IN THE SUPREME COURT OF NEW ZEALAND

I TE KŌTI MANA NUI

SC 29/2020
[2021] NZSC 85

BETWEEN	BATHURST RESOURCES LIMITED First Appellant
	BULLER COAL LIMITED Second Appellant
AND	L & M COAL HOLDINGS LIMITED Respondent

Hearing:	8 and 9 October 2020
Court:	Winkelmann CJ, Glazebrook, O'Regan, Ellen France and Williams JJ
Counsel:	J E Hodder QC, R J Gordon and D P MacKenzie for Appellants A R Galbraith QC, D R Kalderimis and N K Swan for Respondent
Judgment:	14 July 2021

JUDGMENT OF THE COURT

A **The appeal is allowed. The judgments of the High Court and Court of Appeal are set aside and judgment is entered for the appellants.**

B **The application to adduce further evidence is dismissed.**

C **The respondent must pay the appellants costs of $30,000 plus usual disbursements. We certify for second counsel.**

D **Costs should be re-determined in the Courts below in light of this judgment.**

SUMMARY OF RESULT
(Given by the Court)

[1] This appeal concerns the proper interpretation of a contract for the sale of coal mining rights. How to interpret the words of a written contract is a perennial issue in the law, and while over time the test to be applied to find the meaning of those words has become settled, the issue of what evidence outside the words of the contract should be allowed to assist with this task continues to be debated. So too the nature of the test for implication of terms in a contract.

[2] All members of the Court have agreed on the approach to the admissibility of extrinsic evidence in cases of contractual interpretation.[1] The Court has also agreed on the test for the implication of terms.[2]

[3] The Court is unanimous on the interpretation of cl 3.4 of the contract between the parties.[3] Members of the Court have taken different views on the construction of cl 3.10 of the contract. The majority have found in favour of the appellants on this point, which is dispositive.[4] Accordingly, the appeal is allowed. The respondent must pay the appellants costs of $30,000 plus usual disbursements. Costs in the Courts below should be re-determined in light of this judgment. Winkelmann CJ and Ellen France J would have dismissed the appeal.[5]

[4] The reasons of the Court for this result are given in the separate opinions delivered by:

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1 At [54]–[90] per Winkelmann CJ and Ellen France J and [232](a) per Glazebrook, O'Regan and Williams JJ.
2 At [106]–[117] per Winkelmann CJ and Ellen France J and [232](b) per Glazebrook, O'Regan and Williams JJ.
3 At [134]–[158] per Winkelmann CJ and Ellen France J and [232](c) per Glazebrook, O'Regan and Williams JJ.
4 At [281] per Glazebrook, O'Regan and Williams JJ.
5 At [223].

REASONS

WINKELMANN CJ AND ELLEN FRANCE J

Table of Contents

Introduction

[5] The dispute between the parties to this appeal arises in the context of the sale of coal exploration permits over parts of the Denniston and Stockton Plateaus. These

plateaus lie within the Buller Coalfield, which is an historic mining area in the South Island of New Zealand.

[6] In June 2010, Bathurst Resources Ltd (Bathurst) agreed to purchase coal exploration rights and mining-related applications from L & M Coal Holdings Ltd (L&M). Two performance payments, each of USD 40 million, were agreed to be payable when 25,000 tonnes, and then one million tonnes, of coal had been "shipped from the Permit Areas". Then, in 2012, Bathurst and L&M entered into a deed (the Third Deed) varying the original written Agreement for Sale and Purchase (the Agreement) to provide that payment of the first performance payment could be deferred at Bathurst's election while Bathurst continued to pay royalties under a related royalty deed.

[7] After more than 25,000 tonnes of coal was mined and trucked out, Bathurst suspended mining and stopped paying royalties, apart from royalties on a small amount of stockpiled coal. It has yet to pay the first performance payment. Bathurst says that without mining, no royalties are due and so, since it is continuing to pay the royalties due under the royalty deed (which are none), it can continue to defer payment of the first performance payment.

[8] Bathurst and L&M dispute the proper interpretation of the Agreement and the amending Third Deed. There are two core issues between them. The first is as to whether the first performance payment obligation has been triggered in terms of the Agreement, an issue which turns on the interpretation of the expression "shipped from the Permit Areas" in cl 3.4 of the Agreement. The second issue is whether, if the first performance payment obligation has been triggered, Bathurst is contractually entitled to continue to defer that payment when it is not paying any royalties.

[9] In the High Court, in order to support their respective cases for a particular interpretation, the parties produced extensive evidence which was extrinsic to the written contractual documents. This included evidence of pre-contractual negotiations; of what the parties intended the agreements should mean; of surrounding circumstances, both before and after execution of the two documents, which are said to show the commercial purpose of the agreements; and evidence of the parties'

post-execution conduct. The High Court[6] and Court of Appeal[7] each found in favour of L&M on the substantive issues, holding that the obligation to make the first performance payment had been triggered and could not be deferred when no royalties were being paid. However, they differed to some extent in their approach to the admissibility of the extrinsic evidence adduced by the parties.

[10] The test for the admissibility of extrinsic evidence to assist with the task of contractual interpretation and for the implication of contractual terms are issues of general or public importance.[8] Leave was therefore granted to Bathurst to appeal to this Court. The grant of leave included the following indications to counsel to assist in their preparation for the appeal:[9]

(a) The Court would not revisit the principles of contractual interpretation that were set out by this Court in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd.*[10]

(b) However, since *Firm PI* did not address the approach to be taken to the admissibility or otherwise of evidence of prior negotiations or subsequent conduct,[11] we would hear argument on these issues.

(c) We would hear argument on the distinction between interpretation and implication and the appropriate test for the latter.

Factual background

[11] Prior to 2010, L&M was the holder of two exploration permits on the Denniston and Stockton Plateaus.[12] An area known as Escarpment, on the Denniston

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6 *L&M Coal Holdings Ltd v Bathurst Resources Ltd* [2018] NZHC 2127 (Dobson J) [HC judgment].

7 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2020] NZCA 113 (Kós P, Gilbert and Goddard JJ) [CA judgment].

8 Senior Courts Act 2016, s 74(2)(a).

9 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2020] NZSC 73 [Leave judgment].

10 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [60]–[63], [77]–[79], [84] and [88]–[93] per McGrath, Glazebrook and Arnold JJ (Elias CJ and William Young J reserving their positions).

11 On subsequent conduct, counsel were also asked to address the comments of Thomas J in *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 at [113].

12 L&M held these permits through its subsidiary, L&M Coal Ltd.

Plateau, was seen as the most attractive development project for coal extraction. That was because it contained significant volumes of high quality coking coal. The characteristics of coking coal are such that it can be used in the steel-making process. It is of higher value than thermal coal. Thermal coal is degraded coking coal which has lost its coking properties through the process of oxidisation. Thermal coal was also present at Escarpment, a natural by-product of the presence of coking coal.

[12] By 2008, L&M was seeking to either develop this coal resource with a partner, or to sell the development prospects to others. In 2009, Mr Geoff Loudon, a director of L&M's parent company, met with Mr Hamish Bohannan, then Chief Executive of Bathurst. Bathurst already had mining interests in the state of Kentucky in the United States and was seeking opportunities elsewhere. The parties discussed the potential sale, and in December 2009 Bathurst made a formal offer, with a conditional consideration of USD 110 million. In February 2010, a binding letter of intent was signed, and on 10 June 2010 the Agreement was executed.[13]

[13] The transaction was structured as a sale of all the shares in the company which held the assets – Buller Coal Ltd.[14] The assets included two exploration permits and the rights associated with them, and an outstanding application for a mining permit for Escarpment, which fell within the area of one of the exploration permits.[15] The mining permit for Escarpment was granted shortly after the Agreement was entered into, on 24 June 2010.

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13 The original Bathurst party to the Agreement was at the time called Bathurst Resources Limited. Although that is the same name as the first appellant, it is not the same legal entity. The original Bathurst contracting party has been renamed BR Coal Pty Ltd and is now a non-active company, following a reorganisation by way of a scheme of arrangement whereby all of the shares in BR Coal were transferred to the first appellant. On 7 June 2013, a deed of novation was entered into in recognition of the reorganisation, which had the effect that BR Coal's obligations under the Agreement were novated and assigned to the first appellant. None of the issues turn upon the identity of the original contracting party and the novation. We therefore use the name Bathurst Resources Ltd, and the abbreviation Bathurst, without differentiating between the original contracting party and the novated party.

14 At the time of the Agreement, Buller Coal Ltd's name was L&M Coal Ltd. It changed its name to Buller Coal Holdings Ltd on 9 November 2010 and then to Buller Coal Ltd on 28 February 2011. To avoid confusion, we refer to it as Buller Coal throughout.

15 The exploration permits were EP 40628 and EP 51708. The mining permit for Escarpment was MP 51279. The assets transferred on sale also included access agreements, resource consent applications and other records and information.

[14] The payment for these rights included cash consideration, performance payments, performance shares and royalties payable under a royalty deed, the draft of which was attached as a schedule to the Agreement.[16] The Agreement provided for the payment of USD 120 million in instalments as follows:

(a) A deposit of USD 5 million.

(b) A further USD 35 million (the "Settlement Cash Consideration" as defined in the Agreement) payable upon settlement.

(c) Two performance payments – USD 40 million within 30 days of the date on which the first 25,000 tonnes of coal had been "shipped" from the permit areas, and another USD 40 million within 30 days of the date on which the first one million tonnes of coal had been "shipped" from the permit areas.

[15] As noted, part of the price paid by Bathurst for the assets was the ongoing obligation to make royalty payments. The primary parties to the royalty deed were L&M and Buller Coal. The royalty deed provided that royalties on all coal sales were initially to be paid at a rate of 10 per cent of gross sales revenues, dropping to five per cent after the payment of the first performance payment, and then to 1.75 per cent after the payment of the second performance payment. The deed clarified that the obligation to pay royalties ran until the End Date, defined as the later to occur of the end of the term of both exploration permits (and any mining permit issued from them), or the final cessation of mining operations in the permit areas. There was also clarification that royalties would be payable at a rate of 10 per cent until the End Date in the event the first performance payment was not made.

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[16] The Agreement also required Bathurst to complete a guarantee and security deed, again attached as a schedule to the Agreement, by which Buller Coal would guarantee Bathurst's performance and provide a first ranking security over all of the assets to secure payment of all amounts payable. The Agreement and the related deeds imposed obligations on both Bathurst and Buller Coal. For ease of comprehension, we refer to the rights, obligations and conduct of both parties as Bathurst's rights, obligations and conduct. For the purposes of this judgment, it is not necessary to differentiate.

[16] Beyond the payment of royalties, the royalty deed imposed obligations upon Bathurst relating to its exploitation of the permits as follows:

> 8.1 Throughout the currency of this Deed, [Bathurst] shall:
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> (a) satisfy the minimum work programme in respect of … each of the Permits;
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> (b) conduct mining operations in accordance with good mining practice and with a view to maximisation of Coal sales at the best available price;
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> (c) otherwise keep each of the Permits in good standing; and
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> (d) notify [L&M] of the grant of any mining permit within the Permit Areas, within 5 days of receiving notification.

[17] The final part of the agreed price for the mining rights was the issue of performance shares. Bathurst agreed to issue to L&M, or its nominee, fully paid ordinary shares amounting to five per cent of the post-issue share capital of Bathurst. The obligation to issue the performance shares was triggered on the first to occur of two events: the second performance payment falling due or Bathurst receiving notice of an offer from a third party to acquire more than 50 per cent of its shares. If Bathurst failed to issue these shares when the obligation was triggered, then in lieu of the issue of shares, the royalty rate in terms of the royalty deed would increase by two per cent.

[18] Clause 9 of the Agreement detailed procedures and rights on default. Clause 9.3 provided that if the defaulting party did not comply with the terms of the settlement notice, the non-defaulting party could:

> (a) sue the defaulting Party for specific performance; and/or
>
> (b) cancel this Agreement; and/or
>
> (c) sue the defaulting Party for damages.

Clause 9.7 provided that these same rights were available in the event of non-payment of performance payments, aside from the right to cancel.

[19] The Agreement contained an "Entire Agreement" clause stipulating that the written agreement constituted the entire agreement between the parties on the transfer

of the assets and that it superseded and extinguished all earlier negotiations, understandings and agreements, oral or written, between the parties.

[20] The Agreement was subject to a number of conditions, including finance conditions and the completion of a Definitive Feasibility Study (DFS) on the Escarpment Mine to the "reasonable satisfaction" of Bathurst. The content of this study was relied upon by Bathurst as material to the issues of interpretation, although it is a document which was completed after the Agreement was executed.

[21] The Agreement became unconditional and settled in November 2010, with the payment of the Settlement Cash Consideration of USD 35 million. Bathurst needed to raise substantial amounts of capital to meet its payment obligations under the Agreement. Although there was initial success with that capital raising,[17] the project was then subject to substantial delay. The Escarpment Mine took longer to develop than had been projected because of difficulties in obtaining resource consents.

[22] During this period of delay, the international price of coking coal collapsed. The price had peaked in mid-2011 at around USD 330 per tonne. By 2016, it had fallen to what was to be the low point of USD 80 per tonne.

[23] The parties enjoyed a constructive and cooperative relationship as Bathurst worked towards being able to exploit the rights it had purchased. In particular, L&M was flexible in its approach to enforcing its contractual rights in order to help Bathurst get the project up and running. The parties entered into the Third Deed of Amendment to the Agreement in August 2012. Although, as the name of the document suggests, this was the third amendment, the earlier two are not significant to the issues on appeal.

[24] The Third Deed addressed whether Bathurst would be in breach of contract if it failed to pay the first performance payment when due but continued to pay royalties at the initial level. It is a very short document. It is common ground that there are errors in its expression which add difficulty to the task of its interpretation. We highlight three aspects of the Third Deed as bearing upon its interpretation:

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[17] Bathurst raised approximately AUD 165 million through two equity raising rounds in the 2010/2011 financial year.

(a) The purpose of the Third Deed is stated in the background recitals as: "This Deed records the parties' agreement to clarify a matter in relation to the Performance Payments under the Agreement."

(b) Clause 2, the critical operative provision, appears under the heading "Amendment to Agreement". It records that the Agreement is amended by the Third Deed by adding a new clause, cl 3.10, as follows:[18]

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

(c) Finally, cl 3 records:[19]

> **NO WAIVER**
>
> For the avoidance of doubt, nothing in this Deed constitutes a waiver by [L&M] of any of its rights as referred to in clause 9.7 of the Agreement, so long as payments are made in accordance with the Royalty Deed.

[25] It was not until November 2013 that Bathurst obtained the resource consents it needed for Escarpment, and even then work on the mine could still not commence because of delays in obtaining the necessary access rights. Throughout this period of delay, coking coal prices continued to drop.

[26] In February 2014, Bathurst announced to the market that it would be deferring "ramping up" production at Escarpment, indicating there would be only limited mining of coking coal.[20] Bathurst provided as part of the reason for this decision that it expected operating costs at Escarpment to range from about USD 120 per tonne on start-up, dropping to less than USD 90 per tonne once production ramped up to about

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18 The Third Deed purported to insert a new cl 3.9, although the draftsperson seems to have overlooked the fact that the first amendment had already inserted a new cl 3.9. So although the clause is numbered cl 3.9 in the Third Deed, it has been treated by all parties as cl 3.10.

19 The provision mistakenly refers to the rights of the "Purchaser" rather than the "Vendor": see below at n 175.

20 Bathurst announced that it would only mine "sufficient coal to complete market qualification for coking coal supply to steel producers, principally in Japan and India".

one million tonnes per annum. At the time of the announcement, the international spot price for coking coal was around USD 120 per tonne.

[27] The required resource and access consents were in place by June 2014.[21] The first coal was recovered from Escarpment in September 2014. The coal extracted and sold by Bathurst was non-coking coal and was sold domestically to the Holcim (New Zealand) Ltd (Holcim) cement works near Westport. By September 2015, 25,000 tonnes had been extracted and moved off the permit areas. That was the quantity stipulated in cl 3.4 of the Agreement as triggering the first performance payment obligation. However, the USD 40 million was not paid. Through the rest of 2015 and early 2016, Bathurst continued to mine Escarpment and to pay royalty payments on the coal that was sold, which, in terms of cl 3.10, meant Bathurst could delay paying the USD 40 million payment.

[28] By early 2016, the price for coking coal had reached a low of USD 80 per tonne. Holcim had also confirmed that it would be closing its Westport factory.

[29] In March 2016, Bathurst announced that from May 2016 it would suspend mining operations at Escarpment. It has not mined Escarpment since then. Bathurst had also acquired permits at West Whareatea and Coalbrookdale in 2011, both adjacent to Escarpment, as part of its wider "Buller Project". In 2017, it acquired the Sullivan Coal Mining Licence, also adjacent to Escarpment. Further, Bathurst formed a joint venture with Talley's Group Ltd, and in August 2017 that joint venture company, BT Mining, acquired former mining assets of Solid Energy New Zealand Ltd on the Buller Coalfield. Bathurst has since been mining those assets.

[30] As a consequence, the constructive relationship that previously existed between the parties has broken down, with each party expressing very different views as to the meaning of the Agreement.

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[21] The necessary authority to enter and operate Escarpment was obtained in June 2014.

Summary of the parties' submissions

[31] As noted above, the first issue between the parties is whether the first performance payment obligation has been triggered. This issue concerns the meaning of the expression "shipped from the Permit Areas", which appears in cl 3.4 of the Agreement. It is L&M's case that the obligation to make the first performance payment was triggered by Bathurst's extraction and shipment off-site of 25,000 tonnes of non-coking coal, which it sold into the New Zealand market.

[32] Bathurst's case is that the first performance payment is only triggered when the first 25,000 tonnes of coal is extracted and exported by ship – it argues that "shipped" in cl 3.4 is to be given its ordinary literal meaning, being carriage by ship. This is, it says, a necessary construction, because the commercial purpose of the Agreement was always to extract coking coal from Escarpment for sale into overseas markets. Coal that is exported is always transported by ship in this way.

[33] The second issue is the effect of the new cl 3.10, inserted into the Agreement by the Third Deed. This issue only arises if the first performance payment has been triggered.

[34] L&M says that Bathurst's entitlement to defer the payment of the first performance payment lasted only so long as it was continuing to pay royalties flowing from ongoing mining – paying no royalties to reflect the absence of mining and coal sales does not contractually justify deferral. L&M makes three arguments, in the alternative, in support of this proposition:

(a) this interpretation flows from the words of the Agreement, interpreted within the commercial context at the time the Third Deed was negotiated; or

(b) if the contractual wording does not sufficiently spell out that the relevant royalties must be from ongoing mining, such a term must be implied to prevent Bathurst from subverting the parties' bargain; or

(c) even if the contractual documentation is properly construed to allow deferral of the first performance payment in this way, Bathurst's actions in ceasing mining and invoking cl 3.10 amounted to using a contractual discretion for an improper purpose.

[35] Bathurst says that the straightforward reading of cl 3.10 is that it gives Bathurst flexibility as to the date of making the performance payments, so long as it complies with the royalty deed. It says that this interpretation of the express words of cl 3.10 makes good linguistic and commercial sense without requiring the implication of a term. Moreover, says Bathurst, the term that L&M argues should be implied is not capable of clear expression. As to the proper purpose argument, Bathurst says that the alleged contractual discretion is not of a type to engage the court's oversight. In the alternative, if the contractual discretion doctrine is engaged, Bathurst's actions have been in good faith and for proper purposes.

