

A UNIFORM APPROACH TO CONTRACT FORMATION AND INTERPRETATION

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This is a revised and footnoted version of the Sir Ivor Richardson Lecture delivered at Victoria University of Wellington on 4 September 2024. Professor McLauchlan argues that when we ask the questions "is there a contract?" and, if so, "what does it mean?", essentially the same principles apply in New Zealand as a result of the Supreme Court's decision in Bathurst Resources Ltd v L&M Coal Holdings Ltd. This represents a departure from the law in other common law countries, notably the United Kingdom and Australia, where the courts continue to draw a sharp distinction between the principles governing formation of contracts and those governing their interpretation. Nevertheless, Professor McLauchlan suggests that the New Zealand development is to be welcomed because it improves the transparency and coherence of the law of contract and brings that law into line with the best international practice.

Your Honours, colleagues, members of the profession, past and present students, friends and family.

Seeing some members of my family at this lecture tonight reminds me of the reaction of an aunty after I delivered my inaugural professorial lecture over 40 years ago. She said: "I didn't understand a word you said, but it sounded good!"

It is my privilege and pleasure to deliver this lecture in memory of Ivor Richardson who gave such outstanding service to our law and government, to the judiciary, to this university and law faculty, as well as so to many areas of social policy and public administration. Ivor taught me taxation law at both undergraduate and postgraduate level. In 1970 he was Dean of the Law Faculty here and, along with George Barton, he interviewed me for a junior lectureship position. Fortunately, the application was successful and 54 years later I am still gainfully employed here, albeit not for too much longer!

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After his retirement from the bench, Ivor spent a good deal of time at the law school, and I and many of my colleagues greatly appreciated our dealings with him.

My thesis tonight is that when we ask the questions "is there a contract?" and, if so, "what does it mean?", essentially the same principles apply in New Zealand as a result of the Supreme Court's decision in *Bathurst Resources*.¹ This represents a departure from the law in other common law countries, notably the United Kingdom and Australia, but I will argue that this development is to be welcomed, because it improves the transparency and coherence of our law of contract and brings that law into line with the best international practice.

I want to start by highlighting two of the most troublesome terms in the law of contract. These are "subjective intention" and "objective intention". We are routinely told by judges who are faced with issues concerning the formation or interpretation of contracts that their task is to determine the parties' *objective* intention, not their *subjective* intention. It is said that evidence of subjective intention is irrelevant and inadmissible, and such evidence is often understood to include anything that points to the parties' *actual* intention. I have been arguing for years that this is an oversimplification. Of course, no one has ever suggested that a court should be able to inquire into the parties' states of mind and hence allow them to testify as to what they each intended at the time of the alleged contract. However, the situation is entirely different where there is reliable evidence of communications between the parties showing that they reached an agreement that was intended to be binding or, as the case may be, they formed a common understanding as to the meaning of language in dispute. What I am saying is that too often the dirty words "subjective intention" are used to rule out any evidence pointing to the parties' actual mutual intention on the basis that the sole task of the court is to determine their objective intention, sometimes called their presumed intention. In fact, accepting and giving effect to evidence of the kind I have mentioned is not in any way inconsistent with an objective approach. One is still ascertaining the parties' intentions through objective evidence.

I have read judgments that in effect say to the parties "don't you tell me what you intended, it's my job to decide what you intended"! I also recall one New Zealand case that included a finding by a very good High Court judge that the parties actually intended to be bound by an informal commercial property agreement.² He said that their "actual belief at the time was that a binding deal had been concluded" and that "anything which remained was drafting detail".³ However, he then concluded that this was irrelevant. The question of intention to be bound was "not to be approached subjectively". It was "to be approached on an objective basis".⁴ The test was whether a reasonable person would have inferred that the parties intended to be bound. I call this "objectivity gone mad"! How reasonable

1 *Bathurst Resources Ltd v L&M Coal Holdings Ltd* [2021] NZSC 85, [2021] 1 NZLR 696.

2 *Brierley Investments Ltd v Shortland Securities Ltd* (1994) 5 TCLR 615 (HC) per McGechan J.

3 At 660.

4 At 660.

persons would have understood the transaction was irrelevant in this case. While the presence of actual consensus ad idem and intention to be bound is not necessary for formation of a binding contract, it is surely sufficient.

