

Marks and Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey Ltd) [2015] UKCS 72

“It is apparent that Lord Hoffmann’s observations in *Belize Telecom*... should henceforth be treated as a characteristically inspired discussion rather than authoritative guidance on the law of implied terms.”

The leading judgement given by Lord Neuberger of the Supreme Court reinstates the traditional strict test when considering whether to imply words into a commercial contract. The case has set the precedent on the law of implied terms in commercial contracts, making a significant departure from *Attorney General of Belize v Belize Telecoms Ltd* [2009] 1 WLR 1988, a case understood to have defined the modern law of implied terms.

This dispute concerned whether a tenant, who had exercised its right under a break clause, could recover, from the landlords, the apportioned rent in respect of a period during which they would no longer occupy the property. The significance of their lordships majority decision, however, is much wider in scope and impacts every commercial contract that must be submitted to the law of implied terms.

The Background Facts

The litigation arose out of four sub-underleases of various floors of a commercial building. Each sub-underlease was set out in a schedule to a deed. For the purposes of the litigation, the court dealt only with one sub-lease and deed, entered into on 15 January 2010 (the “Lease”).

The Lease provided that the tenant would need to pay rent every year in equal quarterly instalments in advance on the usual quarter days. By 25 December 2011, the rent was £1,239,689 plus VAT. The Lease also provided two break clauses, one taking effect on 24 January 2012 (the first break clause) and another on 24 January 2016 (the second break clause), whereby the tenant could end the tenancy by giving the landlord six months’ prior written notice.

Under the Lease, if the tenant exercised the first break clause, the tenant would have to pay £919,800 plus VAT as an early exit fee. If the tenant did not exercise the first break clause, the landlord would pay the tenant £150,000 by crediting it against the tenant’s liability for rent due on the following quarter date.

The tenant exercised its right under the first break clause and provided notice on 7 July 2011. The tenant subsequently paid (a) the quarterly rent for the period 25 December 2011 to 24 March 2012, amounting to £309,172.35 plus VAT, and (b) the early exit fee of £919,800 plus VAT.

The key question the court had to decide was whether there was an implied term that the landlord was to pay back a proportion of the rent in respect of the period 24 January 2012 (when the lease expired) and 25 March 2012 (the quarter up to which rent had been paid for).

Supreme Court Decision

Lord Neuberger, giving the leading judgement, confirmed that there are two types of contractual implied term: (i) a term implied into a particular contract, in light of the express terms, commercial common sense, and the facts known to both parties at the time the contract was made; and (ii) a term implied because the law (by statute or common law) imposes that term into that certain class of relationship.

In considering the judicial principles of the law of implied terms, Lord Neuberger quoted the following summary provided by the case of *BP Refinery (Westernport Pty Ltd v President Councillors and Ratepayers of the Shire of Hastings* (1977) 52 ALJR 20:

“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.”

In considering this summary, Lord Neuberger added the following comments:

1. The implication of a term is not critically dependant on proof of an actual intention of the parties when negotiating the contract, but rather by reference to notional reasonable people in the position of the parties at the time the contract was entered into.
2. 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 being necessary but not sufficient grounds for implying a term.
3. Business necessity and obviousness are alternatives in the sense that only one needs to be satisfied.
4. If one approaches the issue by reference to the officious bystander test (i.e. if a meddlesome bystander had asked the parties what would happen in a certain event, they would both have replied “of course, so and so would happen; we did not trouble to say that; it is too clear”), it is vital to formulate the question posed to the officious bystander with utmost care.
5. A term can only be implied if, without the term, the contract would lack commercial or practical coherence.

The *Belize Telecoms* Approach

Before leaving the law of implied terms, Lord Neuberger critiqued the approach espoused in *Belize Telecoms*, a case that has been interpreted by practitioners and judges alike to have defined the modern law of implied terms.

Belize Telecoms was a dispute relating to the construction of articles of association of a telecommunications company. In that case, 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.”

