Marks & Spencer PLC -V- BNP Paribas Securities Services Company (Jersey) LTD [2015] UKSC 72

Gareth McAloon

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Introduction

Implying terms into a contract is a facet of contract law which has come in for Supreme Court scrutiny in the last few weeks when the court handed down judgment in *Marks & Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited and another [2015] UKSC 72*. Forever a source of controversy, and therefore a constant source of litigation, a proper understanding of the law of implied terms is crucial to anyone even remotely connected with a commercial practice.

The focus of this article will be on distilling the principles which have evolved through the case law on this topic in recent decades and which have culminated in the *M&S* judgment which now represents the common law. As will become clear, the *M&S* judgment is not without its own issues and is unlikely to have the effect of quelling litigation on this subject, but it now represents the starting point for any commercial lawyer who has a case involving the implication of a contractual term.

An historical overview

The law of implied terms has been a subject of consistent judicial authority over the years with the Courts having framed the test for whether a term should be implied into a contract in many guises. For example in *Shirlaw v Southern Foundries (1926) Ltd [1939]*, Mackinnon LJ determined that a term can be implied into a contract where it is:

> *"... something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common "Oh, of course!"*

Moving forward half a century, Lord Simon in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings (1977) 180 CLR 266*, delivered the following formulation of the test:

> *"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."*

Following this, the then Master of the Rolls, Sir Thomas Bingham, heard the case of *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd [1995] EMLR 472*, re-evaluated Lord Simon's test in *BP Refinery*. At page 481 of his judgment he detracted from Lord Simon's test stating that it could mislead parties due to its simplicity. In particular, it was held that in deciding whether or not to imply a term into a contract, significant caution

should be exercised where the contract was drafted against a back-drop of fully advised parties, who entered into a carefully drafted, and comprehensive contract. He surmised in particular that it would be:

> *"….difficult to infer with confidence what the parties must have intended when they have entered into a lengthy and carefully-drafted contract but have omitted to make provision for the matter in issue [because] it may well be doubtful whether the omission was part of the parties' oversight or of their deliberate decision"*

Accordingly, at page 482 he held:

> *"….it is not enough to show that had the parties foreseen the eventuality which in fact occurred they would have wished to make provision for it, unless it can also be shown either that there was only one contractual solution or that one of several possible solutions would without doubt have been preferred…"*

Lord Hoffmann then re-visited the test in the Privy Council decision of *Attorney General of Belize v Belize Telecom Limited [2009] UKPC 10*. Drawing all of the previous case law together, he held that a more generalised test should be deployed which took account of a broad range of circumstances of the case. As such, at paragraph 21 of his judgment he concluded:

> *"…there is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"*

In *Jackson v Dear [2013] EWCA Civ 89* the position after the Belize was debated, both by Briggs J at first instance in the High Court (*see [2012] EWHC 2060 (Ch)*) and in the Court of Appeal where McCombe LJ held:

> *"….one has to ask whether the consequences would contradict what a reasonable person would understand the contract to mean… I would take the proper touchstone of that proposition to be the consequences would contradict what "any" (rather than "a") reasonable person would understand the contract to mean… As for commercial common sense enabling a choice between alternative interpretations, opinions as to commercial common sense in any given situation may also differ between reasonable people. In such circumstances, there is no room for implication"*

Distilling these judgments down it appears that there are, to some extent at least, consistent trends and themes in the Courts approach which compete with one another. It begins in *Shirlaw* with the officious bystander test which seeks to determine whether or not the implied term sought would be so obvious that it ought to be allowed. By *BP Refinery* the test had evolved, though with the same origins in *Shirlaw*, so that it had the context of business efficacy and the concept of necessity added to it. Under *Philips* the focus had shifted to what the parties would reasonably have agreed to had the parties foreseen the circumstance which now gives rise to the argument for

the implication. This 'shift' still requires an objective assessment but the necessity element of the test seems to have been, to some extent, supressed since where the contract has been carefully drafted and negotiated, the bar for implication is set high. Following *Belize* the general nature of the test was stated which, in this author's opinion, did not change the law but merely summarised it more succinctly in one question to be asked. That test required consideration of reasonableness, business efficacy and necessity, and included the thrust of the judgment from *Philips* in terms of what would have been the likely intention of the parties had they known then what they known now. This is how the test was then interpreted in *Jackson v Dear* by the Court of Appeal - again in this author's view.

