IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

I TE KŌTI MATUA O AOTEAROA
TE WHANGANUI-Ā-TARA ROHE

CIV-2016-485-1007
[2018] NZHC 2127

BETWEEN	L&M COAL HOLDINGS LIMITED Plaintiff
AND	BATHURST RESOURCES LIMITED First Defendant
	BULLER COAL LIMITED Second Defendant

Hearing:	12-16 February; 19-23 February; 26-27 March 2018
Counsel:	A R Galbraith QC and D R Kalderimis for plaintiff J E Hodder QC, R J Gordon and D P MacKenzie for defendants
Judgment:	17 August 2018

RESERVED JUDGMENT OF DOBSON J

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Introduction

[1] This proceeding involves a dispute between the parties over performance of a contract for the sale of permits to explore for and mine coal on the Denniston Plateau on the west coast of the South Island (the permit areas).

[2] The plaintiff (L&M) is a company incorporated under the laws of Belize and has its business office in Hong Kong.[1]

[3] The first defendant (Bathurst) is a company registered under the laws of New Zealand and has its registered office in Wellington. It is in the business of mining natural resources, including coal. At relevant times, Bathurst was a company listed both on the ASX and NZX.[2]

[4] The present transaction was structured as a sale of all the shares in the second defendant, L&M Coal Limited, which was an L&M subsidiary that owned the assets that were the subject of the transaction. L&M Coal Limited subsequently changed its name to Buller Coal Limited.

Background to the dispute

[5] The relevant contract (the ASP) was executed in June 2010. Its provisions relevantly included:

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1 Promotional materials in the evidentiary bundle referred to links to the former publicly listed company on the New Zealand Stock Exchange (NZX) that had a long-standing reputation in the New Zealand mining industry. However, there was no evidence as to the nature of the connection. Mr Geoff Loudon, who effectively governed L&M when this contract was completed, had held interests in the former listed entity.

2 Bathurst has been listed on the ASX throughout, and was listed on the NZX between September 2010 and July 2015.

- Payment of a non-refundable deposit of US$5 million, and consideration of US$35 million to be paid on settlement, which occurred in November 2010.

- Two further performance payments of US$40 million each would become due on defined volumes of coal being shipped from the permit areas. The first performance payment was due when Bathurst had shipped 25,000 tonnes of coal, and the second payment when one million tonnes of coal had been shipped.

- When the second performance payment was due, or if Bathurst received notice of an offer to acquire more than 50 per cent of its shares (or notice of a transaction having substantially the same effect), Bathurst was obliged to issue fully paid ordinary shares representing five per cent of the then current post-issue share capital of Bathurst.

- In addition to that sequence of payments, Bathurst was obliged to pay royalties on amounts received for sales of coal. The detailed royalties provisions were recorded in a separate deed of royalty, a draft of which was annexed to the ASP and which was separately completed in August 2010 (the royalty deed). The initial royalty rate was 10 per cent of gross sales revenue of coal, but after the first performance payment was made the rate would drop to five per cent until the second performance payment was made, and thereafter would be 1.75 per cent.

- If Bathurst was constrained by regulatory requirements, or for any other reason, from issuing shares to L&M when the second performance measure was achieved, then in lieu of the issue of those shares the relevant royalty rate in the royalty deed would increase by two per cent.

[6] For much of the period between completion of the ASP in 2010 and mid to late 2016, the evidence suggests a constructive and co-operative relationship between the parties. L&M demonstrated flexibility in not strictly enforcing its contractual

terms, and provided assistance to Bathurst to enable it to perform the remaining contractual obligations.

[7] It was apparent that Bathurst's ability to raise sufficient funds to make the performance payments would depend on it demonstrating the viability of coal production from the permit areas.

[8] In August 2012, the parties entered into a deed of amendment (the third amendment) that addressed the consequences of Bathurst not paying the performance payments when they became due. The operative part of the third amendment inserted cl 3.10 into the ASP, which provided:

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

[9] Recovery of coal from the Escarpment Mine within the permit areas was delayed much longer than the parties anticipated at the time of the ASP by challenges to the resource consents that were eventually granted for the mining operation. Extraction of coal occurred between September 2014 and approximately March 2016. Between early 2015 and March 2016, approximately 50,000 tonnes were extracted, but Bathurst has not paid the first performance payment of US$40 million.[3]

[10] In March 2016, Bathurst announced that it was to suspend mining operations at the Escarpment Mine, and placed the mine into "care and maintenance". As a result, Bathurst has ceased paying royalties, except for modest amounts payable from small sales of coal from a stockpile.

[11] Bathurst has subsequently acquired a majority interest in another mining venture (BT Mining) that purchased a number of coal mining interests from Solid Energy in a contract entered into in October 2016. That contract was settled in August 2017 and relates to the North Island coal mines at Rotowaro and Maramarua, as well as the existing open-cast mine at Stockton on the west coast.

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[3] A graph produced as schedule 7 to Bathurst's closing submissions notes that production ended in the fourth quarter of 2016 with 6.1 million tonnes of coal having been produced.

[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.

[13] L&M commenced this proceeding in December 2016. It seeks a declaration that the first performance payment has become due and owing, and an order that Bathurst pay US$40 million to L&M, together with interest and costs.

[14] L&M's case is that from some point in 2014, Bathurst's board decided on a change of strategy. Instead of working to establish the feasibility of mining operations within the permit areas and raising the capital to make the performance payments required under the ASP, Bathurst would instead deny that any further obligations were owed under the ASP and pursue a course of action intended to support that denial on legal and factual grounds as managed by Bathurst.

[15] Bathurst's first response to the claim is that the first performance payment is not due because coal produced from the Escarpment Mine has been sold for domestic use (principally to Holcim, a west coast producer of cement). Bathurst contends that this coal has not been "shipped" because it has not involved carriage by sea, so arguably does not count in quantifying relevant production.

[16] Bathurst says that the essential focus of the coal mining prospects that were the subject of the ASP was the extraction of high quality hard coking coal, the only market for which is in metallurgical use overseas. It treats the presence within the permit areas of quantities of lower grades of coal, for which there may be a domestic market for thermal purposes, as merely incidental or fortuitous. Arguably, the parties were focused on the export prospects, in which event "shipped" would inevitably involve carriage by sea.

[17] In addition to disputing Bathurst's narrower interpretation of when coal is "shipped" from the permit area, L&M argues that Bathurst cannot rely on cl 3.10 to defer paying the first performance payment when it is not paying the royalties that it

says the parties contemplated would compensate L&M for the delay in receiving the first performance payment. L&M submits that this limitation on Bathurst's entitlement to rely on cl 3.10 arises either as a matter of interpretation or, if necessary, by the implication of a term to that effect.

[18] Bathurst's response is to argue that cl 3.10 affords it an option which it is lawfully exercising, namely Bathurst stands ready to pay all royalties that become payable in terms of the royalty deed, but that amount is practically zero because of the absence of mining activity. The ASP, including cl 3.10, contemplates that contingency and there is no actionable default.

[19] If L&M is unsuccessful in limiting Bathurst's resort to cl 3.10 because Bathurst's argument in the preceding paragraph is upheld, then L&M would argue that cl 3.10 introduced a discretion as to how Bathurst would pay for the assets, and Bathurst's conduct has amounted to the exercise of that discretion other than for proper purposes.

[20] Bathurst's rejoinder to this alternative argument is that there is no relevant constraint on the options available to it as business conditions evolve. There is no provision in the ASP compelling it to maintain production in all or any circumstances. Arguably, a very substantial reduction in the price of high quality coking coal justified the decision to cease production. Accordingly, non-payment of royalties is simply a consequence of Bathurst deciding not to produce coal and non-payment of the first performance payment is not a breach of the ASP because cl 3.10 confirms that it is not.

Outline of the issues

[21] Accordingly, the issues in the case are:

- First: Has the coal extracted and transported from the Escarpment Mine been "shipped" so as to trigger the first performance payment?

- Second: If so, does a proper construction of the "no default" acknowledgement in cl 3.10 allow Bathurst to deny liability for the first performance payment while paying only nominal royalties?

- Third: If the limitation on Bathurst resorting to the "no default" acknowledgement in cl 3.10 does not arise as a matter of interpretation, does an implied term arise having the same effect?

- Fourth: If the terms of cl 3.10 do permit Bathurst to deny liability for the first performance payment when it is also not paying royalties, is its discretion to do so subject to a constraint that it be exercised only for proper purposes, consistent with the intent of the contract?

- Fifth: If a proper purpose constraint on Bathurst's resort to cl 3.10 does apply, then has L&M made out the exercise by Bathurst of that discretion other than for a proper purpose?

The development of the assets

[22] There has been coal mining activity on the Denniston and Stockton Plateaux on the west coast since the late 1800s. From about 1960, permits to explore and mine coal resources in the area were predominantly held by the State-owned coal mining organisations that became Solid Energy. In the 1990s and early 2000s, Solid Energy relinquished their permits for much of the area, including the permit areas involved in this litigation.

[23] In February 2003, L&M applied for an exploration permit over parts of the area that had been relinquished by Solid Energy. That permit was granted in January 2005. A second exploration permit for an adjoining but smaller area was acquired in February 2009. The exploration permits would run for initial periods of five years.

[24] L&M undertook exploration work within the permit areas that involved a review of the records of coal resources previously undertaken, a geographical mapping exercise and new drilling and coal quality analyses.

[25] L&M's work identified promising coal resources. The Escarpment Mine was seen as the most attractive development project, with the prospect of progressing to mine in the Deep Creek area relatively nearby. It was contemplated that mining would be done on an open-cast basis. This involves stripping away the layers of material covering seams of coal, extracting the coal and then reinstating the area by replacing the material that had been removed.

[26] By mid to late 2008, L&M was seeking partners to join in exploitation of the resource. An alternative for L&M was to sell the development prospects to others. Mr Geoff Loudon, who was then in effect the sole director of L&M,[4] was introduced to Mr Hamish Bohannan, then chief executive of Bathurst, in London in October 2009.

[27] At that time, Bathurst had mining interests in the state of Kentucky in the United States, but was seeking opportunities elsewhere. Further negotiations ensued, with an initial letter of offer sent in December 2009 and then a binding letter of intent signed in February 2010. In June 2010, the ASP was executed on terms broadly consistent with the earlier binding letter of intent.

Relevant contractual provisions

[28] The ASP transferred ownership of all the shares in L&M Coal Limited that owned the assets. The ASP contained numerous obligations on both parties, including pre-settlement. For example, it obliged both parties to use all reasonable endeavours to obtain regulatory consents. Both parties provided warranties relevant to performance of their contractual obligations and there was a provision in conventional terms that the ASP constituted the entire agreement between the parties, superseding any previous understandings or agreements. The ASP obliged Bathurst to complete a separate royalty deed and also a guarantee and security deed pursuant to which L&M Coal Limited would guarantee Bathurst's performance and provide a first ranking security over all of the assets to secure payment of all amounts payable to L&M.

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4 As a matter of form, L&M's parent company, Auriferous Mining Limited, was the sole director until 2015. Mr Loudon was a director of the parent company and represented it in the governance of L&M.

[29] Bathurst was responsible for procuring the completion of a Definitive Feasibility Study (DFS). Its completion to Bathurst's reasonable satisfaction was a condition to be satisfied prior to settlement. The ASP was also conditional on Bathurst arranging sufficient finance to pay the settlement cash consideration of US$35 million. Those conditions were both satisfied.

[30] The guarantee and security deed and the royalty deed were completed in August 2010.

Scope of the evidence

[31] It is unnecessary to provide an extensive summary of all of the evidence that was called. L&M called evidence from:

- Mr David Manhire, a geologist who had worked for, and more recently been a contractor to, L&M since 1987. Mr Manhire described the assessments that had been undertaken of the coal mining prospects in the permit areas in the period up to execution of the ASP.

- Mr Duncan Gordon, who is based in Adelaide, South Australia, and whose corporate advisory firm was retained by L&M to market the coal mining assets. Mr Gordon helped prepare valuations of the assets and was involved in the negotiations for L&M with Bathurst that led to the letter of intent and the ASP.

- Mr Geoff Loudon, who currently lives in Christchurch and is a trained geologist with more than 50 years' experience in the mining industry. Interests associated with Mr Loudon are significant shareholders in the ultimate owner of L&M. He was effectively the controlling director of L&M throughout the period in which the ASP and amendments to it were completed, and remained one of three directors between April 2015 and February 2017 when he resigned. Mr Loudon led negotiations for L&M and made decisions on acceptable terms for the sale to Bathurst.

- Mr Gregory Hogan, who currently lives in Australia but who worked for L&M between June 2002 and completion of the ASP. Mr Hogan dealt with commercial aspects of the mining operation, such as permit applications and L&M's relationships with third parties. He was involved in a number of the meetings leading to completion of the binding letter of intent and the ASP and was a line of communication between Mr Loudon, the decision-maker for L&M, and those representing Bathurst.