[36] Both the High Court[22] and Court of Appeal[23] found in favour of L&M. They found that the first performance payment obligation had been triggered, rejecting Bathurst's argument as to the meaning of "shipped". They also found that cl 3.10 was to be construed to allow deferral only for so long as royalties were actually being paid by Bathurst, neither finding it necessary to imply a term to that effect. The Court of Appeal found that the conditional right to suspend the first performance payment obligation applied only so long as L&M continued to receive royalties from continuing mining and sales at a level not materially less than that which had resulted in the USD 40 million payment being triggered in the first place.[24] Bathurst says that while denying it was doing so, the Court of Appeal's approach to interpreting cl 3.10 involved nothing less than the implication of a term.

[37] In the High Court, Dobson J said, however, that had he been required to do so, he would have implied a term limiting the circumstances in which the cl 3.10 deferral mechanism could be relied upon to where Bathurst was engaged in ongoing mining in the permit areas.[25]

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22 HC judgment, above n 6, at [226].
23 CA judgment, above n 7, at [104]–[108].
24 At [96].
25 HC judgment, above n 6, at [189]–[190].

[38] The effect of these judgments is that, pending the outcome of this appeal, Bathurst is obliged to pay L&M USD 40 million.[26]

[39] The parties' arguments are rehearsed on this further appeal. Before addressing them, it is necessary to set the parameters of the evidence which the courts may take into account when interpreting written contractual documentation and the circumstances in which a term will be implied into a contract – necessary because the law in each of these areas remains unsettled in New Zealand.

Evidence available to assist in contractual interpretation

[40] Just where to draw the line on the material extrinsic to the written contract that can be admitted into evidence is an important issue in contractual interpretation cases.[27] This material typically falls into three categories: the commercial context and purpose of the contract, evidence of prior negotiations, and evidence of subsequent conduct. A number of policy objectives underlie the question of whether this evidence should be admissible: the desirability of providing the certainty needed to facilitate the efficient conduct of commerce; of holding people to the bargains they make; and of supporting access to justice through the efficient and just conduct of proceedings.[28] Although views may differ as to which approach to admissibility best serves any or all of these policy objectives, there can be little doubt that clarity in the law as to what evidence is admissible is highly desirable.

[41] There is a very considerable volume of case law in other jurisdictions and in New Zealand that traverses this issue. In each case, the approach to admissibility is shaped by the test adopted for contractual interpretation, because only evidence relevant to the application of that test is admissible. We start our discussion of the test for contractual interpretation with the following passage from the judgment of

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[26] Dobson J found that L&M was entitled to a declaration that the first performance payment had become due and owing, and to an order that Bathurst must pay it: at [226].

[27] Oral contracts raise different considerations, which we need not address here. However, for discussion, see David McLauchlan "Contract Formation and Subjective Intention" (2017) 34 JCL 41; and *Thorner v Major* [2009] UKHL 18, [2009] 1 WLR 776 at [82]–[83].

[28] For a discussion of these policy objectives, see Donald Nicholls "My kingdom for a horse: the meaning of words" (2005) 121 LQR 577 at 587–588; and Andrew Tipping "The subjective and objective dimensions of contract interpretation" [2020] NZLJ 388 at 390–391.

Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society*:[29]

> (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
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> (2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
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> (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.
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> (4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd*.
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> (5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Compania Naviera SA v Salen Rederierna AB*:
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> > "if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense."

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[29] *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912–913 (citations omitted).

[42] In *Chartbrook Ltd v Persimmon Homes Ltd*, Lord Hoffmann revisited the exclusionary rule he described in (3) in respect of pre-contractual negotiations.[30] Lord Hoffmann accepted that there were no conceptual limits to what could be admitted as evidence of background. In principle, he accepted that previous negotiations may be relevant and that it:[31]

> … would not be inconsistent with the English objective theory of contractual interpretation to admit evidence of previous communications between the parties as part of the background which may throw light upon what they meant by the language they used.

Nevertheless, he said that policy considerations justified the continuation of the exclusionary rule, and grounds were not made out for departing from it. He said that the admission of such evidence would add to the cost of advice and litigation and create uncertainty; yet there was no evidence that the rule was impeding the development of the law or causing injustice. Evidence of prior negotiations is usually irrelevant to the question the court has to decide, and the claims of rectification and estoppel by convention, operating outside the rule, act as safeguards against injustice.[32]

[43] Recent New Zealand law in relation to contractual interpretation has developed with *Investors Compensation Scheme* as the starting point. This Court's decision in *Firm PI* can be regarded as settling the general approach to contractual interpretation.[33] McGrath, Glazebrook and Arnold JJ summarised the approach in this way:

> [60] … the proper approach is an objective one, the aim being 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". This objective meaning is taken to be that which the parties intended. While there is no conceptual limit on what can be regarded as "background", it has to be background that a reasonable person would regard as relevant. Accordingly, the context provided by the contract as a whole and any relevant background informs meaning.

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30 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101.

31 At [33].

32 At [33]–[42]. Lord Hoffmann would accept that such evidence may be admitted to prove that the parties habitually used words in an unconventional sense, the so-called "private dictionary" principle.

33 *Firm PI*, above n 10.

> [61] The requirement that the reasonable person have all the background knowledge known or reasonably available to the parties is a reflection of the fact that contractual language, like all language, must be interpreted within its overall context, broadly viewed. Contextual interpretation of contracts has a significant history in New Zealand, although for many years it was restricted to situations of ambiguity. More recently, however, it has been confirmed that a purposive or contextual interpretation is not dependent on there being an ambiguity in the contractual language.
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> …
>
> [63] While context is a necessary element of the interpretive process and the focus is on interpreting the document rather than particular words, the text remains centrally important. If the language at 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. But the wider context may point to some interpretation other than the most obvious one and may also assist in determining the meaning intended in cases of ambiguity or uncertainty.
>
> (footnotes omitted)

[44] As can be seen, the Court adopted Lord Hoffmann's formulation of the test for contractual interpretation.[34] The Court did not address issues of admissibility in any detail, but it endorsed Lord Hoffmann's statement that there is no conceptual limit to what can be regarded as admissible "background".[35] And while it emphasised the primacy of the text to the task of determining meaning, the Court confirmed that it is unnecessary for there to be an ambiguity in the wording of a contract before a court can resort to background or context.[36]

[45] The Court in *Firm PI* also clarified the principle of commercial absurdity in relation to contractual interpretation, which is often linked to the use of extrinsic material. McGrath, Glazebrook and Arnold JJ, while emphasising the primacy of the text, accepted that "if a particular interpretation produces a commercially absurd result, that may be a reason to read the contract in a different way than the language might suggest".[37] However, this does not mean that a court should conclude that a

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34 This formulation was itself of older derivation, as was acknowledged by the United Kingdom Supreme Court in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, [2017] AC 1173 at [10].

35 Subject, the Court said, to the exception in relation to pre-contractual negotiations, which it did not address: at [60], n 39 and [61], n 42.

36 See also *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [4] per Blanchard J, [22]–[23] per Tipping J, [64] per McGrath J and [151] per Gault J (expressing agreement with the reasons of Blanchard J).

37 *Firm PI*, above n 10, at [89] (footnote omitted).

contract does not mean what it says simply because this interpretation would be unduly favourable to one party. There is a need for caution in this area, when "commercial absurdity tends to lie in the eye of the beholder",[38] and courts are not necessarily well placed for the assessment of what can be industry-specific considerations. Moreover, the compromises that occur in commercial negotiations may not be easily perceived or understood by a court in hindsight, even if exposed as part of the relevant background.[39] Therefore, the conclusion that an ordinary and natural meaning of contractual language produces a commercially absurd result "should be reached only in the most obvious and extreme of cases".[40]

[46] The objective approach as articulated in *Firm PI* is one grounded in the policy objectives identified above: the desirability of providing the certainty needed to facilitate the efficient conduct of commerce; of holding people to the bargains they make; and of supporting access to justice through the efficient and just conduct of proceedings. Giving primacy to the written words of the agreement accords with the policy of providing commercial certainty. It also recognises that since the written contract contains the words the parties chose to record their agreement, the language used to do so has to be important. But by allowing a contextual reading of those words, the *Firm PI* approach recognises both that words have to be read in context and that the promotion of commercial certainty should not be allowed to defeat what the parties actually meant by the words in which they recorded their agreement. The objective approach to this contextual assessment is a legal construct designed as the best way of reliably determining the true agreement as recorded in the words of the contract. It rejects the parties' subjective evidence of intent as irrelevant to what both parties meant and as generally unreliable. Rather, the court (embodying the reasonable person) assesses the evidence reasonably available to both (or all) of the parties at the point of contract which could bear upon the meaning of those words. Overall, this is a test which best supports the aim of the efficient and just conduct of proceedings.

[47] It is also worth noting that the majority in *Firm PI* acknowledged "the scope for resort to background is itself contextual".[41] For example, the approach to extrinsic

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38 At [90].
39 At [91].
40 At [93].
41 At [62].

evidence may be more restrictive where the parties are aware their contract may be relied upon by third parties. The significance of interested third parties for the admissibility of extrinsic evidence in contractual interpretation was expanded on by this Court in *Green Growth No 2 Ltd v Queen Elizabeth the Second National Trust* (in that case, in the context of registered documents).[42]

[48] The Court in *Firm PI* did not address the exclusionary rules concerning prior negotiations and subsequent conduct as articulated by Lord Hoffmann. But that issue, alongside the broader issue of admissibility of extrinsic evidence, has been traversed in other cases, both before and since *Firm PI*. New Zealand courts have approached the issue of admissibility by reference to a standard of relevance.[43] As a result, New Zealand courts have continued to exclude evidence of uncommunicated subjective intent as irrelevant to the objective approach to contractual interpretation.[44] But the courts have also, reasonably consistently, allowed evidence of prior negotiations to the extent those negotiations would affect the way the language adopted is interpreted.[45]

[49] Nevertheless, around the edges of this broad consensus lie areas of uncertainty, in particular as to the admissibility of subsequent conduct and as to the extent of material that can fall within the rubric of the factual matrix. Given the variety of possible approaches evident in these areas in the case law, and evident even in the approaches to admissibility taken by the Courts below in this case, we think it a fair

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42 *Green Growth No 2 Ltd v Queen Elizabeth the Second National Trust* [2018] NZSC 75, [2019] 1 NZLR 161 at [60] and [73]–[74] per William Young and O'Regan JJ and [151] per Glazebrook J (concurring).

43 See, for example, *Firm PI*, above n 10, at [60]; *Gibbons Holdings*, above n 11, at [53] and [56] per Tipping J; and *AFFCO New Zealand Ltd v New Zealand Meat Workers and Related Trades Union Inc* [2017] NZSC 135, [2018] 1 NZLR 212 at [38].

44 See, for example, *New Zealand Air Line Pilots' Association Inc v Air New Zealand Ltd* [2017] NZSC 111, [2017] 1 NZLR 948 at [79] and [83]–[86] per Arnold, O'Regan and Ellen France JJ, [140]–[141] per William Young J and [199] per Glazebrook J (concurring with the majority on this point).

45 See, for example, *Manning v Manning* [2013] NZCA 671, (2013) 29 FRNZ 586 at [45]–[59]; and *I-Health Ltd v iSoft NZ Ltd* HC Auckland CIV-2006-404-7881, 8 September 2010 at [40] (upheld on appeal: *i-Health Ltd v iSoft NZ Ltd* [2011] NZCA 575, [2012] 1 NZLR 379). However, as prior negotiations are part of the contractual background, the ability to resort to them will be contextual and in some cases restricted: see above at [47].

account that the law in New Zealand remains unsettled.[46] For this reason, and because there has been little discussion to date of the application of the Evidence Act 2006 in this area, we consider there is a need for clarification of the law. This case raises many of the issues as to the admissibility of extrinsic evidence that arise in contractual interpretation cases and we therefore propose to give guidance in this judgment as to those issues.

Parties' submissions on the admissibility of extrinsic evidence

[50] It is common ground between the parties that the issue of admissibility of extrinsic evidence is an issue of evidence, and is therefore governed, in New Zealand, by the Evidence Act. Bathurst proposes that the touchstone for admissibility is "whether the evidence is capable of demonstrating, objectively, what the meaning is", which can only be found in evidence that is "mutual, overt and proximate". On this approach, evidence of a party's subjective intent is not admissible because it is non-mutual.

[51] Bathurst submits this approach is consistent with s 7 of the Evidence Act because evidence that falls outside this gateway for admissibility, which it accepts is narrow, is not relevant.

[52] L&M also submits that the touchstone as to admissibility must be relevance in accordance with s 7 of the Evidence Act. While it accepts that evidence of that which is "mutual, overt and proximate" will often be more helpful than evidence which lacks these characteristics, as a test for admissibility it is both "inadequate and over-prescriptive". Some evidence which fulfils these criteria may be inadmissible as having no bearing on the disputed interpretation. On the other hand, evidence which is neither mutual nor overt "*may* be probative" if it "tend[s] … to suggest the correctness of one possible interpretation of the relevant words". It gives an example of evidence which is not overt but which may reveal a tacit understanding. It submits

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[46] See Jeremy Finn, Stephen Todd and Matthew Barber *Burrows, Finn and Todd on the Law of Contract in New Zealand* (6th ed, LexisNexis, Wellington, 2018) at 198; Stephen Todd and Matthew Barber *Laws of New Zealand* Contract (online ed) at [110]; and Tipping, above n 28, at 389. See also below at [84]–[88] as to the different approaches to the admissibility of subsequent conduct in *Gibbons Holdings*, above n 11.

the "most important requirement for extrinsic evidence is a *probative* or *cogent* link" to the text requiring interpretation – it must be "helpful".

[53] Regarding prior negotiations, L&M submits that this evidence is by definition mutual, and that if the parties' understanding suggests an "objectively apparent consensus as to meaning operating between the parties", it may be "helpful". As to subsequent conduct, L&M submits that such evidence "can be probative without being mutual", contrary to Bathurst's position, as the "focus is on cogency".

The approach to admissibility in New Zealand

[54] The issue of the admissibility of evidence is determined by the laws of evidence.

[55] The approach to be taken to contractual interpretation is governed by the law of contract, but it is the law of evidence that ensures the trial court's inquiry focusses only on evidence that will materially assist in applying that test. The rules of evidence do not, therefore, operate independently of the law of contractual interpretation. Rather, the law of evidence serves the law of contract. As we discuss more fully below, it is the law governing the interpretation of contracts which fundamentally shapes what is relevant, and what is therefore admissible, extrinsic evidence.[47]

[56] The statement that the issue of admissibility is determined by the law of evidence is not without controversy. It has sometimes been suggested that the parol evidence rule governs the admissibility of extrinsic evidence.[48] The parol evidence rule provides that when parties have reduced a contract to writing, extrinsic evidence is inadmissible to add to, vary or contradict the writing.[49] The issue of whether the

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47 This interaction between the law of contractual interpretation and the admissibility of extrinsic evidence is apparent in the case law in discussions of whether evidence is helpful to that task of interpretation. See, for example, *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1384–1385 per Lord Wilberforce.

48 See the discussion in *Zurich Insurance (Singapore) Pte Ltd v B-Gold Interior Design & Construction Pte Ltd* [2008] SGCA 27, [2008] 3 SLR(R) 1029 at [32]–[33].

49 Finn, Todd and Barber, above n 46, at 178. There are also certain preconditions for the rule to apply. For example, the written agreement must be intended to be the whole agreement, and the contract must not be voidable for illegality, fraud, mistake or any other reason.

rule is properly one of evidence or of substantive law has been hotly debated.[50] But it is well settled that the parol evidence rule does not govern the admissibility of extrinsic material in relation to contractual interpretation, as the interpretation of a contract does not involve any change to or overruling of the written terms.[51]

[57] It might also be suggested that the exclusionary rule as articulated in *Chartbrook* was substantive rather than evidential. Again, we do not need to decide that point as the exclusionary rule as articulated by Lord Hoffmann has not clearly been endorsed as part of the law of New Zealand.[52] We are satisfied that in New Zealand, the admissibility or otherwise of extrinsic evidence, and the application of any related exclusionary rules, is to be regarded as an evidential issue, to be determined in accordance with the law of evidence in light of the substantive law on contractual interpretation discussed above.[53]

[58] As noted, it was common ground between the parties that in New Zealand it is now necessary to start with the Evidence Act to determine the admissibility of all evidence in court proceedings.[54]

[59] Section 10 of the Act provides that common law rules are displaced to the extent that they are inconsistent with the Act's provisions and purposes. It is accordingly clear that the provisions of the Evidence Act have primacy in all questions of admissibility.[55]

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50 See, for example, Law Commission of England and Wales *Law of Contract: The Parol Evidence Rule* (Law Com No 154, 1986) at [2.7]; James Bradley Thayer *A Preliminary Treatise on Evidence at the Common Law* (Little, Brown and Co, Boston, 1898) (second reprint, Fred B Rothman Publications, New York, 1999) at 390–391; Charles T McCormick "The Parol Evidence Rule as a Procedural Device for Control of the Jury" (1932) 41 Yale LJ 365 at 373–374; and John E Murray Jr "The Parol Evidence Rule: A Clarification" (1965) 4 Duq U L Rev 337 at 340.

51 Kim Lewison *The Interpretation of Contracts* (7th ed, Sweet & Maxwell, London, 2021) at [3.90]; Edwin Peel *Treitel: The Law of Contract* (15th ed, Sweet & Maxwell, London, 2020) at [6-029]; and HG Beale (ed) *Chitty on Contracts* (33rd ed, Sweet & Maxwell, London, 2018) vol 1 at [13-130].

52 See below the discussion on this point at [70]–[74].

53 A similar view was reached by the Singaporean Court of Appeal in *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] SGCA 43, [2013] 4 SLR 193 at [40]–[44]. We note also that in many countries, including Singapore (which shares the basis of its statutory evidence code, the Indian Evidence Act 1872, with India, Pakistan, Bangladesh, Sri Lanka, Myanmar, Malaysia, and several African and West Indies nations), the admissibility of extrinsic evidence to contractual interpretation is expressly addressed in statutory evidence law regimes.

54 Evidence Act 2006, s 5(3) and s 4(1) definition of "proceeding".

55 Unless there is an inconsistency between the provisions of the Evidence Act and any other enactment: s 5(1).

[60] The purpose of the Act as set out in s 6 is to help secure the just determination of proceedings, including by providing for facts to be established by the application of logical rules, promoting fairness to parties and witnesses, avoiding unjustifiable expense and delay and enhancing access to the law of evidence.

[61] Operating against this background, ss 7 and 8 are the engine room of the Act.[56] Section 7 provides the Act's "fundamental principle": that all relevant evidence is admissible unless it is inadmissible or excluded under the Evidence Act or any other Act; and that evidence that is not relevant is not admissible. Section 7 further provides that evidence is relevant in a proceeding "if it has a tendency to prove or disprove anything that is of consequence to the determination of the proceeding".[57]

[62] Applying s 7 in the context of contractual interpretation, 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 in which they were at the time of the contract.[58] We say prima facie as relevant evidence may still be inadmissible in terms of s 8, or in terms of one of the Act's (or any other Act's) exclusionary provisions.[59]

[63] Section 8(1) of the Evidence Act provides:

> **8 General exclusion**
>
> (1) In any proceeding, the Judge must exclude evidence if its probative value is outweighed by the risk that the evidence will—
>
> (a) have an unfairly prejudicial effect on the proceeding; or
>
> (b) needlessly prolong the proceeding.

