

Express and Implied Terms in Contracts

School of Law, Singapore Management University¹

Lord Neuberger

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Introductory

1. Resolving disputes about the rights and obligations of parties to commercial contracts is a common exercise for judges and arbitrators. A great deal of money can hang on a few words, which were drafted in a hurry, which may not have seemed very important at the time, which were agreed almost unthinkingly, and whose meaning subsequently appears obscure - indeed whose meaning experienced and expert judges may disagree about.
2. A recent example may be found in the United Kingdom Supreme Court *BNY Mellon Corporate Trustee* decision in June this year². Following the 2008 banking crisis, the UK Financial Services Authority (the FSA, which subsequently changed its name) imposed regulatory capital requirements on all banks in the UK and then initiated stress tests on those banks. Following a stress test in 2009, one of the UK's four biggest banks, Lloyd's Bank, issued many billions of UK pounds worth of convertible loan notes in order to enable its balance sheet to comply with the Regulatory Requirements, and in particular to improve what was then known as its Consolidated Core Tier 1 Capital. The Notes carried interest at rates of over 10% per annum with maturity dates between 2019 and 2032. Under clause 19(2) of the terms and conditions, the Bank was entitled to redeem the Notes early if "as a result of any changes to the Regulatory Capital Requirements . . . , the [Notes] shall cease to be taken into account . . . for the purposes of any 'stress test' applied by the FSA in respect of the Consolidated Core Tier 1 Ratio".
3. Between 2009 and 2015 the regulatory requirements for UK banks changed significantly, and, as a result, Lloyd's Bank claimed that it was entitled to redeem the notes. The Bank was very keen to do this, because, by 2015, the coupon of 10% per annum was a very high rate; by contrast, for the same reason, the Note-holders were very keen to avoid the

¹ I am very grateful to Admas Habtleslasie for his assistance in preparing this talk

² *BNY Mellon Corporate Trustee Services Ltd v LBG Capital No 1 Plc* [2016] UKSC 29 [2016] 1 WLR(D) 310

Notes being redeemed early, and they resisted the Bank's claim. Who was right depended on whether the changes in the regulatory rules between 2009 and 2015 entitled the Bank to rely on clause 19(2).

4. The Bank ran two arguments. The first was that, as the regulatory changes involved a new rather different core capital concept, namely Common Equity Tier 1 capital, which replaced the previous Consolidated Core Tier 1 capital, the whole basis for the Notes had gone. The Supreme Court, in agreement with the courts below, had no difficulty in rejecting that argument: the clause had to be interpreted by reference to the regulations as they were from time to time, and the basic purpose of the two concepts was identical.
5. The Bank's second argument was more attractive - and more controversial. The Bank contended that clause 19(2) was satisfied because, although the Notes were capable of being treated as part of Consolidated Core Tier 1 capital, they were no longer capable of enabling the Bank to pass the new stress test, as they would only be treated as part of such capital once the test had been satisfied by other assets. The Note-holders contended that clause 19(2) did not apply because, although the Notes might no longer be able to perform a determinative part in connection with the new stress test, they could still be taken into account as Consolidated Core Tier 1 capital. Three members of the Supreme Court, agreeing with the Court of Appeal, found in favour of the Bank on that issue, but two members of the Court, agreeing with the first instance judge, would have found for the Note-holders. So, on this issue on contractual interpretation, worth billions of pounds, the courts below disagreed and the Supreme Court split three-two.
6. Although the *BNY Mellon* case received quite a bit of coverage in the financial press, the case is of little if any general legal importance, because, although there was a sharp difference of judicial opinion, there was no disagreement as to the appropriate principles which applied to interpreting the Terms of the Notes. However, I think the case is of interest because it helps to demonstrate two very significant points of general application.
7. First, it illustrates that, however hard those who negotiate and draft commercial documents may try, there will be cases of genuine uncertainty when it comes to

interpreting such documents. Certainty is quality to be prized in the law. It is an essential ingredient of the rule of law that the law has to be as certain, as clear and as accessible as possible. The more uncertain, the more unclear, the more inaccessible, the law, the less people feel free to act, in their private and public activities and in their private and public disputes, and therefore the more constrained and more unfree is society and the greater the risk of commerce withering. That is as true of interpretation of legal documents as of any other branch of legal activity. And, in order to have certainty (or at least as much certainty as possible), there have to be principles which are of general application, and which are reliably applied by judges when it comes to resolving disputes.

