or wrongly, *Belize* led to uncertainty. Debate erupted among judges and commentators, mainly about what Lord Hoffman actually meant to say. There were two concerns. First, had Lord Hoffmann suggested that the process of implying a term was merely part of the exercise of interpretation? Secondly, had he suggested that unreasonableness, rather than strict necessity, was a sufficient ground to imply a term? This reaction was sparked by comments in *Belize* such

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67 At [90].
68 At [90].
69 At [47].
70 These factors are discussed in "Jumping off the page", above n 7, at [3.11].
71 *Green Growth no 2 Ltd v Queen Elizabeth the Second National Trust* [2018] NZSC 75,[2019] 1 NZLR 161, at [60], [73] and [74 per William Young and O'Regan J. Glazebrook J agreed with them at [151] and fn 100. See "Jumping off the page", above n 7, at [3.43]-[3.45].
72 *Belize*, above n 9.
73 *BP Refinery*, above n 10.

as: "There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean."[74]

4.3. The United Kingdom Supreme Court in *Marks & Spencer*[75] clarified that implication and interpretation are two distinct processes governed by distinct rules, and that the standard for implication has not been diluted and remains one of strict necessity. In New Zealand, the Supreme Court in *Mobil Oil*[76] expressed reservations about *Belize*, noting that it had been "significantly qualified" by *Marks & Spencer*, and clearly regarded the *BP Petroleum* factors as still applicable.[77] More recently, the Court of Appeal in *Ward Equipment* was divided over whether the law was settled in New Zealand.[78]

The Supreme Court's clarification

4.4. The Supreme Court has now cleared things up, stating that the Privy Council in *Belize* did not set out to change the law on implication. The Court clarified three key things. First, the Court reaffirmed that the standard is one of "strict necessity", a high hurdle to overcome.[79]

4.5. Secondly, the Court confirmed that the *BP Refinery* conditions have a continuing, but slightly modified, role. Conditions 4 and 5 must be met, but conditions 1 to 3 should be viewed as "analytical tools which overlap rather than cumulative requirements".[80] Conditions 2 and 3 – business efficacy and "obviousness" are alternative ways of establishing necessity.

4.6. Thirdly, the Court also confirmed that interpretation and implication are not the same. However, there is no bright line distinction, in that both are exercises are part of the overall "construction" of the contract as a whole. Normally the interpretation exercise will be done first, and the outcome of that will inevitably have an influence on whether or not a further term is then implied.

Specific guidance

4.7. The Court helpfully summarised the principal points governing whether a term may be implied. I have added to this some additional comments, which may have practical use:

(a) The starting point is the words of the contract. The construction of the contract begins with the *interpretation* of the contract, in accordance with the objective test above. If the relevant eventuality has been provided for – either expressly, or by necessary inference from the express terms -- there will be no need for implication.[81]

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74 *Belize*, above n 9, at [21]. The confusion also arose because of misunderstandings about what Lord Hoffmann meant by "construction". He was clearly using it in the broad sense (above n 2), and not as just another word for interpretation.

75 *Marks & Spencer Plc v BNP Paribas Security Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742.

76 *Mobil Oil New Zealand v Development Auckland Ltd* [2016] NZSC 89; [2017] NZLR 48, at [81] per William Young J (giving the reasons of the Court).

77 At [82].

78 *Ward Equipment Ltd v Preston* [2017] NZCA 444, at [46]-[47] per French and Winkelmann JJ (who thought that the correct approach was uncertain) and at [84]-[95] per Kós P (who did not).

79 *Bathurst* above n 1, at [106], [[116](a), and [263].

80 At [108].

81 At [113] and [116](b).

(b) However, if no contractual provision was made for the eventuality, so that there is a gap, the usual inference is that nothing is to happen.[82] Then, as Lord Hoffmann said in *Belize*, if the event has caused loss to one or other of the parties, the loss lies where it falls.[83]

(c) However, it some cases it may be appropriate to imply a term that something *is* to happen that affects the rights of the parties. The process of *implication* is also part of the construction of the contract as a whole, and will be influenced by the interpretation of the contract.

