"ARE WE THERE YET?": IS THERE A CONTRACT, AND WHAT DOES IT CONTAIN?

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Introduction

My starting point today, in discussing the formation of commercial contracts and their interpretation, coincides with the starting point for entry into such contracts: the identification by two or more parties of a commercial opportunity, and the process of negotiation that, if successful, will result in a contract. The process of identifying a commercial opportunity and exploring the possibility of doing a deal is the everyday stuff of commerce. If no agreement can be reached, then that is the end of the matter. The parties depart, to devote their time and money to the exploration of other opportunities. Many – indeed most – commercial opportunities that are identified do not come to fruition.

In some cases, negotiations proceed to the desired conclusion. The deal is done, and with the assistance of lawyers it is carefully documented and signed. The parties embark on performance. There may later be disputes about the interpretation of the contract; or there may be some issues on which the contract is silent, and the parties may disagree about the consequences of this. I will return to these post-contract issues below.

The focus of this paper is on intermediate cases, where the goal of a fully documented and signed contract is not reached, but some measure of consensus has been achieved. One party asserts that there is a contract, while the other says that there is none. The journey from first identification of a commercial opportunity through to a complete, formal written agreement signed by the parties has begun, but has not been completed: have the parties arrived at a legally binding contract, en route? In order to explore this question, I will discuss:

- the requirements for contract formation, and in particular intention to contract;
- the significance of gaps in agreements – and differences in how the courts approach the process of filling gaps, depending on the issue before them;
- interpretation of contracts – and in particular, how interpretation in context is used to fill gaps and make sense of otherwise incomplete agreements;
- implied terms – and in particular, how far one can go in implying terms to fill gaps.

Contract formation – have the parties assumed legally binding obligations?

In some situations it is possible to answer the question of whether the parties have arrived at a legally binding contract by applying the familiar tools of offer and acceptance. If the parties have exchanged a series of proposals and counterproposals, with the area of common ground increasing, but outstanding differences remaining in their respective proposals, it will generally be easy to conclude that there is no contract.

Matters become more complex, and giving advice becomes more challenging, where the parties have paused to record or confirm the extent of consensus reached: the understanding, or agreement (in a broad non-technical sense), which has by that point been achieved. In this paper, I will refer to these as "interim agreement" cases.

Typically, discussions between the parties continue after that point. Where differences emerge, one party falls back on the interim agreement and claims that it represents a binding contract; the other says that there is no contract, either because it was the parties' intention that no contract come into existence until a formal contractual document was prepared and signed, or because essential terms remain unsettled, or because the alleged agreement is so vague, uncertain or incomplete that it is unworkable, or (put more technically) the interim agreement is insufficiently certain to amount to a contract.

In interim agreement situations of this kind the parties, their legal advisers and the courts have to grapple with a complex mix of questions about intention to contract, completeness of contracts, interpretation and gap filling. And in the background lie the issues that will be discussed by other presenters today: the legal consequences of steps taken in the expectation of entry into a contract, where negotiations subsequently break down and no contract is entered into.

A number of recent cases have addressed these issues, and the principles to be applied have become much clearer. The courts have also provided helpful guidance on the material that can be referred to for this purpose. However, as the frequency of dissenting judgments in these cases illustrates, applying those principles is often far from simple.

Express provisions addressing intention to contract

In interim agreement cases, where there is an expectation of further documentation or further negotiation, it is of course always open to the parties to expressly deal with the question of whether they intend that interim agreement to be contractually binding. Well advised parties will generally do this; the desirability of expressly addressing this issue is something that every lawyer advising on a "heads of agreement" or similar document should always bear in mind.

Express provision that there is no contract

Where parties record an understanding that has been reached, but expressly provide that there is no contract until further negotiations have taken place, or until a formal document is prepared and signed, their intention not to be bound will invariably be respected. Contractual obligations are voluntary obligations: if the parties (or any of them) do not yet wish to assume contractual obligations, they can ensure that they do not do so.

The more complex the transaction, the more likely it is that the parties will want to reserve their position until they see a complete fully documented package, in respect of which they have received appropriate professional advice. Parties can, and often do, reserve their legal position until the t's has been crossed and the i's dotted. Where there is an express indication that that is indeed the case, for example where an interim

agreement is "subject to contract", there will be no legally binding contract. See eg *Verissimo v Walker* [2006] 1 NZLR 760 (CA), esp paras [29]-[35].

Thus if the intention of the parties is clear, there may be no contract even though the journey is virtually complete, and there is a full written record of the transaction which both parties have indicated they will sign. If one or more signatures have not yet been obtained, there is no contract and obligation.

Express provision that there is a contract

Conversely, the parties may expressly record that they intend to be contractually bound, even where the consensus reached is skeletal, and even though further negotiations and a formal written agreement are expressly contemplated. It is relatively common to see, in a heads of agreement entered into between substantial commercial parties, a provision to the effect that the heads of agreement is intended to be binding on the parties. In such cases, an intention to contract is plainly present.

The courts will strive to give effect to that intention and to uphold the agreement reached, unless it is impossible to do so. In order to make the agreement work, the courts will readily fill gaps through interpretation, implication of terms, or invocation of dispute resolution mechanisms provided for in the agreement. In this area the courts strive to be upholders of bargains, not destroyers of bargains: if the parties say they want to have a contract, the courts will do everything within their powers to ensure that that is achieved. Even if important terms are not included, the courts will look for ways to supply that omission. A passage from the majority judgment[1] in *Fletcher Challenge Energy Ltd v ECNZ Ltd* [2002] 2 NZLR 433 makes this point very clearly:

> [58] The Court has an entirely neutral approach when determining whether the parties intended to enter into a contract. Having decided that they had that intention, however, the Court's attitude will change. It will then do its best to give effect to their intention and, if at all possible, to uphold the contract despite any omissions or ambiguities (*Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503; [1932] All ER 494, *R & J Dempster Ltd v The Motherwell Bridge and Engineering Co Ltd* 1964 SC 308 and *Attorney–General v Barker Bros Ltd* [1976] 2 NZLR 495). …
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> [60] Something should be said about the place that the controversial decision of the House of Lords in *May and Butcher Ltd v The King* [1934] 2 KB 17n has in the modern law of contract. We take the view that this case is no longer to be regarded as authority for any wider proposition than that an "agreement" which omits an essential term (or, as Lord Buckmaster called it, "a critical part"), or a means of determining such a term, does not amount to a contract. No longer should it be said, on the basis of that case, that prima facie, if something essential is left to be agreed upon by the parties at a later time, there is no binding agreement. The intention of the parties, as discerned by the Court, to be bound or not to be bound should be paramount. If the Court is satisfied that the parties intended to be bound, it will strive to find a means of giving effect to that intention by filling the gap. On the other hand, if the Court takes the view

[1] Richardson P, Keith, Blanchard and McGrath JJ; in his dissenting judgment Thomas J agreed with the majority on this point, at para 125.

that the parties did not intend to be bound unless they themselves filled the gap (that they were not content to leave that task to the Court or a third party), then the agreement will not be binding.

[61] On its own facts we respectfully doubt that *May and Butcher* would be decided by Their Lordships in the same way today. We are now perhaps more accustomed to resort to arbitration in order to settle even matters of considerable importance to the contracting parties. We find curious the notion that, in a commercial contract where price is left to be agreed, a reasonable price cannot be fixed and that, even where there is an arbitration clause, that clause cannot be used to determine the price because "unless the price has been fixed, the agreement is not there" (p 20).