8. However, the law cannot simply be concerned with dry principle: it must also reflect human life and experience. After all, legal disputes are ultimately based on real life problems, sometimes personal and sometimes commercial. The law should never forget that commercial documents are meant to embody practical arrangements whereby business can be done. And it is business people and lawyers, who negotiate and draft documents, it is lawyers who argue about what the documents mean, and it is judges who decide what the documents mean. And business people, lawyers and (even) judges are human beings, which means that there will be uncertainties, not least because it is not possible to foresee the future, and contracts and other documents have to be applied in the future. But, quite apart from that, the parties to a contract sometimes have a positive interest in obscurity, in lack of clarity. Both sides to a negotiation may be content to include an ambiguous provision in it, on the basis that, if they try and spell it out more clearly the deal may fall apart, and they would rather leave it unclear - not least because it will probably never lead to a dispute anyway. So, while judges and other law-makers should try and keep uncertainty in the law to a minimum, what with human fallibility, inability to predict the future and commercial realism, it is unrealistic to believe that the outcome of every dispute could and should be confidently predicted.
9. The second point I would like to make about the *BNY Mellon* case is that it highlights the importance to a successful and thriving commercial and financial market of a respected and honest judicial system. The very fact that the decision could have gone either way demonstrates the need for a dispute resolution system in which both parties have confidence, in terms of efficiency, efficacy, honesty and expertise. There are occasions in the world of both personal and commercial disputes when there is much to be said for

the apparently unprincipled view that it is more important to have an answer than it is to have the right answer. Indeed, I would suggest that that view can be said to be an aspect, albeit a somewhat morally unsatisfactory aspect, of the need for certainty. Indeed, the need for efficiency, efficacy, honesty and expertise can in part be seen as included in the need for certainty, but, obviously, those desiderata go far, far wider than that: they are each an essential ingredient of the rule of law generally, and indeed of access to justice in particular. Ironically, it is especially when an issue could go either way that the need for an efficient, efficacious, honest and expert judiciary is crucial. Even if you are the losing party, even if you strongly believe that the court got the wrong answer, you respect it and move on.

10. These considerations, the need for as much certainty as possible, the need for both principle and practicality, the recognition of human frailty, and the need for a respected court system are all in play when it comes to identifying rights and obligations under commercial contracts. In this talk, I am concerned with what one might call internal issues – ie rights and obligations which the parties have agreed, not what may be called external issues - ie issues which arise due to matters which arise outside the contract, such as the right to rescind for fraud, misrepresentation or mistake, or the right to claim frustration. I accept that the distinction is by no means perfect: interpretation is a classic internal issue, and it depends in part on surrounding circumstances; rectification can be seen as an internal issue, but it is in many ways very close to rescission, an external issue.

11. There are undoubtedly two types of internal issues – the interpretation of expressed terms in a contract, and the implication of unexpressed terms into a contract – ie express terms and implied terms. And then thirdly there is rectification – ie the correction by the court of express terms so that they are changed to mean something different from what they say. Classically, interpretation, implication and rectification have been treated as three distinct concepts, subject to different rules, and indeed normally being sequential in operation. Thus, before the court can consider implying a term that is not expressed or correcting a term which is expressed, it first has to interpret the contract as it is expressed – and indeed before the court can correct a term which is expressed, it must work out whether any terms are to be implied. Although it is idle to pretend that complete compartmentalisation is achievable in every case, I would suggest that, despite apparent suggestions that all three exercises (particularly interpretation and implication) overlap to

a substantial extent, there is a great deal to be said, in principle and practice, for the classical view that they should be regarded as distinct exercises.

Interpreting express contractual terms

12. Before I develop that argument, let me begin by considering the first of the three internal exercises, interpretation, or construction as it is sometimes confusingly called. The UK Supreme Court last year had to consider the proper approach to interpreting contracts in *Arnold v Brittan*³. The facts were these. Between 1970 and 1991, a landowner had let around 90 plots of land on a Oxwich Leisure Park on the Welsh coast to individual tenants – most of them in the early 1970s. Each lease was for 99 years at a low rent on terms which entitled the tenant to build a holiday home on the plot. The landlord agreed to pay the expenses of providing services, such as fencing, rubbish collection, lawn-mowing and water pipes, for which, crucially for present purposes, the tenant agreed to pay under clause 3(2) “as a proportionate part of [such] expenses ... the yearly sum of Ninety Pounds ... for the first Year of the term ... increasing thereafter by Ten Pounds per hundred for every subsequent year ...”. (The formula was a little different in some of the tenancies, but nothing hangs on that for present purposes).
13. The landlord argued that the natural meaning of clause 3(2) was that the tenants had to pay an annual service charge of £90 which increased year on year by 10% compounded. As many know to their costs, compound interest can be something of a financial wolf in sheep’s clothing. And so it proved for the wretched tenants of Oxwich Leisure Park. As the Supreme Court explained, “[i]f one assumes a lease granted in 1980, the service charge would be over £2,500 this year, 2015, and over £550,000 by 2072”⁴. The tenants argued that clause 3(2) was not concerned with identifying the amount of the service charge, but with identifying the maximum amount of the charge. While accepting that this was not the natural meaning of the words of the clause, read on their own, the tenants said that the natural meaning as favoured by the landlords, was so outrageous in its practical consequences that an alternative meaning had to be adopted. The majority of the Supreme Court reluctantly disagreed with the tenants.