(d) As with interpretation, the implication exercise is an objective inquiry – it is the understanding of the notional reasonable person with all the relevant background knowledge reasonably available to the parties at the time of the contract.[84]

(e) The implication of a term "does not depend on proof of the parties' actual intention, nor does it require the court to speculate on how the actual parties would have wanted the contract to regulate the eventuality if confronted with it prior to contracting".[85]

This test of wholly presumed intention may be at odds with the Court's restated approach to interpretation, which now allows in evidence that the parties reached a consensus or mutual understanding during their negotiations. If, for example, there is evidence that the parties did contemplate the eventuality but chose not to provide for it, then it would be inappropriate for the Court to imply a term. As Lord Neuberger has observed:[86]

> If one party is arguing for an implied term, it might appear to be rather unsatisfactory if the other party was precluded from establishing that the parties had specifically discussed and rejected the notion of including such a term in the contract.

In *Sembcorp* the Singapore Court of Appeal considered that the only circumstance where an implied term would be appropriate is where the parties did not contemplate the issue at all.[87]

(f) The implication of a term must be "strictly necessary", in the sense that it is needed to "give effect to what the contract, objectively interpreted as above, must be understood to mean". Necessity may be shown by application of either *BP Refinery* condition 2 (business efficacy) or condition 3 (obviousness), both of which are "useful tools". The latter is more appropriate where the contract is not a business one.[88] The Court does not suggest that condition 1 (reasonable and equitable) could of itself demonstrate the required "necessity". Rather the Court noted that it will usually overlap with 2 and 3. A term that is obvious and/or necessary for business efficacy is unlikely to be unreasonable or inequitable.[89]

(g) The *BP Refinery* conditions 4 and 5 "must always be met" before a term will be implied.[90] Thus, the term must be capable of clear expression, and must not contradict the express terms of the contract.

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82 At [113], [116](b).
83 *Belize*, above n 9, at [17].
84 At [112], [116](d).
85 At [112], [116](e).
86 Lord Neuberger, "Express and Implied Terms in Contract", paper presented to School Of Law, Singapore Management University, 19 August 2016, at [31].
87 *Sembcorp Marine v PPL Holdings Pte Ltd*, above n 57, at [95] per Sundaresh Menon CJ.
88 *Bathurst*, above n 1, at [109].
89 At [108], citing Lord Neuberger in *Belize* above n 9 at [27].
90 At [108] and [116](f).

5. The Supreme Court's application of the principles to the facts

5.1. This part of the judgment is just as important as the articulation of the principles. It provides invaluable practical guidance as to how extrinsic evidence should (or should not) be used. The majority approach also reflects a hardline judicial 'mood' in respect of interpretation and implication where there is a detailed written commercial contract between experienced parties.

First issue – the meaning of "shipped" in cl 3.4

5.2. Under cl 3.4 the first performance payment of US$40 million was triggered when 25,000 tonnes of coal had been "shipped from the Permit Areas". L&M argued that "shipped" simply meant transported, which had occurred. Bathurst argued that it meant exported by ship, which had not occurred.

5.3. Unsurprisingly, the Supreme Court unanimously agreed with the courts below that "shipped" meant transported. The Court first examined the text. It "strongly supported" this interpretation. The word "shipped" had come to be used in a variety of contexts to describe all means of transport of goods from one place to another. "Anyone who has ever purchased goods online knows that".[91] The phrase in which it appeared reinforced this by linking "ship" to moving coal from the permit areas. The permit areas are high on the Denniston Plateau, a long way from the sea, and plainly coal could not be transported directly from there to a ship. Further, the agreement did not make any distinction between coking coal for export and thermal coal for local use.

5.4. The Court thought that Bathurst was asking it to "write into" the payment obligation a very significant qualification on the type of coal, by limiting it to export coking coal. This could be expected to have been expressly provided for:[92]

> If the qualification to cl 3.4 Bathurst contends for was agreed, we expect it would have been expressly stated, and not merely gestured at through what the Court of Appeal was right to suggest was a mangled expression

The extrinsic evidence considered by the Court

5.5. The Court then turned to the external context, and considered extrinsic evidence comprising the factual matrix, prior negotiations, and subsequent conduct.