[64] In the context of contractual interpretation, s 8(1)(b) will often be relevant to a court's task in determining admissibility. This provision addresses the policy concerns

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56 They are subject to s 9(1), which provides for the admission of evidence by consent.

57 Section 7(3).

58 Subject to the qualification, already noted, that the scope for resort to background is itself contextual: see above at [47] and n 45.

59 Other exclusionary provisions will no doubt apply only infrequently, given the general nature of evidence called in contractual interpretation cases.

that the admission of extrinsic material will involve unnecessary expenditure of time and resources for the parties and the courts. Where the judge's assessment is that the probative value of the evidence is outweighed by the risk that it will needlessly prolong the proceeding, the evidence will be excluded.[60]

[65] Bathurst argues that the test for admissibility should be whether the evidence is of conduct which is mutual, overt and proximate. While we accept that these characteristics will usually be good indications of relevance, and often of probative value, they cannot be the test for admissibility given the provisions of the Act. Moreover, as L&M argues, some evidence which fulfils these three criteria may nevertheless be inadmissible as having no bearing on the disputed interpretation. And it is also the case that evidence may lack one or more of the features Bathurst identifies, but nevertheless still be admissible if it is evidence which assists the objective search for meaning. In short, ss 7 and 8 are the touchstones for admissibility, utilising the objective standard for contract interpretation as the standard against which relevance and probative value must be measured.

[66] We propose to outline how this basic framework can be applied to the various categories of extrinsic evidence often sought to be admitted in aid of contractual interpretation.[61] In some cases it is possible to give a strong indication of the likelihood of admission, but even so, we do not lay down hard and fast rules. The Evidence Act governs admissibility, and the situations in which admissibility issues arise are so varied that it is appropriate to provide guidance rather than to attempt rigid rules overlaying the Act. The risk is that in any given case, any such rules could operate in a manner inconsistent with the Act's provisions.

Declarations of subjective intent

[67] Evidence of subjective intent falls principally into two categories:

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60 When weighing the probative value of evidence for the purposes of s 8, the court may have regard to its reliability: see *W (SC 38/2019) v R* [2020] NZSC 93, [2020] 1 NZLR 382 at [70] and [88(b)] per Glazebrook, O'Regan and Ellen France JJ and [191] per Winkelmann CJ and Williams J.

61 We are not commenting on evidence that may be relevant and admissible for other purposes, such as to support an allegation of an oral contract, or an estoppel, or in support of a claim for rectification.

(a) evidence of conduct or statements during negotiations that tends to prove a party's subjective intent as to what the contract should mean; and

(b) oral evidence proposed to be given at the hearing as to a party's subjective intent or understanding of the contract.

[68] We deal with category (a) below within the topic of prior negotiations. As to category (b), evidence of what a party subjectively understood or intended as to the meaning of the contract will not be admissible if that was not communicated to the other party prior to contract formation. An undeclared understanding or intention as to the meaning of a contract is not evidence that would have been available to the notional reasonable person having all of the information reasonably available to the parties at the time. It is not therefore relevant to the task of contractual interpretation.

Prior negotiations

[69] The term "prior negotiations" is often used to refer to early drafts of the contract and pre-contractual communications between the parties as they negotiate their agreement.[62] It can also extend to evidence regarding the content of oral negotiations.

[70] The exclusionary approach in respect of this category of evidence, as outlined by Lord Hoffmann in *Investors Compensation Scheme* and in *Chartbrook*, has not been applied in New Zealand for some time. *Vector Gas Ltd v Bay of Plenty Energy Ltd* has to date been the leading case on the admissibility of prior negotiations in New Zealand.[63] In that case, Blanchard J (with whom Gault J agreed)[64] considered that evidence of prior negotiations was admissible, but only in order to establish the commercial purpose of the contract, its genesis, the background, context and market in which in the parties were operating, and its subject-matter.[65] He reserved his position on how "much further the courts … should go towards admitting evidence of

62 Finn, Todd and Barber, above n 46, at 194.
63 *Vector Gas*, above n 36.
64 At [151].
65 At [13] and [14].

negotiations for the light they may shed on the objective intention of the parties".[66] And any material "simply declarative of the subjective intentions of one party must be disregarded".[67]

[71] Tipping J approached the issue on the basis that relevance was the guiding principle, in accordance with s 7 of the Evidence Act. He held that "[w]hereas evidence of the subjective content of negotiations is inadmissible on account of its irrelevance, evidence of facts, circumstances and conduct attending the negotiations is admissible if it is capable of shedding objective light on meaning".[68] He concluded 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".[69]

[72] Wilson J held that a court – provided "there is genuine and relevant ambiguity" because "the words are not clear or because of internal conflict"[70] – may have regard "to any extrinsic material which assists in assessing objectively the intention of the contracting parties in using the words they did", except claims of "undeclared intent (what the parties were thinking, in contrast to what they were saying)", which "cannot possibly assist in ascertaining objective intent".[71]

[73] McGrath J agreed with the House of Lords in *Chartbrook* that the exclusionary rule was valid for policy reasons.[72] He said that admitting evidence of this kind, even when it "would provide a reliable guide to the parties' intended meaning", would have significant detrimental consequences to the law of contractual interpretation.[73] However, he accepted that "objective facts existing when the contract was made [that] could be proved by pre-contractual negotiations" were admissible.[74]

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66 At [14].
67 At [14].
68 At [29] (footnote omitted).
69 At [31]. See also at [27].
70 At [120].
71 At [122].
72 At [78].
73 At [75].
74 At [70].

[74] As has been observed, the range of approaches evident in *Vector Gas* left the law unsettled on this point.[75] Nevertheless, courts have tended to follow Tipping J's approach.[76]

[75] The issue for a judge is whether evidence of prior negotiations tends to prove anything relevant to the notional reasonable person. Evidence of the content of prior negotiations will be inadmissible to the extent that it proves only a party's subjective intention or belief as to the meaning of the words, or what their undeclared negotiating stance was at the time.[77] That is because such evidence is irrelevant to the objective task of interpretation.[78] Often the prior negotiations will not have addressed (even by necessary implication) the issue that has arisen in the proceedings, because that was an issue not identified by the parties prior to contract formation.[79] Often they will also reveal no more than a negotiating stance adopted by one party that is not agreed to by the other.

[76] However, if evidence shows what a party intended the words to mean, and that this was communicated, it may tend to show a common mutual understanding as to the meaning of the contract. 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. Such an understanding is relevant to the objective search for meaning. The evidence will be relevant and, subject to the s 8 assessment, admissible. As Lord Nicholls put the matter, writing extrajudicially:[80]

> Why should counsel's client not be able to give evidence of pre-contract discussions between the parties which cast light on the purpose of [a contractual clause]? Why should it be thought this evidence of the parties'

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75 Finn, Todd and Barber, above n 46, at 198.

76 Finn, Todd and Barber, above n 46, at 198, citing, among other cases, *Hall v Attorney-General* [2012] NZHC 3615 at [77]; *Donovan Drainage & Earthmoving Ltd v Halls Earthworks Ltd* HC Auckland CIV-2010-404-29, 2 June 2011 at [9]–[12]; and *Bethell v Bethell* [2013] NZHC 3492 at [28].

77 See, for example, *New Zealand Air Line Pilots' Association*, above n 44, at [79] and [83]–[86] per Arnold, O'Regan and Ellen France JJ, [140]–[141] per William Young J and [199] per Glazebrook J (concurring with the majority).

78 We note that different considerations apply where the issue is the admissibility of evidence in relation to claims for rectification and estoppel: Finn, Todd and Barber, above n 46, at 195.

79 David McLauchlan "Contract Interpretation: What Is It About?" (2009) 31 Syd LR 5 at 9–10.

80 Nicholls, above n 28, at 581–582.

> actual intentions, because that is what this is, can never assist in determining the objective purpose of a contractual provision or the objective meaning of the words the parties have used? The notional reasonable person would be aware of these discussions and, hence, what the parties had in mind. Why should the court be denied this assistance? In everyday life, when interpreting a letter a reader takes into account earlier correspondence. Is a reasonable reader to be worse placed? ... Where such evidence would assist, it is not easy to see why *in principle* an essentially artificial barrier should be erected against its use.

[77] This interpretation and application of these provisions of the Evidence Act aligns well with its principles and purposes. In terms of those purposes, it is fair to admit evidence tending to objectively prove what parties intended the words to mean to assist with the interpretation of the text of the contract – fair because it is the approach most consistent with holding the parties to their true bargain. But it is also an approach which avoids unjustified expense in litigation by excluding purely subjective evidence (subjective in the sense that it is not reasonably available to the other contracting parties) as irrelevant, and which allows for the exclusion of duplicative or low quality evidence under s 8.[81]

[78] Moreover, this approach strikes a balance between promoting certainty in the law and holding parties to their bargains. It promotes certainty by leaving the text of the contract central to the task of interpretation (and is therefore distinct from a claim for rectification), and by maintaining an objective approach to what constitutes relevant background for that task. It holds parties to their bargains because it allows that text to be interpreted in light of what, objectively assessed, the parties intended the words to mean.

[79] Viewed in this way, the policies that underpin the Evidence Act approach to admissibility meet the competing policy considerations identified by Lord Hoffmann in *Chartbrook*. In our view, the overall framework of the Act balances those objectives, while better securing the objective of giving effect to the parties' true agreement than does the application of blanket rules of exclusion. The clarity provided by the Evidence Act should assist parties in determining which evidence to rely upon.

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[81] This approach also allows for the exclusion of marginally relevant evidence where its admission would needlessly prolong the proceedings. We note that in *Sembcorp*, above n 53, the Singaporean Court of Appeal suggested some procedural reforms to address the risk of courts being overwhelmed with extrinsic evidence: at [73]. As we did not hear argument on this point, it is not appropriate for us to comment on it further.

And as we have said,[82] prior negotiations will often be irrelevant as not addressing the issues in contention in the litigation or as evidencing only one party's subjective intent.

[80] Before we leave this point, we note comments made in the Court of Appeal judgment that the admission of extrinsic evidence risks crowding out the remedy of rectification.[83] In our view, it is important not to overstate this risk. The line between interpretation, rectification and estoppel is adequately preserved through the application of the provisions of the Evidence Act when deciding questions of admissibility. Those provisions keep the focus on the relevance of the evidence to the legal test for the purposes of interpretation, which is the objective interpretation of the contract.

Specialised meanings

[81] Evidence that tends to prove that the parties have agreed upon a word having a particular meaning – the private dictionary principle – has long been recognised as admissible.[84] In *Chartbrook*, Lord Hoffmann limited the application of this principle to where parties had used a word unconventionally.[85] Because relevance and probative value are the touchstones for admissibility in New Zealand, this constraint falls away.

[82] In other cases, evidence has been admitted to show that it is the practice within a particular profession, trade, industry or locality to give a word a specialised meaning.[86]

[83] The admissibility of such evidence is now to be determined by applying the Evidence Act. The question is again whether this evidence tends to prove anything relevant to the notional reasonable person tasked with interpreting the contract. Objectively ascertainable evidence, which could include words or conduct, showing that the parties understood words to carry a particular meaning at the time of contract will be relevant – although not necessarily determinative – and subject to s 8.

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82 Above at [75].

83 CA judgment, above n 7, at [44].

84 This rule has its origins in *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd* [1976] 2 Lloyd's Rep 708 (QB) [*The Karen Oltmann*]. See also *Firm PI*, above n 10, at [84].

85 *Chartbrook*, above n 30, at [45].

86 See, for example, *Firm PI*, above n 10, at [84]–[87]; and *Zeus Tradition Marine Ltd v Bell* [1999] 1 Lloyd's Rep 703 (QB) at 706–707 and 713.

Evidence of one party's subjective belief as to a particular or specialised meaning is not relevant, and so not admissible, if this evidence would not have been reasonably available to the notional reasonable person at the time of contract.

Subsequent conduct

[84] The term "subsequent conduct" refers to evidence of a party's or all parties' conduct in undertaking their contractual obligations after the agreement has been entered into. This issue was discussed by this Court in *Gibbons Holdings Ltd v Wholesale Distributors Ltd*.[87] Four Judges said that evidence of subsequent conduct was admissible in order to interpret a contract.[88]

[85] While finding it unnecessary in that case to have regard to the subsequent conduct of the parties, Elias CJ accepted "that how the parties subsequently treated their contractual obligations may be helpful evidence as to the meaning of the contract".[89]

[86] Anderson J said that "where the conduct of the parties logically suggests that they had a mutual understanding of the terms which is inconsistent with ordinary linguistic use, the courts should take into account all relevant and cogent evidence of that conduct, including post-contract conduct".[90]

[87] Thomas J viewed such evidence as admissible.[91] Unlike the others, Thomas J did not consider the conduct needed to be "common", "shared" or "mutual", but thought it could be the conduct of one party alone, at least if that conduct was contrary to the meaning asserted by that party.[92]

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87 *Gibbons Holdings*, above n 11.

88 Blanchard J reserved his position. However, he observed that "on the question of whether the subsequent actions of the parties can be taken into account in the interpretation of their contract", he had "seen no convincing argument against such use and there is force in the argument in its favour": at [27].

89 At [7].

90 At [74] (provided the conduct was that of all parties: at [73]).

91 At [111], referring to his position in *Attorney-General v Dreux Holdings Ltd* (1997) 7 TCLR 617 (CA) at 630–633, where he accepted subsequent conduct was admissible.

92 At [135].

[88] Tipping J said he found "the case in favour of admitting post-contract conduct … distinctly more persuasive than the case for not doing so",[93] provided it was "mutual or shared".[94] If, in performing their contract, the parties together conducted themselves "in a way that is relevant to the meaning of the disputed provision, the court should be able to take that into account".[95] It is right to record, however, that Tipping J later refined this in *Vector Gas*, preferring the approach he articulated in that same case in relation to the admissibility of prior negotiations:[96]

> [31] There is no logical reason why the same approach should not be taken to both post-contract and pre-contract evidence. 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.

[89] Again then, we proceed on the basis that the law, not being settled on this point, requires clarification. We agree with Tipping J that the approach to the admissibility of subsequent conduct should be the same as the approach to the admissibility of prior negotiations. Applying the provisions of the Evidence Act, the court must ask itself whether the subsequent conduct tends to prove anything relevant to the objective approach to interpretation. Subsequent conduct need not necessarily be mutual, but non-mutual conduct is more likely to be relevant to a claim of estoppel. Further, in assessing the relevance of subsequent conduct, it must not be forgotten that the court is interpreting the contract as at the time it was made.[97]

[90] To the extent that evidence of subsequent conduct may cross the relevance threshold (which we suggest will not be often), s 8 is likely to come into particular play. Care will be needed to assess the probative value of that evidence. For example, conduct that occurs post-dispute is very unlikely to be admissible. By then, the parties

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93 At [55].

94 At [53]. Tipping J appeared to recant on the "mutual or shared" requirement in *Vector Gas*, above n 36, at [30].

95 At [60].

96 *Vector Gas*, above n 36.

97 This temporal restriction is particularly clear in Canada. In *McDonald Crawford v Morrow* 2004 ABCA 150, (2004) 348 AR 118 at [72], Côté JA said that the interpretation of a contract "cannot depend on the stage or time at which one party chooses to go to court and have it interpreted. A contract must be interpreted as at the date it was made, not later" (citations omitted). See also Geoff R Hall *Canadian Contractual Interpretation Law* (2nd ed, LexisNexis, Ontario, 2012), which says that it is "a fundamental proposition of contractual interpretation that a contract is to be interpreted as of the date it was made", and therefore unlike statute law, a contract's interpretation cannot change with evolving social norms: at 52.

will have retreated into their respective corners, and their conduct may well be self-serving. Its admission is likely to add time and cost, especially in light of the inevitable calling of rebuttal evidence. Another example of problematic evidence is where the subsequent conduct is that of executives of corporate parties to the contract who had no involvement with negotiating the contract and no knowledge of its background. Such 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.

Test for implication of terms: the same as interpretation?

[91] The issue of the implication of a term arises only if Bathurst is successful in its argument that the Court of Appeal was wrong to interpret cl 3.10 as limiting Bathurst's right to defer the first performance payment, without the need for the implication of any limiting words.

[92] Two principal types of contractual terms are described as "implied terms".[98] The first is default terms brought into operation not on the basis of any intention of the parties, but rather by operation of law – the classic example of this category is terms implied under Part 3 of the Contract and Commercial Law Act 2017.[99] The second is terms said to be implied "in fact" to give a contract business efficacy – this form of implication is based on an intention imputed to the parties by the courts,[100] often referred to as presumed intention. It is this second category of implied term at issue on this appeal.

[93] The law in this area has been thrown into uncertainty in recent times by the decision of the Privy Council in the case *Attorney General of Belize v Belize Telecom Ltd*.[101] Lord Hoffmann, writing for the Board, sought to restate the principles in relation to implied terms. But far from settling those principles, this judgment has

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98 There is a third category of implied term which arises much less frequently – terms implied by custom in a particular trade or area of business.

99 Terms are also implied by the common law. For example, courts are becoming more willing to imply a duty of good faith in certain types of contract: see the discussion below at [227]–[229]. See also Beale, above n 51, at [14-028]; and Finn, Todd and Barber, above n 46, at 213–216.

100 *Luxor (Eastbourne) Ltd v Cooper* [1941] AC 108 (HL) at 137 per Lord Wright.

101 *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988.

excited a great deal of controversy in case law and in academic writing as to whether it has fundamentally changed the law governing implication of terms.[102]

[94] Prior to the decision in *Belize*, the following passage from Lord Simon's judgment in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* was the most commonly cited authority in New Zealand in relation to the implication of terms:[103]

> … for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that "it goes without saying"; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

[95] In *Belize*, Lord Hoffmann did not disapprove this test but said that it was:[104]

> … best regarded, not as [a] series of independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means, or in which they have explained why they did not think that it did so.

[96] In a passage which has caused controversy, he described the implication of a term as an exercise in the construction of the instrument as a whole.[105] He said that where the instrument does not expressly provide for what is to happen when some event occurs, the most usual inference in such a case is that nothing is to happen. If the parties had intended otherwise, the instrument would have said so.[106] But on some occasions, the only meaning consistent with the other provisions of the instrument, read against the relevant background, is that something is to happen:[107]

> The instrument may not have expressly said so, but this is what it must mean. In such a case, it is said that the court implies a term as to what will happen if

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102 See, for example, the discussions in *Spencer v Secretary of State for Defence* [2012] EWHC 120 (Ch), [2012] 2 All ER (Comm) 480 at [52]–[59]; and David McLauchlan "Construction and implication: in defence of *Belize Telecom*" [2014] LMCLQ 203.

103 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266 (PC) at 283. See, for example, the authorities set out in Finn, Todd and Barber, above n 46, at 217, n 243.

104 *Belize*, above n 101, at [27].

105 At [19]. Lord Hoffmann used the expression "instrument" because the case itself concerned articles of association.

106 At [17].

107 At [18].

> the event in question occurs. But the implication of the term is not an addition to the instrument. It only spells out what the instrument means.