[62] We agree with Professor McLauchlan ("Rethinking Agreements to Agree" (1998) 18 NZULR 77 at p 85) that "an agreement to agree will not be held void for uncertainty if the parties have provided a workable formula or objective standard, or a machinery (such as arbitration) for determining the matter which has been left open". We also agree with him that the Court can step in and apply the formula or standard if the parties fail to agree or can substitute other machinery if the designated machinery breaks down. This is generally the approach taken by this Court in *Attorney–General v Barker Bros Ltd.*

[63] However, if essential matters (ie legally essential or regarded as essential by the parties) have not been agreed upon and are not determinable by recourse to a mechanism or to a formula or agreed standard, it may be beyond the ability of the Court to fill the gap in the express terms, even with the assistance of expert evidence. In *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1 at p 20, Kirby P remarked:

> Courts are not well equipped, drawing on their own experience, to fill out the detail of such contracts where the parties leave gaps in their own agreement. The fact that this may result in wasted time and money is a risk which parties to negotiation must always weigh up. Courts cannot enforce such agreements because they are incapable of judging where the negotiation on particular points would have taken the parties, acting bona fide but legitimately in their own interests.

It will be a matter of fact and degree in each case whether the gap left by the parties is simply too wide to be filled. The Court can supplement, enlarge or clarify the express terms but it cannot properly engage in an exercise of effectively making the contract for the parties by imposing terms which they have not themselves agreed to and for which there are no reliable objective criteria.

[64] Where the intention to contract is found to have existed, the Court may supply an omission by implying a term. It is true that the Privy Council remarked in *Aotearoa International Ltd v Scancarriers A/S* [1985] 1 NZLR 513 at p 555 that, in order to determine whether there is a legally binding bargain, it is impermissible to add to the express terms further implied terms upon which the parties have not expressly agreed, and then, by adding the express terms and the implied terms together,

thereby to create "what would not otherwise be a legally binding bargain". But this observation was made on the particular facts of that case, where there does not appear to have been a mutual intention to contract. Mustill LJ, having referred to it in *Malcolm v The Chancellor, Masters and Scholars of the University of Oxford* [1994] EMLR 17, said that there could not be found in this passage the route to a decision on whether there is a contract or not "since it requires the court to assess the contractual efficacy of express terms which the court knows, *ex hypothesi*, could be bulked out by implied terms" (at p 35). It provided, he said, a valuable reminder of the risks involved in the exercise of taking potential implied terms one group at a time, implying them, moving on to another group, implying those, and so on until a contract is built up out of implied terms from no express bargain at all. Mustill LJ thought it was necessary instead to "consider whether there was a sufficient skeleton of express terms to be fleshed out by implication". We respectfully agree. Gaps can be filled by implication, but only if there is such a skeleton of express terms combined with an intention to contract.

[65] A helpful analysis of various possible situations is given by Lloyd LJ in *Pagnan SpA v Feed Products Ltd* (1987) 2 Lloyd's Rep 601 at p 619. After pointing out that the parties may intend to be bound forthwith even though there are further terms still to be agreed, His Lordship said that, if they then failed to reach agreement on the further terms, the existing contract is not invalidated unless the failure to reach agreement renders the contract as a whole "unworkable" or void for uncertainty. By "unworkable" we take him to mean that the transaction is lacking in business efficacy. Lloyd LJ continued:

> (6) It is sometimes said that the parties must agree on the essential terms and that it is only matters of detail which can be left over. This may be misleading, since the word 'essential' in that context is ambiguous. If by 'essential' one means a term without which the contract cannot be enforced then the statement is true: the law cannot enforce an incomplete contract. If by 'essential' one means a term which the parties have agreed to be essential for the formation of a binding contract, then the statement is tautologous. If by 'essential' one means only a term which the Court regards as important as opposed to a term which the Court regards as less important or a matter of detail, the statement is untrue. It is for the parties to decide whether they wish to be bound and, if so, by what terms, whether important or unimportant. It is the parties who are, in the memorable phrase coined by the Judge, 'the masters of their contractual fate'. Of course the more important the term is the less likely it is that the parties will have left it for future decision. But there is no legal obstacle which stands in the way of the parties agreeing to be bound now while deferring important matters to be agreed later. It happens every day when parties enter into so–called 'heads of agreement'.

[66] It follows that merely because an important term is deferred to be settled on a future occasion, that does not mean that there is no intention to be bound. In such circumstances, provided the Court is satisfied that the parties did intend to enter immediately into a contractual relationship, it

> will do its best to find a means of giving effect to that intention by determining, if possible, the outstanding matter.
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> [67] Lack of clarity or ambiguity in express terms can also be resolved so as to "save" the contract. It is only if there is such uncertainty in an essential term that the Court cannot determine what the parties meant that the agreement will be held to be meaningless or void – where "the language used was so obscure and so incapable of any definite or precise meaning that the Court is unable to attribute to the parties any particular contractual intention" (*G Scammell and Nephew Ltd v Ouston* [1941] AC 251 per Lord Wright at p 267). Where the term in question is meaningless but inessential (both in law and to the parties) it will simply be disregarded in determining the rights of the parties under the contract.

The interim agreement is silent on its legal effect

The hardest cases of all are those where the status of the interim agreement is not expressly provided for. As noted above, the mere fact that a further formal agreement is contemplated is not decisive.

The New Zealand courts have suggested that there is a natural inference that parties to agreements for sale and purchase of land, and commercial agreements generally, intend to contract by a document which each will be required to sign, and that the parties would expect their solicitors to handle the transaction in a way which would give them proper protection from the legal point of view. See *Carruthers v Whitaker* [1975] 2 NZLR 667 at 671-2; *Concorde Enterprises v Anthony Motors (Hutt) Ltd* [1981] 2 NZLR 385 at 389; *Verissimo* paras 32-33; and compare *Fletcher Challenge Energy Ltd v ECNZ Ltd* [2002] 2 NZLR 433 at para 71. But this prima facie inference can be displaced by indications to the contrary in the interim agreement, or in the surrounding circumstances.

Where the question is whether a contract has been entered into, and in particular whether the parties intended to enter into immediately binding legal obligations, the courts approach the enquiry neutrally, with no predisposition to find that a contract has been formed. Once the court is satisfied that the parties did intend to enter into a contract, the court will strive to give effect to that contract. But this predisposition comes into play only when the first hurdle, intention to contract, is crossed:[2]

> the principle that courts should be the upholders and not the destroyers of bargains, which is the principle that underlies this approach, is not applicable where the issue to be decided is whether the parties intended to form a concluded bargain. In determining that issue, the court is not being asked to enforce a contract, but to decide whether or not the parties intended to make one. That enquiry needed not be approached with any predisposition in favour of upholding anything. The question is whether there is anything to uphold.

The correct approach to determining the legal effect of an interim agreement that does not expressly provide for its contractual status was the subject of a thorough and thoughtful analysis by the Court of Appeal in *FCE v ECNZ*:

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[2] *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101 at 132-133, cited with approval by the Court of Appeal in *Fletcher Challenge Energy Ltd v ECNZ Ltd* [2002] 2 NZLR 433 para 58.

