Neutral Citation Number: [2019] EWCA Civ 526

Case No: A4/2018/1793; A4/2018/1796

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES, CIRCUIT COMMERCIAL COURT (QBD)
HHJ KEYSER QC
[2018] EWHC 1506 (QB)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 28/03/2019

Before:

LORD JUSTICE LONGMORE
LORD JUSTICE DAVID RICHARDS
and
LORD JUSTICE LEGGATT

- -

Between:

MERTHYR (SOUTH WALES) LIMITED (FKA BLACKSTONE (SOUTH WALES) LIMITED)	**Appellant**
- and -	
MERTHYR TYDFIL COUNTY BOROUGH COUNCIL	**Respondent**

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Hugh Sims QC and **Oliver Mitchell** (instructed by **Veale Wasbrough Vizards Llp**) for the **Appellant**
Matt Hutchings QC and **Shomik Datta** (instructed by **Merthyr Tydfil County Borough Council**) for the **Respondent**

Hearing date: 12 March 2019

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Approved Judgment

Lord Justice Leggatt:

1. The issue on this appeal is one of interpretation of a contract to establish an escrow account.

The background

2. The appellant (which I will call "the mining company") is a company which carries on open cast coal mining at a site in South Wales for which the respondent council is the local planning authority. The planning permission granted by the council in 2005 for this use of the land included conditions that:

   (1) All coal extraction must cease no later than 6 September 2022;

   (2) Final restoration of the land must be completed no later than 6 December 2024; and

   (3) "After care" must be undertaken for not less than five years after each phase of a progressive restoration scheme has been certified as complete.

3. The mining company also entered into an obligation to carry out restoration works at the site under an agreement made with the council pursuant to section 106 of the Town and Country Planning Act 1990.

4. The mining company is a wholly owned subsidiary of a company which I will call the "holding company". Until 6 January 2016 the holding company was in turn owned by Miller Group Limited and Argent Group Plc, two substantial companies which I will refer to as the "original parent companies".

5. On 13 July 2007 the original parent companies entered into a deed of guarantee, limited in amount to £15m, by which they guaranteed that the mining company would perform its obligations in relation to the reclamation of the site.

6. In or about August 2015, when the original parent companies were looking to divest themselves of their interests in coal mining, a written proposal was presented to the council on behalf of the mining company and the holding company entitled "Proposal for the Replacement of Parent Company Guarantee and the Establishment of an Escrow Account". This Proposal stated that the mining company was now a profitable company generating over £10m of operating profit each year and with net assets in excess of £20m. It also stated that the original parent companies were no longer the "top" companies in their respective groups, which were being restructured for strategic reasons, and were effectively being "traded out". Against that background it was proposed that:

   (1) The original parent company guarantee should be replaced by a guarantee from the holding company, also limited to £15m; and

   (2) In addition, "a cash escrow fund will be established for the purpose of securing £15m of the restoration costs of [the land reclamation scheme]".

7. The chief executive of the council wrote what was described as a "Full Council Report" on the Proposal dated 7 September 2015. This advised that the Proposal would provide a "significantly stronger security package" than the existing guarantee from the original parent companies, which were being progressively wound down over time, and recommended that the Proposal be approved. That recommendation was accepted and the Proposal was approved at a council meeting on 9 September 2015.

8. On 21 December 2015 the Escrow Account Agreement was executed. On the same day the holding company executed a guarantee, limited to £15m, of the mining company's obligations to carry out the restoration works and on 22 December 2015 the original parent companies were released from the guarantee which they had previously given.

The Escrow Account Agreement

9. The parties to the Escrow Account Agreement are the council, the mining company and HSBC Bank Plc as the "Account Bank". By clause 3.1 of the agreement, the mining company undertook to open and maintain an account with the Account Bank designated the "Escrow Restoration Account".

10. The critical clause of the agreement for present purposes is clause 4.2, headed "Funding the Account", which provides as follows:

> "(a) Subject to paragraphs (b) and (c) below, on each Funding Date, the Company shall deposit an amount equal to £625,000 (as adjusted pursuant to paragraphs (c) and (d) below,[1] the 'Quarterly Amount') into the Account.
>
> (b) Subject to paragraphs (c) and (d) below, if on any Funding Date the Company fails to pay all or part of the Quarterly Amount into the Account (the 'Missed Funding Date'), the Quarterly Amount for the following Funding Date shall be equal to £625,000 plus the outstanding amount payable on the Missed Funding Date.
>
> (c) Subject to paragraph (d) below, if the Company fails to pay all or part of the Quarterly Amount on two or more consecutive Funding Dates, the Quarterly Amount shall increase on each subsequent Funding Date by an amount equal to the aggregate outstanding amounts on each previous Missed Funding Date.
>
> (d) If the Final Funding Date is a Missed Funding Date, the Company shall pay an amount equal to Total ERA Sum less the amount standing to the credit of the Account on the Final Funding [Date] by 30 June 2022 (the 'Funding Longstop Date')."

