SQUIRE PATTON BOGGS

International Commercial Disputes

The Principle of Futility in Contractual Construction

***(1) Astor Management AG; and (2) Astor Recourses AG -v- (1) Atalaya Mining Plc; (2) Atalaya RioTinto Mineral SL; (3) Emed Holdings (UK) Limited; and (4) Emed Marketing Limited* [2017] EWHC 680 (Comm)**

The Honourable Justice Leggatt: "There is, in my opinion, no principle of law or even interpretive presumption which enables a contractual precondition to the accrual of a right or obligation to be disapplied just because complying with it is considered by the court to serve no useful purpose."

The Background Facts

The litigation arose out of an agreement relating to the ownership and exploration of a copper mine in southern Spain, known as the Rio Tinto Project (the "Master Agreement").

Under the Master Agreement, the claimants agreed to give up their 49% stake in the Rio Tinto Project and their right to claim ownership of it, in return for payment of up to €63.3 million.

At the time the Master Agreement was entered into, the copper mine was dormant, but potentially very valuable. The mine had 123 million tonnes of proven and probable reserves.

As the mine was dormant, no revenue was being generated. It was therefore agreed that most of the payment under the Master Agreement was to be deferred until production could commence.

Under Clause 6(b) and Schedule 2 of the Master Agreement, the deferred consideration was to be paid on the following schedule:

First Payment Date: €17,533,382.70 within 30 business days of the date on which:

- Authorisations to restart mining activities in the Rio Tinto Project were granted
- Senior debt finance and related guarantee facilities for a sufficient sum to restart mining operations was secured ("Senior Debt Facility")
- The Senior Debt Facility could be effectively drawn down on

Second Payment Date: €13,175,000 within 20 business days of the first anniversary of the restart of the mining activities.

Third Payment Date: €13,175,000 within 20 business days of the second anniversary of the restart of the mining activities.

The parties had originally expected that the permits to restart mining would be granted by end of 2009. Unfortunately, the process took far longer and it was not until 16 July 2015 that the permit approvals were granted.

During this period, efforts were made to secure the Senior Debt Facility, including discussing the matter with various banks, as well as appointing brokers and an investment bank. However, due to the delay in obtaining the necessary permits, substantial costs amounting to €73 million were incurred in maintaining the mine site and getting it into a condition which satisfied the necessary requirements of the requisite permits.

As a result, it no longer became financially feasible to obtain funding through the Senior Debt Facility. Instead, the funds were raised through the issuance of equity.

The equity fundraising was completed on 23 June 2015, mining restarted on 31 July 2015 and, by late 2016, the mine had achieved a production rate of 9 million tonnes per year.

The "Principle of Futility"

Although it was agreed that the first precondition of payment was met, namely the necessary permits were granted, the defendants argued that because Senior Debt Finance was not the method of financing used, the second condition for payment had not been met. As such, neither the First Payment Date nor any other payment date for the deferred consideration arose. The deferred consideration was, therefore, in the defendant's opinion, not payable.

The claimants, on the other hand, argued that, to make commercial sense of the Master Agreement, the payment conditions should only be applicable for as long as was necessary to restarting mining operations. If the Senior Debt Facility was no longer required because sufficient sums had been raised using equity fundraising, compliance with that condition would be pointless and unnecessary.

In support of this proposition, the claimants relied on what they described as a "principle of futility" in the interpretation of contracts. The principle, they said, was that, "if the fulfilment of a precondition to the accrual of a contractual right becomes futile or unnecessary, the courts do not insist upon it".

In support of this proposition, the claimants referred to a number of cases, including the case of *Barret Bros v Davies* [1966] 1 WLR 1334, where an insured had failed to comply with a condition of a motor insurance policy requiring him to forward to the insurers any notice of prosecution arising from an accident. The policy provided that fulfilment of the policy conditions was a condition precedent to the liability of insurers. In concluding that the insurers had waived the requirement to provide notice, Lord Denning stated: "Seeing that they had received the information from the police, it would be a futile thing to compel the [insured] to give them the self-same information. *The law never compels a person to do that which is useless and unnecessary"* (our emphasis).

In addition to the principle of futility, the claimants argued that the parties plainly did not contemplate that mining might be restarted through funding which did not take the form of Senior Debt Finance. If the parties had contemplated this possibility, they would have intended that, in such a situation, the only precondition to payment of the deferred consideration would be the grant of permit approval.