Factual matrix

(a) ***Genesis and purpose***. The Court had regard to objective evidence of the commercial genesis and purpose of the contract, including a feasibility study, to conclude that while the focus of the project was export coking coal, it was not the project's sole focus. The commercial purpose did not exclude the extraction of thermal coal. Again, the Court emphasised that if the establishment of export markets was so critical to Bathurst, "we would expect to see some vestige of it somewhere in the Agreement."[93]

(b) ***Expert evidence***. The Court also considered the testimony of an expert called by Bathurst about the sense in which the word shipped is used in the coal industry. The Court accepted

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91 At [134].
92 At [138].
93 At [145].

that evidence of industry practice can be helpful, but that was not the case here. The focus of the witness' experience was different from the context in which the word was used in the agreement. His evidence was "not materially helpful", and was excluded under ss 23 and 25 of the Evidence Act.[94]

Prior negotiations

(c) ***Testimony of negotiators***. L&M relied on evidence given by a Mr Geoff Loudon, former managing director of L&M, and a Mr Hamish Bohannon, former chief executive and director of Bathurst. They had been the chief negotiators of the agreement on behalf of L&M and Bathurst respectively. Unusually, both witnesses gave evidence for L&M. Their oral testimonies were "*ad idem* as to what they had intended the [agreement] to record". This included a "common view" that "shipped" simply meant "transported". In the High Court Dobson J thought that to the extent the evidence established mutual intentions, it was admissible.[95] Alternatively, he considered that such evidence of shared intention was within the concept of "background".[96]

However, the views of Mr Loudon and of Mr Bohannan were not actually communicated to the other at the time. The evidence was therefore clearly no more than the individual subjective intent of two different witnesses, and therefore inadmissible. As counsel for Bathurst submitted, "repetition by a number of witnesses of the same subjective recollections did not change their character."[97] The Court of Appeal appears to have accepted that submission, and was critical of the extent of subjective evidence that had been adduced:[98]

> …*ex post* evidence of intent, and of the course of negotiations, was advanced before the Judge without due heed to limits germane to objective interpretation.

The Supreme Court agreed that "without some outward manifestation" of the mutual understanding the evidence was of individual subjective belief or intent and so "of no relevance to the objective exercise of contractual interpretation".[99] It was therefore inadmissible under s 7. It was also evidence that could have been excluded under s 8 as it was likely to have needlessly prolonged the proceeding.

Subsequent conduct

(d) ***Letters sent by L&M***. Bathurst relied on letters sent by L&M's solicitor to obtain regulatory consents on which the Agreement was conditional. L&M asserted that this was "mutual" because L&M was plainly helping Bathurst with efforts to obtain the consents. In the letters the description of Escarpment focused on the export of coking coal. The Supreme Court accepted that the evidence was "marginally relevant", but thought it should have been excluded under s 8. It was unhelpful, and, because it invited the admission of "further low value evidence" to rebut it, it would have unnecessarily prolonged the proceeding.

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94 At [157] and fn 164.
95 *Bathurst*, HC, above n 13, at [40] and [58]-[61].
96 At [40], "Ruling 1-admissibility of evidence", annexed to the judgment, at [13], [14].
97 Ruling 1, at [12]. It is also difficult to see how this subjective evidence could have been part of the factual matrix.
98 *Bathurst*, above n 1, at [44].
99 At [154]

(e) ***Financial statements***. L&M relied on Bathurst's 2014 to 2016 financial statements, annual reports and presentations, which acknowledged that the amount of thermal coal sold had (or would) trigger the first performance payment. The Court of Appeal .disregarded this evidence, on the grounds that it was unilateral, and equally consistent with a mistaken understanding as with a common understanding. However, the Supreme Court disagreed. It was "marginally relevant" because Bathurst had consistently, throughout the series of documents, expressed a view contrary to the one it was now advancing.[100] The Court did not attach much weight to the evidence, but said it was "properly regarded as corroborative of the interpretation we favour". This is surprising. Conduct that occurred four to six years after entry into the contract does seem a bit remote.

(f) ***Letter sent by Bathurst***. Finally, L&M relied on a letter of June 2016 sent to L&M by Bathurst's chief executive, in which he did not deny that the the performance payment had been triggered but said the non-payment was not a breach. The Supreme Court said this was admissible on the same basis as the financial statements.[101] Again, a letter written six years after the contract was made seems remote.