[97] Lord Hoffmann emphasised the objective nature of the exercise the court is required to undertake, cautioning against becoming diverted into "barren" discussion as to how the actual parties would have reacted to the proposed implied term.[108] As to the test to be applied, he said:

> [21] It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. … [T]his question can be reformulated in various ways which a court may find helpful in providing an answer—the implied term must "go without saying", it must be "necessary to give business efficacy to the contract" and so on—but these are not in the Board's opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?

[98] He therefore placed the test for implication of terms within the same conceptual framework as contractual interpretation – framing the fundamental question for the court as what the instrument would convey to a reasonable person, having all the background knowledge which would have been reasonably available to the contracting parties.

[99] The judgment has been treated variously as an unremarkable but compelling restatement of the existing law in relation to implication of terms, and as a radical shift in the law which equated the interpretation of a written contract with the implication of a term.[109]

[100] In New Zealand, *Belize* was referred to with apparent approval by Tipping, McGrath and Wilson JJ in this Court's decision in *Dysart Timbers Ltd v Nielsen* – although the approach to the implication of a contractual term was of only peripheral relevance to the issue in that case.[110] However, in the later case of *Mobil Oil New Zealand Ltd v Development Auckland Ltd*,[111] this Court said that there was scope for

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108 At [25].

109 See generally McLauchlan, above n 102, for a discussion of these views.

110 *Dysart Timbers Ltd v Nielsen* [2009] NZSC 43, [2009] 3 NZLR 160 at [25], n 12 per Tipping and Wilson JJ and [62] and [64], n 43 per McGrath J.

111 *Mobil Oil New Zealand Ltd v Development Auckland Ltd* [2016] NZSC 89, [2017] 1 NZLR 48.

argument as to whether the undiluted adoption of Lord Hoffmann's approach in *Belize* was appropriate, noting that it had been "significantly qualified" by the United Kingdom Supreme Court in *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd*.[112]

[101] In *Marks and Spencer*, Lord Neuberger, writing for the majority, said that while interpretation and implication are related, Lord Hoffmann's judgment "could obscure the fact that construing the words used and implying additional words are different processes governed by different rules".[113] He said:[114]

> When one is implying a term or a phrase, one is not construing words, as the words to be implied are ex hypothesi not there to be construed; and to speak of construing the contract as a whole, including the implied terms, is not helpful, not least because it begs the question as to what construction actually means in this context.

[102] It is only once the process of construing express words is complete, he said, that the issue of implied terms falls to be considered.[115] He confirmed that the approach to implied terms in fact remained unchanged since *Belize*, so that there had been no dilution to the traditional requirements.[116] Nevertheless, Lord Neuberger did not wholeheartedly endorse the approach in *BP Refinery*, noting a level of duplication between the five conditions. And as to business efficacy, he said that it may be better to say "that a term can only be implied if, without the term, the contract would lack commercial or practical coherence".[117]

Parties' submissions

[103] Bathurst argues that New Zealand should affirm that interpretation and implication are two distinct processes – the express meaning of the words of the contract must be interpreted before an additional requirement can be implied on top of that express meaning. Bathurst submits that the bright line distinction and sequential analysis approved in *Marks and Spencer* should be applied.

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112 At [81], citing *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742.
113 *Marks and Spencer*, above n 112, at [26].
114 At [27].
115 At [28].
116 At [24].
117 At [21].

[104] As to the nature of the exercise of implication, Bathurst asks this Court to confirm the five-stage test set out in *BP Refinery*, so that necessity and the *BP Refinery* conditions remain the touchstone for the implication of a term and therefore a "high hurdle to overcome".

[105] L&M says that *Belize* is not properly understood as diluting the traditional requirements for implication, but rather as providing insight as to the nature of the judicial task involved in it. The point Lord Hoffmann was making in *Belize* was that when a term is implied into the contract, the court is not imposing that term, but rather discovering a term that represents what the contract must have meant in a situation it did not expressly address. L&M says that *Belize* and the later judgment in *Marks and Spencer* make clear that the principles in *BP Refinery* continue to be useful tools to guide the court in discovering what the contract "must have meant", and that the bar for implication remains high.

Our approach to the test for implication of terms

[106] We do not propose to enter, at least at any length, into the debate as to whether *Belize* has changed the law in relation to implication of terms, save to say that in our view, the Privy Council in *Belize* did not set out to change the law in relation to implication of terms, but rather to clarify the doctrinal basis of implication. It is worth noting that the principal points made by Lord Hoffmann in that regard were well supported by authorities which come from the same family tree as *BP Refinery*, and indeed that these principal points were in large part endorsed by the United Kingdom Supreme Court in the later case of *Marks and Spencer*.[118] We do not believe that Lord Hoffmann in *Belize* intended to depart from the notion that the test for implying a term is one of strict necessity, a high threshold to meet.[119]

[107] We therefore confirm the continuing role of *BP Refinery* in our law. New Zealand cases have long referred to and relied upon *BP Refinery*, and those cases also continue to be of relevance. However, we add some qualifications.

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118 *Marks and Spencer*, above n 112, at [21]–[23] per Lord Neuberger, [68]–[74] per Lord Carnwath and [76] per Lord Clarke.

119 *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 (HL) at 459 per Lord Steyn; and *Marks and Spencer*, above n 112, at [23] per Lord Neuberger.

[108] It is important that the conditions not be applied in a rigid and formulaic way. As Lord Hoffmann said in *Belize,* the five conditions in *BP Refinery* are:[120]

> … best regarded, not as [a] series of independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means …

It seems to us that while conditions (4) and (5) must plainly be met for the implication of a term, there is considerable overlap between conditions (1)–(3). For example, as Lord Neuberger observed, it is hard to see that a term could clear the hurdle of being "so obvious that 'it goes without saying'" and not clear the hurdle of being reasonable and equitable.[121] Therefore, conditions (1)–(3) are best viewed as analytical tools which overlap, and are not cumulative.[122]

[109] In his article "Implication of contractual terms: a single blended test of 'obvious necessity'", the Rt Hon Sir Andrew Tipping suggested that conditions (2) (business efficacy) and (3) (so obvious that "it goes without saying") should be blended into a test of "obvious necessity".[123] However, we consider that the conditions test different propositions and even though, as noted, there is substantial overlap, each remain useful in their own right. It is conceivable that a clause could be implied which, although not necessary to give the contract business efficacy, meets the threshold of being "so obvious that 'it goes without saying'". It is worth remembering that the test for implication of a term applies to contracts formed outside the business context.

[110] As to the business efficacy test, we note that it is sometimes formulated in different ways, including by Lord Neuberger in *Marks and Spencer* when he adopted Lord Sumption's suggestion in argument that it should be expressed as "commercial or practical coherence".[124] We consider that this formulation risks distracting from the purpose of implication, which is to give effect to the parties' bargain as objectively

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120 *Belize*, above n 101, at [27].

121 *Marks and Spencer*, above n 112, at [21].

122 See at [21], wherein Lord Neuberger described the second and third conditions as "alternatives in the sense that only one of them needs to be satisfied".

123 Andrew Tipping "Implication of contractual terms: a single blended test of 'obvious necessity'" [2021] NZLJ 2.

124 *Marks and Spencer*, above n 112, at [21].

assessed. It is the parties' bargain, not some broader concept of business coherence, that is the focus of implication.

[111] We add one note of caution regarding condition (3), "so obvious that 'it goes without saying'". It is a foreshortened version of the "officious bystander" test, formulated by MacKinnon LJ in *Shirlaw v Southern Foundries (1926) Ltd* as:[125]

> Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common "Oh, of course!"

[112] We highlight the risk identified by Lord Hoffmann in *Belize*, that this notional inquiry can divert attention "from the objectivity which informs the whole process of construction into speculation about what the actual parties to the contract … would have thought about the proposed implication".[126] Therefore, although we consider it is a useful analytical tool, it should not divert attention from the essentially objective nature of the task.

[113] Bathurst contends that we should also make clear the sequence in which interpretation and implication occurs, emphasising the bright line that exists between interpretation and implication. We agree that the issue of implication only arises after the express terms of the contract have been interpreted and found not to provide for the eventuality. This process of interpretation we refer to includes any logical or necessary inferences from the expressly agreed terms.[127] However, where the contract does not address the eventuality through express language or necessary inferences from that language, the court then moves on to address whether a term should be implied.

[114] Having said that, notions of clear sequence and bright lines carry the risk that they obscure what was described by Lord Carnwath in *Marks and Spencer* as the iterative process of contractual interpretation.[128] Ultimately, it is through the

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125 *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 206 (CA) at 227.
126 *Belize*, above n 101, at [25].
127 Lewison, above n 51, at [6.13].
128 *Marks and Spencer*, above n 112, at [71], citing Anthony Grabiner "The Iterative Process of Contractual Interpretation" (2012) 128 LQR 41.

interpretation of the express words of the contract that the implied term is arrived at. In *Marks and Spencer*, Lord Carnwath doubted whether the case law referred to by Lord Neuberger supported "a sharp distinction between interpretation and implication, still less for the necessity of a sequential approach".[129] He noted that in the case of *Aberdeen City Council v Stewart Milne Group Ltd*, Lord Hope, who carried majority support and decided the case on the basis of an interpretation of the express terms of the contract, "clearly saw [interpretation and implication] as part of a single exercise: the implied term was the 'product' of interpretation".[130] Lord Clarke (with whom the majority of the Court in *Aberdeen City Council* also agreed) would have preferred to resolve the appeal by way of implied term rather than interpretation, but acknowledged that both processes achieved the same result.[131]

[115] Therefore, in our view, the idea of a bright line provides an artificial constraint and might tend to obscure the fact that the text remains central, even to the exercise of implication. In deciding whether and what term to imply, the court is very much still concerned with the express terms of the contract, interpreted in light of the relevant background. That interpretation provides the court with the necessary objective information as to the purpose of the contract, and helps the court to ascertain whether it is strictly necessary to add something to spell out what the contract, read against the relevant background, must be understood to mean. As Lord Hope said in *Aberdeen City Council*, the term to be implied was the "product" of his interpretation of the contract.[132] Another way of putting this is that the implication arises from the text of the contract, interpreted against the relevant background.

[116] To conclude, the principal points that govern the implication of terms are as follows:

(a) The legal test for the implication of a term is a standard of strict necessity, a high hurdle to overcome.[133]

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129 At [71].

130 At [71], referring to *Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56, 2012 SLT 205 at [20].

131 *Aberdeen City Council*, above n 130, at [33].

132 At [20].

133 *Equitable Life*, above n 119, at 459 per Lord Steyn; and *Marks and Spencer*, above n 112, at [23] per Lord Neuberger.

(b) The starting point is the words of the contract.[134] If a contract does not provide for an eventuality, the usual inference is that no contractual provision was made for it.[135]

(c) While the task of implication only begins when the court finds that the text of the contract does not provide for the eventuality, the implication of a term is nevertheless part of the construction of the written contract as a whole.[136] An unexpressed term can only be implied if the court finds that the term would spell out what the contract, read against the relevant background, must be understood to mean.[137]

(d) As with the task of interpreting a contract, the inquiry for the court when considering the implication of a term is an objective inquiry – it is the understanding of the notional reasonable person with all of the background knowledge reasonably available to the parties at the time of contract that is the focus of this assessment. The court is tasked with the role of constructing the understanding of that reasonable person.[138]

(e) Thus, the implication of a term does not depend upon proof of the parties' actual intentions, 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.[139]

(f) The *BP Refinery* conditions are a useful tool to test whether the proposed implied term is strictly necessary to spell out what the contract, read against the relevant background, must be understood to mean.[140] Whilst conditions (4) and (5) must always be met before a term will be implied, conditions (1)–(3) can be viewed as analytical

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134 *Equitable Life*, above n 119, at 459 per Lord Steyn.
135 *Belize*, above n 101, at [17].
136 *Trump International Golf Club Scotland Ltd v Scottish Ministers* [2015] UKSC 74, [2016] 1 WLR 85 at [42] and [44] per Lord Mance.
137 *Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601 (HL) at 609 per Lord Pearson; *Equitable Life*, above n 119, at 459 per Lord Steyn; *Belize*, above n 101, at [21]; and *Marks and Spencer*, above n 112, at [69] per Lord Carnwath.
138 *Marks and Spencer*, above n 112, at [23] per Lord Neuberger and [72] per Lord Carnwath.
139 *Equitable Life*, above n 119, at 459 per Lord Steyn; *Belize*, above n 101, at [25]; and *Marks and Spencer*, above n 112, at [21] per Lord Neuberger. See above at [112].
140 *Belize*, above n 101, at [27].

> tools which overlap and are not cumulative. The business efficacy and the "so obvious that 'it goes without saying'" conditions are both ways, useful in their own right, of testing whether the implication of a term is strictly necessary to give effect to what the contract, objectively interpreted by the court, must be understood to mean.[141]

[117] We see this approach to the implication of terms as aligning with the objective theory of contractual interpretation. It promotes the primacy of the words of the contract, while also seeking to reach a complete understanding of what the contract, read against the relevant background, must be understood to mean.[142] By excluding speculation as to how the actual parties would have wanted the contract to regulate an unforeseen eventuality, this approach treats as irrelevant (and unreliable) evidence of subjective intent, given with the benefit of hindsight. It thereby promotes the efficient and just conduct of proceedings.

[118] We now go on to apply this framework to the facts of the present case.

Was the first performance payment under cl 3.4 triggered?

[119] By September 2015, Bathurst had transported from the permit areas more than 25,000 tonnes of thermal coal. It did not pay the first performance payment, but continued paying L&M royalty payments in accordance with the royalty deed, as it went on to mine some 25,000 further tonnes of thermal coal before it ceased mining in May 2016.[143] Bathurst says that the Court of Appeal erred in finding that the first performance payment had been triggered as at September 2015.

[120] It is helpful to set out the text of cl 3.4 in full at this point before addressing the parties' arguments. Clause 3.4 provides:

> 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:

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141 See *Belize*, above n 101, at [21]; and *Marks and Spencer*, above n 112, at [21].

142 See above at [116](c).

143 Bathurst continued to pay royalties on a very low level of coal sales from its existing stockpiles while Escarpment was on care and maintenance.

(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 this clause 3.4.

Parties' submissions

Bathurst

[121] While Bathurst accepts that by September of 2015, 25,000 tonnes of thermal coal had been extracted from the permit areas through works undertaken by Bathurst, and that it had been moved off those areas and sold, it maintains that cl 3.4 was not triggered. It argues that the word "shipped" in the clause has its ordinary literal meaning, carriage by ship, and that this meaning is supported by the relevant background.

[122] Bathurst submits that the Court of Appeal erred in its interpretation of this clause because it critically mischaracterised the factual matrix and, in particular, the genesis of the transaction. While the Court of Appeal accepted that the export of coking coal was "the focus of the project", it rejected Bathurst's proposition that it was the project's sole focus.[144] Bathurst says that it was wrong to do so. It says that this was the sole focus to the knowledge of both parties, as the DFS, contemporaneous documents and evidence given at trial made clear.

[123] Bathurst argues that since the Agreement provides for a performance-based trigger, it is correct to first understand what performance meant in the context of this contract – and that depends upon the commercial genesis and purpose of the transaction. The genesis of this transaction was, it says, the future establishment by Bathurst of an export coal mining business initially focussed on the Escarpment Mine, and the sale of around one million tonnes of high quality coking coal per annum to overseas customers. Since the market for coking coal was entirely overseas, the coal would have to be conveyed to that market by ship.

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144 CA judgment, above n 7, at [60].

[124] The performance payments, it argues, were calibrated with the export of coking coal in mind. At the point that 25,000 tonnes of coking coal had been shipped to export markets, there would be a well-established mine; the necessary infrastructure would have been built for a large scale coking coal operation and overseas markets developed and secured. But by September 2015, when on L&M's argument the first performance payment obligation was triggered, very little of the necessary construction had taken place, no export market had been established and no coking coal shipped offshore. The relevant performance had not, Bathurst argues, occurred.

[125] Bathurst says that this interpretation of what constitutes performance is also necessary to make the transaction work commercially. The parties knew, it says, that Bathurst would not be able to pay the first performance payment just from the proceeds of sale of the first 25,000 tonnes of coking coal. It would need to raise money from capital markets to do so. But it could only realistically do so having reached the milestone of demonstrating actual production of coking coal and a viable route to market.

[126] As to the express terms of the Agreement, Bathurst argues it is significant that the performance payment trigger was set by reference to coal "shipped", whereas the royalty obligation under the royalty deed relates to coal sold. It says the difference in these measures is conspicuous and shows a deliberate focus on sales to offshore markets as the measure of performance – it constructs this argument on the fact that in export coal sales contracts, the point of shipping is typically the point at which exchange of title in the product occurs.

[127] Bathurst also relies upon expert evidence as to the ways in which methods of transport are referred to in the coal industry, as well as such references by L&M in other mining contexts.

[128] Bathurst says that against this background, a reasonable person in the position of the parties would have understood coal "shipped from the Permit Areas" to mean the export by ship of coal extracted from the permit areas. Set in the context of the Agreement, and read against the relevant background, that was the plain ordinary meaning of the expression.

L&M

[129] L&M supports the reasoning of the Court of Appeal that cl 3.4 is properly construed as "transported".[145] The respondent says that a full consideration of the DFS and documentation at the time shows that the focus of the transaction was not exclusively to export coking coal. L&M also refers to the evidence of the principals of both parties, Messrs Loudon and Bohannan, who negotiated the deal, and their understanding of the meaning of the word "shipped".

[130] L&M further relies upon the subsequent conduct of Bathurst, which on numerous occasions expressly or implicitly acknowledged that the first performance payment had been triggered.

High Court decision

[131] In the High Court, Dobson J reviewed an extensive volume of extrinsic evidence tendered by both parties, which included evidence of the prior negotiations and subsequent conduct of the parties, as well as expert evidence as to industry descriptions of transportation. On this evidence, the Judge interpreted cl 3.4 as applying to coal "transported" out of the permit areas.[146]

Court of Appeal decision

[132] Having rejected Bathurst's contention that the exclusive focus of the Agreement was to export coking coal, the Court of Appeal said that an objective observer, cognisant of context, would not conclude that the words "coal … shipped from the Permit Areas" were merely a mangled description of export tonnages.[147]

[133] The Court of Appeal adopted the High Court Judge's reasoning save in one respect, disagreeing with the "admittedly limited reliance placed by the Judge on Bathurst's post-contract conduct in its financial statements of 2014 to 2016".[148] The Court of Appeal reached its conclusion on the meaning of cl 3.4 without reference to

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145 CA judgment, above n 7, at [60] and [104].
146 HC judgment, above n 6, at [113].
147 CA judgment, above n 7, at [60].
148 At [62].

that evidence, which was "of very little assistance" as it was unilateral subsequent conduct of one party.[149]

Our analysis

The text of the contract

[134] We begin with the words of the Agreement. Whatever the etymology of "shipped" (which no doubt originates from transportation of a thing on a ship), it is a word which has 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. Bathurst accepts that this is an available meaning, but submits that it is not the right one to best do justice given the context and purpose of the Agreement. In our view, when we zoom out from the word to the phrase in which it appears, this broader meaning of the word "shipped" is reinforced. The action "to ship" is linked in the sentence to moving goods away from the permit areas. But the permit areas are inland – it is impossible to transport coal directly from the permit areas on a ship.

