Buy one get one free

Dov Ohrenstein investigates a recent case of implied terms

Dov Ohrenstein is a member of Radcliffe Chambers, Lincoln's Inn

'A term will only be implied (other than if required to be implied by statute) if it satisfies the test of business necessity or it is so obvious that it goes without saying.'

The decision of the Supreme Court in *Marks & Spencer plc v BNP Paribas Securities Services Trust Company Ltd* [2015] should be of interest to anyone considering the question of how and when a court will imply terms into contracts.

The facts

The case concerned the exercise of a tenant's break clause. The conditions for the exercise by Marks & Spencer of such a clause were the payment of a break fee of £919,000 and that the rent (which was payable quarterly in advance) was not in arrears on the break date. The break fee was paid and the rent was prepaid for a full quarter although the effect of the break clause was to terminate the lease before the end of the relevant quarter. The Supreme Court unanimously rejected Marks & Spencer's claim that there was an implied term in the lease that it would be entitled to a refund for the overpaid rent. The landlord therefore received (in addition to the break fee) a windfall upon the exercise of the break clause in respect of rent for the period after the termination of the lease. Those involved in the drafting of leases will doubtless consider the implications of this decision carefully and (if advising a tenant) will try to ensure break dates are immediately before the expiry of rental period or else negotiate appropriate express wording to ensure an apportionment, so that overpaid rent is refunded if a break date is not immediately before a rent day.

Implied terms

What is of more general importance about the *Marks & Spencer* decision is the detailed review by Lord Neuberger (with whom Lord Sumption and Lord Hodge agreed) of the case law and principles concerning the implication of terms into contracts and the rejection of the suggestion (contrary to the views of some judges and of many academic commentators) that the judgment in the Privy Council case *Attorney General of Belize v Belize Telecom* [2009] diluted the test for the implication of contractual terms.

Attorney General of Belize was a dispute relating to the construction of articles of association of a telecommunications company. Although it was a decision of the Privy Council, so merely a persuasive authority which was not strictly binding, it has been followed by English courts on countless occasions. In *Attorney General of Belize* Lord Hoffman summarised the test as to whether a term is to be implied as follows:

> ... in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean.

According to Lord Hoffman, other tests for implying terms, such as the requirement that the proposed implied term must be necessary to give business efficacy to the contract, or the 'officious bystander' test, should not be treated 'as if they had a life of their own'. He considered that:

> ... danger lies... in detaching the phrase 'necessary to give business efficacy' from the basic process of construction of the instrument.

Lord Hoffman's judgment in *Attorney General of Belize* must now be qualified and treated with caution and not as an authoritative statement of the current law.

Reasonableness

Lord Neuberger emphasised in *Marks & Spencer* that reasonableness alone is not a sufficient ground for implying a term. In considering the judicial principles of the law of implied terms and reviewing the cases prior to *Attorney General of Belize*, which 'represent a clear, consistent and principled approach', Lord Neuberger quoted the following summary provided by Lord Simon in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977):

> 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.

Lord Neuberger pointed out that the first of Lord Simon's requirements in the above summary, ie reasonableness and equitableness, will rarely, if ever, add anything as if a term satisfies the other requirements it is hard to think that it would not be reasonable and equitable to imply it. He further said that the second and third requirements (business efficacy and obviousness) can in theory be alternatives but in practice it would be a rare case where a term would be implied that only satisfied one of them. He also stated that the business efficacy test involves a value judgement as the test is not one of 'absolute necessity', and that a more helpful way of putting the test would be to say that 'a term can only be implied if, without the term, the contract would lack commercial or practical coherence'.

According to Lord Hoffman, other tests for implying terms, such as the requirement that the proposed implied term must be necessary to give business efficacy to the contract, or the 'officious bystander' test, should not be treated 'as if they had a life of their own'.

In *Attorney General of Belize* Lord Hoffman had also said that the process of implying terms into a contract was part of the construction or interpretation of the contract. Lord Neuberger in *Marks & Spencer* disagreed and said that 'construing the words used and implying different words are different processes governed by different rules'. Lord Neuberger went on to say that:

> In most, possibly all, disputes about whether a term should be implied into a contract, it is only after the process of construing the express words is complete that the issue of an implied term falls to be considered. Until one has decided what the parties have expressly agreed, it is difficult to see how one can set about deciding whether a term should be implied and if so what term... Further, given that it is a cardinal rule that no term can be implied into a contract if it contradicts an express term, it would seem logically to follow that, until the express terms of a contract have been construed, it is, at least normally, not sensibly possible to decide whether a further term should be implied.

Lord Neuberger tactfully said that:

> ... [i]n those circumstances, the right course for us to take is to say that those observations [of Lord Hoffman in *Attorney General of Belize*] should henceforth be treated as a characteristically inspired discussion rather than authoritative guidance on the law of implied terms.

Although Lord Carnwath and Lord Clarke attempted to water down the criticism of Lord Hoffman's approach in *Attorney General of Belize*, the majority of the Supreme Court in *Marks & Spencer* agreed with Lord Neuberger.

The current state of the law on implication of terms can therefore be summarised as follows:

- The question of implication of terms should normally only be addressed after the express words are construed.
- A term will only be implied (other than if required to be implied by statute) if it satisfies the test of business necessity or it is so obvious that it goes without saying.
- The implication of a term is not critically dependent on proof of the actual intention of the parties. Instead of the question as to what the parties would have agreed, one is concerned with the hypothetical answer of notional reasonable people in the position of the parties at the time they were contracting.
- It is a necessary but not sufficient condition for implying a term that it appears fair or that one considers that the parties would have agreed it if it had been suggested to them.

It is only correct to say that a term will be implied if a reasonable reader of the contract, knowing all its provisions and the surrounding circumstances, would understand it to be implied, provided that:

- the reasonable reader is treated as reading the contract at the time it was made; and
- they would consider the term to be so obvious as to go without saying or to be necessary for business efficacy.

Conclusion

The approach of the majority of the Supreme Court in *Marks & Spencer* to the question of implication of contractual terms has clear similarities to the approach Lord Neuberger (again as part of a majority) took a few months ago in *Arnold v Britton* [2015]. There he gave guidance on the question of construction of contracts rather than on the implication of terms. *Arnold* concerned service charge provisions which increased at a compound rate of 10% each year with the effect that a service charge of £90 per annum in 1974 would rise to £1,025,004 by 2072. The ordinary meaning of the provisions was upheld regardless of the obvious unfairness. Endorsing a literal rather than a purposive approach, Lord Neuberger made clear that:

> ... reliance placed in some cases on commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed.

It is a necessary but not sufficient condition for implying a term that it appears fair or that one considers that the parties would have agreed it if it had been suggested to them.

In the light of the Supreme Court's decisions in *Marks & Spencer* and *Arnold*, parties and their advisers should recognise the increasing difficulty in arguing against the literal interpretation of contracts. Although, as pointed out in *Arnold*, the worse the drafting the more ready a court may be to depart from the natural meaning of contractual language, the current judicial trend is firmly against departing from the natural meaning of contractual terms so as to make them more reasonable, whether by construing the language in an unnatural manner or by implying terms. ■

Arnold v Britton & ors
[2015] UKSC 36

Attorney General of Belize & ors v Belize Telecom Ltd & anor
[2009] UKPC 10

BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings
[1977] UKPCHCA 1

Marks & Spencer plc v BNP Paribas Securities Services Trust Company Ltd & anor
[2015] UKSC 72