Overall

5.6. What is striking is that in the end, and despite the vast amount of evidence adduced, the Court took into account very little extrinsic material. It boiled down to the relevant factual matrix, as well as the subsequent public financial statements and the letter of June 2016 (to which the Court did not attach much weight). The Court's interpretation was firmly based in the text. The admissible extrinsic evidence provided "little assistance as to the interpretation of the term."[102]

Second issue – the meaning of "relevant royalties" in cl 3.10

Preliminary interpretation issue

5.7. A preliminary question was whether cl 3.10 merely clarified the parties' existing agreement, or whether it changed the agreement by giving Bathurst a concession or indulgence. The Court unanimously agreed that it was the latter.[103] Clause 3.10 gave Bathurst some flexibility to delay the first performance payment, and to deny what would otherwise be an actionable breach or default, provided "relevant royalty payments" continued to be made.

5.8. The Court's conclusion followed from an analysis of the text, but was also supported by extrinsic evidence in the form of the unchallenged testimony of two L&M executives who had been involved in the negotiations. Their testimony explained the genesis of the Third Deed and was treated as part of the objective background facts (factual matrix).[104] The relevant facts were that the parties had been working co-operatively to optimise Bathurst's chances of raising the capital necessary to bring the mine into production and make the first performance payment. If that payment fell due before Bathurst had its financing in place, Bathurst would have to announce to the ASX that it had defaulted under the agreement. It would then be harder to raise the finance,

[100] At [151]. This reflects Thomas J's view in *Gibbons*.
[101] At fn 157.
[102] At [158].
[103] At [177]-[182] per Winkelmann CJ and Ellen France J, and at [238], fn 227 per Glazebrook, O'Regan and Williams JJ.
[104] At [182], fn 181, per Winkelmann CJ and Ellen France J.

a "catch-22" situation.[105] It was therefore not in L&M's interests to push Bathurst into default or to pursue remedies for breach. Hence the cl 3.10 concession.

Main interpretation question

5.9. The second and more crucial question was the meaning of "relevant royalty payments" in the phrase "for so long as the relevant royalty payments continue to be made under the Royalty Deed". Was it enough for Bathurst to pay zero or nominal royalties on a trickle of coal from a stockpile? On this the Court was sharply divided, and this part of the judgment may be controversial.

The minority's view

5.10. The minority interpreted "relevant royalty payments" to mean royalty payments arising from a level of mining consistent with that which triggered the first performance payment.

5.11. Starting with the text of cl 3.10, they considered that the words "so long as" and the reference to "payments" that "continue to be made" were the "language of continuity", consistent with the idea that the actual payments that were being made when cl 3.10 is triggered were to continue afterwards.[106]

5.12. The minority also regarded this as also consistent with their view of the commercial structure of the agreement:

- The provision for royalty payments was meant to incentivise the payment of the performance payments. Payment of zero or nominal royalties would not have that effect.
- Neither party contemplated that, having reached the 25,000 tonne threshold, Bathurst would drastically scale back production or cease mining. There was a shared assumption that the continuing payment of royalties would have to compensate L&M for the delay in receiving the US$40 million.
- Clauses 8.1 of the royalty deed requiring Bathurst to satisfy the minimum work programme and to "conduct mining operations in accordance with good mining practice and with a view to maximization of Coal sales at the best available price," was consistent with this structure.

5.13. Like the courts below, the minority were heavily influenced by "commercial common sense" considerations. If Bathurst's interpretation were correct, that would involve L&M giving away a right to US$40 million in return for a 'unilateral option to pay'. Such a concession would in their view "deprive L&M of most of the commercial value of the transaction".[107]

5.14. However, it does seem quite a step to read into clause 3.10 a significant qualification about a minimum level of royalties – the level that triggered the first performance payment – and hence a minimum level of mining. The words are not there. There is an element of rewriting. It improves the parties' bargain (at least from L&M's perspective).

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[105] At [240] per Glazebrook, O'Regan and Williams JJ.
[106] At [184]-[186], per Winkelmann CJ and Ellen France J
[107] At [193], per Winkelmann CJ and Ellen France J.

The majority's view

5.15. The majority's approach appears more compelling, and more firmly grounded in the text. They held that the "relevant royalty payments" in cl 3 10 simply meant the payments at the rates determined under the royalty deed.[108]

5.16. This arose from the clear direction in cl 3.10 that the royalties being addressed were those payable under the royalty deed. The expression "continue to be made" also had an element of conditionality to it. The most obvious one was that payments only had to be made "as and when" the royalty deed required them to be.[109] This does seem to be the more natural reading of the text.

5.17. The majority considered the following aspects of the contract, read as a whole, to be relevant:

- The US$40 million in dispute was not (as the Court of Appeal assumed) part of the purchase price, but rather a performance payment.