- Mr Michael Brogan, formerly a Sydney based chartered accountant and now a Hong Kong resident director, including of L&M. Mr Brogan was appointed to the board of L&M's parent company in September 2011. He had no involvement with the completion of the ASP, but was involved when the third amendment was completed in July 2012.

- Mr Hamish Bohannan, a mining company executive with over 30 years' experience in that industry. He currently lives in Perth and works in Indonesia. Between 2008 and March 2015 Mr Bohannan was chief executive and a director of Bathurst. Mr Bohannan gave evidence from his perspective as the principal negotiator of the ASP for Bathurst.

- Mr Graeme Duncan, an expert called on behalf of L&M. He holds Bachelor and Master's degrees in engineering (mining) and is a member of the Australasian Institute of Mining and Metallurgy. He provided opinion evidence on the feasibility of Bathurst economically mining the high quality coking coal from the Escarpment Mine.

[32] Bathurst called the following witnesses:

- Mr Richard Tacon, who has been employed by Bathurst since March 2012 and has been its chief executive since March 2015. Mr Tacon has worked in the mining industry for 37 years in New Zealand and Australia. He explained Bathurst's approach to assessment of the mining resources purchased from L&M, the difficulties encountered in attempting to exploit those resources, and Bathurst's present intentions with its larger portfolio

of mining assets in this part of the west coast. Prior to L&M's opening, Mr Tacon provided a commentary to an aerial view, filmed by a drone, of the topography of the Escarpment Mine, and other mining prospects in the vicinity.

- Mr Marshall Maine, who was Bathurst's chief financial officer between March 2013 and March 2015. He described the tough economic times encountered by Bathurst during the period he was employed there. He was directly involved in attempts to raise capital and in the preparation of financial statements for the company in that period. His evidence addressed decisions made to write down the value of the assets obtained from L&M, and a corresponding write-off of the performance payments that had formerly been recognised as liabilities.

- Mr Tokorangi Kapea, who has been a member of Bathurst's board of directors since May 2013 and was chairman of that board between May 2015 and January 2018. Mr Kapea gave his perspective on attempts to raise capital in 2013, the board's decision not to develop the Escarpment Mine and the board's perspective on the writing down of assets and liabilities that had been acquired from L&M. Mr Kapea also addressed the board's perspective on the decision to place the Escarpment Mine on care and maintenance.

- Mr David Clarke, a solicitor who was a partner at Russell McVeagh until 2016. In that capacity, he acted for Bathurst on legal work in respect of a capital-raising initiative in mid-2013. At that time, he was involved in communications intended to clarify the third amendment's meaning for the purposes of describing Bathurst's obligations in offer documents issued in the capital-raising exercise. Mr Clarke was present at a meeting with Ms Brigid McArthur, L&M's lawyer who drafted the third amendment. With L&M's authority, she met with representatives of Bathurst and explained her perspective of the third amendment.

- Mr Dean Fergusson, a Christchurch based consultant who is a chartered professional geologist. He has a Bachelor of Science in earth science and Master's degree in geology, and has been a member of the Australasian Institute of Mining and Metallurgy for more than 20 years. Mr Fergusson has spent a large part of his career as an employee of Solid Energy and its predecessors. He opined on the reasonableness of Bathurst's decision in February 2014 to defer development of the Escarpment Mine, and the March 2016 decision to place the mine under care and maintenance. He also opined on the reasonableness of the view taken by Bathurst that it has not been feasible to develop the Escarpment Mine and explained why he disagreed with the opposite conclusions expressed by Mr Duncan.

- Mr Christopher Russell, who has been involved in the coal industry since 1978 and whose work has focused on the logistics of transporting bulk cargoes of coal. Mr Russell provided his opinion on the use of the word "shipped" in coal logistics in New Zealand.

[33] Both sides served and filed briefs from accounting experts. L&M retained Mr Tim Fairhall, a retired audit partner from PricewaterhouseCoopers. He opined on the appropriateness of Bathurst's impairment in 2014 of the assets acquired from L&M and on the standards he considered should apply to revisiting that impairment regularly in preparation of financial statements for subsequent periods.

[34] In response to Mr Fairhall's brief, Bathurst served a brief from Professor Tony van Zijl, who is a professor of accounting and financial management at Victoria University of Wellington. He expressed somewhat different views on the application of appropriate accounting standards to the treatment and need for reconsideration of impaired assets.

[35] Counsel agreed during the hearing that it was unnecessary to cross-examine either of the accounting experts. I was invited to take their briefs as read and form my own views on the opinions they expressed, to the extent they became relevant to issues in the case.

Objections to evidence as to contractual intentions

[36] Numerous passages in the briefs of evidence of L&M's factual witnesses contained statements about what those witnesses intended when negotiating the terms of the ASP, and their beliefs as to what contractual terms meant.

[37] At the outset of the trial, Bathurst raised an objection that such passages were inadmissible and should not be read. At that stage, I ruled that the challenged passages be treated as admissible *de bene esse*, on the basis that I would revisit their admissibility in light of the totality of the evidence.

[38] I was persuaded to adopt that stance by Mr Kalderimis, who characterised the challenged passages as a combination of permissible evidence about the context in which the ASP had been negotiated and evidence of shared belief as to what both parties intended. This last characterisation depended on the proposition that the statements of witnesses who were involved for L&M coincided with, or were confirmed by, the recollection of Mr Bohannan, who negotiated the terms of the ASP for Bathurst.[5]

[39] On a review of all the evidence after it had been tested in cross-examination, I am satisfied that a number of the challenged passages are no more than subjective recollections of a participant with some involvement in the contractual process, or matters of subjective understanding by individuals. As such, they are not admissible and I have disregarded them.

[40] On the other hand, I am satisfied from the evidence of Messrs Loudon and Bohannan that they were *ad idem* as to what they intended the ASP to record. To the extent that the evidence establishes mutual intentions, I consider it is admissible on that topic.[6] Where the principals negotiating a contract subsequently confirm that they shared the same view of what was to be intended by the terms of the contract when it was being negotiated, in the terms of Wilson J in *Vector Gas Ltd v Bay of Plenty*

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5 See Ruling 1, issued 19 February 2018. The relevant content of that ruling up to [16] is annexed to this judgment.

6 See, for example, *Partenreederei M.S. Karen Oltmann v Scarsdale Shipping Co Ltd* [1976] 2 Lloyd's Rep 708 (QB) [*The Karen Oltmann*], discussed in more detail at [60]–[61] below.

Energy Ltd they can "illuminate, in advance of consensus being achieved, what the parties were intending to achieve in their contract".[7] Alternatively, such evidence of shared intention as to contractual meaning is within the concept of "background" as Arnold J acknowledged it in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*.[8]

The nature of the contract

[41] Counsel were agreed that a primary influence, if not the determinative factor, in deciding many issues in the case was the character to be attributed to the ASP. The parties characterised it in starkly different terms. L&M described it as a contract for the sale and purchase of assets, with provision for partial deferred consideration to be treated as a form of vendor finance. L&M treated the conditions on which that vendor finance would become payable as not out of the ordinary, and that transporting the first 25,000 tonnes of coal from the permit areas had triggered Bathurst's obligation to make the first performance payment. There was no element of a joint venture about the conduct of the business. L&M was concerned to facilitate performance by Bathurst of its remaining obligations under the ASP, but had no interest in, or ability to influence, whether and in what way mining activities were undertaken. Instead, the ASP required Bathurst to comply with the terms of all permits that were issued, and to keep the permits in good standing.

[42] Bathurst characterised the ASP as the transfer of opportunities to exploit coal mining resources for which it paid the initial consideration of US$40 million. Thereafter, the parties shared the risks on economic extraction of the coal, with no certainty that the conditions for further payments would be fulfilled. For instance, the necessary permits and consents to conduct mining may never have been obtained, and if the price of high quality coking coal collapsed (as did occur) there could be no expectation that Bathurst would be obliged to conduct mining activities on an uneconomic basis.

[43] The ASP was concluded in the knowledge that Bathurst did not have the financial resources to make substantial payments without establishing the viability of

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7 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [122].

8 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [60]. See Ruling 1 at [7]–[9].

export coal operations. Therefore the performance payments provided for would only be received by L&M if the numerous risks were overcome and economic mining on a commercial scale was undertaken.

[44] Bathurst characterised the ASP as a long-term venture under which it was in complete control of the assets and had unconstrained opportunities to develop (or sit on) the mining resources as it saw fit in its own interests. It emphasised the inherently risky and uncertain prospects for the venture at the time the ASP was concluded.

[45] Bathurst also characterised the ASP as focusing on the export opportunity for high quality coking coal. Assessments of the resources acknowledged (on Bathurst's view only incidentally) the presence of lower quality thermal coal for which there would be a domestic market, but the important aspect of the resource on Bathurst's characterisation was the prospect for exporting hard coking coal.

[46] In contrast, L&M characterised the ASP as a sale of the permits and accumulated mining opportunities, which included a not immaterial component of thermal coal that would likely only be sold domestically.

[47] The structure and terms of the ASP reflect what commercial parties would reasonably expect of a conventional sale and purchase agreement, transferring property in all the shares that give a right to the assets held by that company in return for amounts to be paid in cash. The ASP includes conditions about when the subsequent components of the cash consideration would be paid, without any acknowledgement of an issue as to whether those payments would be made. Given that the contingency relates to US$80 million, some reference to the contingency of the payments not becoming due might be expected, if indeed that was in the parties' contemplation.

[48] Instead, "aggregate consideration" is described in unqualified terms:

> 3.1 … the aggregate consideration payable for the purchase of the shares shall comprise …

To similar effect, the stipulation for payment of the performance payment is simply in terms that the purchaser "shall pay the Vendor … US$40 million within 30 days".

[49] As to the extent to which the prospects for the business were risky and uncertain, Bathurst could rely on the DFS, the completion of which to its reasonable satisfaction was a condition of settlement.[9] Together with the research conducted by L&M and other data available to Bathurst, it was able to make a well-informed assessment prior to the ASP becoming unconditional.

[50] The DFS was compiled by a Melbourne consultancy, Marston & Marston, with input from various expert consultants, as well as L&M and Bathurst. It contains 1,573 pages and appears as an extensive identification of business risks and analysis of them. As an appendix to the definitive study in respect of the Escarpment Mine, it also contains a preliminary assessment of the neighbouring mine within the permit area at Deep Creek.

[51] The DFS included a discounted cash flow (DCF) valuation for rates of return on the proposed investment. That applied variables for a range of business conditions including labour, diesel, capital and direct cash costs, as well as coal revenue and exchange rates. The DCF valuation was calculated both if the Escarpment Mine was developed standing on its own (about 18 per cent) and if it was combined with the subsequent development of Deep Creek, which projected a DCF rate of return at about 35 per cent.

[52] The DFS included a section on risk assessments, recognising some 31 risks to successful development of the business. Two risks proven wrong by history were the period of five months projected as required to obtain the necessary consents, and the price projection of hard coking coal. The latter projection appears to have adopted reasonable, if not conservative, projections used in the industry, but failed to identify the extent of the drop in prices in later years. The DFS also qualified its projections and, in some respects, recommended that further research be undertaken. Despite that, it appears as a comprehensive and positive business case for development of the Escarpment Mine.

[53] A first hurdle to overcome was procurement of the requisite permits to extract the coal. Whilst there was no guarantee that they would be granted, the prior payment

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9 See [29] above.

of US$40 million, and the terms of the DFS, rendered that more of a business risk than a condition precedent to the trigger of the subsequent payment obligations.

[54] The parties committed to a standard form of acknowledgement that the transaction was occurring at the lowest price. Although it is to be interpreted in light of its explicit purpose of addressing financial arrangements rules in the Income Tax Act 2007, it may nonetheless be relevant:

> … the Parties agree that the aggregate consideration set out in this clause 3 is the value of the Shares, and is the lowest price they would have agreed for the sale and purchase of the Shares, on the date this Agreement was entered into, if payment would have been required in full at the time the first right in the contracted property (being the Shares) was transferred.

[55] Despite the limited relevance of that provision, it is a further inconsistency with the structure that might otherwise have been expected if the consideration for the assets was US$40 million, with the prospect of L&M being paid further substantial amounts as a form of earn-out fee should Bathurst subsequently operate the business at a level reasonably in contemplation at the time of the ASP.

[56] Although it could not carry material weight as a separate consideration in deciding between the parties' competing characterisations of the ASP, my overall reflection on the documentation is that it does not support Bathurst's approach. It does not present as a sale of assets on terms where the first third of the consideration is to be paid on settlement, and the remaining two thirds of the potential consideration represents a shared risk between the parties for US$80 million, dependent on Bathurst's unfettered decisions as to how the assets are to be managed and developed.

[57] To the contrary, it presents as a contract under which the latter two thirds of the quantified consideration is deferred, but will become payable at dates unknown at the time of the contract, with only limited risks that the milestones triggering the obligations for those later payments would not be achieved at all. That is certainly the case for the first performance payment.

