Not just any contract…

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examine the implication & construction of contract terms following *Marks & Spencer*

IN BRIEF

- The importance of the traditional tests for implied terms.
- Commercial parties should not rely on the courts to correct contracts.

The circumstances in which courts will imply a term into a commercial contract and the Hoffmann approach to contractual interpretation has been a matter of controversy between practitioners, academics and even between judges in recent years. *Marks & Spencer v BNP Paribas Securities* [2015] UKSC 72, [2016] 4 All ER 441 gave the Supreme Court an opportunity to clarify this vital area of the law of contract. But has the Supreme Court's gentle rejection of Hoffmann's unitary theory of contractual construction taken the courts into calm or stormy waters in the months following its definitive rulings?

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Implied rent rebate?

The question in *Marks & Spencer* was whether a rent rebate had to be implied into a carefully drafted commercial lease. Annual rent was payable in equal quarterly instalments in advance. The break clause permitted termination in January 2012 by giving six months' prior written notice. However on that break date, there could be no arrears of rent and M&S had to pay one year's rent as a break premium. Notice was duly given and the rent and break premium paid in December. This meant that M&S had paid to March but the lease terminated in January. M&S claimed that the lease must imply repayment in such circumstances. The High Court found it was indeed unreasonable to overpay on the rent and implied the term, but the Court of Appeal and the Supreme Court reversed that determination.

The Supreme Court reviewed recent case law and confirmed the traditional approach that a term can only be implied if it is necessary to give business efficacy to the contract (*The Moorcock* (1889) 14 PD 64, [1886-90] All ER Rep 530) and/or if at the time the contract was being negotiated the parties would both have said it was too obvious to mention (*Reigate v Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592, [1918-19] All ER Rep 143). The Supreme Court endorsed the five overlapping conditions for an implied term:

i. it must be reasonable and equitable;
ii. 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;
iii. it must be so obvious that "it goes without saying";
iv. it must be capable of clear expression; and
v. it must not contradict any express term of the contract.

The courts hesitate to infer what the parties must have intended when they have entered into a lengthy and carefully-drafted contract because any omission may be oversight or deliberate. A similar strict approach is taken to the exercise of contractual construction. The courts do not "easily accept that people have made linguistic mistakes, particularly in formal documents", and that it "clearly requires a strong case to persuade the court that something must have gone wrong with the language" (*Chartbrook v Persimmon Homes* [2009] UKHL 38, [2009] 4 All ER 677). Not only must there be such a strong case, it must further also "be clear what correction ought to be made to cure the mistake". If faced with a contractual provision that can be seen to be ambiguous in meaning, with one interpretation leading to an apparent absurdity and the other to a commercially sensible solution, the court is likely to favour of the latter. Such an approach can, however, only be adopted in a case in which the language of the provision is truly ambiguous and admits of clear alternatives as to the sense the parties intended to achieve (*Prophet v Huggett* [2014] EWCA Civ 1013, [2014] IRLR 797). If a commercial party enters into a bad bargain, he cannot expect the courts to extract him from his obligation just because the outcome is unreasonable.

Implication with the benefit of hindsight

In the same way the Supreme Court held back the liberal trend towards implying a term where otherwise the contract may have unreasonable effects on a party. When a court approaches the task of implication with the benefit of hindsight, it must not be tempted to fashion a term which will reflect the merits of the situation as they then appear. *Cavanagh v Secretary of State for Work and Pensions* [2016] EWHC 1136 (QB), [2016] IRLR 591 refused to imply a term that the government had a power to terminate deductions of trade union subscriptions from salary on reasonable notice. The judge commented that "the fact that the defendant finds the arrangement costly or inconvenient does not begin to show that the implication of such a term is necessary in order to give the contract business efficacy".