Difficulties also arise in relation to the term "objective intention". It is routinely said that it is a basic principle that the law is concerned only with the intention of the parties as objectively ascertained. So, in an interpretation dispute the judge must try to ascertain what a reasonable person would have understood the parties to have meant. But who is this reasonable person and what does he or she know about the background to the contract and the parties' dealings? It is widely thought that the common law depersonalises contracting parties and asks what a detached or outside observer would have taken their intention to be. On one view, this observer is imbued with business common sense and has knowledge of all the terms of the contract and the surrounding circumstances, but apparently he or she is unaware of, or wholly unconcerned with, the parties' actual intention, even if it is shared and manifested in communications between them.

Nevertheless, it is equally common to refer to the objective test as requiring a determination of what the reasonable person in the position of the parties, or in the position of the promisee, would have inferred. On this version of objectivity, a reasonable person, who is asked to determine what the parties appeared to mean by particular language, would surely give decisive weight to communications between them establishing either a shared actual understanding of the meaning of the language or the understanding of one party where that party was led reasonably to believe that its understanding was also shared by the other party. In this context there is no sensible distinction between meaning and *what the parties meant* because what the parties meant *is* the meaning! Similarly, a reasonable person, who is asked to determine whether the parties intended to be bound, would give decisive weight to communications between them establishing either a shared actual intention to be bound or the intention of one party where that party was led reasonably to believe that its intention was also shared by the other party.

I have handed out a document that looks like an obvious binding contract.⁵ Sam Sellars and Betty Byers have signed an unambiguous and unconditional agreement for the sale of land. But it may not be binding. What if there is convincing evidence that prior to signing the agreement the parties orally agreed that it was subject to Betty obtaining finance of \$100,000? I am sure that many lawyers would be startled to learn that there is well-established case authority to support the view that extrinsic evidence is admissible, without contravening what remains of the parol evidence rule, to show that the agreement was executed subject to a condition precedent.⁶ It is equally clear that evidence is admissible to show that the document was not intended by either party to create the legal rights and

⁵ See Appendix.

⁶ See for example *Pym v Campbell* (1856) 6 El & Bl 370, 119 ER 903 (KB); *Wallis v Littell* (1861) 11 CB (NS) 369, 142 ER 840 (CP); and *Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd* [1985] 2 NSWLR 309 (NSWCA) at 336.

obligations it appeared to create and therefore it was a sham. Perhaps Sam prevailed on his friend Betty to help him delay a potential mortgage sale.

What if Betty did not actually intend to be bound because she thought that there would be no binding commitments until her lawyer had approved the agreement or until she had paid the deposit? Is she nevertheless bound? The answer is probably yes. It suffices that Sam was led reasonably to believe that she intended to be bound. This is the objective principle. As Justice Blackburn famously said in *Smith v Hughes*:⁷

If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.

As this statement makes clear, the objective principle involves a subjective element. The parties' actual intentions and beliefs *are* relevant.⁸ The principle requires not only that a reasonable person would believe that Betty intended to be bound in my last example but also that "that other party upon that belief enters into the contract with him".⁹ So Sam cannot reasonably believe that Betty intended to be bound, if he knows otherwise,¹⁰ or indeed ought to know otherwise.¹¹ The position is the same if it is established that he shared Betty's intention at the time of the alleged contract.¹² However:¹³

7 *Smith v Hughes* (1871) LR 6 QB 597 at 607.

8 As Lord Phillips pointed out in *Shogun Finance Ltd v Hudson* [2003] UKHL 62, [2004] 1 AC 919 at [123], "the task of ascertaining whether the parties have reached agreement as to the terms of a contract can involve quite a complex amalgam of the objective and the subjective".

9 See for example *Paal Wilson & Co A/S v Partenreederei Hannah Blumenthal* [1983] 1 AC 854 (HL) at 915–917 and 924; *Magnum Photo Supplies Ltd v Viko New Zealand Ltd* [1999] 1 NZLR 395 (CA) at 401; and *Giltrap City Ltd v Commerce Commission* [2004] 1 NZLR 608 (CA) at [20]. Where, for example, the other party knows that the promisor is mistaken about the terms of the contract, this requirement is not satisfied and the promise cannot be enforced in its "objective" sense. A party who alleges the formation of a binding contract because a reasonable person in her position would have been entitled to infer a contractual offer can succeed only if, in addition, she subjectively understood that there was an offer, although in practice this will be assumed in the absence of a challenge from the alleged offeror.