- the question whether negotiating parties intended the product of their negotiation to be immediately binding cannot sensibly be divorced from a consideration of the terms expressed or implicit in that product (para [50]);
- contractual intent and adequacy of agreed terms must be examined together. The more numerous and more significant the remaining gaps, the less likely it is that the parties intended to be immediately bound on those terms, without more (see para [59], citing with approval *Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540 at p 548);
- the parties must have agreed on all terms that are essential to the formation of a contract of the type under negotiation (paras [50]-[51], [53]);
- the parties must have reached an agreement on all matters which they themselves regarded as a prerequisite to any agreement, and in respect of which they have reserved to themselves alone the power of agreement. A term is regarded as essential in this sense if one party maintains the position that there must be agreement upon it, and communicates this position to the other party (paras [52]-[53]);
- whether the parties intended to enter into a contract, and whether they have succeeded in doing so, are questions to be determined objectively (para [54]). This simply reflects the basic point that contract law is not concerned with the subjective intentions of the parties, but rather with the objectively assessed manifestations of those intentions. In asking whether party A intended to be bound immediately, we look not to the secret wishes of party A, but to how a reasonable person in the shoes of party B would have understood the communications and other conduct of party A, in context;
- context is very important. "In considering whether the negotiating parties have actually formed a contract, it is permissible to look beyond the words of their "agreement" to the background circumstances from which it arose - the matrix of facts. This can include statements of the parties made orally or in writing in the course of the negotiations and drafts of the intended contractual document." (para [54]) The rules which exclude some forms of evidence in the context of contract interpretation disputes do not apply where the question is whether the parties intended to be bound by a contract (para [55]);
- it is also permissible to look at subsequent conduct of the parties towards one another, including what they have said to each other after the date of the alleged contract, and, with appropriate caution, internal documents and communications by one party with a third party (para [56]);
- a skeleton of the express terms can be fleshed out by implication of further terms, provided the parties had an intention to contract. But a contract cannot be built up out of implied terms from no express bargain at all (para [64]);
- it does not follow from the fact that an important term has been deferred to be settled on a future occasion, that there is no intention to be bound. "[P]rovided the court is satisfied that the parties did intend to enter immediately into a contractual relationship, it will do its best to find a means of giving effect to that intention by determining, if possible, the outstanding matter." (para [66])
- ambiguity is not the same thing as uncertainty. If the court is satisfied that the parties did intend to enter into a contractual relationship, lack of clarity or ambiguity will generally be overcome using interpretive techniques (paras [67], [105]). In *FCE v ECNZ* the court felt able to give meaning to a number of terse, verging on cryptic,

> provisions. The most impressive example was the court's confidence that it could if necessary give meaning to the provision that FCE would deliver gas "only if delivery is economic". The meaning and effect of this term was one of the key issues on which the parties' subsequent negotiations foundered. But as the court said at para [112], "it is a rare in modern times for a court to throw up its hands and say that an essential express provision of an intended commercial contract is so vague that it cannot be given a meaning. Although it may be a considerable task, we are satisfied that the term "economic" can be interpreted by the court guided by expert evidence. … by following a series of steps, the court would determine what was and what was not to be taken into account in deciding whether FCE could deliver economically. It would not be easy – there might be differences of judicial opinion as there frequently are on questions of interpretation – but, in the end, we are sure that an appropriate meaning could be found. The word "economic" has built in to it the standard to be applied. It is in this context ambiguous but not uncertain. The parties accordingly reached an agreement on this clause."

A party that is denying that a contract has been formed generally deploys a range of interrelated arguments. First, and most importantly, they will argue that the parties did not intend, at that stage of their negotiations, to be immediately contractually bound. As noted above, this is often a natural inference where parties have indicated that they intend to enter into a formal contractual document, and sign it. But this inference (which must always depend on context) will be displaced by other evidence of an intention to be bound immediately. And in considering that evidence, the court will adopt a neutral approach that is biased neither for nor against the conclusion that the parties intended to be bound.

Second, that party may argue that an issue which the parties considered essential to formation of a contract had not yet been agreed. This is in fact a subset of the previous argument: if the parties have agreed that a particular term is essential for there to be a contract, or if one party has made it clear to the other party that it regards a particular term as essential before a deal is concluded, failure to reach agreement on that term means that the parties did not yet both intend to be bound.

Third, that party may argue that a term of a kind that is essential to the existence of a contract of the type under negotiation has not been agreed. This is also a legitimate argument, but success will be infrequent because "normally negotiating parties will have an appreciation of what basic terms they need to reach agreement upon in order to form a contract of the particular type which they are negotiating. It is comparatively rare that, having an intention to contract immediately, not only do they fail to deal expressly with an essential or fundamental term but it also proves impossible for the court to determine the contractual intent in that regard by implication of a term or by reference to what was reasonable in the particular circumstances or to some other objective standard." (*FCE v ECNZ* para [50])

Fourth, that party may argue that one or more provisions of the interim agreement are so vague and uncertain that it cannot be given effect. This argument is very unlikely to succeed. If the court is satisfied that the parties did intend to be immediately contractually bound, it will go a very long way to try to resolve any apparent lack of clarity or ambiguity.

Fifth, that party may point to important terms that have been deferred for future resolution. But if those terms do not fall into the second category above (terms which the parties agreed were essential for there to be a contract) or into the third category

above (terms that are essential to the existence of a contract of the type under negotiation), this deferral is most unlikely to be fatal to the existence of a contract. In some cases, the court will find a way to determine the outstanding matter. Often, the result will simply be that the relevant risk lies where it falls.

It is worth elaborating a little on this point. A very common approach, where a party wishes to argue that there are fatal gaps in a contract, is to call expert evidence about the types of issues that are commonly dealt with in a contract of that kind, and to argue that a contract that does not deal with those issues is unusual, unsatisfactory, or unfair. The *Anaconda* case referred to above provides an illustration of this approach (see in particular paras [85] to [87]). The question before the court was whether a letter agreement concerning mining activities amounted to a binding contract. The party arguing that there was no contract pointed to a number of issues on which the letter agreement was silent, and argued that these meant that the agreement was uncertain and incomplete. The court had little difficulty in finding that where the letter agreement was silent on certain issues, the risks lay where they fell. For example, there were statutory expenditure obligations attached to the mining tenements that were the subject of the letter agreement, and the letter agreement was silent as to responsibility for meeting these statutory responsibilities. The court found that this meant that the party that held the relevant mining leases and exploration licences, and was subject to the statutory obligations under the relevant legislation, was required to perform those obligations, and was not entitled to look to the other party to meet them or contribute to them (other than by making certain payments expressly provided for under the letter agreement). Similar conclusions were reached in relation to responsibility for dealing with claimants under native title.

So merely pointing to issues that might prudently have been dealt with, and are commonly dealt with in contracts of that kind, will not get you very far.

If the party denying the existence of a contract does not succeed on one of the first three types of argument noted above, it is extremely unlikely that their overall argument will succeed. Once the first three arguments have failed, the court has reached the point of concluding that there is an intention to contract and that all essential terms are present. At this point, the court's strong bias towards upholding agreements comes into play, and significant effort and ingenuity will be brought to bear by the court to resolve uncertainties and fill gaps. Indeed objections of this kind are often brushed off with the observation that resolving such issues is well within the capability of the court, if required; actual resolution may not be attempted there and then.

Agreements to negotiate

Where an interim agreement is entered into, the parties normally expect to continue their negotiations and prepare a more complete, formal agreement. If there is express provision in the interim agreement requiring further negotiations, what effect will that have?