- Under the agreement Bathurst controlled all decisions about the development and operation of the mines in the permit area, acting in its own interest. The royalty deed made it clear that L&M had no say over the development and operation of the mine. L&M had therefore accepted the that it might receive no performance payments if Bathurst did not fully develop and exploit the mine. That risk continued after the parties added cl 3.10.

- The parties assumed that Bathurst, after investing $US40 million purchasing the mining rights, would continue mining. However, the agreement imposed no legal obligation on Bathurst to mine at a minimum level. Clause 8.1 of the royalty deed did not have that effect. There was always the possibility of an interruption in mining and therefore of zero or minimal royalty payments. Again, that did not change when cl 3.10 was added. No new obligation to pay minimum royalties was imposed.

- Nothing in the agreement prevented Bathurst undertaking other mining operations in New Zealand or overseas. L&M therefore also accepted the risk that Bathurst would see a better use for its capital elsewhere

5.18. The majority did not agree that commercial common sense required a level of royalties consistent with those that triggered the royalty payments. They emphasised again that both Bathurst and L&M are substantial commercial entities and experienced coal mine investors. The parties, not the Court, were the "best judges of what is commercially realistic". A "sophisticated and experienced vendor like L&M" could be expected to have expressly provided for the eventuality that occurred. When they agreed to cl 3.10 they could have required a minimum level of royalties or the payment of interest:[110]

> If L&M wished to ensure the level of compensation was fixed, or at least had a minimum level, it could easily have provided for that in the Third Deed. It did not.

[108] At [249] and [257] per Glazebrook, O'Regan and Williams JJ.
[109] At [252] per Glazebrook, O'Regan and Williams JJ.
[110] At [256] per Glazebrook, O'Regan and Williams JJ.

5.19. As there was currently no mining the required royalty payments were "either zero or low amounts",[111] and Bathurst was entitled to keep deferring the US$40 million performance payment The majority acknowledged that this was a harsh outcome from L&M's point of view, but it was the one that L&M, "a major commercial entity carrying on business in the mining industry, agreed to".[112] This is reminiscent of the unfortunate deal in *Arnold v Britton*[113], where the United Kingdom Supreme Court refused to rewrite the parties' bargain even though it lead to an "alarming" outcome for one of them. Oxwich Leisure Park comes to the Denniston Plateau?

Overall

5.20. Although the Supreme Court agreed on the governing principles, the application of those principles led to starkly different views about what clause 3.10 meant. This illustrates the inherent limits on the predictability of contract interpretation. Highly skilled judges applying the same principles may, and often do, arrive at different conclusions. Ultimately a (loosely drafted) contract may mean whatever at least three Supreme Court judges decide it means.

5.21. The split decision in this case reflects a strong disagreement about the commercial objectives and commerciality of the contract. Whereas the minority decision has something of a remedial air about it, the majority approach is a robust one in declining to read in words that these commercial parties could have "easily" have included but did not.

The third construction issue – was there an implied term?

5.22. L&M argued in the alternative for an implied term. A total of five different versions of an implied term were put forward in the course of the case. Each one refers to a different level of royalties being required:

- ***pleaded by L&M***: "royalty payments must reflect the proceeds of ongoing mining and substantive coal sales, thereby providing commercial value for L&M".
- ***implied by the High Court***: "continue paying royalties…on a substantive volume of coal".
- ***advanced by L&M at the Supreme Court hearing***: "royalty payments must reflect the proceeds of ongoing mining".
- ***implied by the minority***: "ceasing to mine on a level equating to that which triggered the obligation to make the performance payments".
- ***preferred by the majority***: "royalties at or above a certain minimum level (for example, the level equating to that which triggered the obligation to make the performance payment".

5.23. The number of variations, of itself, highlights the difficulty in implying a term in this case. How long is a piece of string?

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[111] At [249] per Glazebrook, O'Regan and Williams JJ.
[112] At [249] per Glazebrook, O'Regan and Williams JJ.
[113] *Arnold v Britton* [2015] UKSC 36, [2015] 2 WLR 1593.

The minority view

5.24. Because of their interpretation of cl 3.10 the minority did not need to consider L&M's alternative argument for an implied term. However, if that had been necessary they would have implied a term that:[114]

> Bathurst ceasing to mine on a level equating to that which triggered the obligation to make the performance payment (while at the same time refusing to pay the USD 40 million payment that has become due) is a breach of contract, entitling L&M to compensation.