Issue one: Meaning of "shipped" in clause 3.4 of the ASP

[58] L&M's case is that "shipped" was used in its generic sense meaning "transported". This meaning was the common intention of the parties according to Messrs Loudon and Bohannan when they negotiated the ASP for their respective parties. Mr Bohannan introduced the word "shipment" in Bathurst's initial offer in December 2009. The recollections of both witnesses were clear, and demonstrated a common view on how the expression was to apply. The evidence of both principals was credible and reliable on the point.

[59] Bathurst rejected this evidence of a common intention on the basis that the evidence of parties to a contract about their subjective intentions at the time of contracting is not admissible on the issue of what the contractual term means when subsequently interpreted by the Court. However, L&M distinguished the evidence on this point from evidence of subjective intentions because of the agreement between the principals responsible for committing both parties to the ASP.

[60] L&M cited the Queen's Bench (Commercial Court) decision in *The Karen Oltmann* on two points in this context.[10] That case involved a charter party dispute about the scope of the charterers' option to re-deliver the vessel "after 12 months trading". The owners treated that option as exercisable only on the expiry of the first 12 months of the charter, whereas the charterers contended it was available to them at any time after the vessel had been chartered for 12 months. In the era when authorities such as *Prenn v Simmonds* imposed stricter rules against the admission of extrinsic evidence on the meaning of contractual terms,[11] Kerr J held that he was entitled to consider the content of telex exchanges negotiating the terms of the charter party before it was concluded.[12] The Judge looked at those telexes initially *de bene esse* in reliance on the owners' characterisation of them as establishing a common understanding between the parties as to the sense in which the phrase "after 12 months trading" had been used. Once satisfied that the characterisation of the telexes contended for by the owners was accurate as a matter of first impression, the Judge

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10 *The Karen Oltmann*, above n 6.
11 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL).
12 *The Karen Oltmann*, above n 6, at 712.

relied on the telexes to corroborate the interpretation he had initially arrived at, based on the contractual wording alone.

[61] The contemporary approach to admissibility of extrinsic evidence on the meaning of terms used in a contract is substantially more liberal. However, if necessary L&M could apply an analogy with the reasoning in *The Karen Oltmann* to make out the admissibility of the evidence of Messrs Loudon and Bohannan to the extent that it provides a clear and consistent common understanding on the meaning the parties intended for the word "shipped".

[62] L&M also relied on the reasoning in *The Karen Oltmann* to argue that a form of estoppel by convention arose. That estoppel precluded Bathurst from advancing a contrary interpretation to that which it accepted during the negotiations and for six years after completion of the contract. In *The Karen Oltmann*, the owners had pleaded reliance on an estoppel to the effect that the pre-charter party exchanges involved the charterers representing to the owners that the words "after 12 months" created a single opportunity on the expiry of 12 months. Although Kerr J declined to find estoppel per se due to a lack of anything amounting to a representation, his Honour did conclude:[13]

> In these circumstances it seems to me that the charterers cannot now depart from this common meaning by asserting that this word has the opposite meaning in the charter-party.

[63] However, Tipping J in *Vector Gas* later described *The Karen Oltmann* as a case of estoppel.[14]

[64] No such estoppel is pleaded in this case and I would be reluctant to rely on it because of that. However, I accept the point made for L&M that there is a comparable and potentially more compelling course of conduct by Bathurst in the present case. Had the point been taken against it, that conduct could have precluded Bathurst advancing an interpretation of the word "shipped" contrary to that which Mr Bohannan maintained throughout negotiation and completion of the ASP, and to Bathurst's conduct consistent with that for six years after its execution.

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13 *The Karen Oltmann*, above n 6, at 713.
14 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 7, at [34]–[37].

Contractual context

[65] The parties' different characterisations of the ASP were reflected in their different claims as to the context in which the concept of coal "shipped" from the permit areas had been used in cl 3.4. From Bathurst's perspective, the process of preparing parts of the permit areas for open-cast coal mining was to involve a construction phase, in the course of which a quantity of coal would be extracted without it necessarily being the resource intended for production.

[66] Further, from Bathurst's perspective, the economics of coal production in the permit areas depended on selling high quality coal for metallurgical uses which necessarily involved its export. That focus for the venture meant that, once production started, sales would be effected by shipping the coal to buyers outside New Zealand, most likely to steel mills in Asia.

[67] Those features of the ASP supported Bathurst's interpretation of "shipped" as production coal that left the permit areas to be carried by ship to overseas buyers. On that approach, lower quality coal that was extracted during the construction phase would not count as coal "shipped" if that coal was sold domestically. Bathurst treated its sales of such coal to Holcim as fortuitous. Those sales came to an end when Holcim ceased production of cement on the west coast of the South Island in June 2016.

[68] L&M's different perception of the character of the ASP was that the first performance payment was to become payable once the extraction of coal had been established to a meaningful extent. Coal was unlikely to be transported from the permits areas until there was a buyer for it. Until that occurred, it would be stockpiled on site. In negotiating the ASP, L&M accepted that this milestone should occur later in the process of extracting and selling coal than Bathurst had first proposed in the binding letter of intent, which provided for the first performance payment to be paid within 30 days of the earlier of the first shipment of coal after mining in the permits reached commercial production, or the date on which the first 25,000 tonnes of coal had been shipped. In the context in which it was negotiated, adoption of the latter of these two options in the ASP suggests that Bathurst's payment obligation would be

deferred until the volume of coal reached the level of the first 25,000 tonnes to be shipped (transported) from the permit areas.

[69] Bathurst focused on the payment obligations being related to performance in terms of production from the permit areas. The heading of the clause is "Performance Payments". Arguably, the parties agreed that the measure of performance that had to be achieved before the payment obligation was triggered was the production of a significant volume of coking or metallurgical grade coal which would inevitably be exported (that is, by ship). Bathurst would need to raise the capital to make the US$40 million payment, and to do so would have to demonstrate the viability of the export business.

[70] Bathurst argued that, at the time the ASP was entered into, the parties would not have contemplated that the measure of requisite performance would be met by the "incidental" or "fortuitous" production of that volume of lower quality thermal coal. Relevant performance was therefore to be measured by shipping the requisite quantity of higher quality coal, which inevitably would be export sales.

[71] Those arguments were different to Bathurst's approach at the time, as described by Mr Bohannan. According to him, the measure of production was 25,000 tonnes, irrespective of the type of coal involved. Certainly, if the majority was for sale domestically, the capital raising task might be more difficult, but that was the bargain.

[72] The binding letter of intent had described these payments as "deferred cash consideration". Arguably, over L&M's preference to retain that description, Bathurst had insisted on changing the description to "performance payments" as was eventually used in the ASP. In closing submissions, Bathurst argued that the change in description was significant because the former treated the payments as finite existing commitments with the payment obligation delayed. In contrast, the latter description meant that the liability would not arise until certain performance measures had been met, so that if they did not occur the liability would not arise at all.

[73] I accept that Bathurst's distinction can be drawn, but am not persuaded that it can influence the proper interpretation of the word "shipped". The distinction reflects

the parties' recognition at the time of the ASP that they could not predict when either the first or second performance triggers would be reached. The obligation was dependent on performance, but I am not satisfied that the nature of that performance was confined to the subset of potential production of coal for export.

[74] Bathurst supported its argument that performance is the trigger for the obligation to make the performance payment by reference to the different definition in the royalty deed for the scope of production on which royalties would be payable. The draft of the royalty deed annexed to the ASP provided that royalties would be payable on gross sales revenues, which were defined:

> *Gross Sales Revenues* means 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.

[75] Coal was defined:

> *Coal* means coal mined from the area of any Permit part or all of which falls within the external boundaries of the Permit Areas.

[76] Bathurst submitted that there was a material difference in the language used to define the forms of production that were relevant, on the one hand, to reaching the level of coal shipped to trigger the performance payments and, on the other, to the broader concept of production from the permit areas that triggered an obligation to pay royalties. Arguably, this difference was deliberate because royalties were payable on all coal sold, whereas only coal exported (that is, "shipped") counted for the measure of performance that would trigger the performance payment obligation.

[77] L&M explained the difference in terms between the ASP and the royalty deed on the basis that the former was a bespoke commercial deal and the latter an adaptation from standard precedents. Despite the different terminology, L&M disputed that there would be any commercial logic for adopting different modes of measurement. In both contexts, it was production from the permit areas that was relevant. Consistently with the usual structure of royalty payments, they were measured by sale prices achieved. The performance payment was triggered by a specific volume of coal once it had been transported from the permit areas.

[78] I have not found sufficient evidence in the context of the ASP and the negotiation of its terms (including the draft of the royalty deed attached as a schedule) to justify a finding that the different formulae used in defining the two payment obligations was deliberate, or intended to identify different categories of production.

[79] Bathurst also cited internal emails between L&M personnel in the period when the terms of the transaction were being negotiated to support its contention that the performance payment would only be triggered when meaningful production, enabling capital to be raised to make the payments, was occurring.

[80] The first of these was a 3 December 2009 email from Mr Gordon to Messrs Loudon and Hogan, commenting on changes he proposed at that time to the basic terms for the transaction. He stated:

> Last but not least, I've changed the total consideration to $125m. This is mainly at the back end. If they get that far, I am sure they won't mind paying the extra.

[81] This was a comment on changes he proposed, increasing the total consideration from US$110 million to US$125 million. At that time, his suggestion was for an initial payment of US$5 million on signing the binding letter of intent, and thereafter two US$35 million instalments, the first within 60 days of signing the ASP and the second within 30 days of obtaining the permits necessary to commence initial mining. Thereafter, a final payment of the balance was to be paid within 30 days of the shipment of the first 10,000 tonnes of coal.

[82] That proposal required a much greater proportion of the total purchase price at much earlier points in time. The different stages at which payments would be required gives a quite different complexion to Mr Gordon's comment about Bathurst not minding paying the extra $15 million that he was adding to the total.

[83] The second email was from Mr Hogan to Messrs Loudon and Gordon on 21 December 2009, in which he commented that he thought US$40 million "is a very fair deal for us" and that he classed any additional payments as "being bonuses". In his evidence-in-chief, Mr Hogan explained that this comment reflected his view that a US$40 million initial payment was a fair part of the total consideration to expect at

the outset. He referred to the subsequent payments as bonuses to recognise that they would depend on Bathurst's future ability to perform with the assets being acquired. Cross-examination on the point did not change the essence of Mr Hogan's evidence. His reference to US$40 million has to be measured against the initiative of Bathurst at the outset of negotiations in pitching its initial offer at a total consideration of US$110 million to be paid in instalments, and Mr Hogan's agreement in cross-examination that L&M was looking to sell for more than US$40 million.

[84] Those comments by Messrs Gordon and Hogan do not help to illuminate the meaning of the word "shipped" intended by the parties at the time of the ASP.

Subsequent conduct

[85] From the time the ASP was completed until commencement of this proceeding, Bathurst conducted itself consistently with the word "shipped" equating to "transported". Statements in Bathurst's financial statements for the year ended 30 June 2014, and in the interim financial statements for the six months to 31 December 2014, acknowledged that domestic sales of coal to Holcim would trigger the performance payments. Thereafter, in the commentary in the 2015 annual report on the financial statements for the year ended 30 June 2015, Bathurst acknowledged that the coal being mined "has triggered the performance payments". In the financial statements and separately in the annual report for the year ended 30 June 2016, there were similar acknowledgements that the first performance payment had been triggered by the production at the Escarpment Mine. There was a similar acknowledgement in November 2016 when Bathurst made an announcement about its acquisition of Solid Energy assets.

[86] In a June 2016 letter from Bathurst's chief executive responding to a letter outlining L&M's claim on the basis now pursued, there was no suggestion that the first performance payment had not been triggered. Rather, cl 3.10 was relied on to deny that non-payment amounted to a breach of Bathurst's obligations under the ASP. I accept L&M's submission that a denial that the performance payment had been triggered would have been included in that letter, had that been Bathurst's interpretation of the contract at the time.

[87] After the proceeding had been commenced, the notes to the interim financial statements for the six months ended 31 December 2016 signalled a shift in the meaning attributed to "shipped" in the following terms:

> Whilst in excess of 25,000 tonnes has been mined from Escarpment during construction the Company does not believe, in the legal context, that 25,000 tonnes has been shipped from the project. This would therefore not legally trigger the payment of the first performance payment.

[88] Bathurst submitted that, in the absence of some form of estoppel, it could not be held to the interpretation it had adopted at earlier times. If, as submitted for Bathurst, its previous interpretation was incorrect, then all it meant was that the outcome would be inconsistent with Bathurst's earlier understanding. Earlier statements by Bathurst should not deflect the Court from applying the established principles of contractual interpretation by focusing on the language in its contractual context to interpret the expression as a reasonable person appraised of the circumstances of the contract would do at the time.[15]

[89] Bathurst placed a modicum of reliance on an email that was discovered the day before the trial began. I allowed the email to be put to witnesses over L&M's objection at the lateness of its discovery. At a number of interlocutory stages Bathurst had been pressed to check further for discoverable documents, and its performance in doing so was the subject of criticism. Mr Bohannan sent the email in question to others within Bathurst on 5 April 2014, reporting on discussions he and the then Bathurst chairman, Mr Frow, had with Mr Loudon during a lunch meeting the previous day. Mr Bohannan reported Mr Loudon as explicitly stating that the performance payments would only fall due on the export of coal at 25,000 and one million tonnes, meaning that domestic sales would not trigger the payments.