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[1] The reference here to "paragraphs (c) and (d) below" must on any view be a slip in the drafting and should be read as a reference to "paragraphs (b) and (c) below".

The "Funding Dates" are set out in Schedule 1 to the agreement and are a series of 24 quarterly dates beginning on 31 March 2016 and ending on 31 December 2021.

11. Clause 4.3 specifies a procedure by which withdrawals from the account may be made by agreement between the mining company and the council in accordance with a schedule for carrying out the restoration works after the "Drawdown Commencement Date". The "Drawdown Commencement Date" is defined as the date on which the mining company notifies the council that coaling has concluded and the council confirms in writing that the land reclamation scheme may commence. By clause 4.5 of the agreement, the mining company and the council agreed that all amounts standing to the credit of the escrow account should be withdrawn and applied solely in respect of the restoration works and agreed provisions for "after care".

The dispute

12. Since the Escrow Account Agreement was executed, the mining company has made no deposits at all into the escrow account. In this action the council has sought an order for specific performance to compel the mining company to do so.

13. After statements of case had been served, the council applied for summary judgment on its claim. The application for summary judgment was granted by HHJ Keyser QC sitting as a judge of the High Court for reasons given in a judgment dated 19 June 2018: see [2018] EWHC 1506 (QB). By an order dated 13 July 2018 (as later corrected), the judge ordered the mining company to pay £6,250,000 into the escrow account. This was the amount which would by then have been deposited if quarterly payments of £625,000 had been made on each Funding Date specified in the Escrow Account Agreement. It is from that order that the mining company appeals.

14. Before the judge, the mining company sought to rely on three defences to the claim, but only one of these is maintained on this appeal. This is a defence that, on the proper interpretation of the agreement, the mining company is not under an enforceable obligation to pay any money into the escrow account.

15. The judge rejected this defence as having no real prospect of success and, in my opinion, he was plainly right to do so.

The mining company's textual arguments

16. In interpreting a clause in what is plainly a professionally drafted contract, it is appropriate to start, as Mr Hugh Sims QC on behalf of the mining company did in his oral submissions, by analysing the wording. Mr Sims submitted that three features of the language used demonstrate that clause 4.2 of the Escrow Account Agreement should reasonably be understood to mean that, if the mining company does not deposit money in the escrow account on any or all of the Funding Dates, no presently enforceable obligation to make any payment into the account will arise until the Funding Longstop Date of 30 June 2022.

17. First and foremost, he relied on the words "Subject to paragraphs (b) and (c) below" at the start of paragraph (a) and the similar provisos at the start of paragraphs (b) and (c) of clause 4.2. Mr Sims submitted that these words clearly make each provision conditional on the next, which in each case specifies the contractual consequence of

failure to comply with the payment obligation. Thus, if on a Funding Date the mining company fails to comply with its obligation under clause 4.2(a) to deposit an amount of £625,000 into the account, the agreed consequence of that failure is set out in paragraph (b), which – so Mr Sims submitted – provides for the missed payment to be 'rolled forward' to the next Funding Date. Paragraph (c) is said to have a similar effect where two or more payments are missed. The only obligation which does not have such a consequence attached to it is the obligation in clause 4.2(d) to pay an amount equal to £15m (less any amount which the mining company has already deposited) into the account by the Funding Longstop Date of 30 June 2022.

18. Second, Mr Sims relied on the words "as adjusted" in clause 4.2(a). Those words, he submitted, are naturally understood to mean "as altered". They indicate that, if the mining company fails to pay the Quarterly Amount of £625,000 or any part of it into the account on a Funding Date, then the amount payable on that date will be altered in the way required by paragraphs (b) and (c) – which have the effect that the obligation to deposit the relevant amount is rolled forward to the next Funding Date.

19. The third feature of the wording emphasised by Mr Sims is the existence of the Funding Longstop Date provided for in clause 4.2(d). He submitted that there would be no need to provide for payment to be made by a "longstop" date, and no point in including such a provision, unless this was intended to be the only enforceable payment obligation if earlier payment dates have been missed. More generally, Mr Sims submitted that, unless clause 4.2 is understood as having the meaning for which the mining company contends, all its provisions are redundant apart from the obligation in paragraph (a) to deposit £625,000 into the account on each Funding Date. If that obligation were intended to remain enforceable in the event that payment is not made on the Funding Date, it is the only obligation that the council would need and the rest of the clause would be surplusage.