10 As in *Hartog v Colin & Shields* [1939] 3 All ER 566 (KB).

11 See for example *Centrovincial Estates Plc v Merchant Investors Assurance Co Ltd* [1983] Com LR 158 at 158 (CA) (no proof "that the defendants either knew or ought reasonably to have known of the plaintiffs' error"); and *OT Africa Line Ltd v Vickers Plc* [1996] 1 Lloyd's Rep 700 at 703 (no contract if the plaintiffs "either knew or ought reasonably to have known that there had been a mistake" by the defendants as to the terms of the "apparent agreement").

12 See *Air Great Lakes*, above n 6, at 331C–D.

13 JP Vorster "A Comment on the Meaning of Objectivity in Contract" (1987) 103 LQR 274 at 287.

... the courts are entitled to assume, in the absence of proof to the contrary, that a party's subjective understanding of a transaction corresponded with the way in which a reasonable person in his position would have understood it.

Let us assume now that there is no issue concerning lack of intention to be bound. Instead, one party is arguing that not all the terms recorded in the document were agreed to. Suppose that the parties are preparing for settlement of the transaction when Sam realises that the price stated in the document is \$400,000 total, not \$400,000 *per lot*. He says—and let us assume that a court will believe him—that he always intended to sell both lots for the price of \$800,000. What is the legal position? There are three possible legal conclusions here at common law. First, the written agreement stands; secondly, there is no contract; and thirdly, there is a contract at \$800,000.

Let us look at the first possibility, the written agreement stands: that is, there is a contract in accordance with the written terms and Sam is bound to sell at the stated total price of \$400,000. There will be such a contract if Betty intended to buy at that price *and* if Sam led her reasonably to believe that he intended to sell at that price. Obviously, the fact that the written agreement plainly provides for a sale at that price will be a strong factor supporting this conclusion, but it cannot be conclusive because, contrary to a widespread assumption among lawyers and judges alike, a written document that looks like a binding written contract is not necessarily a contract at all. Such a document, of course, normally takes effect as a contract, but this is because the objective principle will be satisfied, not simply because it contains promises that are verified by a signature. In other words, the promisee will normally have been led reasonably to believe that the promisor accepts and intends to be bound by the terms of the document.

That brings us to the second possibility: there is no contract. Sam may be able to convince the court that Betty knew that he did not intend to sell at the stated price. She cannot reasonably have believed that Sam intended to sell at that price if she knew otherwise. The position is the same if Betty ought to have known of Sam's true intention. By definition, she cannot reasonably have believed that he intended to sell the land for \$400,000 if she ought to have known otherwise. We will assume here that, although Betty knew or ought to have known of Sam's understanding, she had not led Sam reasonably to believe that his understanding was accepted. If she had, the third of my possibilities arises: a contract in accordance with Sam's understanding. In other words, there is a contract at \$800,000.

There are two main reasons for such a conclusion. The court may be convinced that the actual intention of the parties was the same, a sale at the price of \$400,000 *per lot*. For example, evidence of the parties' negotiations may establish that they were always haggling over a price in the vicinity of \$400,000 per lot and hence the court is satisfied that the omission of the words "per lot" was inadvertent. This will be an obvious case for seeking the equitable remedy of rectification on the ground of common mistake.

An alternative basis for finding a contract in accordance with Sam's understanding is that, although Betty did not share that understanding, she led Sam reasonably to believe that she was intending to buy the land at the price of \$400,000 per lot. Perhaps all of the discussions prior to the signing of the written agreement were in terms of a price per lot and Betty, noticing the mistake, sought to take advantage of it. This would be a clear case for rectification on the ground of known unilateral mistake. Here rectification is required, not to punish Betty by imposing on her an agreement she did not make, but to give effect to the true bargain as objectively ascertained. The law in this area is murkier than it should be.¹⁴

In all the examples I have given so far, all relevant evidence is admissible. This includes evidence of the parties' prior negotiations and subsequent conduct because it may assist in establishing either party's contention. Furthermore, all the answers I have given are applications of the *Smith v Hughes* version of the objective principle which undoubtedly represents New Zealand law. It has been accepted by our courts on several occasions.¹⁵

Unfortunately, our neighbours across the Tasman take a different view. The leading case is *Taylor v Johnson*.¹⁶ The facts were simple. Mrs Johnson signed a written agreement for the sale of 10 acres of land to Mr Taylor at a price of \$15,000. She actually intended to sell for \$15,000 *per acre* and Mr Taylor knew this. It was held that a contract was formed, albeit one that was voidable in equity, because Mr Taylor behaved badly. Not only did he know of the mistake, he deliberately set out to ensure that Mrs Johnson would not discover it. The judges subscribed to the extreme form of objective theory, commonly referred to as "detached objectivity", under which a contract is formed when to all outward appearances the parties are agreed on the same terms and on the same subject matter, regardless of the actual intention and state of knowledge of either party. They endorsed the heretical view of Lord Justice Denning in *Solle v Butcher* that:¹⁷