[90] In evidence, Messrs Loudon and Bohannan recalled the lunch as a most convivial one, but neither had any recollection of the statement Mr Bohannan's email attributed to Mr Loudon. Mr Loudon considered it most unlikely and Mr Bohannan was inclined to doubt the accuracy of the email, which did not change his overall recollection of the state of contractual commitments between the parties.

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15 *Vector Gas Ltd v Bay of Plenty Energy Ltd*, above n 7, at [19]; and *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 8, at [60]–[63].

[91] There was no evidence of Bathurst taking any steps thereafter to confirm such a commitment from L&M, and the series of later public announcements on behalf of Bathurst was to the contrary effect because they confirmed that domestic sales of coal would count in triggering the obligation to make the first performance payment.

[92] Mr Bohannan made an announcement for Bathurst to the NZX and ASX on 29 August 2014 including:

> … the current mining plan has no production activity scheduled beyond construction phase until international coking coal prices improve. Subsequently, no royalties or financial obligations linked to shipments of export coal will fall due in the foreseeable future.

[93] In closing submissions, it was submitted that the absence of protest at this characterisation of the performance payment obligations suggests acceptance by L&M of the interpretation that is now argued for Bathurst.

[94] I am not satisfied that is a valid aid for Bathurst's interpretation. It would involve accepting that L&M was monitoring all of the public announcements by Bathurst. That is not reasonably made out. It is also inconsistent with the statements made in Bathurst's financial statements up to that time and thereafter, which recognised the performance payment obligation consistently with L&M's understanding.

Other usage by the parties

[95] Bathurst invited analogy with numerous references in documents mostly prepared by L&M before the transaction. In describing the scope of the potential operation at the Escarpment Mine, documents such as information memoranda prepared by L&M for marketing its assets, and valuations of those assets prepared for internal purposes, used more specific language than "shipped" if that term was to be given a generic meaning of "transported". For instance, a June 2008 marketing document referred to coal for export being "shipped through Lyttelton". An L&M information memorandum produced in September 2008 referred to coal being trucked from a mine, then railed to Lyttelton, for export.

[96] Bathurst argued that such references reflected usage by both parties at a more specific level than the generic usage of "shipped". These different levels of specificity were put to Mr Bohannan in cross-examination. Mr Hodder submitted in closing submissions that Mr Bohannan's answers illustrated that the interpretation of "shipped" contended for by L&M was strained. Mr Bohannan's explanation was that the more specific descriptions of modes of transporting coal were appropriate in what were essentially engineering reports, whereas the measure in issue in triggering the first performance payment was the volume of production from the mine, which was a generic reference.

[97] I accept Mr Bohannan's explanation for the different levels of specificity. I am not persuaded that the references distinguishing other modes of transport in the engineering reports and marketing documents cast doubt on the generic sense in which "shipped" had been used in the ASP.

Dictionary definitions

[98] The parties' closing submissions urged adoption of competing dictionary definitions.

[99] Bathurst's choice of dictionaries predictably focused on those with definitions emphasising the carriage of goods by sea. The primary meaning of the word "shipped" in the New Zealand Oxford Dictionary was cited as:[16]

> … put, take or send away (goods, passengers, sailors, etc) on board ship.

[100] Further meanings from that source acknowledged wider usage in certain contexts, including reference to American usage of "ship" as including an aircraft. Bathurst noted this wider definition is reflected in some New Zealand statutes.[17]

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16 Tony Deverson and Graeme Kennedy (eds) *The New Zealand Oxford Dictionary* (Oxford University Press, Auckland, 2005).

17 For example, the Tariff Act 1988; and Customs and Excise Act 1996.

[101] L&M cited definitions where a primary meaning of "to transport … on board a ship" was supplemented with "to transport … by another means, such as by road or rail",[18] or separately "by mail".[19]

[102] From all the references cited, it is clear that the word "shipped" is used in a wide range of contexts, which can reflect both specific and broad meanings. The meaning appropriately attributed to it will depend on context. Unless the context signals to the reader that passage of goods by sea is contemplated, without more it is not appropriate to confine its interpretation to transport on board a sea-going vessel. The context here is the transport of a bulk cargo from a land-locked area on the west coast of the South Island. Coal could never be "shipped" in the narrow sense from the boundaries of the permit areas. On the other hand, if the buyer of the coal was outside New Zealand, carriage for the sea leg of its delivery to the buyer would inevitably be by ship.

[103] The range of dictionary definitions takes the question of interpretation no further than acknowledging the prospects of carriage either by sea or by other means.

Case law

[104] Bathurst cited a number of sale of goods and shipping cases where the meaning of the words "shipment" or "shipped" arose. Approximately half the cases cited were decided in the 19th century.[20] The cases considered issues such as:

- the point in time at which goods had been shipped for the purposes of a provision in the sale contract stipulating a time for performance of that step in the sale process;

- whether the courts in the seller's or buyer's location had jurisdiction over a dispute depending on where the goods were to be shipped; and

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18 Robert Allen (ed) *The New Penguin English Dictionary* (Penguin Books, London, 2000).

19 Angus Stevenson (ed) *Oxford Dictionary of English* (3rd ed, Oxford University Press, Oxford, 2010).

20 *Bowes v Shand* (1877) 2 App Cas 455 (HL); *Witham v Vane* [1881] WN 79 (CA); *The Trustees of the Clyde Navigation v Laird & Sons* (1883) 8 App Cas 658 (HL); and *Wancke v Wingren* (1889) 58 LJQB 519.

- whether an exception which excused a vendor's performance of the contract when "hostilities preventing shipment" had occurred.

[105] The respective interpretations adopted in those cases are all understandable in the context in which those disputes arose. However, they are not helpful beyond illustrating the importance of context to the correct interpretation of the expression in issue. None of those cases involved disputes about the mode of transport contemplated by the language used.

[106] The only possible exception is the case of *Witham v Vane*, which involved a claim by former owners of land under which a coal mine had been operated. They sued the present owners for breach of a covenant to pay them a royalty on all coal "shipped for sale".[21] The present owners denied liability on the ground that coal produced had been sent from the property by railway. In the Chancery Division, Fry J held that the covenant only applied to coal that had actually been shipped for sale by the proprietors and did not include coal sent by railway.

[107] The very brief report available of that litigation provides no detail beyond that in reporting dismissal of an appeal on a different ground. The Chancery Division reasoning cannot be helpful in the absence of more context and the range of arguments that may have been considered.

Expert evidence on usage

[108] Bathurst also relied on the evidence of Mr Russell, who has 40 years' experience in coal markets and logistics in New Zealand, to the effect that those in the coal industry in New Zealand speak specifically or literally, and when they say "shipped" they mean carriage of coal by ship, implicitly for export. The effect of Mr Russell's evidence was that usage in the industry was generally accurate about proposed modes of transport. His opinion was that in dealings between those involved in the industry, if arrangements between them referred to coal being shipped, they meant it was to be carried on board a ship. Such communications would be similarly specific if, in the alternative, the coal was to be trucked or railed.

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[21] *Witham v Vane*, above n 20.

[109] With respect to Mr Russell, I did not find his opinions materially helpful in interpreting the expression in the ASP. The focus of his experience was in the logistics of transporting substantial volumes of coal. His opinions reflected dealings with others who were focused on the logistics of moving what constitutes a bulk cargo. That experience is similar to the level of specificity that was appropriate in the engineering reports and similar documents that Mr Bohannan credibly distinguished from the context in which the expression was used in the ASP.

Construction coal excluded

[110] A further argument in Bathurst's case was that the first 25,000 tonnes should only include production coal, which was to be distinguished from coal extracted in the course of constructing the mine's facilities, which Bathurst labelled "construction coal". On this approach, arguably domestic sales of thermal coal to Holcim would not count as it was extracted in the course of constructing mining facilities to enable later extraction of high quality coking coal to occur. This argument did not feature prominently in Bathurst's closing submissions.

[111] No distinction was drawn between different types of coal in the ASP, in other contractual documents, or in the contemporaneous record of negotiations. L&M denied that any such valid distinction could be drawn and suggested that the concept of construction coal was developed by Bathurst in the course of prolonged resource consent difficulties.

[112] I am not satisfied that the production for domestic sales to Holcim only occurred because it facilitated the construction of facilities for the later extraction of export coal. Although clearly on a very different scale of production, it was nonetheless coal produced from the permit areas, having a commercial purpose once it was transported away from the permit areas for delivery to Holcim.

[113] Having considered all the various grounds for Bathurst's contrary interpretation, I uphold L&M's interpretation of "shipped" in cl 3.4 of the ASP as meaning "transported".

Issue two: Interpretation of clause 3.10

[114] There is no dispute that more than 25,000 tonnes of coal has been transported from the permit areas. The next issue is whether Bathurst can rely on cl 3.10 to deny that non-payment of the first performance payment amounts to a breach of its contractual obligations.

Did clause 3.10 alter the prior contractual position?

[115] During 2012, the parties were working co-operatively to optimise the chances of Bathurst raising the capital necessary to bring the mine into production, including the capacity to make the first performance payment. The consenting processes took longer than had been anticipated. One concern was the consequence of Bathurst going into default under the ASP if the first performance payment obligation was triggered before it had the financing in place to make the payment.

[116] I accept Mr Bohannan's explanation that Bathurst would have been obliged to announce to the ASX that it was in breach of the ASP, and the fact of breach would likely impair attempts to raise the necessary finance. Because of those concerns, Bathurst requested an addition to the ASP to confirm that non-payment of the first performance payment when it fell due would not amount to a breach of its obligations under the ASP. There was no extended negotiation as to how that would work, nor were the terms of cl 3.10 the subject of negotiation. L&M instructed Ms Brigid McArthur of Greenwood Roche Chisnall to draft such an acknowledgement and the third amendment to the ASP was promptly executed without amendment.

[117] Bathurst relied on a number of factors to submit that cl 3.10 represented only a clarification of the existing contractual obligations. In terms of the contemporaneous documentation, it cited Ms McArthur's characterisation that the deed had been prepared "to reflect the mutual expectation that any non-payment of a Performance Payment under the [ASP] is not a 'default' by Bathurst, but has as its consequence the preservation of the higher royalty rate under the Royalty Deed".

[118] The short operative provision in the third amendment was introduced with the statement that the deed "records the parties' agreement to clarify a matter in relation

to the Performance Payments" and the operative provision began "For the avoidance of doubt".

[119] Bathurst submitted that it had always been entitled to defer payment of a performance payment on condition that it continued to pay royalties at a higher rate. This depended on its interpretation of cl 4 of the royalty deed, which provided (in cl 4.1(a)–4.1(c)) for the stepped reduction in the rate of royalty payments. Those provisions were subject to cl 4.1(d), materially in the following terms:

> For the avoidance of doubt:
>
> (d) … 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 in the event that the First Payment Date does not occur;

[120] Bathurst interpreted this provision as creating an option for it to elect to continue paying at the higher royalty rate instead of making the first performance payment. On Bathurst's interpretation, this was sufficient of itself to permit Bathurst to continue making royalty payments at the higher rate without being in breach of the ASP.

[121] I do not agree with Bathurst's submission on the effect of these provisions in the royalty deed. Instead, I interpret them as requiring royalty payments to continue at the higher rate until the performance payment had been made. They eliminated 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. There is nothing in cl 4.1(d) to exonerate Bathurst from the consequence of being in breach of the contract if it did not pay the performance payment when it fell due.

[122] Messrs Bohannan and Hogan gave evidence about the context in which the third amendment came to be drafted, which was not challenged by any evidence of that context from Bathurst. The evidence from both witnesses was that the existing terms of the obligation to make the first performance payment created a problem for Bathurst. They sought an accommodation from L&M to relieve them of the pressure

created by the existing contractual commitment. Mr Hogan described a call from the then chief financial officer of Bathurst, Mr Tim Manners, who described this predicament and requested the amendment as a change, rather than as a clarification to the existing agreement. Mr Hogan did not treat the request as a signal that Bathurst wanted to delay payment of the performance payment when it was due, but simply wanting to avoid having to announce that it found itself in breach if it was unable to make the payment immediately upon it becoming due.

[123] The tenor of Mr Loudon's evidence was that it was not in L&M's interests to push Bathurst into default or to pursue remedies for a breach of contract. The 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.

[124] I find that prior to completion of the third amendment, the position was not that L&M *could not* cite non-payment of the first performance payment as a default by Bathurst once it was due, but rather that L&M *would not* do so. I am satisfied that the effect of the dialogue between Messrs Loudon and Bohannan prior to the addition of cl 3.10 was that L&M would not rely on any breach of Bathurst's payment obligation to treat Bathurst as being in default. The commercial context was that L&M had first ranking security over all the assets it had sold to secure performance of Bathurst's obligations, but that L&M did not have the resources or the inclination to take the assets back and re-market them.