5.25. They considered without such a term cl 3.10 would not have business efficacy. In their view a situation where Bathurst could cease mining, stop paying royalties, and also not pay the performance payment, would deprive L&M of most of the commercial value of the "transaction". This is the same point that was raised under "commercial common sense" in relation to the interpretation of clause 3.10. However, their reasoning also relied quite heavily on two cases involving contracts that could only take effect if a certain state of affairs continued, and it was implicit that a party would do nothing "of his own motion" to put an end to that state of circumstances.[115]

5.26. The wording of the implied term above does not seem obvious, and insofar as it incorporates the words "is a breach of contract", seems odd. In *Vickery*, one of the cases relied on, the obligation implicit in the language of the express terms was that the respondent would maintain the workforce clientele for the catering service by keeping the freezing works open.[116] The respondent's failure to comply with that implied term was then a breach of contract.

The majority view

5.27. If the majority thought that the term that would need to be implied for Bathurst to succeed would be a term that "Bathurst is not entitled to the benefit of cl 3.10 unless [Bathurst] is actually paying L&M royalties at or above a certain minimum level (for example, the level equating with that which triggered the obligation to make the performance payment)".[117]

5.28. On this formulation Bathurst could elect to continue mining and pay royalties, or to make the performance payment that was due. If it did neither then it would be an actionable breach or default under the express provisions of the contract.

5.29. However, the majority declined to imply a term. The *BP Refinery* conditions 2, 3, 4 and 5 were not met. An implied term was not necessary to give the contract business efficacy. There was already a "coherent contract", even though it had not turned out to be a wise choice for L&M. Again, the parties were large, experienced entities who could have, but did not provide for a minimum level of mining or royalties. The implied term also gave rise to issues of degree and uncertainty that the parties were unlikely to have agreed to. The majority did not agree that their interpretation of cl 10.3 deprived L&M of most of the commercial value of the transaction. L&M

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[114] *Bathurst*, above n 1, at [201] per Winkelmann CJ and Ellen France J.

[115] *Vickery v Waitaki International Ltd* [1992] 2 NZLR 58 (CA), and *Rod Milner Motors Ltd v Attorney-General* [1999] 2 NZLR 568 (CA). However these cases appear to reflect the same approach that the Court declined to consider because it relied on evidential matters not considered in the courts below: at [202],[204] and [258].

[116] *Vickery* was not a case about implying a term to give business efficacy to the contract. That type of implied term did not arise. The obligation was implicit in the terms of the contract as a matter of interpretation.

[117] *Bathurst*, above n 1, at [259], per Glazebrook, O'Regan and Williams JJ.

had already received a purchase price of US$40 million and it was always a distinct possibility that mining would cease and no further payments would be made. L&M had good reason to make the concession in cl 3.10 because of its shared interest in the development of the mine.[118]

5.30. Because of the multiple formulations put forward, the implied term did not meet the "obviousness" condition. It followed that the "capable of clear expression" condition was not met either. Finally, the proposed implied term would have contradicted express terms in the contract., which did not oblige Bathurst to mine at any minimum level.[119]

Overall

5.31. As with interpretation, clarification of the underlying principles for implication still did not lead to a consistent outcome. The minority's implied term seems to go too far. The majority's conclusion is harsh, but reflects an understandable reluctance to imply a term in a detailed (and workable) written commercial contract between sophisticated and experienced parties. The bar for implication remains a high one, as it should.

6. Some practical implications

No need for further debate

6.1. Obviously enough, the settling of the principles by a unanimous Supreme Court will bring to an end debate that has been a feature of contract cases for years. *Bathurst* should have the same silencing effect that *Capita Insurance*[120] has had in the United Kingdom. In *Thomas v McIntosh*,[121] the first New Zealand case to cite *Bathurst*, the Court of Appeal simply stated:[122]

> We need not survey the authorities on contract interpretation, about which there is no dispute before us. We adopt the orthodox approach derived from the Supreme Court decisions in *Bathurst Resources Ltd v L&M Coal Holdings Ltd* and *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*. The only point we need emphasise is that while background material is relevant, text remains centrally important.