In arguing this position, the claimants relied on the principle advocated in *Arnold v Britton* [2016] AC 1619 where Lord Neuberger stated:

"…in some cases, an event subsequently occurs which was plainly not intended by the parties, judging from the language of their contract. In such a case, if it is clear from what the parties would have intended, the court will give effect to that intention"

Arnold v Britton

Arnold v Britton was a recent Supreme Court judgement regarding a litigation which arose out of the interpretation of a service charge provision contained in leases entered into between the years 1970 and 1991. In that case, it was argued by the landlord that the service charge provision in the leases required the tenants to pay an initial service charge of £90, which increased by 10% each year.

The Supreme Court, taking a literal approach, agreed with the landlord. This was in spite of the disastrous commercial outcome for the tenants and would mean that each tenant would end up paying, by the end of the lease period, service charge payments totalling more than £11 million. Viewing the commercial reality another way, assuming that a lease was granted in 1980, the service charge payment would have increased from £90 in 1980 to £2,500 in 2015. By 2072, the service charge would be £550,000.

Lord Neuberger, giving the leading judgement, confirmed that, when construing a commercial contract, the court must consider: (i) the natural and ordinary meaning of the clause; (ii) any other relevant provisions of the contract; (iii) the overall purpose of the clause and the contract; (iv) the facts and circumstances known or assumed by the parties at the time the contract was executed; and (v) commercial common sense; but (vi) disregard subjective evidence of any party's intentions.

In doing so, Lord Neuberger emphasised that:

1. Whilst, in some cases, reliance must be placed on commercial common sense and surrounding circumstances, such reliance should not be invoked to undervalue the importance of the language of the provision which is to be construed.
2. Commercial common sense cannot be invoked by reference to facts which arose after the contract was made; it is only relevant to ascertaining how matters would or could have been perceived by the parties, or reasonable people in the position of the parties, as at the date that the contract was made. The fact that an arrangement has worked out badly or even disastrously is not a reason for departing from the natural meaning of the language.
3. While commercial common sense is a very important factor to take into account when entering into a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed.
4. When interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time that the contract was made, and which were known or reasonably available to both parties.
5. When considering centrally relevant words, the less clear they are, the more ready the court can be to depart from their natural meaning. However, that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning.

The High Court Judgement

In considering the claimants' arguments, the High Court first *rejected* the existence of any principle of futility.

In doing so, the High Court held that any reference to "futility" in the case of *Barret Bros v Davies* [1966] 1 WLR 1334, had been interpreted by later cases as *obiter dicta*, which ought not to be followed.

Further, in each of the cases relied on by the claimants, namely *Balbosa v Ali* [1990] 1 WLR 914 and *Mansel Oil v Troon Storage Tankers* [2008] EWHC 1269 (Comm), the High Court found that the decisions had been based on the interpretation of the particular contract and not any general principle of futility.

Concluding that no principle of futility existed, the court subsequently interpreted the deferred payment schedule in the Master Agreement in light of the principles set out in *Arnold v Britton*.

The High Court held that they could not accept the possibility that restarting mining could be financed by means other than senior debt finance was not within the contemplation of the parties when they made their contract. The Master Agreement had all the hallmarks of a professionally drafted contract made by sophisticated commercial parties. The parties, the court said, would have known and have well in mind that senior debt finance is not the only possible way of funding a mining project. If the parties had intended that the deferred payment would become payable once finance of any kind in a sum sufficient to restart mining operations was secured, then the Master Agreement would have said so.

In adopting the literal approach, the court held that the language used specifically made payment conditional on securing a particular type of finance in the form of the Senior Debt Facility. That, the court said, was plainly a deliberate choice and the bad bargain received by the claimants as a result was not a reason for the court to rewrite the Master Agreement and dispense with a requirement that was expressly made to be a precondition to the deferred payments.

Comment

It seems from this judgement, and that of the recent Supreme Court decisions in *Arnold v Britton* and *Marks and Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey Ltd)* [2015] UKCS 72 (for which see our commentary) , that the courts have moved to applying a strict literal approach to the interpretation of commercial contracts.

This does not, however, mean that commercial considerations are no longer important when construing a commercial contract. In fact, in this case, the High Court expressly considered the commercial considerations of the parties and in doing so found that it was in the commercial interest of the claimants to limit the method of fundraising to Senior Debt Finance. This being as, under the Master Agreement, part of the payment to the claimant took the form of shares. If more shares were subsequently issued to other investors, the claimants' shares would have been diluted, which is in fact what happened after the equity fundraising; the claimants' shares in the entity with ownership of the Rio Tinto Project were diluted from 16% to less than 1%. It was, therefore, in the interests of the claimants to limit the source of financing in the manner they did – and when a party takes a risk, they must live with the consequences arising from it.

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