Textual analysis of clause 4.2

20. I agree that the words "subject to" at the start of clause 4.2(a) are reasonably understood to mean that the payment obligation imposed by that provision is conditional on the provisions which follow. I also agree that the words in brackets beginning "as adjusted" indicate that, if paragraph (b) or (c) is applicable, the "Quarterly Amount" to be deposited into the account on the Funding Date will not be the basic amount of £625,000 stated in paragraph (a) and that, instead, this figure must be "adjusted", i.e. altered, in accordance with the subsequent provisions – with the result that the amount required to be deposited on the Funding Date will be a larger sum than £625,000.

21. However, where the mining company's interpretation seems to me to break down is that it treats the clause as potentially requiring not just one but two adjustments to be made to the amount payable on a given Funding Date – with the second adjustment occurring immediately after the Funding Date has passed if the obligation to pay money into the escrow account on that date has not been performed. This interpretation is not consistent with the language of the clause and makes no commercial sense at all.

22. The point is best illustrated by an example. Suppose that (as in fact happened) the company does not deposit any money into the account on the first Funding Date of 31

March 2016 and that the amount of £625,000 that was payable on that date remains outstanding when the second Funding Date of 30 June 2016 arrives. The "subject to" and "as adjusted" wording in clause 4.2(a) requires the amount of £625,000 that must be paid on 30 June 2016 to be adjusted in accordance with paragraph (b). Since the payment due on the first Funding Date was not made, paragraph (b) requires that the amount payable on 30 June 2016 "shall be equal to £625,000 plus the outstanding amount payable on the Missed Funding Date". The amount payable on 30 June 2016 is therefore £1,250,000. So far so good. But, on the mining company's interpretation of the clause, the company's failure to pay the Quarterly Amount of £625,000 into the account on 31 March 2016 not only caused the Quarterly Amount payable on 30 June 2016 to be increased by £625,000 but also had the further consequence that the amount due on 31 March 2016 ceased to be payable. Likewise, if on 30 June 2016 the company again fails to pay any money into the account, then on the mining company's case clause 4.2 requires another adjustment to be made, retrospectively, to the amount that was payable on 30 June 2016. Having previously been adjusted upwards to £1,250,000, the Quarterly Amount payable on 30 June 2016 must now be readjusted downwards to zero.

23. I can see nothing in the language of clause 4.2 which requires such a retrospective adjustment to be made. On a plain reading of paragraph (a), the time when the "Quarterly Amount" that the company must pay into the account is to be calculated is the time when the payment must be made (i.e. on the Funding Date). The parties need to know how much money the company is obliged to pay into the account on that date, and clause 4.2(a) tells them to calculate the amount by starting with the figure of £625,000 stated in that paragraph and then making any adjustment to it required by paragraphs (b) and (c). There is nothing in the wording of paragraph (a) which says that, if the company fails to pay the amount calculated in this way into the account on the Funding Date, then that amount must be revised or written off.

24. Nor is there anything in paragraphs (b) and (c) which says that such a further adjustment must be made. To the contrary, those paragraphs provide only for the Quarterly Amount payable on the <u>following</u> Funding Date or on each <u>subsequent</u> Funding Date to be <u>increased</u>. They do not provide for the amount that <u>was</u> payable on any Missed Funding Date to be retrospectively <u>reduced</u> or extinguished.

25. The mining company's case depends upon reading such an additional provision into the clause. Its case is that, although paragraphs (b) and (c) expressly provide only for the Quarterly Amount payable on the next Funding Date to be increased by the outstanding amount if the company fails to pay the Quarterly Amount (or any part of it) on a Funding Date, those paragraphs should be read as also impliedly providing for the Quarterly Amount that was payable on the Missed Funding Date to be reduced by the same amount (although this is not expressly stated). There are, in my view, compelling reasons why it is not merely unnecessary but illogical and unreasonable to imply such a term.

Business common sense

26. The fundamental objection is one of what is often referred to as "business common sense". Put shortly, the result of implying such a provision into clause 4.2 of the agreement would be to eviscerate the company's obligation to deposit money into the account on the Funding Dates. If the only consequence of failing to pay the specified

amount on a Funding Date for any reason – including simply the company's choice not to pay – is that the amount immediately ceases to be payable until the next Funding Date, then there is in reality no binding obligation to pay any money into the account on any Funding Date. There is nothing more than the option for the company to make such payments if it pleases. It is an extraordinary and improbable intention to attribute to contracting parties that, if a party chooses not to pay a sum of money on the date when the contract says that the money must be paid, then the sum immediately ceases to be due. It is hard to see how such an arrangement could ever make any commercial sense.