³ [2015] UKSC 36, [2015] AC 1619

⁴ *Ibid*, para 30

14. We accepted that, when deciding what a clause in a contract means, the court should not simply look at the words of the clause; it should look also at commercial common sense and the surrounding circumstances. We took the opportunity of summarising the proper approach to interpretation as being this⁵:

“When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to ‘what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean’ And it does so by focussing on the meaning of the relevant words, in this case clause 3(2) ..., in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party’s intentions”.

15. The requirement that one disregards evidence of any party’s intentions means that the negotiations between the parties leading up to the contract are inadmissible on issues of interpretation. This principle has been reconsidered and affirmed recently by the House of Lords in the UK in the 2012 *Chartbrook* case⁶ and by the Court of Appeal in Singapore in the 2013 *Sembcorp* case⁷. As the judgments of Lord Hoffmann and Chief Justice Menon in each case establish, the ultimate justification for this exclusionary rule is pragmatic⁸. First, documentary and oral evidence relating to negotiations is likely to be very extensive in quantity and very expensive to litigate about, and experience suggests that it will in practice be unlikely to prove to be of much help in most cases⁹. Secondly, admitting and

⁵ *Ibid*, para 15

⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101

⁷ *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] SGCA 43

⁸ *Chartbrook*, paras 35-41, cited with approval and applied in *Sembcorp*

⁹ A point developed more fully in *Sembcorp* paras 43-47, citing, *inter alia*, an article by Spigelman CJ, *Contractual Interpretation: A Comparative Perspective* (2011) 85 ALJ 412, 431. further, as pointed out by Lord Hoffmann in *Chartbrook*, para 38, the experience of being able to rely on what was said in Parliament after *Pepper v Hart* [1993] AC 593 as an aid to interpreting statutes has very frequently proved time-consuming, expensive and pointless (my description, not his).

relying on such evidence would lead to greater uncertainty of outcome. Thirdly, admitting such evidence on interpretation could be unfair on third parties who, knowing nothing about the pre-contract negotiations, take an assignment of, or other interest under, the contract. It should also be noted that common law treats post-contractual conduct as inadmissible when it comes to interpretation of contracts¹⁰

16. In that connection, the common law is very different from civilian law, as Chief Justice Menon emphasised in *Sembcorp*¹¹. Thus, as he pointed out, when it comes to interpreting contracts, Chinese, German and French law, and indeed “[t]ransnational conventions dealing with contractual construction also permit the admission of [extraneous] evidence, including pre-contractual negotiations, business practices and subsequent conduct”¹². I think that the difference between the common law and civilian law systems in this connection is partly attributable to the common law’s commitment to certainty and pragmatism as opposed to civilian law’s interest in principle and theory. In addition, French law at any rate is committed to subjective intention, whereas the common law is more interested in objective intention¹³. Additionally, the common law approach can be said to show a high regard for party autonomy¹⁴. But it may also be that the common law approach to litigation, with its disclosure and cross-examination, makes the judges more concerned about the time and cost implications of admitting such evidence than their civilian law colleagues.

17. Nonetheless, while the common law does not allow pre-contract negotiations or post-contract actions to be taken into account when interpreting a contract, the overall purpose of the contract, the surrounding circumstances known to both parties and commercial common sense may all be considered by when assessing what a contractual provision means. However, in *Arnold* we also made the point that “[t]he exercise of interpreting a provision involves identifying what the parties meant through the eyes of a

¹⁰ *James Miller & Partners Ltd v Whitworth Street Estates (Manchester) Ltd* [1970] AC 583, and *L Schuler AG v Wickman Machine Tools Ltd* [1974] AC 235, 252 and 265, applied *London Borough of Tower Hamlets v Barrett* [2005] EWCA Civ 923, para 113