As noted above, the mere fact that further negotiations are contemplated does not mean that a contract has not been entered into. The critical issues are the parties' intentions on whether or not they intend to be bound at that stage, and the nature of the term or terms that the parties have agreed they will negotiate further in the future.

Agreement to negotiate a term the parties consider essential

If the interim agreement provides that the parties will negotiate further on a term that they have agreed (or one party has specified) is essential to the making of a contract, then there cannot be an immediately binding contractual obligation. The second argument listed above will succeed: the will of the parties will prevail, and their desire not to have binding contractual obligations until this issue has been agreed will be given effect.

This point appears to lie at the heart of the conclusion reached by the majority in the *FCE v ECNZ* case that no contract had been entered into. The heads of agreement was seen by the majority as identifying the essential terms on which the parties considered they needed to reach agreement, in order to have a contract. The fact that some of these terms were expressly annotated "not agreed" was seen as express recognition that agreement had not yet been reached on issues which the parties themselves considered essential. [3]

Agreement to negotiate an important term

If the interim agreement provides that the parties will negotiate further on a term that is important but not essential, that will not be fatal to the existence of a contract. As noted above, if the court is otherwise satisfied that the parties intended to enter into an immediately binding contractual relationship, it will do its best to find a means of giving effect to that intention by determining, if possible, the outstanding matter. And very often, the answer will simply be that in the absence of an agreed term, the risk lies where it falls.

Agreement to negotiate secondary terms

Even more plainly, if the parties have agreed to negotiate further on terms that are of secondary importance that will not be fatal to the existence of a contract. Either the court will supply the deficiency, if there is a method of doing so (reference to reasonable terms or usual terms; or suitable machinery), or the contract will proceed without such terms.

Agreement to negotiate a term that is essential for that type of contract

The position is more complex where the parties have agreed to negotiate on a term that is essential for the type of agreement under consideration, so that as it stands the agreement is incomplete in the strict, technical sense. If the court is otherwise persuaded that the parties did intend to enter into immediate binding contractual obligations, it is likely to be receptive to an argument that the omission can be resolved through some other mechanism, if at all possible. If for example the parties have agreed to refer disputes to arbitration, or to expert resolution, the court will almost certainly conclude that there is a contract, and that the dispute resolution mechanism can be used to determine the relevant term, having regard to industry practice, any previous dealings

[3] The principal reason for the different conclusion reached by Justice Thomas appears to be his view that not all the terms identified in the heads of agreement had been agreed by the parties to be essential. If they were not all essential terms, it followed that the fact that agreement had not yet been reached on some of those terms was not fatal to the existence of a contract. The disagreement between the majority and the Justice Thomas seems, at bottom, to be a difference in the application of these tests, rather than a difference about what the test should be.

between the parties, and relevant expert evidence. If that machinery fails, the court can substitute other machinery. If no machinery has been provided for, but the parties have provided a workable formula or objective standard, the court can itself step in and apply the formula or standard. Hence the rejection in *FCE v ECNZ* of *May and Butcher Limited v The King* (see para [62], set out in full above).

Sometimes, however, the interim agreement does not provide a workable formula or objective standard for determining the outstanding issue, and does not designate machinery to resolve the issue. In these cases, it may be beyond the ability of the court to fill the gap in the express terms, even with the assistance of expert evidence. See *FCE v ECNZ* para [63]; *Anaconda* paras [160]-[165].

Agreement to use reasonable/best endeavours to agree

What, however, if the parties have gone beyond merely contemplating that they will negotiate on the issue? It is common to see, in interim agreements, a provision that requires the parties to use reasonable endeavours, or best endeavours, to negotiate and agree outstanding matters. It is also common to see a requirement that such matters be negotiated in good faith. Will this rescue an otherwise incomplete contract?

This issue also arose in *FCE v ECNZ*, and was resolved by the majority in a manner consistent with recent English and Australian authorities on this issue. The majority said:

> [114] On the basis that we have found that the HoA is not a binding agreement, the argument that the "Time Frame for Proceeding" clause by itself obligates ECNZ as a matter of law to use all reasonable endeavours to agree a full sale and purchase agreement within three months seems to us quite hopeless. The Judge found that it could not be binding if the HoA was not binding and there has been no cross–appeal on that point. But, even if the clause were part of an otherwise binding HoA, we would have difficulty in seeing that, because of the nature of the "not agreed" items, it could create any legally enforceable obligation to negotiate further. In *Little v Courage Ltd* (1994) 70 P & CR 469 Millett LJ said at p 476:
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> > An undertaking to use one's best endeavours to obtain planning permission or an export licence is sufficiently certain and is capable of being enforced: an undertaking to use one's best endeavours to agree, however, is no different from an undertaking to agree, to try to agree, or to negotiate with a view to reaching agreement; all are equally uncertain and incapable of giving rise to an enforceable legal obligation.
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> [115] The end in view (the full agreement) is insufficiently precise for the Court to be able to spell out what the parties must do in exercising their reasonable endeavours. Where the objective and the steps needing to be taken to attain it are able to be prescribed by the Court, a best endeavours or reasonable endeavours obligation will be enforceable. That may be possible in relation to some contractual negotiations of relative simplicity and predictability (*Coal Cliff Collieries*). But a negotiation of complex contractual terms is such a variable matter, both in process and in result, and so dependent on the individual positions which each party may reasonably take from time to time during the bargaining, that it is

> impossible for a Court to define for them what they ought to have done in order to reach agreement. The Court neither knows the result nor is able to say how each offer should have been made, nor whether it should have been accepted. If ECNZ had sat on its hands and absolutely declined to bargain – which was not the case – it would have been necessary, in order to provide a remedy to be able to state what, as a minimum, it was obliged to do as part of the bargaining process. That may have been possible, as can be seen from the presumption for good faith bargaining now to be found in s 32 of the Employment Relations Act 2000 and the code promulgated pursuant to s 35 of that Act, but in fact ECNZ did actively participate in a lengthy bargaining process.
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> [116] We take one item at random – the extension of the force majeure clause to the national grid. Did FCE have to agree to it? If so, on what terms? And if FCE was obliged to come to terms on this item, could it seek in return a price adjustment, and by how much? We have no idea how a Court could resolve these questions – by what standards they would be considered and how value would be attributed to the particular covenant which a party might be seeking. A meaning can, with some trouble, be given to "economic", but the task of assessing the parties' performance during a negotiation of this kind and determining whether a position taken by one side – perhaps influenced by the current position of the other – was or was not consistent with "reasonable endeavours", is beyond the expertise of the Court. In *Coal Cliff Collieries*, notwithstanding Kirby P's view that some contracts to negotiate in good faith may be enforceable, he expressed his conclusion that a Court would be extremely ill-equipped "to fill the remaining blank spaces" which a lengthy negotiation between the parties to a mining contract had failed to remove. He pointed out that the Court could not appeal to objective standards or its own experience. At stake were commercial decisions "involving adjustments which would contemplate binding the parties for years and deciding issues that lie well beyond the expertise of the court". How mining executives, attending to the interests of their corporation and its shareholders, might act in negotiating such a complex transaction was "quite unknowable" (p 27). Those remarks are entirely apposite to the present case.

Thus if an essential term is left unresolved, and the parties have supplied neither a workable formula or objective standard, nor machinery to determine that matter, the fact that they have expressly provided for an obligation to use reasonable endeavours or best endeavours to negotiate on that issue and reach agreement, or have agreed to negotiate in good faith on that issue, will not remedy the fatal deficiency in the interim agreement. There will not be a contract.