27. The decision of the Supreme Court in *Arnold v Britton* [2015] UKSC 36; [2015] AC 1619 signalled a need for caution in relying on considerations of commercial common sense in interpreting contracts. In particular, Lord Neuberger emphasised that this criterion should not be invoked to undervalue the importance of the language used. It is salutary to recall that the persons best placed to judge what is a commercially sensible agreement to make are the parties who have chosen to make it, and courts should be correspondingly wary of rejecting a natural interpretation of contractual language because it appears to produce a commercially unreasonable result. But just as there are degrees of naturalness of linguistic usage, so too there are degrees of unreasonableness of result, ranging from the merely imprudent or surprising to the obviously irrational or absurd. In this case no question arises of rejecting the natural meaning of a contractual provision since there are, as I have indicated, no words in the agreement which have as their natural meaning, or which expressly state at all, that the amount to be deposited on each Funding Date ceases to be due if the company fails to pay it: the mining company's case depends on implying such a provision. Furthermore, the consequence of doing so would be to nullify the obligation created by clause 4.2(a) to deposit money into the account on each Funding Date and to treat the contract as taking away with one hand what it gives with the other. Conceptually, let alone commercially, that is an irrational intention to attribute to contracting parties.

Inconsistency with the express terms

28. The reasons why such a provision cannot be implied into the agreement are not only that the result would be irrational and contrary to business common sense. They are also that such a provision is inconsistent with the express terms of the agreement.

29. The amount which, pursuant to clause 4.2(b), must be added to the next Quarterly Amount if the company fails to make a payment on a Funding Date is not the amount which the company "failed to pay" on the Missed Funding Date. It is the "outstanding amount payable on the Missed Funding Date". Similarly, the phrase "outstanding amounts" is used in paragraph (c). If the amount payable on a Funding Date immediately ceased to be payable when the company failed to pay it, it could not accurately be described as "outstanding". The logic of the mining company's case is that, if a payment is missed, there is no outstanding amount to be added to the basic amount of £625,000 when the Quarterly Amount to be deposited on the next Funding Date is calculated in accordance with clause 4.2(a). The use of the word "outstanding" indicates that, contrary to the mining company's case, if the company fails to make a payment on a Funding Date, the liability to make it still subsists.

30. More fundamentally, as the judge pointed out, the mining company's case is inconsistent with the use throughout paragraphs (a) to (c) of clause 4.2 of the

language of obligation. The terms "shall", "fails to pay", "payable" and "outstanding" all signify that paying money into the escrow account on a Funding Date is not intended to be voluntary and a matter of choice for the company but something that it is legally obliged to do. Yet, as already discussed, an 'obligation' to pay a sum of money on a specified date which, if the 'obligor' chooses not to pay it, immediately ceases to be due until a future date is not a genuine obligation to make a payment on the specified date at all.

31. This appears to be recognised in the mining company's statement of case, as paragraph 18B of its amended defence and counterclaim asserts that "the parties did not intend there to be an enforceable obligation to pay monies into the Account and/or a remedy for a failure to pay monies into the Account" before the Funding Longstop Date. Similarly, in their skeleton argument for this appeal, counsel for the mining company recognised that on its case "in practical terms… the obligation to make payments into the Account before the Funding Longstop Date amounted to an expression of intent which was not enforceable via the court before that date." By contrast, in his oral submissions Mr Sims sought to insist that clause 4.2(a) created a genuine legal obligation and that it might somehow be prospectively enforceable through a winding up petition or some form of anticipatory order for specific performance. However, he also wanted to say that the parties have agreed that the sole consequence of failure to make a payment into the account on a Funding Date is that the obligation to pay is converted into or replaced with an obligation to make the payment on the next Funding Date.

32. The cause of the difficulty which Mr Sims encountered on this point is, I am satisfied, no fault of his. It is that the line that he was seeking to tread between not wanting to deny that clause 4.2(a) creates a legal obligation and asserting that the obligation is 'rolled forward' if it is not performed is non-existent. The two positions are irreconcilable. If the only consequence of failure to make a payment is that the date on which the payment falls due is advanced into the future, then the legal reality is that there is no enforceable obligation to make any payment on the original date. Hence counsel for the mining company were, in my view, right to recognise that the practical effect of their interpretation is that the obligation to make payments into the account before the Funding Longstop Date amounts to an expression of intent and is not an enforceable obligation at all. By the same token, the judge was right to say (in para 44 of his judgment) that, on the mining company's interpretation of the agreement, any payments made before 30 June 2022 are "merely optional" and that:

> "It is no answer to this objection to speak of 'obligation' in the Pickwickian sense in which on occasion Mr Sims used it, because that is simply to say that one has an obligation to make a payment but that, if one chooses not to make it, the obligation is cancelled…"

That in turn, I would add, is tantamount to saying that one does not actually have an obligation to make the payment at all.