... once the parties, whatever their inmost states of mind, have to all outward appearances agreed with sufficient certainty in the same terms on the same subject matter, then the contract is good unless and until

14 See David McLauchlan "The 'Drastic' Remedy of Rectification for Unilateral Mistake" (2008) 124 LQR 608; David McLauchlan "Refining Rectification" (2014) 130 LQR 83; David McLauchlan "Rectification Rectified?" (2020) 36 JCL 131; and David McLauchlan "The Many Versions of Rectification for Common Mistake" in Simone Degeling, James Edelman and James Goudkamp (eds) *Contract in Commercial Law* (Thomson Reuters, Sydney, 2016) 193.

15 See for example *Airways Corp of New Zealand Ltd v Geyserland Airways Ltd* [1996] 1 NZLR 116 (HC) at 124–125; *Rattrays Wholesale Ltd v Meredyth-Young & A'Court Ltd* [1997] 2 NZLR 363 (HC) at 374; *Magnum Photo Supplies*, above n 9, at 401; and *Mechenex Pacific Services Ltd v TCA Airconditioning (NZ) Ltd* [1991] 2 NZLR 393 (CA).

16 *Taylor v Johnson* (1983) 151 CLR 422.

17 *Solle v Butcher* [1950] 1 KB 671 at 691. See also *Frederick E Rose (London) Ltd v William H Pim Junior & Co Ltd* [1953] 2 QB 450 at 460–461.

it is set aside ... Neither party can rely on his own mistake to say it was a nullity from the beginning, no matter that it was a mistake which to his mind was fundamental, and no matter that the other party knew that he was under a mistake.

Astonishingly, Justice Blackburn's version of the objective principle in *Smith v Hughes* was viewed by their Honours in *Taylor* as representing a *subjective* theory of contract formation, presumably because it holds that there cannot be a contract when the promisee knows or ought to know that the promisor does not intend to contract on the stated terms. However, the fact that the promisee's state of mind is taken into account does not mean that Justice Blackburn was applying a subjective theory. A subjective approach would inquire into what the promisor, Mrs Johnson, intended, whereas an objective approach asks what a reasonable person in the position of the promisee, Mr Taylor, would believe the promisor intended.¹⁸ And a reasonable person who knew that the promisor did not intend to be bound to a particular term would not treat the promisor as having agreed to that term.¹⁹

What then would the legal position be if the facts of *Taylor v Johnson* arose in New Zealand today? There is a giant elephant in the room that I will ignore because it would unduly lengthen this lecture. It concerns some vexed and unresolved questions about the application of our contractual mistakes legislation that it would take me another hour to explain.²⁰ The key point for present purposes is that there is *prima facie* no contract at common law since Mr Taylor does not satisfy the objective principle in *Smith v Hughes*. Another possibility is that Mrs Johnson might seek to have a contract enforced against Mr Taylor in accordance with her understanding by seeking the equitable remedy of rectification, but for this purpose it would not suffice that he was aware of her understanding. She would have to establish that he led her reasonably to believe that he accepted her understanding.

Given that the objective principle, as formulated in *Smith v Hughes*, is a, if not *the*, core principle of the common law of contract, the next question that arises is: does it also apply when the issue concerns the interpretation of an admitted or assumed contract? To what extent do the actual intentions of the parties, their knowledge and beliefs inform the meaning of a contract? Suppose there is convincing evidence of communications between the parties pointing to a conclusion that they shared

18 See Hugh Collins "Objectivity and Committed Contextualism in Interpretation" in Sarah Worthington (ed) *Commercial Law and Commercial Practice* (Hart Publishing, Oxford, 2003) 189 at 195–196:

[I]n the absence of any further communication about the actual intention of the promisor, the objective test insists that it is not the intention of the promisor which is relevant, but the impression that the words would form on the mind of the reasonable promisee.

19 See Timothy AO Endicott "Objectivity, Subjectivity, and Incomplete Agreements" in J Horder (ed) *Oxford Essays in Jurisprudence, Fourth Series* (Oxford University Press, Oxford, 2000) 150 at 157.

20 See Contractual Mistakes Act 1977, now repealed and replaced by identical provisions in subpt 2 of pt 2 of the Contract and Commercial Law Act 2017.

a particular meaning of the words in dispute at the time of the contract,²¹ or there is evidence of the meaning intended by one party and that this party was led reasonably to believe that the other party accepted her meaning?