The *M&S* Decision

The *M&S* decision was handed down on 2nd December 2015 with the lead judgment being given by Lord Neuberger. The case concerned the Claimant's argument to imply into a commercial lease agreement a term which required the landlord (Respondent) to credit the tenant (Appellant) with rents paid in advance for a quarter during which the tenant had vacated the premises validly under the lease by giving notice to the landlord. Essentially, the lease was concerned with a commercial shop unit which the tenant had leased. The rent was payable per quarter in advance for the following quarter. Under the terms of the lease, if either party wished to determine it prior to its expiration, then they had to perform certain obligations. For the tenant, those obligations were to serve a break notice on the landlord to determine the lease on one of the 'break dates' provided for - the break date in question was 24th January 2012. The second obligation was for the tenant to pay to the landlord, by the quarter date preceding the break date (in this case 25th December 2011) the rent for the following quarter (in this case up to 23rd March 2012). The third obligation for the tenant was to pay the landlord, prior to the break date, the sum of £919,800 plus VAT. Only once all three obligations were undertaken could the break notice be deemed valid. Having done all three, the tenant vacated the property on the break date. The tenant claimed that they should be refunded the rent paid in advance for the quarter which represented the period of time during which they were not in occupation and were outside the period of the lease as a result of the break notice i.e. between 25th January 2012 and 23rd March 2012. It was common ground that there was no express clause within the lease, which spanned in excess of 80 pages in length, which dealt with this issue.

As such the tenants argument was that an implied term should be inserted into the contract so that for the final quarter of rent in which the premises were part occupied by the tenant, the rent paid in advance to the landlord should be apportioned between time in occupation and time out of occupation - the landlord only being entitled to the rent incurred for the time in occupation. Whilst this argument was based on an argument that this would give business efficacy to the contract, the essential thrust of the tenants argument was rooted in an argument of fairness.

The Defendant denied that such a term should be implied and maintained that the landlord should be entitled to retain the entirety of the rent for the quarter notwithstanding the tenant's vacation part-way through.

At first instance the tenant succeeded. On appeal to the Court of Appeal and to the Supreme Court the Landlord was successful.

Moving to the guts of the decision there was significant analysis of the case law on implied terms and, in particular, the effects of the decision in *Belize* (which we will come to below). However, what really won the day for the landlord was the court's analysis of the general law of apportionment of rent payable in advance which features at paragraphs [42] - [48]. The conclusion in paragraph [48] meant that the tenants' case was holed beneath the waterline. Lord Neuberger concluded:

> *"….where a lease provides for payment of rent in advance on the usual quarter days, and the landlord forfeits the lease during the currency of a quarter, he is entitled to retain the whole of the rent due on the quarter day immediately before the forfeiture if it has been paid, and if has not been paid, he is entitled to recover and retain the whole of that rent."*

The fact that this was a comprehensive lease, which had been carefully drafted by two parties who were both aware of their respective needs and the position in law as regards to that conclusion in paragraph [48], meant that the tenants claim was dismissed.

The status of *Belize* after *M&S*

Reading the Supreme Court's judgment one is referred to a long body of case law which has seen much judicial evolution and illumination cast upon the test for whether a term should be implied into a contract. In this authors view, the law after *Belize* did not change as the tenants argued for in *M&S. Belize* did not change the law by substituting the enunciated tests and factors borne out of earlier authorities with one 'new' and singular test. The *Belize* merely encapsulated those principles by stating one overarching question to be asked and answered once those other principles had been analysed by the Court on the particular facts of the case before it. These principles are the "relevant background" which Lord Hoffmann refers to in his 'singular test'.

Therefore, though Lord Neuberger does appear to be back-tracking away from *Belize* in paragraph [31] of his judgment due to the concerns as to how it has been interpreted (which has primarily focussed upon whether the process of implication is part of the process of construction or interpretation of the contract), that 'back-tracking' concerns only Lord Hoffmann's comments that implication is part of construction and not to the overall status of his judgment as a whole. Indeed, in reading paragraph [31] of Lord Neuberger's judgment, it is necessary to bear in mind his previous comment in paragraph [24] when he analysed the Singapore Court of Appeals decision in *Foo Jong Peng v Phua Kiah Mai [2012] 4 SLR 1267*:

> *"….the Singapore Court of Appeal refused to follow the reasoning in Belize at least in so far as "it suggest[ed] that the traditional 'business' efficacy' and 'officious bystander' tests are not central to the*

> *implication of terms"….The Singapore Court of Appeal were in my view right to hold that the law governing the circumstances in which a term will be implied into a contract remains unchanged following Belize Telecom."*

This was something which was supported by Lord Carnwath in his speech at paragraph [74]. Crucially, at paragraph [69] he said:

> *"Whilst I accept that more stringent rules apply to the process of implication, it can be a useful discipline to remind oneself that the object remains to discover what the parties have agreed or (in Lady Hale's words) "must have intended" to agree. In that respect it remains, and must be justified as, a process internal to the relationship between the parties, rather than one imposed from outside by statute or the common law…"*