Commercial purpose

33. A yet further reason for rejecting the mining company's case is that it is contrary to the commercial purpose of the escrow account. It is not in dispute that the purpose of

the arrangement is to build up a fund of money over the period that coal mining is being carried on and is generating revenue, which will then be available to pay for restoration works when coal extraction has ceased. Leaving the mining company free to choose whether to make any payments into the account until coal extraction has finished or nearly finished would defeat this purpose. It would expose the council to the risk that, by the time the obligation to establish the fund arose, the mining company would no longer be earning any income and profits previously made from its activities might have been taken out of the company, leaving it without the resources to fund the escrow account or to satisfy a judgment if the council seeks to enforce the Escrow Account Agreement.

The mining company's further arguments

34. For these reasons, it is my view untenable to read into clause 4.2 a provision that, if the company fails to pay the Quarterly Amount into the account on a Funding Date, the amount thereupon ceases to be payable. When set against the objections to implying such a provision, the mining company's arguments for doing so carry very little weight.

The duplication argument

35. One argument advanced by the mining company is that, unless the amount added to the Quarterly Amount for the following Funding Date pursuant to paragraph (b) or (c) is also subtracted from the amount that was payable on the Missed Funding Date, then, when the following Funding Date arrives, the same amount will be payable twice over. This objection is, I think, easily met. The correct analysis must be that, where the amount payable on the next Funding Date is increased because the amount that was due on the last Funding Date remains outstanding, then the amount payable on the next date includes within it the outstanding amount. Accordingly, if on the next Funding Date the full Quarterly Amount that falls due on that date is paid, then both obligations to pay the amount outstanding from the original date will have been simultaneously discharged.

The redundancy arguments

36. It can be said – and is said on behalf of the mining company – that there is no point in having such an arrangement. Why have multiple obligations to pay the same sum of money into the escrow account, when a single obligation would suffice? This is the argument based on redundancy that I mentioned earlier. A payment scheme which both maintains the liability to pay any arrears and establishes a fresh obligation which arises on each Funding Date to deposit the full outstanding amount can be said to offer no obvious advantage over a simple obligation to deposit £625,000 into the account on each Funding Date.

37. One possible advantage might be that creating a new obligation to pay the full outstanding amount on each successive Funding Date avoids any risk that an action seeking specific performance of the obligation to deposit money into the account will be met by a defence of laches if the council has taken no action while a series of Funding Dates have been missed. I readily accept, however, that this explanation probably involves attributing greater ingenuity and logic to the drafting of the clause than is warranted.

38. This explanation in any event does not account for the "longstop" provision in clause 4.2(d). It is difficult if not impossible to see what purpose is served by requiring the outstanding balance of the total sum of £15m to be paid into the account by the "Funding Longstop Date", if there is already an enforceable obligation to pay the full amount by the Final Funding Date which falls six months earlier. I therefore accept the submission made by Mr Sims that, if clause 4.2(a) creates enforceable obligations, this provision is superfluous.

39. It is, however, by no means uncommon, including in professionally drafted contracts, to find provisions which are unnecessary and could, without disadvantage to either party, have been omitted. For this reason, arguments from redundancy seldom carry great weight. Many judicial observations to that effect are collected in Sir Kim Lewison's book on *The Interpretation of Contracts* (6th edition, 2015) at para 7.03. For example, in *Arbuthnott v Fagan* [1995] CLC 1396 at 1404, Hoffmann LJ, discussing a Lloyds' agency agreement, said that "little weight should be given to an argument based on redundancy", as it is "a common consequence of a determination to make sure that one has obliterated the conceptual target." More generally, in *Total Transport Corp v Arcadia Petroleum Ltd* [1998] 1 Lloyds Rep 351 at 357, Staughton LJ, citing two judgments of Devlin J to similar effect, said:

> "It is well-established law that the presumption against surplusage is of little value in the interpretation of commercial contracts."

Sir Kim Lewison summarises the relevant principle, in terms that I would adopt, as being that "an argument based on surplusage cannot justify the attribution of a meaning that the contract, interpreted as a whole, cannot bear."

40. In the present case, as I have already emphasised, the mining company is seeking to rely on an argument based on surplusage not to attribute a particular meaning to words contained in clause 4.2 of the agreement but to read into the clause words that it does not contain. Moreover, to read such additional words into the clause would contradict its express language, defeat its commercial purpose and be wholly contrary to business common sense. In these circumstances the argument based on surplusage does not begin to justify, let alone necessitate, implying into the agreement a provision of the kind for which the mining company contends.