Historically, most common law courts drew a rigid line between the principles governing formation of contracts and those governing their interpretation. The task of a court when interpreting a contract was to determine the presumed intention of the parties so that, for example, evidence of their actually intended meaning derived from their prior negotiations and/or their subsequent conduct was inadmissible. So, in the first three editions of Sir Kim Lewison's practitioner textbook,²² the author said that "[o]nce it has been established that a contract has been formed, the actual intentions of the parties as to the meaning or effect of the contract become irrelevant". This statement has been omitted from the later editions, perhaps in response to the mounting number of exceptions that I and other commentators have pointed to, but the author's sentiment still commands support from leading courts and judges. The High Court of Australia has been unwilling to loosen the shackles created by Sir Anthony Mason's observation in the *Codelfa* case that evidence of "the actual intentions, aspirations or expectations of the parties before or at the time of the contract" is inadmissible because the court's task is to determine the "presumed intention" of the parties.²³ More recently, Justice Leggatt (now Lord Leggatt of the United Kingdom Supreme Court) highlighted "two distinctive features of the rules of English law governing the interpretation of contracts",²⁴ namely, the irrelevance of the parties' actual intention and the inadmissibility of evidence of their prior negotiations. His Lordship said that:²⁵

What the parties to the contract actually meant, or whether they had any pertinent subjective intention at all, is irrelevant to the task of interpretation. Rather, the court identifies the meaning of the language used by assuming that the parties were reasonable people using the language of the contract to express a common intention.

21 *Ryledar Pty Ltd v Euphoric Pty Ltd* [2007] NSWCA 65, (2007) 69 NSWLR 603 at [266] (Campbell JA):

[A] subjective intention to use words with some meaning other than the meaning that an ordinary hearer of the words would put on them, if the hearer were not in the specific context in which the words were spoken, comes to be taken into account, in deciding what are the terms of the contract, only because there is some form of communication between the parties, or context, such that a reasonable person would realise that the more usual meaning of the words was not intended.

22 See Kim Lewison *The Interpretation of Contracts* (Sweet & Maxwell, London, 1989) at [1.05]; and Kim Lewison *The Interpretation of Contracts* (3rd ed, Sweet & Maxwell, London, 2004) at [2.05].

23 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352.

24 *Tartisinis v Navona Management Co* [2015] EWHC 57 (Comm) at [8].

25 At [9].

I have long thought that this view is wrong. There is no sensible reason why the interpretation process required to determine whether a contract was formed should differ so fundamentally from the process required to determine the meaning of that contract. The strict objective approach that seeks to discover the "presumed intention" is fair enough when, as frequently happens, the parties did not contemplate the situation that has arisen, but it is entirely another matter to elevate it to a universal rule and to reject out of hand what may be relevant and reliable evidence from the negotiations of the meaning they actually attributed to the words of the contract. Such evidence should be equally as relevant as evidence of their actual intention to be bound to a contract. As Justice Ted Thomas once said in typically forthright fashion:²⁶

The notion that an intention can be imposed on the parties contrary to their actual intention is repugnant to any concept of fairness, common sense and the reasonable expectations of honest men and women. It should be repugnant to the common law.

This is particularly so when it is considered that disputes over the meaning of contractual language will very often call into question whether, due to misunderstanding between the parties, a binding contract was formed in the first place. Take, for example, the facts of the celebrated American case of *Frigalimint Importing Co Ltd v BNS International Sales Corp* where a famous judge, Judge Friendly—what a great name for a judge!—began his judgment by asking "what is chicken?".²⁷ The plaintiff company entered into a written agreement with the defendant for the purchase of a large quantity of "chicken" meeting certain detailed specifications as to weight, packaging and so on. The shipment met these specifications but it was rejected by the plaintiff on the ground that it was stewing chicken. It certainly was not the sort of chicken that Colonel Sanders would have wanted for his burgeoning number of KFC outlets at the time! The plaintiff sued for damages arguing that the word "chicken" meant young birds suitable for frying, as opposed to "fowl" which were more mature birds suitable only for stewing. The action failed because the company had not met the burden of showing that "chicken" was used in the narrower sense claimed. If the parties had been reversed and the seller had been suing for damages or claiming the purchase price, it seems likely that the action would also have failed due to the seller's inability to prove that "chicken" was used in the broader sense. Essentially there was no contract formed since both understandings were equally reasonable.