Thus, properly understood and considered, Lord Carnwath was absolutely correct to hold in his final paragraph [74]:

> *"…I regard it [Belize] as a valuable and illuminating synthesis of the factors which should guide the court."*

Lord Clarke echoed the views of his fellow Judges in paragraph [77] and dealt with the concerns identified by Lord Neuberger from *Belize* concerning the categorisation of implication as either part of interpretation or construction as follows:

> *"….the critical point is that in Belize the Judicial Committee was not watering down the traditional test of necessity….although Lord Hoffmann emphasised that the process of implication was part of the process of construction of the contract, he was not resiling from the often stated proposition that it must be necessary to imply the term and that it is not sufficient that it would be reasonable to do so…."*

The end game here is that *Belize* not only remains good law, but it remains a true reflection of the law which preceded it. The *Belize* 'test' for implication may be a short statement, but it involves a wide consideration of other previously identified factors which may or may not be relevant in any given case - the extent of a factors relevance, as ever, being totally contingent on the established facts.

Implication of contractual terms - the distilled principles

Looking at the judgments in *Belize* and *M&S*, the true approach to the implication of terms concerns two categories of principles. The first category is best described as 'overarching principles' which are principles to which the court will always have to have regard. The second category can then be classified as being 'general principles' which will be applicable to a greater or lesser extent in each individual case contingent on the established facts and will

feed into the overarching principles as part of the court's determination process. These general principles therefore, are neither contingent on one another, nor co-extensive, nor does one always outweigh another. They of course may combine or feed into one another in a given case, but this is by no means necessary or required, it depends on the facts and, crucially, the nature of the agreement between the parties.

(1) The overarching principles

(i) Necessity

This really is the golden principle in implying terms. It has been emphasised time and time again by the Courts. Ultimately, in *M&S* the principle that the term to be implied must be necessary to make the contract work, was emphasised by Lord Neuberger at paragraph [21] when he said that:

> *"….a term can only be implied if, without the term, the contract would lack commercial or practical coherence."*

Lord Carnwath emphasised the same in paragraph [69] above, and Lord Clarke likewise at paragraph [77] above. Those pronouncements follow a long line of case law which have alluded to the same requirement.

In short, the implied term must add something to the performance of the contractual obligations of the parties which equates with what the parties are actually taken to have agreed. It must assist the workability of the contract - note create a new one.

(ii) The implied term cannot contradict an express term

This overarching principle has not featured heavily in M&S, though it is undoubtedly clear from the judgments of previous courts which were summarised by Lord Neuberger and its most explicit origin lies in Lord Simon's point 5 in *BP Refinery*. The point is a crucial one which operates as a 'check' on the necessity of the implication. Put simply it can't be necessary if there is an express term covering the same ground, or which contradicts that which is seeking to be implied - it is not within the realm of the court to substitute the implied term for the express one. This is based on two points; firstly, the notion of agreement is sacrosanct - the court will not interfere with what the parties expressly agreed as independent parties. Secondly, the court will not come to the aid of a party who has entered into a bad bargain (see 'fairness' below). If an express term were to be overruled by an implied term, one would be in the unfortunate situation of the 'tail wagging the dog'.

(iii) What is 'fair' is irrelevant for implication

This overarching principle is yielded directly from the result in *M&S*. Lord Neuberger very frankly admitted that he sympathised with the arguments put forward by the tenants - the fair result was to reimburse them. He stated at paragraph [33] (and further to the same effect at paragraph [49]):

> *"A provision that the defendant landlords should reimburse the claimant tenant the apportioned sum would thus seem to be reasonable and equitable."*

One of course notes that the words 'reasonable and equitable' derive directly from point 1 from Lord Simon in *BP Refinery*. To the extent that Lord Simon referred to a test of fairness, or even that fairness should play a role in establishing necessity (both of which are debatable), it is this author's view that that 'test' is now, following *M&S* (if not following *Philips*), wholly overruled. In *Philips*, Sir Thomas Bingham said at page 482:

> *"….it is tempting for the court then to fashion a term which will reflect the merits of the situation as they then appear. Tempting, but wrong."*

In *M&S* Lord Neuberger said of Lord Simon's first requirement, at paragraph [21]:

> *"….a term should not be implied into a detailed commercial contract merely because it appears to be fair or merely because one considers that the parties would have agreed it if it would have been suggested to them."*

(2) The general principles

(i) The officious bystander

Though referred to as the 'officious bystander', one uses that title out of nostalgia more than anything else. It was of course termed in such a fashion in *Shirlaw*. In reality all that one is saying here is that once the facts are established, which of course includes what the parties did actually know of at the moment of agreement, would a reasonable person with that level of knowledge have thought that the implication argued for was present in the context of this particular contract? In applying this test, the standard to be applied appears to be one of 'obviousness' - only if the reasonable person say that the implication was 'obvious' will this principle be satisfied. This can be most clearly seen in paragraph [23] of Lord Neuberger's speech:

> *"….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 is quite acceptable, provided that (i) the reasonable reader is treated as reading the contract at the time it was made and (ii) he would consider the term to be so obvious as to go without saying or to be necessary for business efficacy."*

Given this standard, one can see immediately how this principle then feeds into the overarching necessity principle but it would be a mistake to think that because the implication is obvious to a reasonable person it will be necessary to imply it into the contract as night follows day - though it is a good indicator.