The "genesis" of the provision

41. I have not yet addressed an argument put at the forefront of the grounds of appeal that the judge failed to have appropriate regard in interpreting clause 4.2 to evidence of the "genesis" of the clause. This evidence consists in a passage that appears in identical terms in both the Proposal presented to the council on behalf of the mining company and the "Full Council Report" prepared by the council's chief executive which recommended acceptance of the Proposal. The passage states:

> "In the (unlikely) event that [the mining company] is unable to meet a quarterly payment, then it is agreed with [the council] to roll forward the outstanding payments, subject to the full £15 million being deposited into [the escrow restoration account] no later than six months after the final date in the "Schedule of

> Quarter Dates for Payments" detailed above, i.e. by 30 June 2022."

42. Mr Sims submitted that this passage assists in interpreting clause 4.2 because, although not exactly replicated in the contract, it shows that the object or aim of the clause was to establish an arrangement whereby, if payments were not made on the scheduled quarterly payment dates, the outstanding sums would be "rolled forward": in other words that the only consequence of missing a payment was intended to be that the date on which it was due would be advanced to the next quarter date (subject to the obligation to deposit the full £15m into the account by 30 June 2022).

43. The classic statement of the principle that evidence of the "genesis" and "aim" of the contract is admissible is that of Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381 at 1385:

> "It may be said that previous documents may be looked at to explain the aims of the parties. In a limited sense this is true: the commercial, or business object, of the transaction, objectively ascertained, may be a surrounding fact. …
>
> In my opinion, then, evidence of negotiations, or of the parties' intentions, and *a fortiori* of [one party's] intentions, ought not to be received, and evidence should be restricted to evidence of the factual background known to the parties at or before the date of the contract, including evidence of the 'genesis' and objectively the 'aim' of the transaction."

The sense in which the exercise is objective was spelt out by Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen (The "Diana Prosperity")* [1976] 1 WLR 989, 996, when he said that:

> "when one is speaking of aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have in mind in the situation of the parties."

44. The mining company contends that evidence of pre-contractual negotiations is admissible to show the "genesis" and objective "aim", not just of the transaction as a whole, but of a particular provision in a contract. As authority for this extension of the principle, reliance is placed on the following observations of Sales J in *Investec Bank (Channel Islands) Ltd v The Retail Group Plc* [2009] EWHC 476 (Ch), at para 76:

> "Accordingly, in interpreting a contract, regard may be had to the content of the parties' negotiations to establish 'the genesis and object' of a provision. This seems to me to be a relevant part of the factual matrix, since if the parties in the course of their negotiations are agreed on a general objective which is to be achieved by inclusion of a provision in their contract, that objective would naturally inform the way in which a reasonable person in the position of the parties would approach the task of interpreting the provision in question."

45. The word "accordingly" refers back to a passage quoted by Sales J from the judgment of Lawrence Collins LJ in *Chartbrook Ltd v Persimmon Homes Ltd* [2008] EWCA Civ 183, at paras 129-130. In the passage quoted, Lawrence Collins LJ cited *Jones v Bright Capital Ltd* [2006] EWHC 3151 (Ch) as an example of a case where the use of pre-contractual correspondence to aid the interpretation of a term in a contract was "justified on the basis that it showed the genesis and object of the provision and provided a ground for treating the parties as having negotiated on an agreed basis." Sales J recorded that this was agreed by the parties in the *Investec* case to correctly state a principle relevant to the construction of a contract.

46. The *Investec* case was decided before the appeal to the House of Lords in the *Chartbrook* case. On that appeal, counsel for the appellant invited the House of Lords to depart from the rule which excludes evidence of pre-contractual communications as an aid to the interpretation of a contract and to hold that such evidence is admissible where it shows that, objectively, the parties reached a consensus on a particular point. Amongst other authorities, *Jones v Bright Capital Ltd* was cited as supporting this approach, which was an approach that Lawrence Collins LJ had in principle favoured in the Court of Appeal.

47. The House of Lords declined to depart from the exclusionary rule. Lord Hoffmann (with whom the other members of the House agreed) accepted that "it would not be inconsistent with the English objective theory of contractual interpretation to admit evidence of previous communications between the parties as part of the background which may throw light upon what they meant by the language they used": see *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38; [2009] 1 AC 1101, para 33. But Lord Hoffmann also accepted that practical difficulties would potentially arise if the rule were to be abrogated or relaxed. These included the fact that:

> "It is often not easy to distinguish between those statements which (if they were made at all) merely reflect the aspirations of one or other of the parties and those which embody at least a provisional consensus which may throw light on the meaning of the contract which was eventually concluded. But the imprecision of the line between negotiation and provisional agreement is the very reason why in every case of dispute over interpretation, one or other of the parties is likely to require a court or arbitrator to take the course of negotiations into account."

Ibid at para 38. Lord Hoffmann concluded (at para 41) that there was no clearly established case for departing from the exclusionary rule, as a rule which sometimes causes relevant material to be left out of account "may be justified in the more general interest of economy and predictability in obtaining advice and adjudicating disputes."