[135] What is not in the Agreement is also significant. At the time of contract formation, both parties knew that there was both thermal and coking coal in the permit areas. But there is no attempt to differentiate between the different types of coal for the purposes of the cl 3.4 triggers.

[136] To meet these difficulties, Bathurst presents a sophisticated argument, contrasting the ways in which payment obligations are triggered in the royalty deed and in the Agreement. We do not think the fine distinctions that Bathurst seeks to draw between the definitions can carry any weight. These differences are more obviously explained as simply variations in the words used by a human draftsperson, all the more so because the clauses are doing different work in their respective documents.

[137] What is more significant, however, is the fact that the royalty deed defines "coal" as "coal mined from the area of any Permit part or all of which falls within the external boundaries of the Permit Areas". Bathurst was therefore obliged to pay

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149 At [62]–[63].

royalties on any kind of coal it extracted from the permit areas and sold. This reflects the even more fundamental point that the Agreement conveyed to Bathurst rights in relation to all types of coal in the permit areas, not just coking coal.

[138] The difficulty with Bathurst's argument is that it seeks to write into the payment obligation a very significant qualification on the coal that counts towards the triggering event for the performance payment. It has to do this because this sub-category of coal is not expressly identified and, more perplexing still, does not feature elsewhere in the contractual arrangements between the parties. In this circumstance, 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 would have been "mangled" expression.[150]

Commercial purpose

[139] Bathurst argues that to the knowledge of both parties, the commercial genesis and purpose of the transaction throughout was to set up a successful coking coal export operation. In so doing, Bathurst relies upon the well-established principle that objective evidence of the "genesis" and "aim" of the transaction is relevant to interpreting the text of an agreement.[151] Our starting point for identifying the commercial genesis of the transaction is the text of the contract itself.

[140] Bathurst places principal reliance upon the DFS undertaken on the development of the Escarpment Mine, which it says shows that the sole focus of the Agreement was the export of coking coal.[152] It is true that the Agreement was conditional on the completion of this study to Bathurst's reasonable satisfaction.[153] That conditionality is helpful to understanding the commercial purpose of the transaction, particularly the focus upon Escarpment. But while it does support Bathurst's contention that Escarpment, and coking coal, was a focus of the transaction, it does not on its own suggest that it was the sole focus. The clause sits within the

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150 CA judgment, above n 7, at [60].

151 *Prenn*, above n 47, at 1385 per Lord Wilberforce; and *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 WLR 989 (HL) at 995 per Lord Wilberforce.

152 A preliminary mining study of the Deep Creek mine was also included as an addendum to the DFS.

153 See above at [20].

broader document in which Bathurst secured to itself all of the rights to coal that might flow from the various permits. It did not limit itself to coking coal. Relevant too, as already observed, is the royalty deed which imposed royalty payment obligations no matter what kind of coal was extracted and sold, thereby clearly contemplating the extraction for commercial sale of non-coking coal.

[141] Modelling contained in the DFS refers only to coking coal. That shows that profitability modelling was done on that basis, and this modelling satisfied Bathurst to proceed to make the Agreement unconditional. This may in turn tend to prove that Bathurst would not have proceeded with the Agreement without profitability of coking coal being confirmed, but that does not establish that Bathurst's commercial objective was only the development of export markets for coking coal, let alone that this was, objectively assessed, the only commercial aim of the transaction. Indeed, the DFS itself made reference to the potential extraction of thermal coal: "[i]n addition to the coking coal that is to be produced from the Escarpment Project, the potential exists for placement of thermal coal that can be sold into the export market".

[142] Part of the context to the contract's formation was that there was, and was known to be, thermal coal in the permit areas. Other extrinsic evidence even refers to Bathurst's plans to extract it. For example, in an announcement to the market by Bathurst on 17 May 2010, which was prior to the formation of the Agreement, Bathurst said it could confirm that the Buller Coal asset had "an initial resource of 7.3 million tonnes of high quality coking and thermal coal, which will underpin the first seven years of production". This announcement was reasonably available to the parties at the time of contract formation. It is part of the relevant background, even if somewhat tangential to it, and is admissible.

[143] The reasonable interpretation is that Bathurst's focus was on coking coal and that both parties knew this. But it was also known there was thermal coal present at Escarpment, and it is hardly credible that if the right circumstances arose (as they did with Holcim), this would not be sold as well.

[144] To conclude on this point, we are satisfied that the connection between the DFS and the content of the Agreement makes it relevant and therefore properly admissible.

However, it does not have the weight Bathurst would ascribe to it. If anything, it reveals Bathurst's own commercial assessment of the opportunity.

[145] Bathurst also points to the fact that the first performance payment was denominated in United States dollars and that royalty payments were, it says, to be payable in the original (overseas) denominations of the gross sales revenues. It says that this highlights the overseas export purpose of this venture. It is true that the first performance payment was denominated in United States dollars, but so are all of the payments, including the initial payments before there could be any issue of the export of coal. If the establishment of export markets was so critical to Bathurst, we would expect to see some vestige of it somewhere in the Agreement. But there is no express reference to different categories of coal anywhere in the Agreement, let alone in the payment structure that was agreed.

[146] Clause 4.3 of the royalty deed does provide that amounts payable are to be paid in the denomination of the relevant gross sales revenues, but that is consistent with what is not in dispute – that there would be overseas export sales of coking coal. It does not exclude the possibility of local sales, denominated in New Zealand dollars.

[147] Here, as L&M argues, there is a commercial logic to the use of the word "shipped" to mean transported. In that way, coal sold will attract the obligation to pay royalties whereas unsold coal, usually stored on site, will not attract the obligation to pay royalties.

[148] For these reasons, we are satisfied that the Court of Appeal was correct to find that "while the focus of the project was export coking coal, it was not the project's exclusive focus".[154] There is nothing in the extrinsic material we have been referred to that supports Bathurst's formulation of the commercial objective of the Agreement as excluding the extraction of thermal coal. The commercial purpose of the contract therefore does not require "shipped" to bear the particular meaning for which Bathurst contends.

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154 CA judgment, above n 7, at [60].

Subsequent conduct

[149] Both parties relied upon aspects of post-contract conduct to support their arguments. We have already referred to Bathurst's reliance upon the DFS. In addition, Bathurst relied upon two letters, in almost identical form, sent to obtain necessary consents under the Crown Minerals Act 1991 and the Overseas Investment Act 2005, which the Agreement was conditional upon. In both of these letters, written by the solicitor acting for L&M, the description of Escarpment focussed on the export of coking coal. Bathurst says this evidence should be admitted: it is mutual because L&M was plainly aware of and helping with efforts to obtain the consents, it was proximate to the contract's formation, and it was overt conduct.

[150] We do not consider this material helpful. It is post-contract formation. While it is plainly proximate and, we accept, mutual conduct, it is material prepared for a particular purpose – a purpose which would shape how the business aim of the transaction was described, and what was and was not focussed on. Although it may be marginally relevant, its slight probative value must be weighed against the fact that admitting it invites the admission of further low value evidence to rebut or place it in context. As such, it would unnecessarily prolong proceedings and we would have been inclined to exclude this evidence.[155]

[151] L&M relied on Bathurst's 2014, 2015 and 2016 financial statements, annual reports and presentations which acknowledged that the extraction and sale of the thermal coal had triggered (or would trigger) the first performance payment. The Court of Appeal said it reached its view as to the meaning of cl 3.4 without reference to that evidence, since it was evidence of unilateral conduct of one party only, and equally consistent with a unilateral but mistaken understanding as with any reflection of the parties' common understanding.[156] We are of a different view. The position taken by Bathurst in relation to the obligation to pay the performance payment is

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155 Evidence Act, s 8(1)(b).
156 CA judgment, above n 7, at [62].

consistent throughout this series of documents.[157] It is evidence that could support the inference that the meaning now argued for by Bathurst was not the meaning the parties attributed to those words at the time. This negates Bathurst's suggestion that "shipped" had the particular and agreed meaning it argues for. While we do not attach much weight to this evidence, it is properly regarded as corroborative of the interpretation we favour.

Evidence as to the meaning of the word "shipped"

[152] L&M relies on the evidence of Messrs Loudon and Bohannan as to their understanding of the meaning of the word "shipped" – that it is a generic term for transported. These men negotiated the Agreement, and both had extensive mining experience. Although these witnesses did not expressly communicate their mutual understanding of the word "shipped" to each other at the point of contract, L&M submits that the evidence of this understanding is nevertheless admissible on this issue. It says that understandings, particularly between experienced parties, can be tacit and understood in the course of like-minded discussion and negotiation.[158] Contractual interpretation requires ascertaining how a reasonable person in the position of the parties would have understood the relevant words. This requires in turn that the judge place themselves in the position of the parties. When both parties to a particular contract share a similar background, understand a term in the same way, and act consistently with that understanding, their shared, tacit understanding should help the judge see the issues from the correct standpoint. L&M supports this proposition by reference to *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd* (*The Karen Oltmann*).[159]

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157 It is also consistent with the June 2016 letter from Bathurst's Chief Executive to the Chairperson of L&M, in which he did not deny that the performance payment had been triggered but said that non-payment did not amount to a breach of Bathurst's obligations (see HC judgment, above n 6, at [86]). We view this evidence as admissible for the same reasons as the financial statements. We note that in August 2014 (before 25,000 tonnes had been extracted), Bathurst announced to the market that because, based on coking coal prices, it had made the decision that there would be "no production activity scheduled beyond construction phase [at Escarpment] until international coking coal prices improve", this meant that "no royalties or financial obligations linked to shipments of export coal will fall due in the foreseeable future". However, we do not see this as contradicting the consistency of Bathurst's position once the performance payment had fallen due, by virtue of the fact that the extraction of 25,000 tonnes of thermal coal did in fact take place.

158 Relying on *FSHC Group Holdings Ltd v GLAS Trust Corpn Ltd* [2019] EWCA Civ 1361, [2020] Ch 365; and *The Karen Oltmann*, above n 84.

159 *The Karen Oltmann*, above n 84.

[153] The evidence relied upon in *The Karen Oltmann* was an exchange of telex messages which shed light upon which of two possible interpretations of the word "after" was intended by the parties to a contract. Kerr J said as to the relevance of this evidence:[160]

> If a contract contains words which, in their context, are fairly capable of bearing more than one meaning, and if it is alleged that the parties have in effect negotiated on an agreed basis that the words bore only one of the two possible meanings, then it is permissible for the Court to examine the extrinsic evidence relied upon to see whether the parties have in fact used the words in question in one sense only, so that they have in effect given their own dictionary meaning to the words as the result of their common intention. Such cases would not support a claim for rectification of the contract, because the choice of words in the contract would not result from any mistake. The words used in the contract would ex hypothesi reflect the meaning which both parties intended.

[154] *The Karen Oltmann* case is distinguishable from the present case. Here there was no evidence of communication between Messrs Loudon and Bohannan which bore upon the meaning of the word "shipped", to take the matter beyond their individual subjective understandings. Nor was this understanding objectively apparent from their words or actions at the time of contract. As Bathurst argued in the High Court, repetition by a number of witnesses of the same subjective recollections does not change their character.[161] Without some outward manifestation of this mutual understanding, this is not objective evidence that would have been reasonably available to the parties at the time of contract, and it is therefore not admissible.[162]

[155] The evidence in this case is evidence of subjective belief or intent, and so has no relevance to the objective exercise of contractual interpretation. It is irrelevant and inadmissible. It is also evidence the admission of which is likely to have needlessly prolonged the proceedings, as one party responded to the other's subjective understanding.

[156] Bathurst refers to L&M's use of language in other mining publications, which it says shows L&M used very precise language to describe methods of transport. It

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160 At 712.

161 HC judgment, above n 6, annexure at [12].

162 It follows that we disagree with the High Court Judge on this point: at [38]–[40], [58]–[61], and annexure at [13].

says this is consistent with Bathurst's meaning of "shipped". That evidence is also irrelevant. It bears upon L&M's use of words in other contexts, and would not reasonably be regarded as relevant background for the purpose of the interpretive exercise.

[157] Finally, Bathurst called Mr Christopher Russell to give expert evidence as to the sense in which the word "shipped" is used in the coal industry. He was qualified as an expert through over 40 years' experience in coal markets and logistics in New Zealand. He gave evidence that the industry was usually specific and accurate in its description of modes of transport. While we have no doubt that evidence as to industry practice and custom can assist in understanding the meaning of particular words or phrases,[163] that is not true here. In the High Court, Dobson J said that Mr Russell's opinions were not materially helpful in interpreting the expression in the Agreement.[164] He said that the focus of Mr Russell's experience was in dealing with logistics and communications in that context. That was "credibly distinguished" from the context in which the word was used in the Agreement.[165] We agree.

Conclusion

[158] The text of the Agreement strongly supports interpreting the expression "shipped from the Permit Areas" as meaning "transported" from the permit areas. The word "shipped" is now commonly used, following a sale, to mean transported. The language and structure of the clause and the broader Agreement is supportive of this meaning, and is not consistent with the meaning argued for by Bathurst. As to the extrinsic evidence relied upon by the parties, to the extent that such evidence is admissible, it provides little assistance as to the interpretation of the term, and does not support the meaning contended for by Bathurst.

The construction of cl 3.10

[159] Bathurst also appeals the interpretation of the Third Deed, entered into on 21 August 2012. The Third Deed was executed prior to completion of the consenting

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163 See above at [82]–[83].

164 To put this in Evidence Act terms, the evidence was not substantially helpful: Evidence Act, s 25(1).

165 HC judgment, above n 6, at [109].

process when Bathurst was seeking to raise the capital necessary to enable production to occur at the mine. At that time, the parties were working productively to get Bathurst into production. However, over a period of some three years from late 2012, the price for coking coal dropped and continued to fall. In February 2014, Bathurst decided to defer developing Escarpment into export production state, and in March 2016 Bathurst announced that mining operations at the Escarpment Mine were being suspended. The mine was placed in "care and maintenance". After that, Bathurst ceased paying royalties, apart from small amounts payable for sales of stockpiled coal.

[160] The other contextual points to note are as follows.

[161] Later in 2016, Bathurst obtained a majority interest in BT Mining which purchased various coal mining interests from Solid Energy, including an existing open-cast mine on the Stockton Plateau on the West Coast, which produces coking coal and serves an established export customer base.[166] When Mr Richard Tacon, Bathurst's current Chief Executive, gave his evidence, the Stockton Mine was producing one million tonnes per annum of coking coal. The Rotowaro and Maramarua Mines purchased by BT Mining from Solid Energy produce approximately 700,000 and 150,000 tonnes per annum of thermal coal respectively for the domestic market. Consequently, Escarpment is no longer Bathurst's priority. As the High Court said, and as Bathurst generally accepts:[167]

> [12] Bathurst's business plans for its west coast mining interests contemplate the ex-Solid Energy resources being exploited before the resumption of mining at Escarpment or other prospects within the permit areas acquired from L&M. That sequence has been decided upon despite the ex-Solid Energy areas not having all necessary regulatory consents.

[162] In the meantime, from September 2016 there has been a substantial recovery of coking coal prices.

[163] Against this background, the particular question of interpretation arising is whether the Court of Appeal was correct to conclude that cl 3.10 of the Third Deed

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166 Settlement for this purchase occurred in August 2017.

167 HC judgment, above n 6. See also CA judgment, above n 7, at [17].

did not allow Bathurst to deny that its non-payment of the first performance payment was a breach of contract. As foreshadowed above, and as matters stand, if the interpretation advanced by Bathurst is correct, it neither has to pay the performance payment nor any royalties because it is not mining Escarpment and, possibly, may never do so.[168]

[164] To put the question of interpretation in context, it is helpful first to set out again the key terms of the Third Deed and to briefly outline the approach to cl 3.10 taken in the Courts below.

The relevant provisions

[165] Clause 3.10 provides as follows:

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

[166] In addition, the "No Waiver" clause states that:

> For the avoidance of doubt, nothing in this Deed constitutes a waiver by [L&M] of any of its rights as referred to in clause 9.7 of the Agreement, so long as payments are made in accordance with the Royalty Deed.

The approach in the Courts below

[167] As we have noted above, both Courts below found in favour of L&M on this question.[169] The High Court concluded that prior to the Third Deed, "L&M was entitled to treat non-payment of the first performance payment when due as a default".[170] Clause 3.10 changed that position and provided for "an alternative money flow to the payment of the performance payment".[171] This change reflected the parties' agreement that, although prior to the Third Deed L&M could have cited

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168 As noted above, royalties may be paid on a low level of sales of stockpiled coal.
169 See above at [36].
170 HC judgment, above n 6, at [129].
171 At [144].

non-payment of the first performance payment as a default, L&M agreed that it would not do so.

[168] The High Court also said that under cl 3.10, the "quantum is at large, in that no minimum level of royalties" is set out but, the Court considered, the clause was:[172]

> … reasonably to be interpreted as the level of royalties calculated in accordance with the royalty deed that become payable on a reasonable level of production from the permit areas.

[169] The Court of Appeal agreed with the interpretation of the High Court, but for slightly different reasons. The Court of Appeal emphasised the context of the Agreement, all of which led the Court to conclude that there was nothing to suggest, "to an objective observer, an entitlement to simply place a US$40 million debt on ice, indefinitely".[173] Rather, the Court considered:

> [96] … the [objective] observer would take the words "for so long as the relevant royalty payments continue to be made" to mean that the debt would not be payable so long as L&M continued to receive 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. That would provide commercially realistic compensation to L&M for the delay in receipt of the performance payment. Otherwise, the agreement would have made no commercial sense at all from L&M's perspective. …
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> [97] In context, the requirement that "relevant royalty payments continue to be made" is not met by merely nominal royalties from sales from a stockpile of coal left after mining has ceased. Any other interpretation would be devoid of commercial sense and cannot be what the words mean.

Overview of submissions

[170] Two principal questions of interpretation arise from the parties' submissions. The first is whether cl 3.10 changed the parties' contractual arrangements by granting Bathurst a concession or whether it was simply clarifying the existing Agreement. The second issue is what was necessary to enable Bathurst to take advantage of the concession. That question focusses on the meaning of "relevant" royalty payments.

[171] In terms of the first question, it is important to Bathurst's argument that prior to execution of the Third Deed, it was entitled to defer payment of the performance

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172 At [144].
173 CA judgment, above n 7, at [91].

payment so long as it paid royalties at the higher rate under the royalty deed. On this approach, cl 3.10 simply made it clear that Bathurst had flexibility about making the first performance payment. Bathurst could avail itself of that flexibility if it continued to pay royalties at the higher rate. On the second question, Bathurst says that as it had complied with its obligations under the royalty deed, it was protected from any adverse action against it by L&M.

[172] L&M, by contrast, says that the clause altered the parties' contractual arrangements. In particular, cl 3.10 provided that non-payment of the performance payment on the due date, which would otherwise have been a breach of the Agreement, was not a breach, provided Bathurst continued to pay royalties from mining. As to what was required to enable Bathurst to take advantage of the concession, L&M says the royalties had to continue to be paid on mining consistent with that which triggered the performance payment. In other words, the clause provided Bathurst with a breathing space but did not allow Bathurst to defer payment of the performance payment indefinitely in a situation where it also did not pay any royalties because no coal is being extracted from the Escarpment Mine.

[173] We deal with whether or not the clause altered the parties' contractual arrangements first and then turn to the second question. We address further detail of the parties' submissions in the discussion which follows.