Thankfully, one of the effects of our Supreme Court's decision in *Bathurst Resources* is that there is no longer a sharp divide in New Zealand law between the principles of contract formation and the principles of contract interpretation.²⁸ In essence, the *Smith v Hughes* principle now pervades both

26 *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 at [122].

27 *Frigalimint Importing Co Ltd v BNS International Sales Corp* 190 F Supp 116 (SD NY 1960).

28 *Bathurst Resources*, above n 1. I have expressed disagreement with the decision by a 3:2 majority to allow Bathurst's appeal (see David McLauchlan "The Lottery of Contract Interpretation" [2021] NZLJ 295), but the present concern is solely with the Court's unanimous exposition of the principles of contract interpretation.

areas. The Court rightly accepted that "evidence of uncommunicated subjective intent" is irrelevant under the objective approach,²⁹ but ruled that "the promotion of commercial certainty should not be allowed to defeat what the parties actually meant by the words in which they recorded their agreement".³⁰ The judges were clearly of the view that the objective test requires a determination of what the reasonable person *in the position of the parties* would have inferred and that such a person would ordinarily give decisive weight to communications between the parties establishing what I said earlier, namely, either a shared actual understanding of the meaning of the language, or the understanding of one party where that party was led reasonably to believe that its understanding was also shared by the other party. As a result, relevant evidence of the parties' prior negotiations and subsequent conduct must be able to be taken into account.

In so ruling, the Court endorsed the "private dictionary" principle adopted in the much discussed case of *The Karen Oltmann*.³¹ This was a case in which it was clear from the parties' negotiations that the word "after" in a term giving a charterer the right to terminate a charter "after 12 months' trading" was being used in the sense of "on the expiry of 12 months' trading", not in the other possible sense of "at any time after the vessel has traded for 12 months". Therefore it was held that the charterer was not entitled to terminate the charter 17 months into the 24-month term. The contrary view of the House of Lords in the *Chartbrook* case,³² that the "private dictionary" principle constituted an "illegitimate" exception to the rule excluding evidence of prior negotiations, was expressly rejected by the Supreme Court.³³ The British illegitimate exception is now the law in New Zealand!

The Court in *Bathurst* was rightly a little more guarded concerning the admissibility of evidence of subsequent conduct because it stressed that "[c]are will be needed to assess the probative value" of such evidence and that it will not often be relevant.³⁴ The main impact of such evidence is that it may assist in the task of proving the existence of an agreed meaning. The fact that the parties have acted consistently with a particular interpretation, or at least the party now denying that interpretation has so acted, may sometimes provide a reliable basis for an inference that, at the time of the contract, they attached that meaning to the words in question, or that one of them attached that meaning and was led reasonably to believe that the other did so too. However, the conduct will rarely, if ever, be conclusive by itself. The party who denies the interpretation that the conduct allegedly supports will often be able to argue that the conduct has limited probative value because it is too equivocal, being consistent with

29 At [48].

30 At [46].

31 *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd's Rep 708 at 712.

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

33 *Bathurst Resources*, above n 1, at [81].

34 At [90].

a mistake in interpretation or the granting of an indulgence. Nevertheless, when taken in conjunction with other evidence of the parties' intention found, say, in the prior negotiations, it may sometimes tip the evidential balance in favour of a conclusion that a particular meaning was indeed adopted at the time of the contract. In other words, the conduct will ordinarily be relevant "only for confirmatory or supporting purposes".³⁵

A good illustration of this, as well as the significance of the changes in the law brought about by *Bathurst*, is provided by the judgment of the Court of Appeal delivered by Ivor Richardson 33 years ago in *Edwards v O'Connor*.³⁶ This was a remarkable case because, no doubt due to the apparently settled state of the law at the time, Ivor did not even countenance basing the Court's ultimately correct decision on the proven actual mutual intention of the parties, let alone having regard to subsequent conduct that strongly confirmed the existence of that intention. The facts were these. The defendant entered into a written contract for the sale of her fishing business to the plaintiffs who alleged that it was orally agreed that if individual transferable quota (ITQ) were eventually allocated to the defendant, it would pass to them. In particular, it was agreed prior to signing the written contract that the terms "fishing licence" and "goodwill" included quota. There was conflicting evidence, but the trial judge preferred the plaintiffs' version. He also referred to the subsequent conduct of the defendant to confirm his conclusion. This included a letter from the defendant's solicitor requesting immediate payment of the balance of the price for the ITQ, a conversation between the defendant's agent and the plaintiffs to like effect and evidence of a conversation between the defendant and a third party in which the defendant acknowledged that the quota passed with the boat and bemoaned the fact that the plaintiffs were acquiring it for a modest sum. On the basis of these findings of fact, this was an easy case. The evidence of the prior negotiations and the subsequent conduct combined to establish beyond question that the actual mutual intention of the parties at the time of the contract was that "fishing licence" and "goodwill" included the quota.