48. At para 42 of the judgment, Lord Hoffmann summarised the exclusionary rule as follows:

> "The rule excludes evidence of what was said or done during the course of negotiating the agreement for the purpose of drawing inferences about what the contract meant. It does not exclude the use of such evidence for other purposes: for

> example, to establish that a fact which may be relevant as background was known to the parties, or to support a claim for rectification or estoppel. These are not exceptions to the rule. They operate outside it."

He went on to consider a group of cases of which the leading example was *The Karen Oltmann* [1976] 2 Lloyds Rep 708, in which evidence of pre-contractual communications had been admitted to show that the parties had negotiated on an agreed basis that certain words should bear a particular meaning. Lord Hoffmann concluded that such an exception to the exclusionary rule could not be justified and that the only legal principles on which evidence of pre-contractual communications can be admitted for this purpose are those of rectification and estoppel by convention: see *Chartbrook* at paras 43-47.

49. In *Excelsior Group Productions Ltd v Yorkshire Television Ltd* [2009] EWHC 1751 (Comm), at para 25, Flaux J found it unnecessary to decide whether the approach adopted by Sales J in the *Investec* case had survived the restatement of the exclusionary rule in *Chartbrook*, but said:

> "It seems to me that there is a very fine line between looking at the negotiations to see if the parties have agreed on the general objective of a provision as part of the task of interpreting the provision and looking at the negotiations to draw an inference about what the contract meant (which is not permissible), a line so fine it almost vanishes."

50. More recently, in *Elmfield Road Ltd v Trillium (Prime) Property Group Ltd* [2016] EWHC 3122 (Ch), affirmed by the Court of Appeal without reference to this point at [2018] EWCA Civ 1556, Mr David Halpern QC sitting as a deputy High Court judge declined to follow the *Investec* case in so far as it suggested that, in interpreting a contract, evidence of the parties' negotiations may be admitted to show the genesis and aim of including a particular provision in a contract. In his view (at para 52):

> "The genesis and aim of a particular provision may be sufficiently important to qualify as part of the genesis and aim of the whole transaction. If so, it will be admissible pursuant to *Prenn v Simmonds*; if not, it is contrary to *Prenn v Simmonds* to allow it to be admitted."

Sir Kim Lewison considers this approach to be correct (see *The Interpretation of Contracts*, 2017 supplement, at 3.09), and so do I.

51. In my view, the relevant principles of law are clear in the light of the decision of the House of Lords in the *Chartbrook* case and can be summarised as follows.

52. It is established law that, as stated by Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381, 1384-5, previous documents may be looked at to show the surrounding circumstances and, by that means, to explain the commercial or business object of a contract. No doubt was cast on that principle in the *Chartbrook* case and the passage from the judgment of Lord Wilberforce which includes this proposition was cited with approval in *Arnold v Britton* [2015] UKSC 36; [2015] AC 1619, para 15, and *Wood v*

Capita Insurance Services Ltd [2017] UKSC 24; [2017] AC 1173, para 10. It is an approach which, as Lord Wilberforce noted, can be traced back at least to Lord Blackburn's judgment in *River Wear Commissioners v Adamson* (1877) 2 App Cas 743, 763, which emphasised the importance in construing written instruments of "seeing what the circumstances were with reference to which the words were used, and what was the object, appearing from those circumstances, which the person using them had in view …"

53. The phrase "genesis and aim of the transaction" is a composite phrase taken by Lord Wilberforce from the judgment of Cardozo J in *Utica City National Bank v Gunn*, 222 NY 204 (1918), a decision of the New York Court of Appeals, which Lord Wilberforce described as following "precisely the English line" and as a judgment which "combines classicism with intelligent realism": see *Prenn v Simmonds* [1971] 1 WLR 1381, 1384F. The approach followed by Cardozo J was, by considering the circumstances which led to the execution of the contract, to identify the purpose of the transaction and to construe the language used in the light of that purpose. Cardozo J concluded (at 208):

> "To take the primary or strict meaning is to make the whole transaction futile. To take the secondary or loose meaning, is to give it efficacy and purpose. In such a situation, the genesis and aim of the transaction may rightly guide our choice."

54. Lord Wilberforce clearly saw no conflict between this approach and the rule, reaffirmed in *Prenn v Simmonds*, that evidence of negotiations, or of the parties' intentions, ought not to be received. (It is equally clear that Lord Blackburn had seen no such conflict, as Lord Hope observed in the *Chartbrook* case at para 4.) What is not permissible, as the decision of the House of Lords in the *Chartbrook* case confirms, is to seek to rely on evidence of what was said during the course of pre-contractual negotiations for the purpose of drawing inferences about what the contract should be understood to mean. It is also clear from the *Chartbrook* case that it is not only statements reflecting one party's intentions or aspirations which are excluded for this purpose but also communications which are capable of showing that the parties reached a consensus on a particular point or used words in an agreed sense. The exclusion of such evidence was justified in the *Chartbrook* case, not on the ground that it will always or necessarily be irrelevant, but because of the costs and other practical disadvantages that would result from relaxing the rule and because the "safety devices" of rectification and estoppel will generally prevent the exclusionary rule from causing injustice.