[125] I consider it most likely that in this context, when Ms McArthur was instructed to prepare the third amendment, she was given to understand a mutual expectation operating that non-payment would not be relied on as a default. That expectation was inconsistent with the terms of the ASP, but acknowledged by both parties as the way in which the commercial relationship had developed between completion of the ASP and completion of the third amendment.

[126] Bathurst submitted that the words "for the avoidance of doubt" indicate that what follows is to spell out what is fairly obvious, rather than subverting the other

provisions of a document.[22] I am not persuaded that, in the circumstances it was used here, the expression signals that the commitments then set out represented only a clarification of the pre-existing contractual position. In this case, the doubt as perceived by the drafter was as to the difference between Bathurst's original contractual obligation to pay the first performance payment on shipment from the permit areas of 25,000 tonnes of coal (with the consequence that Bathurst would be in default if that obligation was not performed), and the informal assurances since completion of the ASP that L&M would work co-operatively with Bathurst to facilitate performance and would not insist on enforcement of its strict contractual entitlements.

[127] Bathurst's 2013 operating plan had been signed off by Mr Bohannan. It appears to have been prepared in mid-2012 somewhat before completion of the third amendment. It stated:

> In discussions with L&M it was always the intent to have performance payments flexible, with the trade-off being a higher royalty. However, this is not how the legal agreement has been drafted. A variation deed is currently being prepared.

[128] Bathurst's submissions characterised this statement as confirming the third amendment was only a clarification of the pre-existing position. However, I interpret it as reflecting a change to the formal commitments as legally recorded, so as to accord with informal assurances that were a feature of the co-operative attitude between the parties at the time.

[129] As drafter, Ms McArthur may have considered the terms achieved no more than the avoidance of doubt. However, I am satisfied that contractual rights and obligations were altered to the extent that, prior to its execution, L&M was entitled to treat non-payment of the first performance payment when due as a default, but no longer held that position once cl 3.10 came into effect.

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[22] *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd* [2004] UKHL 54, [2004] 1 WLR 3251 at [35] per Lord Walker.

Nature of Bathurst's alternative payment obligation

[130] Non-payment of the performance payment when due was agreed not to be an actionable breach of, or default under, the ASP:

> … for so long as the relevant royalty payments continue to be made under the Royalty Deed.

[131] What then was the scope of Bathurst's alternative payment obligation provided for in cl 3.10?

[132] It is the starkly different interpretations the parties attribute to this stipulation that are at the heart of the case. From L&M's perspective, cl 3.10 allowed Bathurst to defer payment of the US$40 million performance payments so long as L&M was receiving royalties at the higher rate on a reasonable level of production from the permit areas.

[133] L&M's interpretation was supported by Mr Bohannan to the extent that he treated continued payment of royalties at the higher rate as compensating for delay in payment of what he saw as a form of vendor finance.[23] For so long as Bathurst kept L&M out of its capital, it had to compensate it by a rough equivalent of an interest payment, calculated by reference to the level of production. The essence of the obligation is that payments have to continue to be made. The quantification of such payments is as provided for in the royalty deed.

[134] From Bathurst's perspective, this obligation was simply to comply with its obligations under the royalty deed, which required a relatively high rate of royalty on gross sales of coal, but no payment obligations if sales were not made. Consistently with its characterisation of the ASP as a long-term venture with shared risks, Bathurst submitted that there was no obligation on it to mine uneconomically, so that circumstances could well arise in which no royalties were payable. In that event, so long as Bathurst was not breaching its obligations under the royalty deed, it could continue to deny that non-payment of the performance payment amounted to an actionable breach of, or default under, the ASP.

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[23] Mr Bohannan's evidence was that this was what it was called internally at Bathurst. He described the "tiered royalty" as "quasi interest" payments.

[135] I am satisfied on all the evidence that at the time the third amendment was completed, none of those involved addressed the contingency that mining operations might occur to an extent that the first performance payment was triggered, and then cease on a semi-permanent basis. It seems an unlikely contingency in 2012 that Bathurst, having paid the first US$40 million for acquisition of the assets and committed to the working capital requirements to finalise permits and generate production of 25,000 tonnes of coal, would then effectively write off that investment or defer any return on it by not proceeding with further production. I acknowledge that there was no accounting analysis focusing on the point. I also accept that there may have been a range of foreseeable contingencies in which that sequence might conceivably occur, but on the state of the parties' positions in 2012 there is no evidence that anyone raised it as a prospect.

[136] Accordingly, Bathurst's subsequent decision to place the mine on care and maintenance so that production ceased and no material level of royalties would be payable was an unforeseen contingency when the third amendment was completed, at least from L&M's perspective.

[137] I am satisfied on Mr Loudon's evidence that this contingency would not have been agreed to by L&M if it was raised at the time. The essence of Mr Loudon's position was that he would not necessarily rely on any default by Bathurst and pursue remedies under the ASP. However, in the absence of royalties paid at the higher rate on a reasonable volume of production, he intended that L&M retain control of its options so that it could not be left in the position Bathurst contends for, namely being entitled to no further payments from Bathurst for so long as sales of coal were not occurring from the permit areas.

[138] Mr Bohannan's approach at the time was somewhat less clear. However, he did recognise that Bathurst could not rely on cl 3.10 if it was also not paying royalties.

[139] This evidence does not necessarily resolve the issue of interpretation. The question is what the words used reasonably convey to a person appreciating the circumstances as they were at the time. There has been no application by L&M for rectification of the terms of cl 3.10.

[140] This again puts the focus on the character of the contract. It is difficult to attribute to the ASP either of the competing characters as contended for by the parties at the time of its execution in 2010, because the character attributed by each party is at least implicitly influenced by subsequent events. As matters stood in 2010, I do not treat the transaction as having the character of any form of joint venture in which risks of subsequent financial outcomes were shared. L&M had no control over the conduct of the business of the assets it was selling, and the consideration to be received was largely finite, although subject to fluctuation. L&M no doubt intended to retain control over any concessions it subsequently might decide to make in favour of Bathurst to facilitate Bathurst's completion of its payment obligations, but it was otherwise uninvolved.

[141] For it to be a venture in which the future risks were shared, L&M might be expected to have protected its position by having some measure of control over how the business of the assets was to be conducted. There was never any suggestion that it should have such control. The nearest the contractual arrangements came to this was the commitment under the royalty deed for Bathurst to satisfy the minimum work programme in respect of each of the permits, to conduct mining operations in accordance with good mining practice and with a view to maximising coal sales at the best available price. That could not give L&M any means of asserting any control over the business.

[142] Bathurst's obligations under the ASP to pay the performance payments and on-going royalties were obviously conditional on the timing and level of production within the permit areas. They were not unconditional obligations because there were prospects that the production would not occur. For instance, all the necessary regulatory consents may not have been obtained. However, the history of mining in the permit areas, plus L&M's survey work made available to Bathurst, was supplemented pre-settlement with the DFS that Bathurst commissioned, and in reliance on which it was prepared to settle and pay the first US$40 million. Once settlement occurred, Bathurst took complete control, subject only to L&M retaining a security interest over the assets in the event of Bathurst defaulting on its contractual obligations.

[143] Progression from that character of the ASP to the adjustment reflected in the third amendment is not such as to make payment of any further consideration to L&M a matter solely at Bathurst's discretion.

[144] I interpret the reference to royalty payments being made under the royalty deed as convenient shorthand to describe the unquantified extent of payments required. It does not go further so that compliance with the royalty deed would inevitably entitle Bathurst to rely on cl 3.10 to deny what would otherwise be an actionable breach or default. What is contemplated is an alternative money flow to the payment of the performance payment. The quantum is at large, in that no minimum level of royalties is stipulated. However, it is 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.

[145] What is in issue is the scope of the proviso with which Bathurst has to comply to bring itself within cl 3.10. L&M's approach gives primacy to the initial proposition in that proviso, namely "for so long as the relevant royalty payments continue to be made". The reference to the quantum being in accordance with the royalty deed is no more than quantification of that obligation.

[146] In contrast, Bathurst contends that there is no payment obligation independent of compliance with the royalty deed, so that if no payments are due under the royalty deed, then Bathurst needs do nothing to bring itself within cl 3.10.

[147] I am satisfied that the former approach is more consistent with the bargain as originally struck, and all the surrounding circumstances of the 2012 modification to that.

2013 clarification

[148] In May 2013, the parties addressed the intended application of the third amendment when Bathurst was drafting documents for an intended capital raising. Wellington solicitors, Russell McVeagh, were acting for Bathurst, and the extent of Bathurst's entitlement to defer making the first performance payment was a material consideration that had to be addressed in the capital raising documents. I accept that

evidence of the 2013 communications over the meaning of the third amendment is admissible as subsequent conduct.[24]

[149] L&M consented to dialogue occurring between Ms McArthur, as drafter of the third amendment, and Russell McVeagh on how its terms should be described. The result of that exchange was concurrence on behalf of L&M with a description in the following terms:

> Failure by Bathurst to make a performance payment when due is not a breach of the [ASP] 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.

[150] Bathurst submitted that L&M's agreement to the description of the contractual position in these terms in 2013 reinforces its position that its obligations were limited to compliance with the royalty deed. As a result, if there were no coal sales generating revenue on which the royalty was to be calculated, then L&M was not contractually entitled to receive any payments.

[151] I am satisfied on the evidence of Mr Clarke that the contemplation of the parties in 2013 was as it had been in 2012. The option for Bathurst would be to pay either royalties at the higher rate, or the performance payment. The alternative of paying neither was not addressed because the prospect of Bathurst commencing, and then ceasing, production at the Escarpment Mine was not raised. I am not satisfied that the exchanges in 2013 alter the interpretation of the third amendment on its terms and in the context of its completion in 2012.

[152] It is understandable that the prospect of no mining occurring would not have been addressed when Bathurst was focusing on a capital raising intended to fund mining operations. In seeking further capital, Bathurst would have been addressing the positive prospects of successful mining and it would detract from the tone of any capital raising documents to acknowledge the prospect that no mining would occur, or

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[24] *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 at [7] per Elias CJ, [62]–[63] per Tipping J, [73] per Anderson J and [122] per Thomas J.

that mining operations might stop completely after the 25,000 tonne milestone had been reached.

[153] In cross-examination, L&M elicited acknowledgements from some Bathurst witnesses that the third amendment reflected "a trade-off". Arguably, if it did, Bathurst's commitment to continue paying royalties at the higher rate would not create any advantage to L&M in return for its concession not to treat non-payment of the performance payment as a breach of contract. This was because the terms of the royalty deed obliged payments to continue at the higher rate in any event.

[154] Mr Kalderimis suggested that the trade-off incentivising L&M to agree to the terms of the third amendment was the implicit assurance or commitment by Bathurst to continue mining at a level that would generate royalties comprising a rough equivalent to interest on the unpaid performance payment.

[155] I am not satisfied that the arrangements reflected each party making a change to their rights or obligations in return for the new promise being made by the other. Rather, the third amendment represented a concession by L&M intended to make it easier for Bathurst to complete its contractual obligations.

Issue three: Implied term in clause 3.10

[156] Against the prospect that my interpretation of the limits to which Bathurst can resort to cl 3.10 is wrong, I next consider L&M's alternative argument for an implied term to the effect that Bathurst could only rely on cl 3.10 to defer making a performance payment whilst it was continuing to make royalty payments that reflected the proceeds of on-going mining and substantive coal sales.

[157] As a matter of pleading, L&M contended for an implied term as follows:

> … 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 LMCH being denied receipt of a sum otherwise due and owing.

[158] This pleading was for a more elaborate implied term than is necessary for L&M's purposes. The last component of the proposed implied term acknowledges a purpose for the requirement to pay royalties but does not add anything to the means of quantifying the liability. Similarly, the reference to entitlement to further defer payment of a performance payment is repetitive of the purpose of cl 3.10 on its original wording. The essence of the term sought to be implied is that, to rely on cl 3.10 during the period when the performance payment is due but remains unpaid, Bathurst has to continue paying royalties at the higher rate on a substantive volume of coal sales. It is not an implied term that would require Bathurst to continue mining. Rather, it would require it to either continue mining and paying royalties, or to make the performance payment that is due. It would not permit Bathurst to do neither.

[159] Bathurst denied that any such term could be logically implied. The term was not necessary to give business efficacy to the ASP and, further, the addition of any such implied term was contrary to the entire agreement provision in the ASP.

[160] The detailed approach to the test for implication of a term into a commercial contract has been revisited periodically at the highest appellate levels. There is consensus that the five-point test enumerated by Lord Simon in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* remains the starting point.[25] That provides:

> … 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.

[161] In *Attorney General of Belize v Belize Telecom Ltd*, Lord Hoffmann made observations about the process for implying a term that provided a gloss on the settled process applying the test from *BP Refinery*.[26] Lord Hoffmann treated the process for implying a contractual term as part of the exercise of determining the proper construction of the contract.