However, the Court of Appeal, although finding for the plaintiffs, did not regard the case as nearly so straightforward. An easy case was made much more complicated than it need have been. It was decided at a time it was accepted that the task of the court was to determine the parties' presumed intention and it was thought that evidence of negotiations or other manifestations of the parties' actual intention was admissible only in a suit for rectification. The plaintiffs' claim to the allocated ITQ only succeeded because the Court was prepared to hold that a reasonable person with knowledge of the factual background and the aim of the transaction would infer that quota was covered. The position in New Zealand now is that a court would not have to look for a presumed intention when their actual intention that quota was to pass is established. The law of contract is no longer as silly as it used to be. The telling admissions in the subsequent conduct, which understandably did not even rate a mention in Ivor's judgment, would now be entitled to considerable weight as verifying that the parties

35 *Gibbons Holdings*, above n 26, at [50] per Tipping J.

36 *Edwards v O'Connor* [1991] 2 NZLR 542 (CA).

did actually intend that the quota was to pass to the plaintiffs. Of course, if the evidence of the subsequent conduct had stood alone—that is, there was nothing in the prior negotiations to support a finding that the matter had been addressed and agreed—the evidence would have carried much less weight. The defendants would have been in a stronger position to explain away the admissions as based on a mistaken interpretation of the contract.

Let me conclude with some brief observations about the important changes over the past 30 years in the basic aspects of contract law that I have been talking about. There is no longer a plain meaning rule that previously required a finding of ambiguity before a court could have regard to *any* extrinsic evidence at all. As recently as 1993, the rule was the basis for the largest ever award of damages, some \$73 million, in a New Zealand contract case. That was the case of *Benjamin Developments*³⁷ which has barely rated a mention in the numerous subsequent cases that have adopted Lord Hoffmann's restatement of the principles of interpretation in the *ICS* case.³⁸ Under those principles, the task of the court is to ascertain the meaning that a reasonable person with knowledge of the background would give to the contract, and the fact that the disputed words have an ordinary or conventional meaning is not conclusive. Indeed, it is now accepted that, just as can happen with any serious utterance in ordinary life, sometimes people can convey their meaning unambiguously even though they use the wrong words. We have no real difficulty in understanding what the British Deputy Prime Minister meant when he said in Parliament "The Government intend to ... eliminate the homeless"!³⁹

The decision in *Bathurst* has liberalised the law even further with the consequence, which is my thesis tonight, that there is no longer an artificial divide between the principles of contract formation and interpretation. Not only is our law of contract interpretation much more coherent and transparent than it used to be, but it now almost exactly replicates best international practice as reflected in ch 4 of the UNIDROIT *Principles of International Commercial Contracts* and ch 5 of the *Principles of European Contract Law*. In this respect I agree with Justice Ted Thomas's observation in the *Dreux Holdings* case that "it is clearly desirable that the approach of the Courts in this country to the interpretation of contracts coincides, as far as is possible, with international practice".⁴⁰ I should also mention that under the United Nations Convention on Contracts for the International Sale of Goods, a convention that has been part of our domestic law since October 1995, evidence of the parties'

37 *Benjamin Developments Ltd v Robt Jones (Pacific) Ltd* [1994] 3 NZLR 189 (CA).

38 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912.

39 (13 July 2004) 423 GBPD HC 1268.

40 *Attorney-General v Dreux Holdings Ltd* (1996) 7 TCLR 617 (CA) at 642. In the same case (at 627), Blanchard J, delivering judgment also on behalf of Richardson P and Keith J, said that "[t]here is something to be said for the idea that New Zealand domestic contract law should be generally consistent with the best international practice".

negotiations and subsequent conduct is admissible as an aid to interpretation.⁴¹ It would be odd if such evidence were admissible when interpreting international sales contracts but not other commercial contracts, or indeed contracts generally.