Lord Neuberger criticising the summary stated:

1. The notion that a term will be implied if a reasonable reader of the contract, knowing all its provisions and surrounding circumstances, would understand it to be implied is acceptable, only if: the reasonable reader is treated as reading the contract at the time it was made; and he would consider the term so obvious as to go without saying or to be necessary for business efficacy (i.e. reasonableness is not a sufficient ground for implying a term).
2. The exercise of implication should neither be classified as part of the exercise of interpretation nor should it be carried out at the same time as interpretation – express terms of a contract must be interpreted before one can consider any question of implication.
3. The courts’ usual role in contractual interpretation is resolving ambiguities or reconciling apparent inconsistencies, to attribute the true meaning to the language in which the parties themselves have expressed in their contract. The implication of contractual terms involves a different and altogether more ambitious undertaking: the interpolation of terms to deal with matters for which, *ex hypothesi*, the parties themselves have made no provision.

As such, Lord Neuberger emphasised that there had been no dilution of the requirements which have to be satisfied before a term will be implied.

Application

Applying the above, the Supreme Court found against the tenant and held that the rent paid was not capable of apportionment.

The decision was based on the following two key findings: the lease was a full and professionally drafted contract, which included express obligations of the same nature as the proposed implied term, namely financial liabilities in connection with the tenant’s right to break; and in accordance with the conclusions of the Court of Appeal in *Ellis v Rowbotham* [1900] 1 QB 740 and Section 2 of the Apportionment Act 1870, 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 it has not been paid, he is entitled to recover and retain the whole of that rent.

It is important to note that this judgement was given in spite of the following findings: (i) if the landlord retained the apportioned sum, it would be unfairly prejudicial to the tenant and a pure windfall for the landlord; (ii) it was unlikely to be intended that the apportioned rent was to be retained by the landlords as part of the compensation for the tenant’s operation of the break clause; and (iii) the rent was stated to be paid yearly and “proportionately for any part of a year” by equal quarterly payments in advance, meaning that, if the lease

had run its full course to 2 February 2018, the tenant would only have had to pay an apportioned part of the rent due on 25 December 2017 – so commercial common sense would suggest that this should be the same position for the rent payment made for the quarter beginning 25 December 2011.

Comment

It seems from this judgement and that of the recent Supreme Court decision in *Arnold v Britton and others* [2015] UKCS 36 (for which see <http://www.squirepattonboggs.com/insights/publications/2015/07/the-supreme-court-adopts-a-literal-approach-to-the-construction-of-a-commercial-contract>) that the courts are moving away from commercial interpretation and are returning to a strict literal approach to the commercial contracts and the laws that govern them.

This is a crucial development for those involved in international commercial contracts, particularly those used in the shipping, offshore oil & gas and commodity industries.

It is often the case in such international commercial contracts that parties focus on key commercial terms encompassing the general financial agreement reached. For example, when fixing a vessel, particularly for voyage charters, express terms are typically in a short covering email. It is only once these terms are finalised that subsequent boiler plate wording is added.

Boiler plate wording, although useful, rarely encompasses fully the commercial intentions of the parties. A stark reminder can be seen from the court’s reference to *The APJ Priti* [1987] 2 Lloyd’s Rep 37 where Bingham LJ rejected the argument that a warranty, to the effect that the port declared was prospectively safe, could be implied into a voyage charterparty. His reasons for rejecting the implication were “because the omission of an express warranty may well have been deliberate, because such an implied term is not necessary for the business efficacy of the charter and because such an implied term would at best lie uneasily beside the express terms of the charter.”

It seems likely (if not obvious) that a commercial shipowner fixing a vessel would only agree to charter their vessel to safe ports. However, the starting premise that an omission of express wording may have been deliberate leaves those commercial parties attempting to enforce what they view as a clear, but not express, legal right, very much at risk. What they consider to be commercially obvious, may not, by law, be sufficient to imply the term they seek to enforce.

Ensuring careful attention is given to the language used in expressing the contracting parties’ intentions is a sure way to avoid such costly litigation.

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