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[25] *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 (PC) at 283.
[26] *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988 (PC).

[162] More recently, a majority of the United Kingdom Supreme Court has expressed a preference for glosses on the five-point *BP Refinery* test that adhere more closely to the original articulation of that test than to Lord Hoffmann's application of it. In *Marks & Spencer plc v BNP Paribas Securities Services*, Lord Neuberger, with the agreement of Lord Sumption and Lord Hodge, summarised the glosses on the *BP Refinery* tests in the following terms:[27]

> [21] In my judgment, the judicial observations so far considered represent a clear, consistent and principled approach. It could be dangerous to reformulate the principles, but I would add six comments on the summary given by Lord Simon in the *BP Refinery* case as extended by Bingham MR in the *Philips* case and exemplified in *The APJ Priti*. First, in *Equitable Life Assurance Society v Hyman*, Lord Steyn rightly observed that the implication of a term was "not critically dependent on proof of an actual intention of the parties" when negotiating the contract. If one approaches the question by reference to what the parties would have agreed, one is not strictly concerned with the hypothetical answer of the actual parties, but with that of notional reasonable people in the position of the parties at the time at which they were contracting. Secondly, a term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them. Those are necessary but not sufficient grounds for including a term. However, and thirdly, it is questionable whether Lord Simon's first requirement, reasonableness and equitableness, will usually, if ever, add anything: if a term satisfies the other requirements, it is hard to think that it would not be reasonable and equitable. Fourthly, as Lord Hoffmann I think suggested in *Attorney General of Belize v Belize Telecom Ltd*, although Lord Simon's requirements are otherwise cumulative, I would accept that business necessity and obviousness, his second and third requirements, can be alternatives in the sense that only one of them needs to be satisfied, although I suspect that in practice it would be a rare case where only one of those two requirements would be satisfied. Fifthly, if one approaches the issue by reference to the officious bystander, it is "vital to formulate the question to be posed by [him] with the utmost care", to quote from *Lewison*, *The Interpretation of Contracts*. Sixthly, necessity for business efficacy involves a value judgment. It is rightly common ground on this appeal that the test is not one of "absolute necessity", not least because the necessity is judged by reference to business efficacy. It may well be that a more helpful way of putting Lord Simon's second requirement is, as suggested by Lord Sumption JSC in argument, that a term can only be implied if, without the term, the contract would lack commercial or practical coherence.

[163] Lord Neuberger disagreed with Lord Hoffman's approach that the process for implying a term into a contract is "part of the exercise of interpretation", although he still accepted that the process involves "determining the scope and meaning of the

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[27] *Marks & Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742 at [21] (citations omitted).

contract".[28] However, Lord Carnwath saw no reason to depart from Lord Hoffman's articulation, saying:[29]

> … it can be a useful discipline to remind oneself that the object remains to discover what the parties have agreed or (in Lady Hale's words) 'must have intended' to agree.

[164] Lord Carnwath did not regard this approach as removing the narrow constraints on the implication of terms, describing the process of the construction of a contract as comprising two roles:[30]

> … the "usual role" involving the resolution of ambiguities in the language used by the parties, and the "extraordinary power" involving interpolation of terms that they have not used.

[165] Lord Clarke helpfully reconciled the two positions in the following way:[31]

> As Lord Carnwath says at para [62], I did not doubt Lord Hoffmann's observation that "the implication of a term is an exercise in the construction of the contract as a whole". I recognise, however, in the light of Lord Neuberger's judgment, especially at paras [22]-[31], that Lord Hoffmann's view involves giving a wide meaning to "construction" because, as Lord Neuberger says at para [27], when one is implying a word or phrase, one is not construing words in the contract because the words to be implied are ex hypothesi and not there to be construed. However, like Lord Neuberger (at para [26]) I accept that both (i) construing the words which the parties have used in their contract and (ii) implying terms into the contract, involve determining the scope and meaning of the contract. On that basis it can properly be said that both processes are part of construction of the contract in a broad sense.

[166] The New Zealand Supreme Court has left open whether, following *Belize Telecom*, the process for implication of a contractual term should be determined "as a matter of interpretation". In *Mobil Oil New Zealand Ltd v Development Auckland Ltd*, the Supreme Court noted that Lord Hoffmann's approach had been "significantly qualified" by the decision in *Marks & Spencer*.[32]

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28 *Marks & Spencer*, above n 27, at [26]–[27].

29 At [69], referring to *Geys v Socieìteì Geìneìrale, London Branch* [2012] UKSC 63, [2013] 1 AC 523 at [55] per Lady Hale.

30 At [70].

31 At [76].

32 *Mobil Oil New Zealand Ltd v Development Auckland Ltd* [2016] NZSC 89, [2017] 1 NZLR 48 at [81].

[167] Following the observation of Lord Clarke, regardless of whether the implication of the term sought by L&M is considered as a separate part of a broader process of the construction of the contract, or as a different process from construction altogether, it is clear that the matter goes beyond the usual process of interpreting the ASP. I have already interpreted the terms of cl 3.10 as limiting Bathurst's ability to resort to it to excuse non-payment of the first performance payment to those circumstances in which Bathurst is continuing to pay royalties on "substantive" levels of production. If that interpretation is in error, then I come to the alternative task of whether the test for an addition to the existing terms is met. That requires the Court to embark on the more onerous responsibility of attributing to the parties a provision that was not part of their articulated bargain. This task is still concerned, however, with determining the scope of the agreement objectively reached by the parties in the ASP, albeit a part of that agreement that was not written down. Because of that difficulty, the test must be a rigorous one. An implied term cannot be made out lightly.

[168] Addressing each of the five conditions from *BP Refinery* raises again the stark difference between the parties as to the character of the ASP. For instance, on the first condition, L&M contends that such a limitation on the circumstances in which Bathurst can rely on cl 3.10 is reasonable and equitable. The arrangement was that continued payment of royalties at the higher rate provided a form of compensation in lieu of interest for being kept out of its capital.

[169] From Bathurst's perspective, L&M had no entitlement to expect the first performance payment, or royalties in lieu of it, if Bathurst was not proceeding with any substantial level of production. The parties shared the risk that economic extraction of coal from the permit areas might not occur. Therefore it would not be reasonable and equitable to limit Bathurst's resort to cl 3.10 to circumstances where substantial royalties were being paid if Bathurst was not producing coal from the permit areas. Such production on economically viable terms was necessary to enable Bathurst to raise finance to make the performance payment. Accordingly, depriving it of the entitlement to defer payment when there was no production removed that commercial advantage when it was most needed.

[170] On the requirement for the implied term to be necessary to give business efficacy to the contract, the answer similarly depends on the character attributed to the ASP. From L&M's perspective, constraining the circumstances in which Bathurst could rely on cl 3.10 to deny it is in breach is essential for L&M to retain its basic contractual entitlement to insist on the remaining performance obligations that Bathurst was committed to under the ASP. If L&M fails on its interpretation argument, then without the implied term it has given Bathurst a free option to defer any further payment indefinitely. That would destroy what L&M treats as the core of its bargain with Bathurst.

[171] Bathurst treats the proposed implied term as unnecessary because, on the character it attributes to the ASP, cl 3.10 reflects business efficacy in this contract. The clause gives it an unfettered option to defer or even abandon further production from the permit areas. L&M has no unconditional claim to any additional consideration from the ASP, so that for as long as the coal stays in the ground, the US$40 million already paid is all L&M is entitled to.

[172] The third condition of obviousness is similarly answered by reflecting the character attributed to the ASP. On L&M's view of the purpose of cl 3.10, the limit on its application reflected in the implied term is an obvious one. The evidence from L&M witnesses enables me to find that had they been asked at the time if this constraint on the scope of cl 3.10 was to apply, they would all have answered "of course". That observation includes the hypothetical question being asked of Mr Bohannan at the time.

[173] None of Bathurst's acknowledgements in 2014 and 2015 that the first performance payment would be, or had been, triggered were expressed in terms that Bathurst had a free option to pay neither that payment, nor royalties, in the event that production ceased. The obligation to pay was referred to implicitly because it was relevant. In order to now deny that the constraint on resort to cl 3.10 was obvious at the time, Bathurst representatives would have to re-cast its own corporate conduct from those years.

[174] In this analysis, I am mindful of the first of Lord Neuberger's comments on the *BP Refinery* tests in *Marks & Spencer*, derived from an earlier judgment of Lord Steyn that one is not strictly concerned with the hypothetical answer of the actual parties, but with that of notional reasonable people in the position of the parties at the time at which they were contracting. I consider that the implied term would have been equally obvious to a notional reasonable person in the circumstances, if L&M's view of the character of the ASP is accepted.

[175] The fourth condition from *BP Refinery*, namely that the implied term must be capable of clear expression, raises somewhat different issues. The implied term as pleaded is not capable of precisely quantified enforcement. It was criticised by Bathurst as introducing a number of vague and elastic concepts that are not reflected in the express terms of the ASP. The level of royalty payments contemplated is a level reflecting on-going mining and substantive coal sales, sufficient to provide commercial value for L&M relative to being kept out of its capital payment.

[176] I have acknowledged that the proposed terms are more elaborate than is necessary, possibly because of the point at which this claim is pleaded in a relatively complex sequence of alternative claims. If and when coal was being extracted, the rate of shipment from the permit areas would be dictated by the level of purchases, and the quantum of royalties would reflect 10 per cent of the sale prices achieved.

[177] The uncertainty of volumes produced does not prevent recognition of an adequate level of production per month or year, which would take the volume on which royalty payments were made to a substantive level. 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.

[178] There could be scope for argument as to what minimum volume of coal sales would be necessary in any given period to qualify as substantive. However, I am satisfied that the concept being described permits flexibility in the rate of production without being inadequately clear.

[179] The last of the conditions from *BP Refinery* is that the implied term ought not to contradict any express term in the contract. It was submitted for Bathurst that such an implied term would contradict four existing provisions in the contractual arrangements between the parties. First, it contradicted an entire agreement clause in the ASP. Secondly, it contradicted an end date provision addressing the final cessation of mining operations but which made no provision for temporary cessation. Thirdly and fourthly, Bathurst argued that it was in contradiction of provisions in the royalty deed that recognised Bathurst has the decision-making role regarding mining operations, which provided the only limit on Bathurst's obligations in terms of on-going compliance with permits to mine.

[180] The entire agreement clause was in conventional terms stipulating that the ASP constituted the entire agreement and denying contractual effect to all earlier negotiations, understandings and agreements. Although Bathurst's closing submissions were not explicit on the point, for the entire agreement provision to prevent the implication of a term into the third amendment, it would need to be applied *mutatis mutandis* to the circumstances of completion of the third amendment in 2012.

[181] Entire agreement clauses are to take effect according to their terms.[33] In *White v Reserve Bank of New Zealand*, the Court of Appeal recognised in general terms that entire agreement clauses may be an impediment to establishing an implied term, but not in a context that supports Bathurst's argument in the present circumstances.[34]

[182] I note also that counsel for Bathurst drew to my attention after closing submissions a judgment of the Supreme Court of the United Kingdom given on 18 May 2018 in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd*.[35] The analysis in that case takes the propositions no further than those I have just set out.

[183] I am not persuaded that the entire agreement clause operates to exclude the implication of a term in cl 3.10 as added to the contract in 2012. Given the circumstances of its completion, the implied term would not draw on earlier

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33 Kim Lewison *The Interpretation of Contracts* (6th ed, Sweet & Maxwell, London, 2017) at [3.16].
34 *White v Reserve Bank of New Zealand* [2013] NZCA 663, (2013) 11 NZELR 406.
35 *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2018] UKSC 24, [2018] 2 WLR 1603.

negotiations, understandings or agreements. Rather, it records the scope of the concession made in favour of Bathurst subsequent to execution of the ASP 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.

[184] Bathurst's written closing submissions also suggested an inconsistency between the implied term as proposed for L&M, and the provisions of cl 4.1 of the royalty deed.[36] That provided for the calculation and payment of royalties, including that the duration of the obligation was until the later of either the end of the term of both permits, or the final cessation of mining operations in the permit areas, which was defined as the end date. Because those payment obligations did not preclude temporary cessations of mining operations, and therefore impliedly permitted them to occur, the additional provision L&M sought to imply into cl 3.10 was arguably inconsistent by requiring continuous mining operations to trigger continuous obligations to pay royalties.

[185] I do not accept any such inconsistency. The effect of the term L&M seeks to imply 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.

[186] Bathurst also argued that the term L&M sought to imply into cl 3.10 was inconsistent with cls 8.1 and 13.1 of the royalty deed. Clause 8.1 obliges Bathurst to satisfy the minimum work programme required under each of the permits, to conduct mining operations in accordance with good mining practice and with a view to maximisation of coal sales at the best available price, and to otherwise keep the permits in good standing.[37] Clause 13.1 excludes L&M from having any interest in either permit or any right to participate in decision-making regarding mining operations.