6.2. The focus will now be on the practical application of the *Bathurst* principles. As the above analysis shows, this will not always be a straightforward exercise, and there is room for imaginative advocay.

More rigorous approach to evidence

6.3. Parties will need to be more discerning about what they put before the court. *Bathurst* forewarns that ss 7 and 8 of the Evidence Act, and other provisions such as ss 23 and 25, will readily be invoked to control the use of irrelevant, unhelpful or excessive extrinsic material. Judges are likely to, and must, exercise tighter control.

6.4. In my earlier paper I discussed several ways of ensuring, a more disciplined use of extrinsic material.[123] I will not repeat the detail. They are in summary:

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118 At [270].
119 At [269](e), [260].
120 *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, [2017] AC 1173.
121 *Thomas v McIntosh* [2021] NZCA 344.
122 At [56] per Miller J (giving the reasons of the Court).
123 Jumping off the page, above n 7, at [3.97]-[3.85].

(a) ***Full particulars***. Parties should provide in their pleadings particulars of (i) the nature of the surrounding circumstances on which they rely (whether factual matrix, prior negotiations or subsequent conduct) and (b) their assertions as to the relevance and effect of those facts on the interpretation of the disputed words. Assertions of an implied term (or rectification or estoppel by convention) should also be fully particularised. The scope of the evidence and discovery would then be constrained by the pleaded facts.

(b) ***Limited discovery***. Discovery should be carefully tailored, to discourage parties from trawling through mountains of documents in the hope of striking "black gold". In the *Forsgren* case, for example, Forsgren sought discovery of all the negotiations between NZTA and/or the Crown (or their agents) and RBL leading up to the execution of a compensation agreement. This was not even the agreement in issue between the parties.[124] The new proposals on discovery, if implemented, should also encourage restraint.

(c) ***Advance admissibility rulings***. If a party's witness briefs contain inadmissible evidence then objection should be made before the trial in accordance with rule 9.11 of the High Court Rules. Judges are now more willing to exclude evidence up front, where that can be done fairly. In *Bathurst* the briefs of L&M's factual witnesses contained many statements about what those witnesses intended when negotiating the agreement, and their beliefs as to what the contract terms meant. Bathurst gave notice before trial challenging this evidence as being inadmissible statements of subjective understanding or recollection. Dobson J allowed it in *de bene esse*, then later ruled that it was inadmissible.[125] Such evidence is now more likely to be excluded in advance.

Giving advice

6.5. Those advising on disputes about interpretation will need to look at the prior negotiations and any subsequent conduct. Careful lawyers do this anyway. The guidance given in *Bathurst* should help identify the limited material likely to be relevant and helpful.

Drafting

6.6. For those at the frontline who draft contracts, this case highlights the importance of parties, especially commercial parties, saying what they mean. A few extra words and "a bit of imaginative pessimism" in drafting the *Bathurst* contract might have prevented the dispute.[126] Although extrinsic evidence may be relevant, the text remains of central importance. If the parties do not provide for a contingency then, as in *Bathurst*, they cannot count on the court being willing to fix up the bargain. The loss may just lie where it falls.

7. Conclusion

7.1. The settling by the Supreme Court of the principles governing extrinsic evidence and implication of terms is to be welcomed. For the individual parties, the journey since December 2016 (when

[124] *Restaurant Brands v Forsgren NZ Ltd* [2019] NZHC 602. Associate Judge Smith declined to make such a wide order, and so qualified it by the words "which include breakdowns, explanations, evidence or support for any of the figures making up the compensation payment…".

[125] *Bathurst*, HC, at [37]-[39, and Ruling 1 (annexed to the judgment) issued 19 February 2018.

[126] Matt Farrington "In-house lawyers, Bathurst Resources, the Supreme Court and Humpty Dumpty", Linkedin.com, 20 July 2021.

the proceeding was filed) has been an arduous one, and the war may not yet be over.[127] It seems fitting that I end with the following lament, written by a Coaster in 1884:[128]

Damn Denniston
Damn the track
Damn the way both there and back
Damn the wind and damn the weather
God damn Denniston altogether

……...

[127] *Bathurst*, above n 1, at [263] per Glazebrook, O'Regan and Williams JJ, and at [195], fn 194 per Winkelmann CJ and Ellen France J.

[128] J T Ward, "Recollections of a Lifetime on the West Coast of the South Island", *Westport News*, 21 September 1884.