The view expressed by the majority in *FCE v ECNZ* that an obligation to use reasonable endeavours to negotiate terms cannot be enforced, or operate as machinery to determine the content of those terms, seems to apply equally to terms that are not essential but important. And it probably also applies to terms that are not important. But this is unlikely to be a significant practical issue, as the court is likely to find that the parties intended that terms of a machinery or boilerplate nature be "reasonable", or that they be consistent with standard industry practice. An objective standard of this kind, either express or implied, will supply the deficiency; not the obligation to negotiate. The

courts will find a way around the omission, if at all possible, and give effect to the parties' intention to enter into an immediately binding contractual relationship. But they will not do this by enforcing the obligation to negotiate, as such.

Interpretation of contracts to fill gaps

The modern approach to interpretation

It is clear from the contemporary authorities that the courts' approach to interpretation of contracts is purposive, contextual, and directed to making the agreement work in the dual sense of being consistent with the parties' shared intentions at the time of contracting, and with commercial common sense.

Approached in this way, interpretive techniques will often fill apparent gaps in contracts. The willingness of the court in *FCE v ECNZ* to interpret the term "economic" provides a striking example of this.

Another example is provided by the leading New Zealand case on interpretation of contracts, *Boat Park Ltd v Hutchinson* [1999] 2 NZLR 74 (CA). In that case, the central issue was whether a valuation of land provided by the purchaser to the vendors in connection with provision of a vendor mortgage was improperly rejected by the vendors. The court had no difficulty in finding that the failure by the parties to specify minimum requirements in respect of the valuation did not mean that any document that purported to be a valuation prepared by a registered valuer would be sufficient for the purposes of the contract. Rather, what was required was a valuation that was prepared in good faith, by a registered valuer, in accordance with basic valuation principles and basic valuation methods. Similarly, it would not be acceptable as a valuation if it disclosed patent and material errors in the calculations which it contained. The court also suggested that it could probably be assumed that the parties intended the valuation to comply with the requirements of the standards published by the New Zealand Institute of Valuers.

In this way, the single word "valuation" was treated as incorporating in the contract a number of process and content requirements that were necessary for the contract to make commercial sense, and that in many commercial agreements would be expressly set out at some length.

The court in *Boat Park* reiterated the helpful guidance provided by Lord Hoffmann on the modern approach to contractual interpretation, in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 at pp 114 – 115:

> My Lords, . . . I think I should preface my explanation of my reasons with some general remarks about the principles by which contractual documents are nowadays construed. I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v Simmonds* [1971] 3 All ER 237 at 240 – 242, [1971] 1 WLR 1381 at 1384 – 1386 and *Reardon Smith Line Ltd v Hansen-Tangen, Hansen-Tangen v Sanko Steamship Co* [1976] 3 All ER 570, [1976] 1 WLR 989, is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be

interpreted in ordinary life. Almost all the old intellectual baggage of 'legal' interpretation has been discarded. The principles may be summarised as follows.

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the 'matrix of fact', but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352, [1997] 2 WLR 945).

(5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1984] 3 All ER 229 at 233, [1985] AC 191 at 201:

> . . . if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.

Admissibility of evidence of negotiations in interpretation disputes

The exclusionary rule referred to in Lord Hoffman's para [3] is generally accepted as correct in New Zealand, but as His Lordship noted, its precise limits are unclear. A number of incursions into the rule have already been recognised, for example to enable the court to receive evidence that the parties agreed, in their negotiations, that a phrase would have a particular meaning: see Burrows, Finn and Todd*, The Law of Contract in New Zealand* (3rd ed, 2007) section 6.2.2(g). And, of course, such evidence can be admitted if the parties are in dispute on whether a contract has been formed, or on questions such as mistake, misrepresentation and rectification. Once this material has been admitted for one purpose, it tends to colour the overall picture before the court, and influence interpretation.

Admissibility of subsequent conduct evidence in interpretation disputes

The Supreme Court has recently addressed the question whether the court can consider the subsequent conduct of the parties as an aid to the interpretation of their contract. An earlier New Zealand decision questioned whether the English authorities prohibiting reference to such material should be followed in New Zealand today.[4] In *Wholesale Distributors Ltd v Gibbons Holdings Ltd* [2007] NZSC 37 four of the five judges held that reference to such material is permissible, where it sheds light on the actual intention of the parties at the time the contract was entered into.[5]

It is worth setting out in full the discussion of this issue by Justice Tipping and Justice Thomas, as it explains the rationale for admitting such evidence, and the purpose for which it is admitted. The other reason for setting these passages out in full is that these judges disagreed on whether certain types of "subsequent conduct" evidence are admissible, an issue which appears to remain open, as the other members of the court did not commit themselves on this point.

Justice Tipping said:[6]

> [50] Two questions arise on this aspect of the case. The first is whether the court should be able to consider the subsequent conduct of the parties as an aid to the interpretation of their contract. The second is whether the subsequent conduct relied on by Gibbons in the present case has any material bearing on the true meaning of cl 4. Although I have already held that the meaning asserted by Gibbons is the correct one, the issue of subsequent conduct has general importance and the point is not wholly redundant in this case. That is because it is desirable for there to be clarity as to whether subsequent conduct can be examined as an aid to interpretation, if only for confirmatory or supporting purposes.
>
> [51] The point of principle must be addressed first. Much has been written about whether evidence of post-contract conduct should be admissible on an interpretation issue. Traditionally it has been regarded as admissible only for rectification, formation and estoppel purposes, and not to assist interpretation. There is, at the outset, some conceptual difficulty in

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4 *Attorney-General v Dreux Holdings Ltd* (1996) 7 TCLR 617 at 626; Thomas J argued strongly in his dissenting judgment that such material should be referred to (at 640 – 644).

5 Justice Blanchard reserved his position on the issue, while noting that he had seen no convincing argument against such use, and that there is force in the argument in its favour (para [27]).

6 Footnotes omitted.

adopting different evidential rules for those purposes on the one hand as against interpretation purposes on the other.

[52] As a matter of principle, the court should not deprive itself of any material which may be helpful in ascertaining the parties' jointly intended meaning, unless there are sufficiently strong policy reasons for the court to limit itself in that way. I say that on the basis that any form of material extrinsic to the document should be admissible only if capable of shedding light on the meaning intended by both parties. Extrinsic material which bears only on the meaning intended or understood by one party should be excluded. The need for the extrinsic material to shed light on the shared intention of the parties applies to both pre-contract and post-contract evidence. Provided this point is kept firmly in mind, I consider the advantages of admitting evidence of post-contract conduct outweigh the disadvantages. The latter comprise primarily the potential for ex post facto subversion of earlier jointly shared intentions and the lengthening of interpretation disputes by encouraging the parties to produce evidence which is often only tenuously relevant at best.

[53] For good policy reasons the common law has consistently adhered to what is usually called an objective approach to contract interpretation. An objective inference from conduct in which the parties are mutually involved after they have contracted does not significantly depart from the conventional approach. I will call conduct in which both parties are involved, either actively or passively, mutual or shared conduct. Inviting inferences from the conduct of one party, in which the other party is not involved, would make a significant inroad into the need to ascertain objectively the shared intention of the parties as to their meaning. The words they have used, construed in the light of all the relevant and objective circumstances in which the parties have used them, must prima facie be the best guide to their meaning. But, if some mutual or shared post-contract conduct of the parties is objectively capable of shedding light on the meaning they themselves placed on the words in dispute, I consider more is to be gained than lost by allowing the court to take it into account.