55. I would accept that there may be borderline cases in which the line between referring to previous communications to identify the "genesis and aim of the transaction" and relying on such evidence to show what the parties intended a particular provision in a contract to mean may be hard to draw. The present case, however, is not one of them. In my view, it very well illustrates this distinction.

56. I have summarised at paragraphs 2 to 7 of this judgment the circumstances which led to the execution of the Escrow Account Agreement. It is apparent from those circumstances that the commercial purpose of the transaction was to establish a fund of money which would provide security for the mining company's obligations to carry out restoration works. Although this aim could be inferred simply from the various

transaction documents themselves, it is permissible to look at the Proposal and the Full Council Report as evidence for it. Not only do those documents contain a useful summary of the background to the establishment of the escrow account, but they expressly record that the aim of the transaction was to establish a cash escrow fund for the purpose of securing £15m of the restoration costs.

57. By contrast, the passage in the Proposal and in the Full Council Report on which the mining company seeks to rely does not shed any light on the commercial purpose of establishing the escrow account. It is, at best, evidence of a provisional agreement about one aspect of the proposed arrangements for funding the account. It indicates that the parties had a common intention regarding what should happen in the event that the mining company was unable to make a quarterly payment into the account because its mining operations had not generated sufficient cash to fund the payment. The expressed intention was that, in such an event, payments would be "rolled forward", provided that the full £15m was deposited into the account by the date which in the contract became the "Funding Longstop Date".

58. The only possible reason for introducing this evidence, as it seems to me, is to advance an argument that clause 4.2 of the Escrow Account Agreement should be interpreted as bearing a meaning which is consistent with the intention expressed during the negotiations and, in particular, that the clause should be interpreted as providing for a quarterly payment to be "rolled forward" in the event that it is not made on the due date. This is precisely the kind of reasoning which is prohibited by the exclusionary rule.

59. As is almost invariably the case, the reasoning which the rule excludes in this case would not justify the desired conclusion even if it could properly be entertained. As mentioned, the premise of the provisional agreement to "roll forward the outstanding payments" was that the mining company "is unable to meet a quarterly payment". On any view this is not an occurrence addressed by clause 4.2, which says nothing about what is to happen if the mining company is unable, because of insufficient operating profits or for any other reason, to pay the amount due on a Funding Date. Rather, clause 4.2 includes provision for what is to happen if on any Funding Date the company "fails to pay all or part of the Quarterly Amount" into the account. This provision covers failure to pay for any reason, whether it be inability to pay or simply that the company chooses not to make the payment because it does not wish to make it. There is no reason to infer that, when the relevant event is not inability to pay but a choice not to pay even though the company has the funds available, the intended consequence will be the same.

60. Furthermore, the phrase "roll forward" – which is itself imprecise – is not one used in the contractual document. In circumstances where clause 4.2 uses different language to address a situation which is materially different from that contemplated in the Proposal, no inference can reasonably be drawn from the Proposal about what reasonable people in the situation of the parties would have intended the words of clause 4.2 to mean. Construing the clause objectively simply leads to the conclusion that the previously expressed intention as to how the funding arrangements would operate was superseded by a different provision.

61. I therefore consider that the material on which the mining company seeks to rely as evidence of the "genesis" of clause 4.2 is not admissible as an aid to interpretation

and, even if it were admissible, would provide no guidance as to the meaning of the clause.

Conclusion

62. For these reasons, I think it clear that, on the proper interpretation of the agreement, the mining company is under a current and continuing obligation to make quarterly payments into the escrow account which the judge was right to enforce by an order for specific performance. I would therefore dismiss the appeal.

Lord Justice David Richards:

63. I agree.

Lord Justice Longmore:

64. I also agree.

ORDER

UPON the Appellant's appeal of the orders dated 19 June 2018 and 13 July 2018 (filed with the Civil Appeals office on 31 July 2018) with permission of Lord Justice Longmore dated 14 September 2018 (the **Appeal**)

AND UPON hearing Hugh Sims QC and Oliver Mitchell for the Appellant and Matt Hutchings QC and Shomik Datta for the Respondent

IT IS ORDERED THAT

1. The Appeal is dismissed

2. The Appellant shall pay the Respondent's costs of the Appeal, to be assessed in detail, if not agreed.

Dated this 28th day of March 2019