Lord Neuberger offers a useful restatement of the principles for implication of contractual terms:

i. The implication of a term is not critically dependent on proof of an actual intention of the parties when negotiating the contract. If one approaches the question by reference to what the parties would have agreed, one is not strictly concerned with the hypothetical answer of the

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actual parties, but with that of notional reasonable people in the position of the parties at the time at which they were contracting.

ii. A term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them. Those are necessary, but not sufficient grounds for including a term.

iii. However, it is questionable whether reasonableness and equitableness, will usually, if ever, add anything: if a term satisfies the other requirements, it is hard to think that it would not be reasonable and equitable.

iv. Business necessity and obviousness can be alternatives. Only one of them needs to be satisfied although normally both will be satisfied.

v. If one approaches the issue by reference to the officious bystander, it is vital to formulate the question to be posed by him with the utmost care.

vi. Necessity for business efficacy involves a value judgment. The test is not one of "absolute necessity"—a term can only be implied if, without the term, the contract would lack commercial or practical coherence.

The last point was applied in *Phoenix Developments (JPJ) Ltd v Lancashire CC* [2016] UKUT 38 (LC), where the suggestion that a term must be implied concerning the determination of the purchase price in an option agreement was rejected. The principle was also applied in *Monde Petroleum SA v WesternZagros Ltd* [2016] EWHC 1472 (Comm), [2016] All ER (D) 179 (Jun) where the court refused to imply a term that the party would not terminate the contract in bad faith. The contract was coherent without such a term and a contractual right to terminate could be exercised irrespective of the party's reasons for doing so. The court also stressed that subjective evidence, such as the parties' intention as to the meaning of words used, could not be taken into account. This last point was also applied in *Marussia Communications Ireland Ltd v Manor Grand Prix Racing Ltd* [2016] EWHC 809 (Ch), [2016] All ER (D) 92 (Apr). The parties' subjective thoughts and intentions are irrelevant.

Retreat on unitary approach

Marks & Spencer also saw some retreat on Lord Hoffmann's unitary approach to contractual construction and implication of terms. Traditionally approached as two different legal exercises, Lord Hoffmann formulated the theory that construction and implication were in fact two sides of the same coin. In *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 2 All ER 1127, he famously held that there is only one question: what the instrument, read as a whole against the relevant background, would reasonably be understood to mean.

The Supreme Court made two points in relation to this approach. Lord Hoffmann's formulation must not be interpreted as suggesting that reasonableness alone is a sufficient ground for implying a term. The reasonable reader must always be treated as reading the contract at the time it was made and it will only be reasonable to imply if that reader would consider the term to be so obvious as to go without saying or to be necessary for business efficacy.

The second point to be made about what was said in *Belize Telecom* concerns the suggestion that the process of implying a term is part of the exercise of interpretation. It is now clear that Lord Hoffmann's analysis in *Belize Telecom* does not mean that construing the words used and implying additional words are governed by the same test. They are different processes governed by different rules. It is unhelpful to classify the exercise of implication as merely part of the exercise of interpretation, particularly as that might suggest it should be carried out at the same time as interpretation. It should not.

Although construing the words which the parties have used in their contract and implying terms into the contract, both involve determining the scope and meaning of the contract and so are both part of construction of the contract in a broad sense, the Supreme Court has decisively ruled that they are subject to different processes, with different approaches. But that is not to say that the two tests are radically different. The strict approach to deciding whether "something has gone wrong with the language" in *Chartbrook* only where it is obvious what the parties intended to say is consistent with the strict approach to implying something into the contract only when it is obvious what has been left out.

> *"Where does that leave contract lawyers? Some would say in a strong position to attract more work"*

Belize Telecom overruled

However tactfully worded, *Marks & Spencer* effectively overrules *Belize Telecom*. The tests for construction of express terms and implication of terms, while related, are different in important respects and must be addressed sequentially. The Supreme Court has declared that Lord Hoffmann's observations "should henceforth be treated as a characteristically inspired discussion rather than authoritative guidance on the law of implied terms".

Comment

Where does that leave contract lawyers? Some would say in a strong position to attract more work as commercial clients know that the courts will not step in to save them from bad bargains or unreasonable results and that it is vital to draft contracts with care, ensuring that the words used reflect the intention of the parties making the deal. *Marks & Spencer* and the line of cases that has followed this year emphasise the primacy of the black letter words of a contract and the limits to the circumstances where the courts will step in to re-write language that has gone wrong or insert clauses that have been omitted. The advantage is that English law is more predictable when the express words of the agreement will normally be enforced and there are tight controls on judicial interference when deals do not turn out as the parties expected. **NLJ**

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