[54] I do not propose to embark on any detailed review of the substantial literature, both judicial and academic, which exists on this topic. In the end the court must decide, on the overall balance of competing interests, whether, and if so, to what extent, evidence of post-contract conduct is to be admissible in aid of interpreting written contracts. Some of the more influential recent materials are *Montreal Trust Co of Canada v Birmingham Lodge Ltd*; *Attorney-General v Dreux Holdings Ltd*; "The Intractable Problem of The Interpretation of Legal Texts"; "My Kingdom for a Horse: The Meaning of Words"; and "In Defense of a Role for Subsequent Conduct in Contract Interpretation".

[55] I also point out that art 2-208 of the Uniform Commercial Code and art 202(4) of the Restatement of Contract Law (2nd) in the United States allow consideration to be given to specified subsequent conduct in which both parties are involved. As Blanchard J (writing as well for Richardson P and Keith J) suggested in *Dreux*, taking account of subsequent conduct would also accord with general international trade practice. In the same case, Thomas J concluded that, as a matter of principle, the courts should

be able to have regard to the subsequent conduct of the parties for the purpose of elucidating the meaning the parties intended their contract to have at the time they entered into it. In short, as I have already indicated, I find the case in favour of admitting post-contract conduct for that purpose distinctly more persuasive than the case for not doing so.

[56] Questions of interpretation concern the objective meaning of the parties' words rather than their subjective intentions. The law generally presumes that the objective meaning of their words reflects those intentions. The parties are not allowed, on an interpretation issue, to tell the court what they intended the words to mean or what they thought the words meant. Interpretation difficulties arise when the parties have used words of uncertain meaning and they assert competing meanings for those words. In this situation the traditional view has been that the court must ascertain what meaning the words bear, taking into account the document as a whole and all relevant circumstances that would have been apparent to the parties at the time they contracted. The traditional phrase "matrix of facts" means all the objectively relevant surrounding circumstances.

[57] The phrase was first used by Lord Wilberforce in *Prenn v Simmonds*, where His Lordship said "[t]he time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set". His Lordship then made reference to "mutually known facts" and to the phrase used by Cardozo J in the New York Court of Appeals in *Utica City National Bank v Gunn*, "the genesis and aim of the transaction". Cardozo J also said that surrounding circumstances might "stamp upon a contract a popular or looser meaning" than what Lord Wilberforce later called the strict legal meaning, an expression which he was equating with purely linguistic literalism. His Lordship emphasised that ultimately the search was for the common intention of the parties as at the time they contracted and as objectively manifested. It does not follow from this classic exposition that objective manifestation cannot properly come from the post-contract conduct of the parties. Surrounding circumstances do not have to precede the contract; indeed the very word "surrounding" implies that the circumstances may fall on the other side of this temporal line.

[58] The surrounding circumstances have conventionally been examined as at the date when the parties entered into their contract. On that basis the post-contract conduct of the parties is obviously not within the scope of the court's inquiry. This is one reason why evidence of post-contract conduct has traditionally been excluded in interpretation disputes. It cannot have been known to the parties when they put pen to paper and hence could not bear on their meaning at that time.

[59] This temporal focus was reinforced by Lord Reid's influential speech in *Whitworth Street Estates (Manchester) Ltd v James Miller & Partners Ltd*. His Lordship said that admitting post-contract evidence "might have the result that a contract meant one thing the day it was signed, but by reason of subsequent events meant something different a month or a year later". The subsequent course of English law was shackled by this rare case of even Homer nodding. Evidence of subsequent conduct does not invite a subsequent meaning. It is directed to the original meaning; that is, the meaning of the contract when it was signed. It is a distraction to

> suggest that post-contract evidence is capable of changing the contract date meaning, when its sole purpose is to elucidate that meaning.
>
> [60] For these reasons, it is now appropriate to allow the traditional date of assessment to come forward to the date of hearing so as to enable the court to take into account how the parties have behaved in the performance of their contractual obligations and in the administration of their contract generally. The focus must still be on objective conduct rather than expressions of subjective intention or understanding. But if the parties have together conducted themselves in the performance of their contract in a way that is relevant to the meaning of the disputed provision, the court should be able to take that into account.
>
> [61] There are connotations of estoppel involved in this approach, albeit the issue is not one of estoppel in any strict sense. Estoppel by convention or otherwise is a separate issue. It can fairly be said that when the issue is examined as at the date of the court hearing, the shared conduct of the parties in the performance of their contract is a part of the surrounding circumstances. The only difference is that post-contract conduct cannot have informed the meaning of the parties' words at the time they contracted, but it can retrospectively have a legitimate bearing on that meaning. There is insufficient reason in principle to insist on a date of contract focus, albeit the ultimate criterion for ascertaining contractual intention remains the objective meaning of the words of the contract at that date. The horizon has expanded but the subject of the search remains the same.
>
> [62] I conclude this topic with the observation that properly focused and limited evidence of post-contract conduct will often be capable of shedding more light on contractual meaning than a lot of the pre-contractual material which is said to bear on that meaning. Post-contract evidence that logically indicates that at the time they contracted the parties attached a particular meaning to the words in dispute can be good evidence that a later attempt by one party to place a different meaning on those words is unpersuasive.
>
> [63] Even if the meaning suggested by the post-contract conduct is not the most immediately obvious objective meaning, the parties' shared conduct will be helpful in identifying what they themselves intended the words to mean. That, after all, must be the ultimate determinant. If the court can be confident from their subsequent conduct what both parties intended their words to mean, and the words are capable of bearing that meaning, it would be inappropriate to presume that they meant something else.

Justice Thomas said:[7]

> [111] I do not need to expand on the desirability of the courts having regard to subsequent conduct as an aid to interpretation in appropriate cases. I traversed that topic 11 years ago in the *Dreux Holdings* case. It will suffice to reiterate that mutual assent is the key to the formation of a valid contract and it follows that the interpretive function should be directed at ascertaining the mutual intention of the parties: what did they mean by their contract at the time they entered into it?

[7] Footnotes omitted

[112] The opinion I advanced in the *Dreux Holdings* case may not have been as complete as I would like today, but I am comforted by the fact that what I may not have said then will have been said by Professor McLauchlan of the Law Faculty at Victoria University of Wellington.

[113] I pause to pay, or repay, a tribute to the learned Professor. His work to bring some logic and cohesion into the task of contractual interpretation has been as outstanding as it has been tireless. Indeed, since argument was heard on this appeal, Professor McLauchlan has published another article under the title "Contract Formation, Contractual Interpretation, and Subsequent Conduct". That article exhibits the same impeccable scholarship that has marked Professor McLauchlan's earlier essays. I for one am indebted to him. It will undoubtedly be a matter of some satisfaction to him that four members of this Court have now decided that evidence of subsequent conduct may be admitted in appropriate cases. The fact that two of the four do not consider that the evidence of subsequent conduct in this particular case is of assistance does not derogate from the fact that the principle has now been established.