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[36] Bathurst's submissions purport to make this point in relation to cl 4.1 of the ASP, but in context I necessarily take it to be a reference to cl 4.1 of the royalty deed.

[37] Clause 8.1 is set out in full at [193] below.

[187] Arguably, cl 8.1 establishes the limit on Bathurst's obligations to conduct mining operations. The proposed implied term would expand the range of such obligations, thereby creating an inconsistency with the scope of the obligations under cl 8.1. That argument is misconceived for the same reason as my comments on cl 4.1: 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.

[188] The implied term would not involve L&M in any decision-making about the conduct of mining operations and is therefore not inconsistent with cl 13.1 of the royalty deed. The absence of inconsistency is for the same reason as just outlined.

[189] If I am wrong in interpreting the explicit words of cl 3.10 as including a requirement for on-going payments of royalties, then I am satisfied the addition of an implied term limiting the circumstances in which Bathurst could rely on cl 3.10 to deny that it was in default on its obligation to make the performance payment does not contradict any other contractual term.

[190] On the competing propositions reflecting each party's preferred characterisation of the contract, I am satisfied that L&M's characterisation is to be preferred, with the consequence that the conditions from *BP Refinery* are made out. Reflecting the last of Lord Neuberger's comments in *Marks & Spencer*, this term may be implied because without it the contract would lack commercial or practical coherence. If I am wrong in my earlier interpretation of cl 3.10, then without the implied term the third amendment would have entirely transformed the nature of any further obligations under the ASP into a free option for Bathurst to elect not to perform the contract any further.

Issue four: Use of contractual discretion for other than a proper purpose

[191] If I found that the performance payment has been triggered (that is, 25,000 tonnes of coal has been shipped) but upheld Bathurst's grounds for relying on cl 3.10 under issues two and three, then L&M's final argument is that cl 3.10 created a

unilateral contractual discretion for Bathurst which must be exercised only for the proper contractual purposes for which it was created.

[192] L&M's argument characterises Bathurst's decision to cease production at the mine, on terms that it would rely on that as complying with the requirement for payment of royalties for the purposes of cl 3.10, as the exercise of a discretion provided for Bathurst under the ASP.

[193] L&M submitted that the nature of Bathurst's relevant discretion is also affected by the provisions of cl 8.1 of the royalty deed, which provides:

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

[194] L&M argued that the obligations on Bathurst under cl 8.1 afford it a discretion to choose how it conducted the mining operations, but not whether mining should be undertaken at all. In other words, Bathurst's work programme (that is, the absence of one) has not been conducted in accordance with cl 8.1 of the royalty deed. This argument rests, at least in part, on the premise that to undertake sufficient work to keep the permits in good standing should, of itself, have ensured an acceptable minimum level of production.

[195] However, the government agency monitoring compliance with the permits has been satisfied with Bathurst's performance and accepted the decision to place the Escarpment Mine on care maintenance without that step compromising Bathurst's good standing under existing permits. Further, I accept Bathurst's point that the obligation in cl 8.1(b) of the royalty deed is designed to require sales to be on arm's length terms. It cannot require Bathurst to develop and conduct mining operations irrespective of the financial viability of doing so at the time.

[196] L&M's case was that the discretions under cl 3.10 of the ASP and cl 8.1 of the royalty deed are not ones that Bathurst could exercise in an unfettered way. They were exercisable only for proper purposes under the ASP and the royalty deed. On L&M's analysis of the evidence, Bathurst decided to cease production and claimed that non-payment of royalties still complies with the ASP by relying on cl 3.10. Bathurst has done so in furtherance of its strategy to no longer perform its obligations under the ASP. Such a rationale for the steps taken to rely on cl 3.10 would be inconsistent with the purposes for which the discretion was created, namely to facilitate further performance of the ASP rather than its frustration. L&M's case was that Bathurst is using resources that should be committed to meeting its obligations under the ASP to instead develop the more recently acquired interests in BT Mining. L&M contends that is not a proper purpose.

[197] The legal basis for this claim rests primarily on the approach adopted by the Court of Appeal of England and Wales in a sequence of contract decisions since the early 1990s.[38]

[198] The prospect of constraining a contractual discretion has been recognised more widely, and in New Zealand has been summarised by Mander J, in the context of discretionary powers granted within the terms of insurance contracts, as follows:[39]

> [73] To summarise, Commonwealth Courts are willing to intervene in the exercise of a prima facie unfettered discretion. Such intervention will ordinarily be premised on an implied term to constrain the exercise of the discretion so as to give effect to the reasonable expectations of the parties. The exercise of contractual discretion will be open to challenge where it can be established that it was not exercised honestly in good faith; or not exercised for the purpose(s) for which it was conferred; or when exercised in a capricious or arbitrary manner; or otherwise falls into the category of what would be considered *Wednesbury* unreasonableness.

[199] The pleaded basis for this additional ground of claim was the subject of pre-trial argument. Bathurst took the pleading to include an allegation that Bathurst had conducted itself in bad faith. L&M clarified that it did not allege Bathurst had acted in bad faith. L&M contended that allegation was unnecessary when its argument was

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38 Including *Abu Dhabi National Tanker Co v Product Star Shipping Ltd (No 2)* [1993] 1 Lloyd's Rep 397 (CA); and *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116, [2008] 1 Lloyd's Rep 558.

39 *C & S Kelly Properties Ltd v Earthquake Commission* [2015] NZHC 1690.

instead that the discretions created by cl 3.10 of the ASP and cl 8.1 of the royalty deed were subject to implied constraints on the purposes for which they could be exercised, and that Bathurst had resorted to cl 3.10 for purposes other than those reflecting the contractual purpose.

[200] A dispute over the precise nature of L&M's allegation of lack of proper purpose persisted until the end of the hearing. After L&M's closing submissions had been presented, counsel for Bathurst sought leave to make additional points in reply on the basis that, however L&M labelled its analysis on this point, the effect of it was to criticise Bathurst's conduct as amounting to actions in bad faith. Given the moral taint associated with any finding of bad faith, it is understandable that there would be heightened sensitivity for all the individuals linked to this allegation, as well as for Bathurst's corporate reputation.

[201] However, before engaging on the facts, Bathurst took the point that its reliance on cl 3.10 did not involve any discretionary decision of the type that might be constrained by an implied term requiring its exercise for only proper purposes.

[202] A rationale for the Court implying constraint on the exercise of a discretion granted to one party by the terms of a contract was provided by Lady Hale in *Braganza v BP Shipping Ltd*:[40]

> [18] Contractual terms in which one party to the contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, are extremely common. It is not for the courts to re-write the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker. Nevertheless, the party who is charged with making decisions which affect the rights of both parties to the contract has a clear conflict of interest. That conflict is heightened where there is a significant imbalance of power between the contracting parties as there often will be in an employment contract. The courts have therefore sought to ensure that such contractual powers are not abused. They have done so by implying a term as to the manner in which such powers may be exercised, a term which may vary according to the terms of the contract and the context in which the decision-making power is given.

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[40] *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661.

[203] The earlier decision of the Court of Appeal of England and Wales in *Socimer* was consistent with that.[41] That litigation arose out of trading between banks in securities of emerging markets. The contractual terms for these trades gave the seller certain rights on default by the buyer, and the mode of exercise of those powers was challenged in the litigation. The Court of Appeal recognised that when a contract allocated to one party a power to make decisions under the contract which might have an effect on both parties, then the decision-maker's discretion is limited as a matter of necessary implication by concepts of honesty, good faith and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. There was a requirement for reasonableness in the administrative law *Wednesbury* sense.[42]

[204] Bathurst argued that cl 3.10 granted it a mere contractual power of a type where courts would not intervene to constrain the manner in which Bathurst, as the party empowered by the provision, placed reliance on it.

[205] Bathurst relied on a line of English decisions in which the *Socimer* approach to implied constraint on contractual discretions was rejected on an analysis of the type of contractual power addressed by the provision in question.

[206] These cases included *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd*, which addressed a contractual dispute between the trust responsible for running a hospital and a business contracted to provide catering and cleaning services to the hospital.[43] The contract specified service levels required of the contractor and if a performance failure was recorded, the trust was entitled to make deductions from the service payment in respect of the performance failure. The proceedings involved a challenge to the actions of the trust in making such deductions in reliance on that provision.

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41 *Socimer International Bank Ltd v Standard Bank London Ltd*, above n 38.

42 At [66].

43 *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* [2013] EWCA Civ 200, [2013] BLR 265.

[207] In distinguishing the *Abu Dhabi* and *Socimer* line of cases in which an implied term constraining the exercise of a contractual discretion has been upheld, Jackson LJ observed:

> [82] … In each of the above cases the implied term was intrinsic. The contract would not make sense without it. It would have been absurd in any of those cases to read the contract as permitting the party in question to exercise its discretion in an arbitrary, irrational or capricious manner. …
>
> [83] An important feature of the above line of authorities is that in each case the discretion did not involve a simple decision whether or not to exercise an absolute contractual right. The discretion involved making an assessment or choosing from a range of options, taking into account the interests of both parties. In any contract under which one party is permitted to exercise such a discretion, there is an implied term. The precise formulation of that term has been variously expressed in the authorities. In essence, however, it is that the relevant party will not exercise its discretion in an arbitrary, capricious or irrational manner. Such a term is extremely difficult to exclude, although I would not say it is utterly impossible to do so. …

[208] In *Mid Essex,* the Court of Appeal found no justification for implying a term of the type contended for here. Mr Hodder suggested a distinction that the *Mid Essex* type cases involved a pure contractual power where the party granted that power was simply making a decision whether or not to exercise a contractual entitlement, whereas the *Socimer* type cases provided for evaluative decisions as to how (potentially choosing from a range of options) an aspect of the contract was to be performed. That distinction may be an oversimplification, but it is apt in assessing the nature of Bathurst's entitlement in the scenario that would pertain if this argument became relevant.

[209] If Bathurst triggered the obligation to make the first performance payment but is able to rely on its present conduct as complying with the obligation to continue to make relevant royalty payments under the royalty deed, then such reliance is the exercise of a pure contractual power and does not involve a discretionary decision as to how the contract is to be performed. Bathurst's ability to cease mining and to rely on cl 3.10 to deny that non-payment of the first performance payment places it in default under the ASP does not involve a discretionary decision whether to continue paying royalties at the higher rate or instead to make the performance payment. Rather, it involves asserting a contractual power, the existence of which L&M disputes, to adopt that course in reliance on its interpretation of these contractual

provisions. Bathurst would not be exercising a discretion as to which option it exercised, but rather asserting a claim that it is able to do neither without being in breach of the contract.

[210] On the basis of my findings on the earlier issues, Bathurst is wrong on the scope of the power it argues is provided for it by cl 3.10. However, if it is right on that, then its course of conduct does not involve the exercise of a discretion of a type where the Court can imply a constraint on the purposes for which that discretion can be exercised. Rather, it would be exercising a contractual right reserved to it, in the circumstances that have arisen.

[211] It follows that, if I am wrong in finding for L&M on the prior grounds for its claim, then the legal basis for L&M's last argument would not avail it.

Issue five: Did Bathurst use clause 3.10 for a proper purpose?

[212] My conclusion on the fourth issue obviates the need to consider the fifth. However, it is one that attracted considerable attention in the evidence and submissions. For the sake of completeness, I provide my preliminary view on whether, if cl 3.10 provides a discretion, Bathurst exercised that discretion for proper purposes.

[213] L&M traversed extensive evidence to attribute to Bathurst a changed intention from around August 2014 to thereafter avoid any further performance obligations under the contract. Bathurst had consulted financial advisers, Forsyth Barr, and had received advice in May 2014 to the effect that the optimal solution for Bathurst would be to avoid mining Escarpment and instead focus on West Whareatea (one of the assets acquired by BT Mining). An internal Bathurst paper from February 2016 headed "L&M Buller renegotiation" included bullet points on "Key messages" (that is, in negotiating with L&M) that "The debt (US$80) [sic] will never be paid" and "We will move on to other projects".

[214] Credible arguments were raised that a change in strategy towards the contract was decided upon. This involved decisions to place the Escarpment Mine on care and maintenance and to write down very substantially the carrying value of the assets acquired pursuant to the ASP with a complementary write-off of the performance

payments as liabilities. Bathurst periodically increased the reported value of its mine licences, properties, exploration and evaluation assets to some $439,616,000 in its half year accounts to 31 December 2013. Bathurst then impaired the value of those assets to $16,166,000 in its financial statements for the year ended 30 June 2014, amounting to a devaluation of those assets of some 99.6 per cent. In the same financial statements, the corresponding liabilities recognised for deferred consideration under the ASP dropped from $172,556,000 to $1,974,000, a reduction of 98.9 per cent in the non-current deferred consideration liabilities.

[215] L&M invited inferences that, after making its decision, Bathurst maintained a stance that the permit areas could not be economically mined, when the work done to justify such a negative view was demonstrably wrong and inadequate. Mr Duncan's analysis was that the Escarpment Mine remained a viable business proposition and could be economically mined.