Nevertheless, I am conscious that the developments I have described, particularly the reforms of the law in *Bathurst*, will by no means have pleased everyone in the profession. One of the most frequently voiced objections to the whole contextual approach to interpretation is that it fails to pay sufficient regard to the interests of third parties. For two reasons, I believe this concern is exaggerated.⁴² First, it is now established that the scope of the background facts that a reasonable reader will take into account in determining meaning may vary according to the nature of the contract and the likelihood of reliance by third parties (as, for example, in the case of public documents, bills of lading, negotiable instruments or other documents transferable by delivery, and security instruments that will be relied upon by third parties or, indeed, to which third parties may become privy). This more restrictive approach to the admissible background, where the original parties are aware that the document is likely to be relied on by third parties, is a sensible refinement of the contextual approach. As pointed out by our Supreme Court in the *Firm PI* case:⁴³

The fact that parties are aware their contract might be relied upon by a third party may justify a more restrictive approach to the use of background in some instances, *the parties' awareness being itself part of the relevant background*.

Secondly, I fail to see why, in the kind of case I have been addressing where there is relevant and reliable evidence of prior negotiations, concern for third parties justifies potentially imposing on the parties, in a dispute between them which affects their interests only, a contractual obligation that is contrary to their actual understanding or agreement. Should circumstances subsequently arise where a third party, to the actual or constructive knowledge of the parties, reasonably expects to be able to take the contract at face value and acts in reliance thereon, his or her legitimate concerns can be met, if necessary, through application of the doctrine of estoppel.

Another frequently expressed concern is that admitting evidence of prior negotiations and subsequent conduct will increase the time and cost involved in civil trials. Where there is a large amount of money at stake, judges will perhaps be inundated with large bundles of documents that have dubious relevance. The answer to this concern lies in appropriate case management and judicial

41 United Nations Convention on Contracts for the International Sale of Goods 1489 UNTS 3 (opened for signature 11 April 1980, entered into force 1 January 1988), art 8. See Sale of Goods (United Nations Convention) Act 1994 and Sale of Goods (United Nations Convention) Act Commencement Order 1995, cl 2. The 1994 statute was replaced by subpt 7 of pt 3 of the Contract and Commercial Law Act.

42 This matter is discussed in more detail in David McLauchlan "The Continuing Confusion and Uncertainty over the Relevance of Actual Mutual Intention in Contract Interpretation" (2021) 37 JCL 25 at 45–46.

43 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [62] per Arnold J, with whom McGrath and Glazebrook JJ agreed (emphasis added).

warnings of adverse costs orders if large amounts of irrelevant material is introduced. In any event, I have highlighted elsewhere five exceptions to the old exclusionary rules that enabled the judges to give a meaning to contractual terms that is consistent with the actual mutual intention of the parties.⁴⁴ So the *Bathurst* rulings will not have the effect of increasing the length and cost of civil trials. I prefer the greater coherence and transparency of the new law. A case like *Edwards v O'Connor* might well be settled in favour of the plaintiffs before a court hearing.

A further common objection is that there will now be greater uncertainty in the outcome of contractual litigation. I believe the opposite will be the case where the evidence reveals that the parties formed a common intention as to the meaning of the words in dispute. Litigants will be aware that they cannot use technicalities to hide the truth. As the great judge Lord Nicholls of Birkenhead, writing extrajudicially, pointed out:⁴⁵

Where the pre-contract negotiations furnish a clear insight into the intended meaning of the disputed provision, admission of that evidence can hardly promote uncertainty. Rather the reverse. It is the exclusion of that evidence which generates uncertainty by enabling one party to contend for a meaning he knows was not intended. Since the extrinsic evidence is not admissible he is able to advance a case which otherwise would be untenable.

44 McLauchlan, above n 42.

45 Donald Nicholls "My Kingdom for a Horse: The Meaning of Words" (2005) 121 LQR 577 at 587.

APPENDIX**AGREEMENT FOR SALE AND PURCHASE OF REAL ESTATE****DATE:** 04-9-24**VENDOR:** Sam Sellars**PURCHASER:** Betty Byers**Address of property:** 250 Colletts Rd, Mangaroa Valley**Legal description: Estate:** FREEHOLD (unless otherwise described)**Area:** 8000 square metres**Lot:** 1 and 2**DP:** 34567**CT:** 15B/458 and 15B/459**Purchase price:** \$400,000**Delete one of these:** Exclusive of GST (if any) OR Inclusive of GST (if any)*If neither is deleted the purchase price includes GST (if any).***Deposit:** \$40,000**Balance of purchase price to be paid or satisfied as follows:**

In full on possession date

Possession date: 27-9-24

Vendor agrees to sell and Purchaser agrees to buy the above described property on the terms set out above and other terms attached (if any).

Signature of Vendor*S Sellars*

.....

Signature of Purchaser*B Byers*

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