[114] Much of the judicial reluctance to admit evidence of subsequent conduct has been due to an inability to distinguish between the objective task of giving effect to the mutual intention of the parties and the misguided exercise of seeking to ascertain the subjective intention of the parties. The latter exercise is illegitimate and will remain illegitimate. Evidence of subsequent conduct is admitted, not for the purpose of importing an intention which was not expressed in the contract, but with a view to elucidating the meaning which the parties intended their contract to have when they entered into it. The reasonable expectations of the parties to the contract should not be defeated by attributing a meaning to it which their subsequent conduct demonstrates they did not intend. As an Australian Judge has put it: "[J]ustice requires that the parties should be held to the bargain in the sense to which they have agreed."

[115] The case for the admission of evidence of the actual intention of parties as an aid to interpretation has been given an exponential boost by virtue of the seminal article of Lord Nicholls, "My Kingdom for a Horse: The Meaning of Words". Although the Law Lord's well-reasoned argument is primarily directed at pre-contractual negotiations, he has this to say about post-contractual conduct: Even so it is surely time the law recognised what we all recognise in our everyday lives, that the parties' subsequent conduct, that is, their conduct after they had reached agreement, may be a useful guide to the meaning they intended to convey by the words of their contract. Such conduct, for what it may be worth in the particular case, is one of the matters the court should be able to take into account when deciding what, in the events which have happened, is the meaning the words would reasonably convey to a reader. Judges are well able to identify, and disregard, self-serving subsequent conduct.

[116] One must, however, acknowledge the force of an ensuing case note by a Tel Aviv solicitor, Alan Berg, entitled "Thrashing Through the Undergrowth". In the course of the note, Berg takes Lord Nicholls to task. Berg's main point centres on the practical difficulties a lawyer faces in giving a client advice as to the meaning of a clause in a contract. He correctly states that a client who asks a lawyer to advise on the meaning

of a particular clause is asking how a court would be likely to interpret it. This means, he argues, that the lawyer would first need to obtain all the relevant background knowledge which was reasonably available to the parties in the situation in which they were at the time of the contract. Berg allows only that this might be possible where the transaction is a straightforward one, the lawyer was personally involved in the drafting, and the transaction is fairly recent. Otherwise, the author adds, the lawyer would have to trawl through volumes of pre-contractual correspondence and drafts. Particular difficulties could occur with purely oral statements between the original parties which would be unlikely to be recorded on the lawyer's file. The difficulties, he implies, would be exacerbated if the contract requiring interpretation had been assigned to other parties. Anderson J succinctly expresses much the same concern in his reasons.

[117] Berg concludes that the "fiction" that contracts are addressed to the original parties should be abandoned. Most professionally drafted commercial contracts, he argues, are intended to be used by, and are therefore addressed to, people who will know the basic background to the deal, but no more than that. There is, therefore, he argues, no logic in insisting that such a contract must be interpreted in the light of *all* the background knowledge which, historically, was reasonably available to the parties at the time of signing.

[118] Berg's criticism deserves close consideration. The notion that lawyers should have to "trawl" through possibly historical pre-contractual correspondence and drafts in order to advise a client on the meaning of a particular clause is intuitively unacceptable. Further, the prospect of a subsequent party having to carry out some sort of "due diligence", so to speak, on what transpired at the time the original contract was entered into and, possibly, the subsequent conduct of the original parties, is also unacceptable. Courts should, of course, always be alert to practical considerations of this kind.

[119] But Berg overstates his case. Notwithstanding his express denial, his approach would herald a retreat to "literalism". His argument is directly aimed at evidence of the surrounding circumstances which is already admissible and, indeed, regarded as essential. Berg does not seek to evade this point. His primary attack is directed at the first of the principles enunciated by Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society*, that is, that interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were in at the time of the contract. Lord Nicholl's article merely served to provoke his attack on that basic principle.

[120] Berg's argument is overstated in another respect. It suggests that a lawyer will face an impossible and endless task advising on the contract generally. But for the most part, a party, or the legal adviser, will ensure that the party's core interests are spelt out and specifically protected in the document. In practice, advice will, more often than not, be called for if and when a dispute arises as to the interpretation of a particular clause. Conscientious lawyers will then, as they do now, amass all relevant and available background knowledge before advancing an opinion or advising

on legal action. It is lawyers at present who put the courts in the position of being seized of that knowledge. Pre-contractual and post-contractual information relevant to the interpretative exercise will be embraced in that same conscientious inquiry. Ultimately, as Lord Nicholls argues, this evidence is necessary to enable lawyers to give coherent advice. Nor will courts expect the impossible. They will be alert to ensure that no party is disadvantaged by virtue only of the difficulty of obtaining access to evidence of pre-contractual or post-contractual conduct.

[121] Finally, Berg's suggestion that the accepted wisdom that contracts are addressed to the original parties is a "fiction" is unsupportable. For the most part, parties wish their interests to be advanced and protected, and their legal advisers draft their contracts to advance and protect those interests. While there is the possibility that one or other of the parties may wish to assign their interest in the contract, assuming that they are contractually able to do so, the primary concern will be to secure the bargain the parties have struck. One of the parties will have paid or given good consideration for that advantage. Furthermore, many contracts, such as one-off contracts, by their very nature are unlikely to be addressed to potential third parties. Common examples are contracts for the sale of property. Then, relational or long term contracts will, again for the most part, seek to define the relationship which the parties intend to endure throughout the duration of the contract. Contracts will be and are assigned, but to suggest that it is a "fiction" that they are not for the most part addressed to the original parties is a signal overstatement.

[122] Although given reason to pause by Berg's note, I believe that the case for the admission of evidence of subsequent conduct remains compelling. It is compelling simply because the courts must be serious about the task of interpreting contracts in such a way as to give effect to the common intention of the parties. 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. But I am more than prepared to let Tipping J have the last word; the advantages of admitting evidence of post-contract conduct outweigh the disadvantages.

…

134] Although prepared to accept evidence of subsequent conduct in appropriate cases as an aid to interpreting the meaning of the contract, Tipping J seems to qualify the admissible evidence by requiring it to be shared or mutual to the parties. Thus, the learned Judge states: "Extrinsic material which bears only on the meaning intended or understood by one party should be excluded, save of course for rectification purposes". "Inviting inferences from the conduct of one party, in which the other party is not involved" is disapproved. He also speaks of "some mutual or shared post-contract conduct of the parties"; "the shared conduct of the parties in the performance of their contract"; "[t]here is no element of mutuality involved, let alone a mutuality involving WDL"; "[t]hese documents do not demonstrate any shared intention as to the meaning of clause 4"; "not conduct of such mutuality"; and "the lack of mutuality aspect".

> [135] I consider that, as it is expressed, this requirement is misconceived and will undoubtedly cause confusion. There is no reason, certainly in this case, why evidence of subsequent conduct should have to be common to establish a common intention. Conduct which is not, and has not been, "shared" or "mutual" may nevertheless point to a meaning contrary to the meaning later asserted by one of the parties. That party has acted inconsistently with the meaning it seeks to persuade the court to place upon the contract. The value of the evidence stems from the inconsistency. I acknowledge that, notwithstanding the explicit stipulation of "shared" or "mutual" conduct referred to above, Tipping J seems to endorse this view when he observes that there are connotations of estoppel involved in the approach he has outlined, albeit that the issue is not one of estoppel in the strict sense.
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> [136] It would be unfortunate if the principle that evidence of subsequent conduct is admissible as an aid to interpretation becomes hedged with qualifications which undermine the objective of the principle. Providing that the evidence is relevant to the question of interpretation before the court, it should be sufficient that, following the completion of the contract, the party concerned has acted inconsistently with the meaning it now asserts in court.
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> [137] I accept, of course, that the courts must be cautious about admitting evidence of subsequent conduct which is equivocal as to the common intention of the parties. This caution, as Anderson J has been concerned to stress, may be particularly necessary where the contract has been assigned or, in the case of a lease, the land sublet, so that some or all of the parties to the dispute are different from the parties who executed the original contract or lease. On the other hand, exercising caution does not mean that the courts should strain to explain away credible evidence. Difficulties may arise if the courts, as they should, feel constrained to avoid a contract having two meanings: one for the original parties and one for the subsequent parties. But those difficulties do not arise in this case. WDL was a party to the Deed of Assignment in question and each of the matters relied upon relate to conduct which is inconsistent with the meaning it now urges upon the Court.

