

A landmark decision for contractual interpretation

The Supreme Court has made a significant ruling on the interpretation and construction of contractual terms

The dispute on what evidence, outside of the wording of contractual terms, can be used for interpretation has been the subject of debate for a long time, as well as the test for implying a term into a contract. In *Bathurst Resource Ltd v L&M Coal Holdings Ltd* [2021] NZSC 85 (*Bathurst v L&M*) the Supreme Court has unanimously clarified the scope and application of law on both of these issues and has provided greater (and long overdue) certainty.

Background

The appeal concerned the interpretation of the term "shipped" in a contract for the sale of coal mining rights. Bathurst Resources Ltd (Bathurst) agreed to purchase coal mining rights from L & M Holdings Ltd (L&M). Bathurst paid a purchase price of USD 40 million and agreed to pay two further performance payments of USD 40 million when 25,000 tonnes and then one million tonnes of coal had been "shipped". The parties also signed a royalty deed whereby L&M was obliged to pay a royalty for every sale. The clause was later varied to provide there would be no actionable breach if L&M delayed performance payments, as long as they continued to pay the royalty payments. Six years later there was a fall in coal prices and Bathurst suspended its mining operations.

There were two core issues between the parties on appeal. The first was whether the performance payment was triggered when 25,000 tonnes of coal was transported from the mine but not 'shipped' internationally. Secondly, whether (if the payment had been triggered) Bathurst could continue to defer that payment when it was not paying royalties.

The majority of the Supreme Court allowed the appeal. The Court found the performance payment was triggered, but the majority declined to imply a contractual term and found the contract allowed the payment to be deferred.

Historical position

Historically, contracts have been interpreted based on the contractual wording alone and pre-contractual negotiations and extrinsic evidence have been excluded from the interpretation exercise. The New Zealand Courts have in more recent cases, since *Vector Gas* (which reviewed the exclusion of pre-contractual negotiations in New Zealand), allowed pre-contractual negotiations and subsequent conduct to be used as an aid in interpretation where that evidence is objective, primary and relevant. However, there was no clear position after separate judgments were issued in *Vector*, rather than a unanimous decision.

The law is also unclear on what test should be applied to determine if a term should be implied into a contract. Traditionally, New Zealand Courts have applied the UK five stage test in *BP Refinery*. That test has since been overtaken in the UK by the new approach in *Belize*. In response New Zealand Courts have typically applied a mixed approach.

A clear position

In their decision the Supreme Court has made clear the correct approach to apply to extrinsic evidence when interpreting a contract and clarified the legal test for implication.

The admissibility of extrinsic evidence

The Court has clarified the touchstone of admissibility is the Evidence Act. Evidence will be relevant 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 with all the background knowledge at the time.

A landmark decision for contractual interpretation (Continued)

The key points are summarized below:

An objective approach to interpretation must be applied. While commercial certainty is important it should not defeat what the parties actually meant by those words.

Prior negotiations

Evidence of prior negotiations may be admissible. Evidence of prior negotiations will not be admissible if it only shows a party's subjective intention or belief of the meaning of the words. Any evidence prior to a contract that shows a common mutual understanding, is relevant.

Post-contractual conduct

The threshold for admitting subsequent conduct is high and post-contract conduct is unlikely to be admissible (and relevant). It will only be admissible if it proves anything relevant to the objective approach to interpretation.

Implied Terms

The Supreme Court clarified that the five stage test in *BP Refinery* continues to apply in New Zealand with a few additional qualifications. The key points emphasized by the Court are:

- The standard for implying an unwritten term into a contract is strict necessity.
- The starting point is the words of the contract.
- An unexpressed term can only be implied into a contract if the term would spell out what the contract, read against relevant background, must be understood to mean.
- The inquiry is an objective one; the focus being on a notional reasonable person with all of the background knowledge reasonably available to the parties at the time.
- The implication of a term is not dependent on the actual parties' intention.

- The *BP Refinery test* is helpful to test whether the proposal term is strictly necessary. Conditions (4) and (5) must always be met before a term can be implied. Conditions (3) – (5) are analytical tools which overlap and are not cumulative.

Practical effect of changes

- Pre-contractual negotiation material may be admissible. This material includes but is not limited to any communications, oral negotiations, draft contracts or terms, and subsequent conduct.
- The Evidence Act, commonly forgotten, is the touchstone for relevance.
- The Court has provided practical examples of conduct that may or may not be relevant and probative.
- It is important for parties as they negotiate contracts to ensure they understand the intention and purpose of the terms. In negotiating avoid a lack of response on issues.
- Good record keeping through negotiations is key.
- Post-contractual conduct is unlikely to be admissible – particularly of those not involved in the original contract negotiations.

Want to know more?

If you have any questions about contractual interpretation, please contact our litigation specialists [here](#).

Key contact:

Melissa Hammer - melissa.hammer@al.nz