(ii) Business efficacy

The extent to which the implication would add business efficacy to the contract is also a highly relevant valuation to make. This exercise requires contrasting how the contract would be performed with and without the implied term sought, as analysed against the context of the commercial positions of the parties. Lord Neuberger in paragraph [21] expressly canvassed the possibility that what may be obvious, may not add business efficacy - the two are to that extent not co-terminus and do act as independent principles to be analysed.

What can be said, therefore, is that the implication cannot result in a commercial absurdity for one party or both. In this regard then, the comments of Mackinnon LJ in *Jackson v Dear [2013] EWCA Civ 89* still sound as true following *M&S*:

> *"As for commercial common sense enabling a choice between alternative interpretations, opinions as to commercial common sense in any given situation may also differ between reasonable people. In such circumstances, there is no room for implication."*

(iii) Intention of the parties

This principle derives almost directly from *Philips*. It is important to understand what each party intended at the moment of agreement. Not only is this relevant for the two other general principles above, it goes further into feeding directly into any assessment of necessity. In any contract case the court must always have regard to the intention of the parties. To this extent their respective positions are vital to understand because, as Sir Thomas Bingham cautioned in *Philips*, where the court is dealing with represented parties who intensely negotiated a comprehensive written agreement, there will need to be hard evidence that the agreement does not represent the entirety of their agreement such that the implication is necessary.

The other limb of significance to intention as a general principle, which is again directly relevant to an assessment of necessity, is that it is only upon a true ascertainment of the intention of the parties that the court can properly assess the reasonable expectations they are now being asked to 'necessarily' give effect to. Without this context necessity simply cannot be properly assessed. This was properly stated by Arden LJ in *McKillen v Misland (Cyprus) Investments Ltd [2013] EWCA Civ 781*:

> *"….the meaning and effect of the process of testing necessity for the purposes of an implied term is not an exercise to be carried out in a manner detached from the reasonable expectations of the parties to the particular agreement being interpreted. In that way, the common law continues to insist in this field on party autonomy as a key principle of contract law."*

(iv) The legal context

This is a general principle which will apply in some cases, but not others. In *M&S* it was the understanding of the law of apportioned rent paid in advance that really won the case for the landlord. The legal context was construed (rightly) as being in direct contradiction to the implied term being sought and accordingly the claim for apportionment failed.

If the implied term touches upon an issue on which there is applicable law therefore, a proper analysis of that law needs to be undertaken to allow for a proper assessment of necessity. This really is a general principle pioneered directly out of *M&S*, and to that extent *M&S* serves as a good example of how this particular principle can potentially sweep aside any other.

Conclusion

The decision in *M&S* has not changed the law. It has affirmed the approach of Lord Hoffmann in *Belize* which also did not change the law - it merely drew the law together. The Supreme Court has allowed for a concentrated distillation of the principles applicable to the process of implying contractual terms which I have endeavoured to set out in this article.

It is apparent that there is one overarching test of necessity when the court decides whether to imply a contractual term. This is determination process takes place against a back-drop of two further overarching principles to which the court must adhere and cross-check - thus necessity may be the goal, but the woodwork making up the goal consists of these two further overarching principles.

The journey to the goal is made up of several potential routes, some of which will only take a party so far in any given case. These routes can be classified as general principles all of which enable the court to assess necessity. These general principles are all principles which the courts have enunciated on many occasions before. The

Supreme Court in *M&S* could arguably be said to have added a further general principle to this list - the legal context principle (though it has arguably always been one which has been appreciated but with reduced importance given the facts the previous cases were decided upon).

Following *M&S* and *Belize*, the Court's approach to implication should now be as follows:

(1) Assess the relevance and extent of application of the general principles disregarding any notion or perceived argument of fairness pursuant to the third overarching principle;

(2) Assess whether the implication is necessary based on the preliminary assessment in (1) above;

(3) Cross-check that, in the event of the implication being assessed as necessary under (2) above, the term to be implied does not offend the other overarching principles that the implied term must not contradict an express term of the contract.

Gareth McAloon

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