Our assessment

[174] The text of cl 3.10 provides that non-payment of the performance payment is not an actionable breach for so long as (that is, while) the royalty payments at the higher rate continue to be made. We interpret the clause as changing the parties' pre-existing contractual arrangements by giving Bathurst an indulgence, conditional on maintaining payments of the relevant royalties. For the reasons which follow, we agree with the Court of Appeal that the relevant royalty payments are those arising from a level of mining consistent with that which triggered the performance payment.[174] Under cl 9.7, L&M otherwise has the same rights as specified in cl 9.3

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[174] The Court of Appeal put it as "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": CA judgment, above n 7, at [96].

(except cl 9.3(b)), that is the right to sue for specific performance, damages or "any other rights or remedies available at law or in equity" apart from cancellation. This is the meaning which the Third Deed 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 Third Deed.

Discussion

[175] We start with the text of the Third Deed. The words used give cl 3.10 a concessionary character. It applies only in the situation where a performance payment is due and not paid. Hence, the clause addresses "a failure by [Bathurst] to make, when and as due, a Performance Payment". It then provides for the situation in which L&M will, nonetheless, not exercise its rights.

[176] The concessionary character of the Third Deed is also highlighted by the non-waiver provision which makes it clear that L&M is not in this way waiving its rights under cl 9.7 of the Agreement for remedies on a default.[175] Accordingly, if Bathurst simply stopped paying royalties, we agree with L&M that, on a natural reading of cl 3.10, the clause does not avail Bathurst. At that point, under cl 3.4(a) of the Agreement, the performance payment of USD 40 million is otherwise due and owing and L&M can enforce payment under cl 9.7. We say that because cl 3.10 only applies "for so long as" the relevant royalty payments are made.

[177] Part of Bathurst's argument, that prior to execution of the Third Deed it was entitled to defer payment of the performance payment so long as it paid royalties at the higher rate, rests on cl 4.1(a) and (d) of the royalty deed and draws on what Bathurst says is the clarificatory nature of the Third Deed. In this respect, Bathurst emphasises the "avoidance of doubt" language in the Third Deed and contends that the purpose of cl 3.10 was to clarify any doubt about the relationship between cl 4.1(a) and (d) of the royalty deed and cl 9.7 of the Agreement.

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[175] The non-waiver provision itself is not well expressed, referring, for example, to the rights of the "Purchaser" (not "Vendor") under cl 9.7. Nonetheless, we consider it clear that a reasonable person with all the background would understand the clause to mean that L&M was not waiving its rights to sue for remedies under cl 9.7 in a situation where the relevant royalty payments under the royalty deed were not paid.

[178] Clause 4.1 of the royalty deed provides for the payment of amounts calculated by reference to the specified percentages based on gross sales revenues, a defined term, and "calculated in accordance with either paragraph (a) or paragraph (b) or, if neither applies at the relevant time, then paragraph (c), subject always to paragraphs (d) and (e) and to clause 4.2".[176] For our purposes, the relevant paragraphs are (a) and (d), which provide as follows:

> (a) from the date on which this Deed becomes unconditional until the date of payment in full of the cash consideration payable by the Guarantor under clause 3.4(a) of the Sale and Purchase Agreement (the *First Payment Date*), at a rate of 10% of Gross Sales Revenues;
>
> …
>
> For the avoidance of doubt:
>
> (d) subject to clause 4.2, the Royalty shall be payable at the rate of 10% of Gross Sales Revenues from the date on which this Deed becomes unconditional until the End Date[177] in the event that the First Payment Date does not occur; and …

[179] Clause 4.2 of the royalty deed deals with the situation where the initial tranche of performance shares have not been issued.

[180] Neither of the Courts below interpreted cl 4.1 of the royalty deed as having the effect for which Bathurst contends. In those Courts, Bathurst focussed on cl 4.1(d). Of that clause, the High Court took the view that the effect of this provision was to require "royalty payments to continue at the higher rate until the performance payment had been made".[178] The effect was to "eliminat[e] the prospect that Bathurst could reduce the rate at which it paid royalties on gross sales revenues from the time the level of production triggered the obligation to pay the performance payment, rather than from the date on which the performance payment was made".[179] There was nothing in the clause to allow Bathurst to escape the consequences of breach of the Agreement for non-payment of the performance payment when due.

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176 "Gross Sales Revenues" are defined as "the gross sales revenues, derived or deemed to be derived from the sale of Coal, with no deductions being made on any account (whether for mine operating costs, hedging or otherwise) and regardless of whether or not mining is profitable".

177 "End Date" is defined in cl 4.1(c) as the "later to occur of the end of the term of both Permits or the final cessation of mining operations in the Permit Areas".

178 HC judgment, above n 6, at [121].

179 At [121].

[181] The Court of Appeal agreed and also said that the clause was not "an option, forestalling the express right in cl 9.7 of the sale agreement to sue for payment".[180] Bathurst submits that in its approach to cl 4.1(d), the Court of Appeal engaged in a subjective exercise because the Court went on to inquire why Bathurst sought the amendment by way of the Third Deed. We do not accept that. Rather, the Court focussed on the wording of cl 4.1(d) and then put that in context. We adopt that interpretation and we also agree with the Courts below that cl 9.7 is the key remedies provision in relation to performance payments. Under that clause, L&M has the right to sue for specific performance, damages or "any other rights or remedies available at law or in equity" apart from cancellation; so it is not correct, as Bathurst would say, that there were no remedial consequences under the original contract for non-payment. Rather, cl 9.7 made it clear that was not the case. It follows that, as the High Court and the Court of Appeal found, cl 3.10 made a change to the parties' contractual arrangements.

[182] Interpreting the text of the Third Deed as a change of a concessionary nature is also supported by the context as reflected in the High Court's factual findings.[181] In particular, having reviewed the evidence, the Judge found that Bathurst's concern leading to the Third Deed was to avoid "having to announce [to the stock market] that it found itself in breach if it was unable to make the payment immediately upon it becoming due".[182] And that it was "not in L&M's interests to push Bathurst into default or to pursue remedies for a breach of contract".[183] Rather, the parties' "relationship remained a co-operative one until Bathurst changed its stance to deny that the obligation to make the first performance payment had been triggered".[184] As Mr Galbraith QC for L&M submitted, the doubt resolved by the Third Deed was the difference between the parties' commercial and legal arrangements.

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180 CA judgment, above n 7, at [86].

181 Like Dobson J, we treat the unchallenged evidence to this effect from Mr Bohannan and Mr Gregory Hogan (whose role at L&M included providing commercial advice to the company during negotiations with Bathurst) as part of the objective background addressing the genesis of the Third Deed: see HC judgment, above n 6, at [116] and [122].

182 At [122].

183 At [123].

184 At [123].

[183] We turn, then, to the second interpretation question, that is, what Bathurst needed to do to take advantage of the cl 3.10 concession. Again, we begin with the text.

[184] The words "so long as" appearing in both cl 3.10 and in the No Waiver clause, the reference to "payments", and the description of payments that "continue to be made" are all consistent with the idea that the actual payments being made when cl 3.10 is triggered are to continue afterwards. The words "relevant royalty" have to be read in that light. As the High Court found, those words are "no more than quantification" of the obligation.[185]

[185] Moreover, these references, which are to a continuance of a state of affairs, plainly contemplate carrying on in the same way as before rather than an interruption. The text of the Third Deed accordingly suggests that the High Court correctly rejected the alternative, advanced by Bathurst, that "if no payments" were due under the royalty deed, "then Bathurst needs [to] do nothing to bring itself within cl 3.10".[186]

[186] A failure to stipulate a minimum level of mining is not fatal to this interpretation given the words of continuity. The assumption is of ongoing mining. The question then is what is meant by the word "relevant" in the phrase "for so long as the relevant royalty payments continue to be made".

[187] As we have noted, Bathurst's case is that all that was needed was to comply with the obligations under the royalty deed, which it has done. We come back to the further limbs of the argument for Bathurst shortly. L&M, by contrast, submits that on Bathurst's approach to interpretation, L&M, for no benefit, gave Bathurst a unilateral option not to pay its debt of USD 40 million. L&M's argument is that the words in context determine that the debt could be deferred only if Bathurst continued to pay royalties from the ongoing mining that was necessary for cl 3.10 to be triggered in the first place. It also says that Bathurst's approach effectively would have the Court read in "and if" to cl 3.10 so that it said "when and as *and if* due".

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185 At [145].
186 At [146].

[188] The Court of Appeal accepted L&M's argument. The Court found that, in context, the requirement for continuing payment was not met by "merely nominal royalties".[187] Any other interpretation, the Court said, "would be devoid of commercial sense".[188]

[189] We consider that this interpretation is correct textually because of the language of continuity and is consistent with the overall commercial structure of the Agreement. That arrangement, as Bathurst accepts, was to incentivise the payment of the performance payment by imposing a requirement to pay royalties at the higher rate until the performance payment was made. We acknowledge that, on the evidence, it does not appear that the royalty payments made over the period from March 2015 to March 2019 in fact provided a particularly significant incentive in monetary terms.[189] But underlying this aspect of the arrangement must have been the assumption that once Bathurst was in production and in full flow (having triggered the 25,000 tonne threshold), mining (as the royalties reflected gross sales revenue) would continue to grow exponentially such that paying the performance payment would be preferable to paying the higher royalty.

[190] Neither party was contemplating that, having reached the 25,000 tonne threshold and having incurred the fixed costs in getting the mine into production, Bathurst would then scale back production drastically and/or indefinitely cease mining.

[191] Further, although providing what the Court of Appeal described as "generalised obligations",[190] the other aspects 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 maximisation of Coal sales at the best available price", are consistent with that overall commercial structure.

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187 CA judgment, above n 7, at [97].

188 At [97].

189 Over that period, at their highest, the royalties paid were less than NZD 1 million per year at the highest royalty rate, the incentive effect of which is to be measured against non-payment of a USD 40 million debt.

190 CA judgment, above n 7, at [67].

[192] The Court of Appeal accepted there may have been an argument about exactly what level of production was required by the words "relevant royalty payments continue to be made". But that would only have been so if Bathurst had "actually maintained commercial mining" and paid more than minimal royalties.[191] As it transpired, however, Bathurst came "nowhere near the level of production, and continuing royalty payments, that would entitle it to rely on cl 3.10".[192] We agree.

[193] We add that as a matter of commercial common sense, there is also force in L&M's argument that the construction favoured by Bathurst is unlikely because it involves L&M giving away a right to USD 40 million in return for a unilateral option to pay. While L&M did have a commercial interest in the continued development of Escarpment, that interest is not in proportion to the concession Bathurst claims L&M made. Such a concession would deprive L&M of most of the commercial value of the transaction. Holding Bathurst to the interpretation which we favour does still allow Bathurst to improve its position. That is because we accept Bathurst could not be in breach of its obligation to pay the USD 40 million debt for so long as it continued to mine Escarpment.

[194] Bathurst's criticism is that the Court of Appeal has essentially implied a term under the guise of interpretation, without satisfying the threshold for implication of a term.[193] Bathurst says that one of those terms is to require Bathurst to keep mining even if that is uneconomic. We do not agree. Rather, the Court's conclusion as to meaning is available as a matter of interpretation of the words of the Third Deed in its relevant contractual context; it is what a reasonable person with all the available background would understand the Third Deed to mean.

[195] Nor do we accept that on this approach, Bathurst is forced to keep mining to insolvency. The position is that there is no indefinite deferral of payment. At some point in time, Bathurst would have to pay its USD 40 million debt if it was no longer paying royalties at a level consistent with a productive mine. That time has come, given there is no mining at Escarpment and the evidence is that Bathurst prioritises the

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191 At [100].
192 At [101].
193 In any event, we are satisfied that the test for implication is satisfied in this case: see below at [201]–[222].

development of other assets. Any development of Escarpment is, therefore, some years away at best, and realistically may never occur.[194] Bathurst can no longer point to falling coal prices but rather, essentially, has changed its business priorities. It is of course entitled to do so, but the effect of the parties' agreement is that L&M is now entitled to be paid the debt owing to it.

[196] Bathurst also suggests that the Court of Appeal's approach has the effect of adding a term containing an obligation to achieve some unspecified level of sales of coal. Again, that misstates the effect of the interpretation adopted. In any event, the evidence was that there would always be a current price at which coal produced from the Escarpment Mine could be sold. Mr Tacon on behalf of Bathurst said that there was always a spot price for coal.[195]

[197] We add that we do not accept the argument for Bathurst that the discussions between the parties in August 2013 altered the position. Bathurst points to the exchanges between L&M and Bathurst in August 2013 as evidence of mutual subsequent conduct relevant to the interpretation of cl 3.10. These exchanges occurred when Bathurst was working on a new capital raise in 2013 (a year after the Third Deed was executed) and its bankers and lawyers requested clarification about the operation of cl 3.10. Bathurst sought this clarification from L&M in a series of exchanges in August 2013.

[198] As the High Court observed, L&M agreed to an exchange between Ms McArthur, the lawyer acting for L&M who drafted the Third Deed, and Russell McVeagh, who acted for Bathurst, as to how the terms of the Third Deed should be described. The end result was L&M's concurrence with the following description:

> Failure by Bathurst to make a performance payment when due is not a breach of the [Agreement] provided Bathurst continues to pay royalties to L&M at the royalty rate applying at the time the relevant performance payment was due. This provides Bathurst with the flexibility to manage the timing of the performance payments provided it makes the required royalty payments at the applicable rate as and when due.

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[194] In its reply submissions, Bathurst acknowledged that the first performance payment will "possibly never" be paid if economic incentives to develop Escarpment never arise.

[195] He said, however, that Bathurst had no coal to sell and was not qualified with any customers with whom it could do a spot shipment.

[199] The High Court Judge said he was satisfied on the evidence of Mr Clarke from Russell McVeagh that the "contemplation of the parties in 2013 was as it had been in 2012".[196]

[200] This aspect was not addressed by the Court of Appeal, but we agree with the High Court that these discussions did not alter the position. Nothing is raised to suggest we should take a different view of the evidence from that of the Judge. Further, as L&M submits, the high point of the exchange set out above does no more than paraphrase the terms of the Third Deed. It therefore has little probative value. On that basis, although the evidence is admissible as evidence of subsequent conduct because it meets the relevance threshold, it does not carry the weight Bathurst ascribes to it. We add that the alternative now advanced by Bathurst of not paying either the performance payment or any royalties was not discussed in these exchanges, presumably because the prospect of Bathurst commencing and then ceasing production at the Escarpment Mine, and for all intents and purposes not resuming production, was not on the agenda at the time.

An implied term?

[201] On our approach, it is not necessary to consider the alternative argument for L&M for an implied term. Nonetheless, like the High Court, for the reasons which follow we would have, had it been necessary, implied a term as to the relevant royalty payments required in order for Bathurst to rely on cl 3.10.[197] In particular, we would imply a term that 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. That term would reflect our objective assessment of the parties' bargain, discussed above.

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196 HC judgment, above n 6, at [151].

197 On the Court of Appeal's approach, it was not necessary to consider implying a term and the Court did not address that topic: CA judgment, above n 7, at [103].

[202] The implied term pleaded by L&M was, as the High Court Judge said, "more elaborate" than necessary.[198] The term L&M advanced at the hearing before this Court was a simpler expression, namely, that in order to rely on cl 3.10, the relevant royalty payments must reflect the proceeds of ongoing mining. In developing the submissions on this point, Mr Kalderimis, who argued this aspect of the case for L&M, said that L&M did not seek the implication of a minimum amount of mining or a term as to its manner or character. Rather, L&M argued for the implication of an "anti-avoidance" term preventing Bathurst from disabling itself from fulfilling the condition in cl 3.10.[199]

[203] Bathurst's response is that the strict test for implication of a term is not met in this case. It argues that an implied term involves rewriting the contract, notwithstanding that the Agreement incorporates:

(a) the express provisions of the royalty deed;

(b) the express provisions of the Agreement's further assurances clause (cl 16.4);

(c) the entire agreement provision in cl 16.9 of the Agreement; and

(d) the express provisions of cl 3.10.

[204] We acknowledge the line of authorities relied on by L&M for the proposition that an "anti-avoidance" term should be implied. However, we do not need to address this argument which would, in any event, require us to consider evidential matters not

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198 HC judgment, above n 6, at [158]. The term pleaded was that "once a substantial volume threshold in clause 3.4 has been met, in order to further defer payment of the deferred consideration comprising the corresponding Performance Payment, continued royalty payments cannot be notional, but must reflect the proceeds of ongoing mining and substantive coal sales, thereby providing commercial value for [L&M] being denied receipt of a sum otherwise due and owing".

199 In this respect, L&M submits that it is conventional that where a party agrees to pay for an asset out of its fruits, the court will imply a term that a party will not sterilise the asset so that it produces no fruit: *M'Intyre v Belcher* (1863) 14 CBNS 654, 143 ER 602 (Comm Pleas); *Stirling v Maitland* (1864) 5 B & S 840, 122 ER 1043 (QB); *Ogdens Ltd v Nelson* [1904] 2 KB 410 (CA); *Hart v MacDonald* (1910) 10 CLR 417; and *Ali v Petroleum Co of Trinidad and Tobago* [2017] UKPC 2, [2017] ICR 531. The gist of this line of cases is aptly stated in the following observation from Willes J in *M'Intyre*, where the Judge said at 665: "if I grant a man all the apples growing upon a certain tree, and I cut down the tree, I am guilty of a breach".

dealt with in this context in the Courts below.[200] Our approach is essentially that it would be necessary to imply a term as set out above at [201] to ensure the business efficacy of the Agreement. As we discuss above at [116], the fact that the implied term is necessary to give business efficacy to the Agreement is a useful analytical tool in determining whether the implication of this term is strictly necessary. This implied term is also capable of clear expression and does not contradict the express terms of the Agreement.

[205] We see the implication of a term in this case as consistent with the approach taken in cases such as *Rod Milner Motors Ltd v Attorney-General*[201] and *Vickery v Waitaki International Ltd*.[202]

[206] In *Rod Milner*, the appellants claimed there was an implied term in their contract with the relevant government department that the terms and conditions for tenders set out in the industry's developmental plan would be substantially adhered to in their tender contracts for import licences. The Court of Appeal agreed, deducing such a term by implication from the express terms of the contract. The Court said it would also be willing to imply such a term to give business efficacy to the contract. This was on the basis that a contract "cannot have business efficacy if one of the parties can so change the basis of it as to destroy or seriously undermine the value of that which was acquired".[203]

[207] In *Vickery*, the appellant had entered into a contract with the respondent to provide catering and cleaning services for the Longburn freezing works. The works were closed at a point when, having exercised rights of renewal, the contract was still on foot and had over two years to run. The works were never re-opened. The appellant had been unsuccessful in seeking compensation from the respondent and so brought a claim for breach of contract. All three members of the Court thought it was implicit

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200 In the High Court the evidence relevant to this argument was only considered in the context of L&M's improper purpose claim.

201 *Rod Milner Motors Ltd v Attorney-General* [1999] 2 NZLR 568 (CA).

202 *Vickery v Waitaki International Ltd* [1992] 2 NZLR 58 (CA). For a more recent application, see *Hunan Holdings Ltd v Virionyx Corp Ltd* HC Auckland CIV-2005-404-1480, 13 December 2005 at [94]–[99]; and *Compcorp Ltd v Force Entertainment Centre Ltd* (2003) 7 NZBLC 103,996 (CA) at [25].