It seems to me that there may be a middle ground between these two positions, which is consistent with the underlying principles accepted by both judges. As Justice Tipping notes at para [52], extrinsic material is only relevant if it is capable of shedding light on the meaning intended by both parties. The private intentions or wishes of one party shed no light at all on the interpretation process. But it seems to me that there could well be unilaterally prepared documents which do not form part of what Justice Tipping calls "mutual or shared conduct", but which shed light on the shared intentions of the parties. Consider, for example, an internal memorandum in which one party records its understanding of the intention of the other party. If party A notes that the other party sought inclusion of a particular clause in order to secure a particular outcome, and it agreed to that in exchange for some other concession, surely that provides helpful evidence of the parties' shared intention.

Provided that the purpose for which extrinsic material is admitted is kept firmly in mind, along the lines explained by Justice Tipping, it seems to me that the full range of material approved by Justice Thomas ought to be admissible for that purpose.

Before leaving this case, a note of caution is warranted about the suggestion in paras [135]-[136] of the judgment of Justice Thomas that conduct by a party that is inconsistent with the view it is putting forward as to the meaning of a contract suggests that its preferred interpretation is incorrect. It is common for parties to contract for certain rights, but then refrain from exercising them in practice provided that the overall relationship of the parties remains satisfactory. A cooperative and practical approach to contract performance, and a willingness not to insist on strict contractual rights, must not be read as a concession that those rights do not exist: otherwise, the flexibility and cooperation that characterises most long term contractual relationships would be seriously hindered. A practical, non-technical and cooperative approach to performing long term contracts is often possible only because it is underpinned by strict rights and obligations provided for in the contract, which can be invoked if it becomes necessary or desirable to do so.[8] The "no waiver" clauses that are found in many contracts reflect this very important practical point. Thus, for subsequent conduct to assist in the interpretation process, one needs to be very confident that that conduct reflects the relevant parties' understanding of their contractual rights and obligations, rather than simply reflecting a practical approach that does not involve insisting on those rights and obligations.

Express terms

There is usually little dispute about what the express terms of the alleged contract are, in interim agreement cases, precisely because there is usually a specific document which one party is pointing to as "the contract". The focus tends to be on whether that document represents an immediately binding contract, rather than on whether other terms form part of the parties' express agreement.

Where parties act as if they have a contract, after exchanging different and inconsistent proposed terms, the classical analysis is that the last missive in the exchange is accepted by the conduct of the other party in embarking on performance.[9] However, if one party has made it clear that they do *not* agree to contract on the terms proposed by the other, subsequent "performance" will not bring into existence a contract inconsistent with that express rejection: *Transpower New Zealand Ltd v Meridian Energy Ltd* [2001] 3 NZLR 700. In such a case it seems there is no contract at all, and the parties' rights and obligations depend on other principles, such as quantum meruit.

As a matter of principle, it must also be the case that where one or both parties have specified that there is no contract until a formal document is prepared and signed, a contract will not come into existence merely because, at some earlier stage in the negotiations, one party embarks on "performance". There is no offer capable of immediate acceptance by performance, where the offeror has specified that there will be no contract until a formal agreement is entered into.

Implied terms

This seminar paper is not the place for an extended discussion of the law relating to implied terms. For the circumstances in which terms will be implied in a contract by the

[8] For a more detailed discussion of this issue, see David Goddard, "Long Term Contracts: A Law and Economics Perspective" [1997] NZ Law Rev 423 at 448 – 450.

[9] See Burrows, Finn & Todd section 3.3.9

courts, and the different categories of implied terms, see Burrows, Finn & Todd, *The Law of Contract in New Zealand* (3rd ed, 2007) section 6.3.3.

In cases where the court is satisfied that the parties intended to enter into a binding contractual obligation, the court will generally be ready to imply terms necessary to give the contract business efficacy. That readiness will be at its greatest in the context of interim agreements, or other agreements that are skeletal or rudimentary.

The courts will show much more caution in implying terms where the parties have entered into a detailed and apparently complete written agreement. In those cases, it is much less likely that the standard test for implying terms in a particular contract will be met.[10] Any suggested implied term is more likely to be inconsistent with one of the express terms of the contract; and is much less likely to meet the requirement of being necessary to give business efficacy to the contract, or of being so obvious that it goes without saying.

The question whether it is possible to imply an obligation to act in good faith into some or all contracts will be discussed by other presenters at this seminar. I will not venture into this territory, except to note that it follows from the reasoning of the court in *FCE v ECNZ* that if an interim agreement is too uncertain to be given legal effect as a contract, inclusion in the interim agreement of an obligation to negotiate the missing terms in good faith will not be sufficient to fill the gap, and bring a binding contract into existence.

There is one other generic implied term that is worth mentioning in this context. "As a general rule ... where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect." (*McKay v Dick* (1881) 6 App Cas 251, cited with approval in Australia in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 263, and in *Anaconda* at para [11]).

Australian authority also favours implying into all contracts a term that one party will do all such things as are necessary to enable the other party to have the benefit of the contract: *Butt v M'Donald* (1896) 7 QLJ 68 at 70 – 71, approved by Mason J in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 263. There is no New Zealand authority supporting an implied term in precisely this form.

These implied terms are not panaceas for all gaps in contracts, and do not go as far as establishing a general implied obligation of cooperation.[11] But they do provide a useful mechanism for answering some concerns about contractual completeness.

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[10] In *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 16 ALR 363 at p 376 the Judicial Committee of the Privy Council laid down a five-point test for the implication of terms in a contract which is frequently cited by the New Zealand Courts:
"In [their Lordships'] view, 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."

[11] An implied obligation which I have argued elsewhere is undesirable: see Goddard op cit pp 447-450. But if the parties have expressly assumed such an obligation, the courts should seek to give effect to it, where possible: op cit pp 450-451.

Final comments

Because contractual obligations come into existence only when both parties intend that they do so, the paramount consideration in determining the time at which a binding contractual obligation comes into existence, in the course of a journey from first contact to final signed agreement, is the expressed intention of the parties. If the parties – or any one party, for that matter – make it clear that they do not intend that there be a contract yet, there will not be one. Conversely, if it is clear that they do intend to be bound, the courts will go to great lengths to give effect to that intention. In intermediate cases, the court will try to identify the common intention of the parties, by reference to a wide range of pre-contract and post-contract material.

If there is a contract, however skeletal, the courts will interpret it to give effect to the intention of the parties, understood objectively and in context. The goal is to make the contract work, in accordance with the parties' intentions, and commercial common sense.

If there is no contract, but steps have been taken in the expectation that a contract has been arrived at, or will be arrived at, the rights of the parties must be determined other than by reference to the law of contract. That is the subject of the remainder of today's seminar.