[216] L&M's evidence laid a credible foundation for criticisms of Bathurst, including that a working paper by its then chief financial officer to justify his recommendation to write down the value of the assets and to write off the liability for the performance payments was inadequately done and unrealistically pessimistic. That recommendation had to be the subject of a board decision, but no minute recording the board's consideration of the recommendation and any reasons for adopting it was discovered, despite focused requests. L&M invited an adverse inference from the absence of the relevant board minute that it recorded matters unhelpful to Bathurst's case.

[217] The effect of Mr Fairhall's brief on audit standards was that the significant write down of assets ought to have been revisited when preparing subsequent sets of financial statements. In that event, the projected improvement in prices for high quality coking coal ought to have required positive adjustments to the value of the L&M assets.

[218] Mining industry bodies, including the Australasian Institute of Mining and Metallurgy, jointly maintain a code for mining companies to apply in reporting the level of reserves and resources recognised as assets in their businesses. These

standards, the product of the Joint Ore Reserves Committee (JORC), are recognised by both the ASX and the NZX, which have incorporated into listing rules the expectation that mining companies will report in accordance with the JORC code. Coal resources are defined as the quantity and quality of coal with reasonable prospects for eventual economic extraction.

[219] In Bathurst's case, it did not reduce its JORC reported resources and reserves consistently with the writing down of the value of its assets.

[220] There were also criticisms in L&M's evidence of the alleged inadequacy of attempts to raise finance to undertake production at the Escarpment Mine. L&M's hypothesis included criticisms that Bathurst is pursuing less researched, uncertain and unconsented assets more recently acquired by BT Mining, in priority to its former plans to develop the permit areas acquired from L&M. The alleged motive is that whilst doing so, Bathurst would not have any further obligations under the ASP.

[221] The alleged change of strategy to frustrate subsequent performance under the ASP was undertaken whilst Mr Bohannan remained chief executive at Bathurst. A significant plank of Bathurst's denial of the criticisms was that L&M, having called Mr Bohannan and relied substantially on the rest of his evidence, did not have an answer to his acknowledgements in cross-examination that, whilst he was chief executive, Bathurst made all reasonable attempts to raise the finance necessary to mine at Escarpment and was unsuccessful in very difficult conditions.

[222] The price of hard coking coal had dropped more dramatically than earlier projections had suggested, and Bathurst's conduct was not out of step with similar producers of hard coking coal. Internationally, there are numerous organisations that monitor and project movements in both spot prices and quarterly benchmark prices for hard coking coal. Statistics compiled on somewhat different bases present varying pictures, one of the more relevant being the averaging of various forecasts of projected prices for a number of years into the future. When decisions were made in March 2014, the average of the prices projected forward to 2019 was US$148 per tonne. By March 2016, the projection to 2021 was down to US$86.7. The current price in May

2016 had dropped to US$80 per tonne, but by November 2016 was back to US$200 per tonne.

[223] I was also provided with a graph of Bathurst's share price, which dropped from a high of more than A$1.25 in late 2011 down to 0.1 cent in March 2016. Mr Bohannan and Bathurst witnesses observed that the drop in the share price was one indication of increasing difficulties for capital raising by Bathurst, by any means.

[224] Because I have found as a matter of law that Bathurst's resort to cl 3.10, if otherwise permitted in the circumstances that ensued, would not involve the exercise of a discretion of the type the law will constrain, it is unnecessary to make factual findings on the relatively extensive evidence heard on this point. However, given the attention it received and the robust terms of Bathurst's rejection of the allegations it took to be ones of bad faith, it is appropriate to comment on what the factual analysis would involve.

[225] The context in which Bathurst's conduct would have to be considered would involve its entitlement to rely on cl 3.10 as a ground for avoiding a finding of breach of contract where it has neither paid the first performance payment, nor is it making royalty payments at the higher rate on substantive mining operations. In those circumstances, Bathurst's contrary views on the earlier issues I have determined against it would be accepted as legally correct. It would be consistent with acceptance of those arguments for Bathurst's board to treat the company as entitled to pursue the course it has. It would be exercising a contractual power of a type that the Court would not constrain.

Outcome

[226] For all the foregoing reasons, L&M is entitled to a declaration that the first performance payment has become due and owing by Bathurst, and an order that Bathurst pay US$40 million to L&M.

[227] Counsel did not address the terms on which, if this point was reached, liability for interest pursuant to s 87 of the Judicature Act 1908 should apply. I confirm an

entitlement to interest and the parties should revert within 30 working days of delivery of this judgment if issues remain as to its quantification.

Costs

[228] L&M is entitled to costs. My provisional view is that a full entitlement appropriate for the proceeding ought to be reduced by 20 per cent to reflect the lack of success on L&M's final alternative, which caused substantial diversion and ultimately generated more heat than light.

[229] I am unsure whether costs issues on any interlocutory stages were deferred pending the outcome. If they were, I acknowledge that I should separately deal with those.

[230] If, in light of this preliminary indication, costs cannot be agreed between the parties, I will receive memoranda, not exceeding 12 pages:

- from L&M, within 30 working days of delivery of this judgment; and
- from Bathurst, within 15 working days of service of L&M's memorandum.

Dobson J

Solicitors:
Chapman Tripp, Wellington for plaintiff
Minter Ellison Rudd Watts, Wellington for defendants

Annexure

Ruling 1 – Admissibility of evidence

[1] Prior to trial, solicitors for the defendants (Bathurst) gave two notices challenging the admissibility of numerous passages in briefs of evidence that had been served for the plaintiff (L&M). The first of the notices objected to extensive passages in the briefs of evidence of Messrs Loudon, Brogan, Hogan, Gordon and Bohannan. The essence of Bathurst's objection was that the challenged passages contained subjective views on pre-contractual positions, subjective understandings as to the intended meaning of contractual provisions that are in issue in the proceedings, and matters of submission on contractual meaning and effect.

[2] The second notice objected to an expert's brief served in reply from Mr Timothy Fairhall, regarding auditing standards on the appropriateness or requirement to revisit the writing down of the value of assets in a company's balance sheet. Bathurst's objection was that Mr Fairhall's brief did not contain material that was legitimately in reply, and that the matters within his expertise as an auditor were not in issue in the proceedings so were therefore irrelevant. Mr Hodder QC also complained that the Fairhall brief had been served too close to trial to afford a reasonable opportunity to reply to it.

[3] I heard argument on Bathurst's objection to admissibility of the contested passages before any of L&M's witnesses were called. At the end of the argument, I indicated that I would admit the challenged evidence, thus far on a *de bene esse* basis, and that I would provide reasons as time allowed. I now do so.

[4] The permissible scope of evidence from participants in the process of settling the terms of a contentious contract has been considered by appellate courts on numerous occasions. Mr Hodder urged that the scope of such evidence should still be constrained within the limits defined by the House of Lords in *Prenn v Simmonds*, or should at least be influenced by the cautions recognised in cases such as that one.[1] That approach would exclude statements made by the parties prior to their reaching consensus on the ground that it would be unhelpful.[2] The exclusion clearly included matters of subjective impression as recalled by participants in settling the contractual terms.

[5] Mr Hodder sought to minimise the extent to which New Zealand appellate courts have relaxed their approach to admissibility of pre-contractual dealings. He emphasised that in *Vector Gas Ltd v Bay of Plenty Energy Ltd*, Blanchard J had confirmed the exclusion of evidence of one party's view as to what a contractual provision meant.[3] Mr Hodder submitted that the Supreme Court had not liberalised this approach in its more recent decision in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*.[4]

[6] Mr Kalderimis responded to the admissibility challenge for L&M. He submitted that the law in New Zealand on admissibility of evidence addressing the context of pre-contractual

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1 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL).
2 At 1384–1385 per Lord Wilberforce.
3 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [14].
4 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [60] and [63].

negotiations is wider than characterised by Mr Hodder, and that the challenged passages were admissible by application of the standards articulated in *Vector Gas* and *Firm PI 1 Ltd*.

[7] In more recent decisions, New Zealand appellate judges have had varying degrees of disinclination to adhere to the line adopted in *Prenn v Simmonds*. Wilson J in *Vector Gas* was relatively forthright, at least in cases where a relevant ambiguity existed:[5]

> [122] … Prior negotiations may well be relevant; the time has come to remove in this country the barrier imposed by *Prenn v Simmonds* to looking at those negotiations in a situation where they illuminate, in advance of consensus being achieved, what the parties were intending to achieve in their contract. Their conduct subsequent to the contract may also be a helpful guide to what was intended in the contract.

[8] What remains inadmissible is internal communications within one party to the contract, including subjective impressions of what contractual terms might mean, where they are not part of the dialogue with other contractual parties that led to consensus being reached.[6]

[9] It is helpful to bear in mind the purpose of admitting such evidence. The Supreme Court in *Firm PI 1 Ltd* re-stated the approach to contractual interpretation in the following terms:[7]

> [60] … It is sufficient to say that 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.

[10] The challenged content of the witness statements from factual witnesses included a narrative of the sequence of dealings between the parties leading to their agreement on the terms of the sale and purchase agreement (SPA), and the later dealings that led to the third amendment to it completed in 2012. The evidence of dealings between the parties is a matter of context. I am satisfied that, in this case, those exchanges may be helpful, and as such are not objectionable.

[11] Other passages objected to comprise statements of subjective belief of the witness as to what the parties intended to be the meaning of contractual provisions that were being proposed or were agreed to. Such statements of subjective belief of one party to a contract remain inadmissible when the Court's task is to interpret the contract. However, Mr Kalderimis submitted that the circumstances are such that these passages should not be assessed on their own. The evidence for L&M is unusual to the extent that the principal negotiators for both L&M and Bathurst are giving evidence for L&M. He characterised the relevant passages as reflecting the objective joint intention of the parties. He did so on the basis that the evidence of Mr Bohannan, speaking from his position as chief executive and a director of Bathurst between 2008 and March 2015, aligned with the views on the matters being addressed by witnesses reflecting their understanding as participants for L&M. To the extent that their views coincided, they arguably constituted consensus in the recollection of

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5 Citations omitted.

6 For example *I-Health Ltd v I Soft NZ Ltd* HC Auckland CIV-2006-404-7881, 8 September 2010 at [41].

7 Citations omitted.

both parties to the contract as to what was intended at the various points in time and on the various provisions that the evidence addressed. Arguably, if both parties explained their pre-contractual positions in the same terms, it may become a part of the context in which the contract was concluded.

[12] Mr Hodder's rejoinder was that repetition by a number of witnesses of the same subjective recollections did not change their character. He submitted that it would be pointless to cross-examine witnesses about their subjective recollections when they were not recorded and, more particularly, not conveyed to the other contracting party at the time.

[13] The counter to that is that evidence of a shared appreciation by those negotiating the contract for both parties may comprise part of the context explaining the process to consensus. To the extent the evidence does not establish a shared view, then such evidence remains a subjective observation of one party and, as such, is inadmissible.

[14] The appropriate limits on admissible evidence in contract interpretation cases require a context-specific analysis in each case. Mr Kalderimis's justification certainly could not extend to cases where the consensus on pre-contractual intentions was not identified in pre-trial witness statements, but the propounding party hoped to elicit consensus in cross-examination. The witness statements suggest a very co-operative approach between the parties which endured when the third amendment to the SPA was settled. The line between admissible evidence of the context in which the relationship between the parties evolved, including the commercial predicament confronting them, and inadmissible views about what the contract did or ought to provide, may not always be clearly defined.

[15] A subset of the passages in the witness statements objected to are statements about whether the parties addressed the intended meaning of the expression "shipped" in describing production from the mine that would trigger the obligation to make performance payments. The meaning of that expression is important to the substantive dispute. This raises the prospect of there being what Tipping J has called a "private dictionary meaning", namely a specific meaning particular to the parties that is not consistent with the natural or ordinary meaning of the expression.[8] Mr Kalderimis characterised the references to whether there was a special meaning to be attributed to "shipped" as being necessary in L&M's witness statements to meet any evidence from Bathurst witnesses asserting that to be the case. Given the likely scope of the issue, there is potential relevance to L&M's witnesses addressing the absence of any dialogue between the parties during negotiations or agreement on a private dictionary meaning.

[16] It was not realistic to undertake a point by point analysis of the extent of commonality between Mr Bohannan and the remaining L&M witnesses (in their recollections of the parties' positions) to test Mr Kalderimis's contention that the evidence from representatives of both sides negotiating the contract reflected a shared view. I took the view that the preferable course was to allow the evidence as recorded in the witness statements, *de bene esse*. This is subject to the exclusion of any views about the meaning or effect of the contract expressed by one or more witnesses describing the L&M perspective where, after the evidence has been tested, they do not reflect what is established as the objective shared intention of both parties. As always, there will be assessments of the weight to be given to evidence that I ultimately find to be admissible, and the ability to disregard evidence that is not a legitimate aid to interpretation of the contract.

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8 *Vector Gas Ltd*, above n 3, at [25]–[26].