203 *Rod Milner*, above n 201, at 580.

in the language of the express terms of the contract that the respondent would keep the works open and maintain a workforce who could be expected to patronise the appellant's catering facilities for the duration of the contract.

[208] As we see it, the value acquired by L&M under cl 3.10 was that it would receive royalty payments at the higher rate to compensate for Bathurst's deferral of the payment of USD 40 million, which was keeping L&M out of its capital. Bathurst would say that such an approach requires treating the performance payments as deferred cash consideration. On Bathurst's approach, they were contingent payments based upon the potential future performance of the Escarpment Mine resulting in an agreement where the parties shared the risk that economic extraction of coal from the permit areas might not occur. As we have found, however, the Agreement is clear that the first performance payment is triggered when the 25,000 tonne threshold is met, and on our interpretation of cl 3.4, that is the position.[204]

[209] On our view, cl 3.10 does not have business efficacy if it allows Bathurst to cease mining as it has done and hence stop paying royalties, while also refusing to pay L&M's capital of USD 40 million. As the Court said in *Rod Milner*, that would allow Bathurst to "so change the basis of [the contract] as to destroy or seriously undermine the value" of what was acquired by L&M.[205] We reiterate here the point made above at [193] that, as a matter of commercial common sense, L&M's commercial interest in the continued development of Escarpment is out of proportion to the concession Bathurst claims L&M has made; a concession which would deprive L&M of most of the commercial value of the transaction.

[210] *Vickery* is also relevant in that Cooke P emphasised that, despite the implied term, the respondent could not be obliged to provide a workforce for the appellant's catering business. Cooke P said:[206]

> In any ordinary circumstances it is unthinkable that specific performance or an injunction would be granted to compel the carrying on of a business in order to provide patronage for a concessionaire or even work for employees. Some of the observations in the learned Judge's reasoning perhaps suggest that he was influenced by some such consideration.

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204 The High Court also disagreed with Bathurst's characterisation of the Agreement.
205 *Rod Milner*, above n 201, at 580.
206 *Vickery*, above n 202, at 63.

[211] Cooke P did not, however, see this as determinative of whether the respondent had breached its contractual obligations. The point made was that although the Court would not restrain the employer in this situation from ceasing business for "sound commercial reasons", that would comprise "a breach of the contract, entitling the other party to compensation by way of damages".[207]

[212] Similarly, in this case the Court could not, on the basis of the contractual arrangements, require Bathurst to take the Escarpment Mine out of care and maintenance and keep mining. But we do consider it is a breach of contract, entitling L&M to compensation, for Bathurst to cease mining 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).[208]

[213] Indeed, the High Court took the same sort of approach when rejecting Bathurst's argument, repeated in this Court, that the proposed implied term by L&M was inconsistent with the express terms of cl 3.10 and with the terms of the royalty deed because the implication required continuous mining operations to trigger continuous obligations to pay royalties. The Judge said the proposed implied term:[209]

> … does not require continuous mining operations. Rather, it limits the circumstances in which Bathurst can rely on cl 3.10 to avoid being in breach for non-payment of the performance payment to situations where such royalties are being paid.

Either Bathurst could keep mining at a level consistent with what triggered the performance payment and pay royalties on that level of production, or it could stop mining and pay the performance payment due. It could not do neither.

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207 At 63.

208 See also *Rod Milner*, above n 201, at 580, where the Court said there was "no question that the Minister was entitled to combine the 1988 rounds. If, however, as we have found, that constituted a breach of the contract between the Crown and individual tenderers, the Crown must be liable for the loss suffered as a result of that breach".

209 HC judgment, above n 6, at [185]. See also at [187]: "the implied term would not impose an obligation to conduct mining; rather it would restrict Bathurst's entitlement to rely on cl 3.10 to avoid paying the performance payment to circumstances where Bathurst is either conducting mining operations or makes payment of the performance payment. The clause cannot be relied on where Bathurst does neither of those things".

[214] In response to Bathurst's argument that the term proposed is not capable of clear expression, we adopt the High Court's view that:[210]

> Defining the level of royalty payments in conceptual terms rather than as a minimum reflects L&M's position that, for cl 3.10 to apply, Bathurst had to be undertaking on-going mining and making substantive, rather than token, sales of coal. The stipulation reflects an unusual notion where precision is inappropriate. Lack of precision is not the same as ambiguity.

[215] Finally, we note that in *Vickery*, Cooke P accepted that there might be "[q]uestions of degree" in deciding on the "fair operation of the agreement" (such as the extent to which the respondent could make changes in employee numbers or temporary closures of the works without incurring liability), but such questions did not arise in that case because the works were never re-opened.[211] Here, as we have noted, there may be questions of the degree to which Bathurst could reduce mining or even temporarily halt mining and not incur any liability, but that does not arise on the present facts where Bathurst has put itself in the position where Escarpment is currently not being mined at any level and will not be mined in the reasonably foreseeable future, if at all.

[216] That being the situation, we would have found that L&M can recover the USD 40 million debt.[212]

[217] We turn, then, to Bathurst's argument based on the further assurances and entire agreement clauses.

[218] The further assurances clause is in the following terms:

> **16.4 Further Assurances**
>
> Each of the Parties agrees to execute and deliver any documents, including transfers of title, and to do all things as may reasonably be required by the other Party to obtain the full benefit of this Agreement according to its true intent.

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210 At [177].

211 *Vickery*, above n 202, at 65.

212 Clause 9.7 gives L&M the rights to remedies in cl 9.3, apart from cancellation. As we have noted, cl 9.3 is not exhaustive, allowing for L&M to pursue those "other rights or remedies available at law or in equity" which must include the right of action in debt. This is consistent with the pleadings and is how the claim was characterised by the lower Courts: see CA judgment, above n 7, at [105]–[108]; and *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2020] NZCA 186, (2020) 25 PRNZ 341 at [2].

[219] Bathurst seeks to draw something from the failure of L&M to make a pleading in reliance on this clause. But cl 16.4 is not relevant to the question of whether the implied term is necessary. We see the clause as a more mechanical provision simply recording the parties' agreement to deliver documents and so on as may be required to ensure the Agreement is implemented.

[220] Further, the entire agreement clause is conventionally expressed, making it clear that the Agreement constituted the entire agreement between the parties, superseding any previous understandings or agreements.

[221] Like the High Court, we do not consider the entire agreement clause operates to exclude the implication of a term in cl 3.10. As the Judge said:[213]

> Given the circumstances of its completion, the implied term would not draw on earlier negotiations, understandings or agreements. Rather, it records the scope of the concession made in favour of Bathurst subsequent to execution of the [Agreement] to address a predicament that Bathurst had perceived as arising, and on which it sought an accommodation from L&M. That context is not caught by the stipulation in the entire agreement clause.

[222] It follows that the implied term set out above at [201] does not contradict the express terms of the Agreement.

[223] Accordingly, we would find that L&M is entitled to a declaration that the first performance payment has become due and owing by Bathurst and to an order that Bathurst pay the USD 40 million debt to L&M. We would confirm the entitlement to interest pursuant to s 87 of the Judicature Act 1908, as Dobson J did.

Proper purposes

[224] Against the possibility that it does not succeed in its argument as to the construction of cl 3.10, L&M contends that Bathurst is obliged to exercise contractual discretions for proper purposes, including the discretion under cl 3.10 whether to pay

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213 HC judgment, above n 6, at [183]. See also *Hart*, above n 199, at 421 per Griffith CJ, 427 per O'Connor J and 430 per Isaacs J, noting that entire agreement clauses do not preclude implications which arise on a fair construction of the agreement itself as such an implication is as much a part of the contract as any term couched in express terms. For a discussion of more recent authority on this point see Peel, above n 51, at [6-063]; and Beale, above n 51, at [14-019]. See also at [13-117].

the triggered first performance payment or rely on cl 3.10 to make royalty payments instead. L&M says Bathurst has not exercised this discretion for a proper purpose because its decision to pay token royalties instead of the USD 40 million was not in order to facilitate development of the mining assets purchased from L&M but rather to facilitate development of alternative mining assets. Bathurst responds that this fall-back argument must fail; first, because it only arises in the event that L&M's construction of cl 3.10 has not been accepted and, second, because cl 3.10 does not establish a discretion subject to review by a court for improper purpose.[214]

[225] We do not address this aspect of the claim. It is not necessary on our approach to construction to do so. The scope of such a claim and how it fits within the framework of contractual construction is an important issue and one that should be resolved in a context in which it is central to the case.

[226] It follows that we also do not need to consider L&M's application to adduce further evidence, opposed by Bathurst, which it raises as relevant to its argument on proper purposes.

Good faith

[227] Finally, we note that the Supreme Court of Canada has recognised that there exists an "organising principle" of good faith that underlies and manifests itself in various more specific contractual doctrines.[215] Recent decisions of that Court, to which the parties have referred us, recognise a duty of honest performance[216] and a duty to exercise contractual discretion in good faith[217] as deriving from this organising principle. The Court has held that both duties operate as a general doctrine of contract law, noting that they "need not find [their] source in an implied term in the contract".[218]

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214 With reference to *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest)* [2013] EWCA Civ 200, [2013] BLR 265; and *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116, [2008] 1 Lloyd's Rep 558.

215 *Bhasin v Hrynew* 2014 SCC 71, [2014] 3 SCR 494 at [33] and [63].

216 *Bhasin*, above n 215, at [73]; and *CM Callow Inc v Zollinger* 2020 SCC 45.

217 *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District* 2021 SCC 7, (2021) 454 DLR (4th) 1.

218 At [91].

Rather, they "operat[e] in every contract irrespective of the intentions of the parties".[219]

[228] In other jurisdictions, such as Australia and England and Wales, courts have recently considered the possibility of implying a duty of good faith or subsets of that duty into contracts. There is no definite conclusion as to their precise place in the law of implied terms in those jurisdictions.[220]

[229] We do not think it necessary to say anything further about the place in New Zealand's contract law of good faith as an organising principle, particular subsets of good faith doctrines, or an implied duty of good faith. It is not necessary to resolve these points to determine this appeal. We would prefer to determine these questions in a case where they mattered.

Result

[230] In accordance with the view of the majority, the appeal is allowed. The judgments of the Courts below are set aside and judgment is entered for the appellants. The application to adduce further evidence is dismissed.

[231] Costs should follow the event. Given the respondent succeeded on the argument relating to cl 3.4, we consider the costs award should be slightly discounted. The respondent must pay the appellants costs of $30,000 plus usual disbursements. We certify for second counsel. Costs in the Courts below are to be re-determined in those Courts in light of this judgment.

GLAZEBROOK, O'REGAN AND WILLIAMS JJ
(Given by O'Regan J)

Table of Contents

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219 At [91]. See also *Bhasin*, above n 215, at [74]; and *CM Callow*, above n 216, at [48].

220 See the discussion of the English position in Beale, above n 51, at [14-028]. See the discussion of the Australian position in NC Seddon and RA Bigwood *Cheshire & Fifoot: Law of Contract* (11th ed, LexisNexis, Chatswood (NSW), 2017) at 484–489.

Points of agreement with the joint reasons

[232] We agree with the reasons of the Chief Justice and Ellen France J (the joint reasons) on:

(a) the approach to the admissibility of extrinsic evidence in contractual interpretation cases;[221]

(b) the test for the implication of terms;[222] and

(c) the interpretation of "shipped from the Permit Areas" in cl 3.4 of the Agreement for Sale and Purchase, dated 10 June 2010 (the Agreement).[223]

Matters on which we differ from the joint reasons

[233] However, we take a different view on the interpretation of cl 3.10 of the Agreement, as inserted into the Agreement by cl 2 of the Deed of Amendment No 3 to the Agreement (the Third Deed)[224] and on whether a term should be implied into the Agreement.[225] In these reasons, we deal with those two issues and briefly address the respondent's proper purposes argument.

The construction of cl 3.10

[234] Before the Third Deed was executed, the payment regime contemplated by the Agreement was that Bathurst Resources Ltd (Bathurst) would pay USD 40 million (USD 5 million deposit and USD 35 million settlement cash consideration) as the

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221 See the joint reasons above at [54]–[90].
222 At [106]–[117].
223 At [134]–[158].
224 At [174]–[200].
225 At [201]–[222].

purchase price for the shares in the company that became Buller Coal Ltd (Buller Coal). At that point, Bathurst became the owner of the shares in Buller Coal and L & M Coal Holdings Ltd (L&M) ceased to have any interest in those shares.[226]

[235] The other payments required under the Agreement were not instalments of the purchase price but rather "performance payments". These depended on the success of the development of a mine or mines in the permit areas, being the area covered by the two coal exploration permits held by Buller Coal. But cl 13.1 of the Deed of Royalty (the royalty deed) made it clear that L&M did not have "any right to participate in decision-making regarding mining operations". So, L&M was in a position where the payment of the performance payments depended on Bathurst deciding to develop and operate a mine in the permit areas (which we will call "the mine") and achieve certain volumes of coal sales from the developed mine.

[236] It is perhaps surprising that L&M did not have any say at all about this when it had, potentially, a USD 80 million interest (plus an unquantified royalty interest) in the outcome, but that is the bargain that was struck. It appears that both parties simply assumed that Bathurst would, having paid USD 40 million for the shares in Buller Coal, go on to develop a mine in the permit areas and exploit it to the fullest extent so that it derived a return on its USD 40 million investment. Such development and exploitation of the mine would, through the royalty regime, yield royalties to L&M and, through the performance payment regime, yield the future performance payments to L&M. Given the stakes, L&M must have been satisfied that Bathurst's commercial incentive to recover its initial USD 40 million outlay made imposing a contractual obligation to develop and exploit the mine unnecessary. But the fact that L&M assumed this would happen did not create a legal obligation on Bathurst to develop and exploit the mine.

[237] Prior to the Third Deed, the first performance payment of USD 40 million was due within 30 days of the date on which the first 25,000 tonnes of coal had been shipped from the permit areas. The second performance payment was due within

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[226] Albeit it had a right to be issued some shares in Bathurst in the future, in the event of successful mining operations in the area covered by the permits held by Buller Coal, or on Bathurst receiving an offer from a third party to acquire more than 50 per cent of its shares or any transaction of similar effect.

30 days of the date on which the first one million tonnes of coal had been shipped from the permit areas. The royalty deed set a graduated royalty rate, depending on the stage of development of mining operations. So, as is clear from the joint reasons, the 10 per cent royalty applied until the first performance payment was made, a five per cent royalty applied after the first performance payment was made and until the second performance payment was made, and thereafter the rate was 1.75 per cent.

[238] We agree with the joint reasons that prior to the Third Deed, Bathurst did not have any option as to when the performance payments had to be made.[227] The fact that the royalty deed provided for a higher level of royalty until the payments were made was simply to ensure that Bathurst and Buller Coal could not take the benefit of the lower royalty rate, which assumed payment of the relevant performance payment, until actual payment had happened. It did not give Bathurst any flexibility about the payment. That means that we agree with the Chief Justice and Ellen France J that cl 3.10 was the making of a concession.

[239] We acknowledge that cl 3.10 begins with the words "[f]or the avoidance of doubt", and recital B to the Third Deed talks about clarifying a matter in relation to the performance payments under the Agreement. But that does not deflect us from the view that there was, in truth, no legal doubt that needed to be avoided. The doubt appears to have been a commercial, rather than legal, doubt; engendered by Bathurst's mistaken view that it had flexibility about the first performance payment under the Agreement (or, perhaps, a view reflecting a commercial understanding between the parties).[228] That doubt was resolved by L&M giving Bathurst some flexibility under cl 3.10.

[240] The background to the Third Deed was that Bathurst predicted a potential "catch-22" situation where development of the mine was proceeding, coal was being extracted, but at the point where 25,000 tonnes of coal had been shipped, the mine would be unlikely to be operating at its predicted capacity of one million tonnes per

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227 At [177]–[182]. As stated at [176], the concessionary character of cl 3.10 is highlighted by the fact that L&M did not waive its rights under cl 9.7 for remedies on a default.

228 As the High Court Judge found, it was "not in L&M's interests to push Bathurst into default or to pursue remedies for a breach of contract": *L&M Coal Holdings Ltd v Bathurst Resources Ltd* [2018] NZHC 2127 (Dobson J) [HC judgment] at [123].

annum. The revenues would therefore be relatively small when measured against the obligation to pay the first performance payment of USD 40 million. Bathurst would have an obligation to pay USD 40 million, but would find it difficult to raise the money to do so. The intent of cl 3.10 was to provide a way out of that catch-22.

[241] In essence, L&M was agreeing not to enforce payment of the performance payments in circumstances where Bathurst (through Buller Coal) would not have generated enough revenue from the mine to fund the payment and would not be able to raise capital because of its impending default or actual default in making the first performance payment. It was not in L&M's interest to hold Bathurst in that position, which is why the concession in cl 3.10 was made.

[242] This concession was made well before the situation it addressed had actually arisen. So, there was no actual or even imminent default by Bathurst. Rather, there was a realisation that the performance payment regime did not provide the appropriate context for Bathurst to raise capital to fund development of the mine.

[243] The L&M Group was established in 1935 and has a long history of mining natural resources. It must have accepted that there was a real possibility that it would never receive anything other than the purchase price for the shares in Buller Coal, even if, on its assessment, such possibility was remote, given Bathurst's initial outlay. If Bathurst had not found a local buyer (Holcim (New Zealand) Ltd (Holcim)) for the low-grade coal that was extracted as part of the early construction activity at the mine,[229] the 25,000 tonne figure at which the first performance payment became payable would not have been achieved. If Bathurst had decided to call a halt to the development of the mine before the 25,000 tonne milestone had been reached, L&M would have had no basis for complaint.[230] It would not have received any performance payments, and would have received either no royalties or only a small amount of royalties.

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[229] For an explanation of the properties of coking coal, see the joint reasons above at [11].

[230] It could be expected that Bathurst would have done so if it had not had the benefit of cl 3.10 and the commercial outlook had not been favourable enough to justify the capital expenditure required.

[244] There was nothing in the Third Deed that created any change to the pre-existing relationship between L&M and Bathurst, aside from the flexibility given to Bathurst in regard to its performance payment obligations. Bathurst remained the effective owner and controller of the permit areas through Buller Coal and the maker of all decisions about the development and/or operation of mines in the permit areas, acting in its own interest. L&M remained a potential recipient of performance payments and royalties, but otherwise had no say over the development and/or operation of the mine.[231] Clause 3.10 changed one aspect of the agreed arrangements: it allowed Bathurst to postpone the performance payments. The risk that L&M assumed in the period before the 25,000 tonne milestone was reached, of receiving no performance payments because the mine was not fully developed and exploited, now continued after that milestone was reached. L&M accepted that risk.

[245] It is true that the parties seemed to assume that once a mine had been developed to the extent that 25,000 tonnes of coal had been shipped, the mine would be operative and would continue to be operative, with coking coal being extracted and exported.[232] That was probably a reasonable assumption, given that Bathurst had invested USD 40 million in buying the shares in Buller Coal. But it was only an assumption, unaccompanied by any legal obligations on the part of Bathurst or Buller Coal.[233]

[246] The scale of the performance payment (USD 40 million) supports the proposition that the parties contemplated the revenues that would be derived from an export coking coal mine, not just a mine selling thermal coal locally. And, if that assumption had proved to be correct, there would have been an incentive for Bathurst to pay the performance payment as soon as it could, as the additional five per cent royalty would have been a substantial amount.

[247] There was nothing in any of the relevant agreements that placed any fetter on Bathurst entering into other business opportunities in New Zealand or elsewhere, and

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231 Other than Buller Coal's obligation under the royalty deed to satisfy the minimum work programme in relation to the permits and to conduct mining operations in accordance with good mining practice and with a view to maximisation of coal sales at the best available price. There is nothing in those obligations to require the operation of the mine in circumstances where it is uneconomic.

232 See the joint reasons above at [189].

233 Other than as described at n 231 above.

nothing that required Bathurst to favour the development of a mine in the permit areas over any alternative business in which it may have become involved. The risk assumed by L&M that the mine would never be fully developed and exploited included the risk that Bathurst would see a better use for its capital elsewhere, whether that was a few kilometres away from the mine or on the other side of the world. L&M knew Bathurst was an international coal mine investor. By the time the Third Deed was signed, L&M would have known that Bathurst had purchased the West Whareatea permit and the Coalbrookdale permits in 2011. Bathurst did not make any commitment to prefer the permit areas above any other potential investment that became available to it, and there was nothing restraining Bathurst from further purchases in the vicinity of the permit areas.

[248] Under cl 3.10, L&M agreed that if Bathurst did not pay a performance payment when due, that would not be an actionable breach "for so long as the relevant royalty payments continue to be made under the Royalty Deed". The drafter started from the premise that, if a performance payment is due, then mining must have started, in which case royalty payments would have been made. So, there was an assumption that despite non-payment of the performance payment, mining would continue and "the relevant royalty payments" would continue to be made "when and as due". But there was no imposition of a new obligation to make royalty payments: the only royalty payments that were required to be made were those which Buller Coal had undertaken to pay under the terms of the royalty deed.[234]

[249] The term the "relevant royalty payments" in cl 3.10 is somewhat opaque, but given the clear direction that the royalties being addressed are those payable under the royalty deed, the "relevant royalty payments" would appear to be the payments at the rates determined under cl 4 of the royalty deed. In the absence of any new requirement in relation to the payment of royalties and any obligation on the part of Bathurst to develop and exploit the mine, the "relevant royalty payments" must be only those

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[234] The wording agreed between the lawyers for Bathurst and L&M in August 2013, for the purposes of an offer document to raise capital by Bathurst, was different again: "provided [Bathurst] makes the required royalty payments at the applicable rate as and when due". This wording seems more clearly limited to royalties required to be paid under the royalty deed. It was not contractual language and was at the time explicitly described as having no legal effect, being no more than an attempt to paraphrase the clause itself. However, it carries some relevance as an indicator of what the parties agreed upon in the Third Deed. See the joint reasons above at [198]–[199].

required to be paid under the royalty deed. Since there is currently no mining in the permit areas, the royalty payments are either zero or low amounts reflecting sales from a stockpile. That may not be a particularly attractive outcome from the point of view of L&M, but it is the one that L&M, a major commercial entity carrying on business in the mining industry, agreed to.

[250] In the High Court, Dobson J commented that the quantum of royalties expected to be paid under cl 3.10 was at large. Yet both he and the Court of Appeal were prepared to interpret "relevant royalty payments" as having a quantum that was not at large, but was rather "commercially realistic" (to use the Court of Appeal's words).[235] In our view, the best judges of what is commercially realistic are the substantial commercial entities that entered into the Third Deed.[236]

[251] The reality facing the parties when the Third Deed was entered into was that Bathurst would be prevented from accessing capital markets to obtain the finance it needed to develop the mine unless some concession in relation to the payment of the performance payments was made. L&M agreed to this concession because it perceived it to be in its interests not to frustrate the potential for Bathurst to develop the mine in this way. L&M could easily have required the payment of interest for delay in paying the performance payment. Under the royalty deed, for example, there is a provision for the payment of default interest if royalties are not paid on the due date. That is the commercially standard way of compensating a payee for late payment of an amount owing, but the parties in this case chose not to use it. In effect, the higher royalty amount was a substitute for default interest.

[252] In our view, cl 3.10 simply required royalty payments to be made under the royalty deed as and when the royalty deed required them. The parties obviously assumed that this would be a continuous stream of royalty payments, but there was no legal obligation behind that to ensure that assumption became reality. L&M's agreement to accept elevated royalty payments as compensation for late payment of

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235 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2020] NZCA 113 (Kós P, Gilbert and Goddard JJ) [CA judgment] at [96].

236 As noted in the joint reasons above at [45], this Court in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 pointed out that courts are not necessarily well placed to assess the commercial common sense of a contractual provision: at [89]–[93].

the performance payments involved an acceptance that the compensation for late payment was tied to the winning and sale of coal from the mine, something entirely within the control of Bathurst.

[253] There was always a chance that the royalty payment stream would be interrupted. For example, there could have been an accident at the mine. There is nothing to indicate that an interruption in royalty payments (possibly a prolonged one) in such an event would have meant Bathurst lost its protection under cl 3.10. What actually happened was that prices for coking coal fell, making the mine uneconomic. That was always a possibility. So, the expression "continue to be made" must have had an element of conditionality to it. The most obvious one is that the payments had to be made only when the royalty deed required them to be.

[254] The fact that Bathurst is now focussed on its joint venture operation with Talley's Group Ltd involving the mining of assets acquired from Solid Energy New Zealand Ltd seems to us to be a red herring in the context of the interpretation exercise. It cannot affect the interpretation of cl 3.10. Would the interpretation be different if Bathurst had not become a party to the Talley's joint venture but still deferred mining operations in the permit areas? It is hard to see how that could be the case. Bathurst would have deferred development anyway if the international price for coking coal had made it unattractive for Bathurst to incur further capital cost in establishing the mine, or if it had been unable to raise the finance to do so.

[255] With the fall in international coking coal prices, Bathurst reduced its capital expenditure and deferred construction of the proposed conveyor system, focussing instead on low-cost extraction of thermal coal to meet contractual obligations to Holcim. It was common ground that international coal prices are volatile and had entered a period of negative volatility at the time of the Third Deed. A sophisticated and experienced vendor like L&M can be expected to have required express provision in the contract for the downside (to it) of that volatility, if it considered this was necessary.

[256] On the Court of Appeal's analysis, the royalty payments (at the same low rate as applied when the performance payment was triggered, based on the volume of low

value coal sold to Holcim) were required to render the arrangement commercially realistic. That would have provided very modest compensation to L&M for the unpaid USD 40 million, unless production had been substantially increased.[237] The Court of Appeal's analysis is that L&M must have contracted for a level of compensation that could be extremely low, but not lower than what the Court of Appeal considered to be the commercially realistic amount.[238] We do not see any justification for interpreting the clause in that way. If L&M wished to ensure the level of compensation was fixed, or at least had a minimum level, it could easily have required that to be provided for in the Third Deed. It did not.

[257] We conclude that the "relevant royalty payments" referred to in cl 3.10 are the royalty payments that are, or became, payable under the royalty deed. We do not agree that "relevant royalty payments" should be interpreted as royalty payments equal to those arising from a level of mining consistent with that which triggered the performance payment.[239]

Implied term?

[258] The Chief Justice and Ellen France J would, if necessary, have implied a term into the Agreement that 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 the Agreement.[240] As noted in the joint reasons, this differs from the elaborate term pleaded by L&M,[241] and the modified version of the term advanced by L&M at the hearing in this Court.[242]

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237 See the joint reasons above at [189] and n 189.

238 CA judgment, above n 235, at [96].

239 See the joint reasons above at [174].

240 At [201].

241 It is doubtful, for the reasons set out above at [256], that compliance with the term implied by the Chief Justice and Ellen France J would have been sufficient to comply with the pleaded term, which required a level of royalties reflecting "the proceeds of ongoing mining and substantive coal sales, thereby providing commercial value for [L&M] being denied receipt of a sum otherwise due and owing".

242 The term advanced at the hearing in this Court was that in order to rely on cl 3.10, the relevant royalty payments must reflect the proceeds of ongoing mining. L&M submitted that this impliedly prohibited Bathurst from disabling itself from fulfilling the condition in cl 3.10. As noted in the joint reasons above at [204], n 200, the evidence that would be relevant to this was not considered in this context in the Courts below.

[259] We have a different starting point for our analysis, because on our interpretation of cl 3.10, Bathurst's deferral of its obligation to pay the performance payment has not created an actionable breach. The term that would need to be implied for L&M to succeed would be a term that Bathurst is not entitled to the benefit of cl 3.10 unless Buller Coal is actually paying L&M royalties at or above a certain minimum level (for example, the level equating to that which triggered the obligation to make the performance payment).

[260] We do not think there is a sufficient evidential basis for us to consider the alternative implied term proposed by L&M, namely a term prohibiting Bathurst from disabling itself and Buller Coal from paying royalties.[243] We do not think it is clear that, even if such a clause was implied, Bathurst did, in fact, disable itself (and Buller Coal) by entering into the Talley's joint venture and mining the Stockton mine as part of that joint venture. And we see such a provision as inconsistent with the structure of the Agreement, given it did not oblige Bathurst to mine at any minimum level or place any restriction on Bathurst from undertaking mining operations elsewhere.

[261] We agree with the Chief Justice and Ellen France J that neither the further assurances clause nor the entire agreement clause stands in the way of the implication of a term.[244] We say no more about them.

Application of principles to this case

[262] We propose to address the principles governing the implication of terms as set out in the joint reasons and apply them to the present case.[245]

[263] The first of these principles is that the legal test for the implication of a term is a standard of strict necessity, which is a high hurdle to overcome. We do not accept that such a necessity arises in the present case. As we have already noted, there was always a real possibility that L&M would not receive more than the initial USD 40 million payment.[246] L&M must have accepted this. All cl 3.10 did was

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243 See the joint reasons above at [204].
244 See above at [218]–[221].
245 Above at [116].
246 See above at [243].

expand the circumstances in which that possibility arose. That may not have turned out to be a wise choice by L&M, given the circumstances as we now know them to be,[247] but there is still a coherent contract in place between the parties and the possibility of a further performance payment becoming payable is not yet ruled out. This case therefore does not get over the high hurdle of strict necessity, in our view.

[264] The second principle is that if a contract does not provide for an eventuality, the usual inference is that no contractual provision was made for it. In the present case, the contract was between two significant commercial entities, both operating as experienced coal mine investors. The potential difficulties in establishing a mine in the permit areas and the very substantial amount of capital that would have been required to do this was well known to L&M. While the parties seemed to assume that if 25,000 tonnes of coal was shipped from the permit areas, the mine must already have become operational for the long term, the Agreement and the Third Deed did not impose any obligations in that regard.

[265] The third principle is that the implication of a term is part of the construction of the written contract as a whole. Our interpretation of the contract is set out above, and we see that as a coherent contract, albeit one that is not favourable to L&M in the circumstances that have arisen. We do not consider it is necessary to imply a term into the contract to arrive at the correct understanding of what the contract means.

[266] The fourth principle is that implying a term is an objective inquiry – it is the understanding of the notional reasonable person with all the background knowledge reasonably available to the parties at the time of the contract that is to be applied. As we see it, the parties chose to provide for the higher rate of royalty as a proxy for the cost of delaying the performance payment. But they chose not to specify any minimum level, in circumstances where they knew there was no minimum requirement in the royalty deed. It is telling that the pleaded implied term, the term implied by the High Court, the term advanced at the hearing and the term implied in the joint reasons all refer to different levels of royalty payment as being required. Also, as noted in the joint reasons, there would still be questions of degree. For example,

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[247] But would have been satisfactory from L&M's point of view if the assumption of a working export coking coal mine had eventuated.

how far Bathurst could go to reduce or even temporarily halt mining without attracting liability for the performance payment would always be a moving question of degree and circumstance.[248] While it is true that Cooke P in *Vickery v Waitaki International Ltd* accepted some questions of degree may be acceptable,[249] it must be remembered that the consequence of not meeting the level of royalties required by the implied term triggers a USD 40 million payment obligation. In a commercial contract, such a degree of uncertainty about such a large liability seems to us undesirable and an indicator that the implication of the term is not appropriate.

[267] The fifth principle is that the implication of a term does not depend upon proof of the parties' actual intentions. In the present case, the parties did not (for the most part) seek to argue for an implied term based on actual intentions anyway.

[268] The sixth principle is that the *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* conditions are a useful tool to test whether the proposed term would spell out what the contract, read against the relevant background, must be understood to mean.[250] Because this is the first case in which we have applied our principles, it is helpful to also explain how we would see the *BP Refinery* conditions assisting in the analysis in this case. We deal with those conditions below.

BP Refinery *conditions*

[269] The *BP Refinery* conditions, and our comments on them, are as follows:

(a) *The implied term must be reasonable and equitable*: we do not think a clause requiring a minimum level of royalty payments would have been unreasonable and inequitable, but nor do we see the absence of such a clause as unreasonable or inequitable.

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248 See the joint reasons above at [192] and [215].

249 *Vickery v Waitaki International Ltd* [1992] 2 NZLR 58 (CA) at 65.

250 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266 (PC) at 283. The conditions are set out in the joint reasons above at [94].

(b) *The term must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it*: we do not consider that the implication of a term is necessary to give business efficacy to the contract in this case. We expand on this below.

(c) *The term must be so obvious that "it goes without saying"*: as is apparent from our earlier analysis, we do not consider this factor as met in this case. As we note in relation to (d) below, a number of proposed implied terms have been considered, which indicates a lack of obviousness. And if the development of the mine had proceeded as the parties seem to have assumed it would, there would not have been any need for an implied term as the differential royalty scheme would have been a commercially workable arrangement.

(d) *The term must be capable of clear expression*: as noted earlier, there are several different versions of the proposed implied term.[251] Each can potentially be expressed clearly. The difficulty is identifying which one should be implied.

(e) *The term must not contradict any express term of the contract*: as indicated earlier, we consider the proposed implied term would be a contradiction in this case.[252]

[270] The Chief Justice and Ellen France J consider that cl 3.10 does not have business efficacy if it allows Bathurst to cease mining and stop paying royalties while also not paying the performance payment, because this would deprive L&M of most of the commercial value of the transaction.[253] We do not agree that cl 3.10, interpreted as we interpret it above, deprives L&M of most of the commercial value of the transaction. As already indicated, we think this overlooks the fact that L&M has already received USD 40 million under a contract where it was always a very distinct possibility that no development of a mine would occur and therefore no further

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251 See above at [266].

252 See above at [260]. The comment we make there applies equally to any of the proposed implied terms.

253 See above at [209].

payments would be made.[254] The additional payments were performance-based. Similarly, the concession made in cl 3.10 was made because the parties realised that the possibility of Bathurst being in breach of the Agreement if it failed to make the first performance payment at the 25,000 tonne trigger point would be an impediment to Bathurst raising the capital needed to develop the mine. L&M had good reason for making this concession because of its shared interest in the development of the mine, given the future royalty revenue and performance payment entitlements that a fully developed and operating mine would confer.

Conclusion

[271] We do not consider that the requirements for the implication of a term are met in this case. We would therefore decline to imply a term.

Proper purposes

[272] The argument made by L&M in relation to proper purposes is not addressed in the joint reasons.[255] It was clearly a fall-back argument, and we can address it briefly.

[273] The essence of the argument was that cl 3.10 confers on Bathurst a contractual discretion, and this discretion must be exercised for proper purposes. L&M's argument is that Bathurst has exercised what it classifies as "contractual discretions" for improper purposes, by deciding not to develop the mine in the permit areas for the foreseeable future (and to mine elsewhere), and not to pay the performance payment that would be due but for the operation of cl 3.10.

[274] The High Court Judge rejected this argument on the basis that if Bathurst was correct as to the scope of cl 3.10, then Bathurst's conduct in reliance upon cl 3.10 did not involve the exercise of a contractual discretion "of a type where the Court can imply a constraint on the purposes for which that discretion can be exercised".[256]

[275] The Court of Appeal did not address this argument.

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254 See above at [243].
255 See above at [224]–[226].
256 HC judgment, above n 228, at [210].

[276] L&M argued that the High Court Judge erred in concluding that cl 3.10 conferred an absolute contractual entitlement on Bathurst. Rather, it argued that Bathurst had a contractual discretion as to the manner in which future mining operations would be conducted following the 25,000 tonne threshold being reached, and whether it would make the performance payment or rely on cl 3.10 to make higher royalty payments instead. As cl 3.10 gave Bathurst these choices, it was correctly classified as a discretion and must therefore be exercised honestly and in good faith, and not arbitrarily, capriciously or unreasonably.[257]

[277] Bathurst supported the analysis of the High Court Judge. It said cl 3.10 of the Third Deed and cl 4.1(d) of the royalty deed together recognise and protect a specific contractual power, which cannot sensibly be categorised as a discretion.[258]

[278] In *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest)*,[259] Jackson LJ reviewed the authorities on contractual discretions and contrasted contractual discretions with absolute contractual rights. He observed that the former involves "making an assessment or choosing from a range of options, taking into account the interests of both parties".[260]

[279] We think it is clear that, in the present case, the contractual rights under cl 3.10 cannot be classed as contractual discretions that could be subject to review by a court on the basis that they were exercised for an improper purpose. Clause 3.10 simply provides for a modification of cl 3.4 as to whether delay in paying the performance payments is an actionable breach. While it is true that Bathurst could choose not to take the benefit of cl 3.10, that could be said about most contractual rights. That choice does not convert the contractual right into a contractual discretion. We agree, therefore, with the High Court Judge's analysis. Given that conclusion, the proposed

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257 Citing *Abu Dhabi National Tanker Co v Product Star Shipping Ltd (The "Product Star") (No. 2)* [1993] 1 Lloyd's Rep 397 (CA) at 404.

258 Clause 4.1(d) of the royalty deed provides that the higher, 10 per cent, rate of royalty is payable by Buller Coal until the performance payment is made by Bathurst. Clause 4.1(d) is quoted in full in the joint reasons above at [178].

259 *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest)* [2013] EWCA Civ 200, [2013] BLR 265.

260 At [83].

further evidence that L&M sought to adduce serves no useful purpose and we decline leave to adduce it.

[280] The good faith variant on the proper purposes argument that is mentioned in the joint reasons was not relied on by L&M and, even if it had been, would not have assisted its case.[261] As already indicated, we do not consider there is a sufficient evidential basis for concluding that Bathurst's decision to enter into the Talley's joint venture and devote its attention to developing and operating the joint venture's mining assets demonstrates a lack of good faith in relation to its obligations to L&M under the Agreement. As we have noted, there was nothing in the contractual arrangements between Bathurst and L&M that required Bathurst to mine within the permit areas in preference to any other mine, and nothing requiring that, once mining in the permit areas commenced, it could not be stopped. We agree with the joint reasons that the issues relating to the place of good faith in contract law are best left for another day.

Conclusion

[281] We conclude that Bathurst was entitled under cl 3.10 to delay payment of the performance payment, which would otherwise have been an actionable breach of cl 3.4 of the Agreement. We agree with the orders as to disposition of the appeal and costs set out in the joint reasons.[262]

Solicitors:
MinterEllisonRuddWatts, Wellington for Appellants
Chapman Tripp, Wellington for Respondent

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261 See the joint reasons above at [227]–[229].
262 At [230]–[231].