¹¹ *Sembcorp*, para 12

¹² Citing Bing Ling, *Contract Law in China* (2002) at para 5.007, Art 1341 of the French Civil Code (consolidated version of 2 June 2012) read with Art 110-3 of the French Commercial Code (Rev Ed 2010), the German Civil Code (promulgated on 2 January 2002, and Art 4.3 of the UNIDROIT Principles of International Commercial Contracts (Rev Ed 2010); Art 5:102 of the Principles of European Contract Law (Rev Ed 2002); and Art 8(3) of the United Nations Convention on Contracts for the International Sale of Goods (enacted on 11 April 1980)

¹³ See Catherine Valcke, *Contractual Interpretation at Common Law and Civil Law: An Exercise in Comparative Legal Rhetoric* in J. Neyers, ed *Exploring Contract Law* (2008)

¹⁴ see per Leggatt J in *Tartsinis v Navona Management Company* [2015] EWHC 57 (Comm), para 11

reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract”¹⁵. We also made the point that “commercial common sense is not to be invoked retrospectively”¹⁶ – ie one has to assess commercial common sense at the time the parties made the contract, not in the light of what happened afterwards. That was important in that case, because, when most of the leases were entered into, inflation was running at well over 10%¹⁷, and therefore to have agreed a compound annual growth rate of 10%, while very imprudent for a period of over 90 years, was not quite as ill-advised as it would have seemed in 2015.

18. When it comes to the sort of issue raised in *Arnold*, I believe that a common law judge has to harden his or her heart, and to bear in mind that, while a decision on an issue of principle in a particular case will undoubtedly affect the parties in that case, it is very likely to affect many more people who are in a different and unknowable position. I come back to the fundamental importance of the law being certain, or, perhaps a better word, predictable. A common law judge has the privilege of making and developing the law as well as interpreting and applying it, and with that privilege comes the responsibility of not being wrongly swayed by sympathy for the plight in which an imprudent or unlucky litigant finds himself. If the judge is so swayed, the danger is that the resulting decision will muddy the clear water of certainty which is such an important ingredient in the rule of law. As Professor Glanville Williams once said, “[w]hat is certain is that cases in which the moral indignation of the judge is aroused frequently make bad law”¹⁸. But, as Lord Denning at his best demonstrated, that should not prevent a judge from moving on the law in an appropriate way when the right case arises.

19. In this connection, there is a great deal of attraction in the late Professor Ronald Dworkin’s comparison of a common law judge trying a case with the writer of an episode in a TV soap opera¹⁹. The judge is landed with the story so far – ie the law as developed

¹⁵ *Ibid*, para 17

¹⁶ *Ibid*, para 19

¹⁷ *Ibid*, para 35

¹⁸ Glanville Williams, *The Sanctity of Life and the Criminal Law* (1957), p 105

¹⁹ R. Dworkin *Law’s Empire* (1986), p 237

by judges (and sometimes by the legislature) in the past, but, provided that the judge remains faithful to that, he or she is free to develop the law as seems fit.

20. Of course, it is fair to say that the requirements of certainty and principle, on the one hand, and, on the other hand, the need for practicality and development are inevitably in tension, which means that deciding cases involves an element of practical assessment, even common sense. It may be a cheap point, but it is perhaps worth saying that resolving issues of law and fact ultimately involves judgment, and it is no coincidence that the deciders are called judges. In that connection, law is not like mathematics, where logic alone holds sway. Indeed, the common law always has to hold the balance between logic and practicality. A great US judge, Oliver Wendell Holmes, famously said that “[t]he life of the law has not been logic: it has been experience”²⁰. By contrast, one of my colleagues, Lord Wilson, recently said in a judgment, “logic is the blood which runs through the veins of the law: allow it to escape and ultimately the edifice collapses”²¹. Both views have force, and one of the tasks of common law judges, when carrying out their judicial functions, can be to resolve the tension between them as seems appropriate in the case before him or her.

Implying terms into contracts²²

21. Moving on to implication of terms, the role of the court in implying terms into contracts was well described by Lord Wright in *Luxor v Eastbourne*, where he said that “[t]he implication of terms in fact is the process by which the court fills a gap in the contract to give effect to the parties’ presumed intentions”²³. In that connection, the law is normally slow to imply rights and obligations into contracts because it involves holding parties to something which they have not expressly agreed. When interpreting what the contract means, the importance which the law attaches to the words in which the parties have expressed their contract is mirrored by the reluctance of the law to impose on the parties

²⁰ Oliver Wendell Holmes, *the Common Law* (1881), p 1

²¹ Re J (Children) [2013] UKSC 9, [2013] 1 AC 680, para 75

²² Implied terms are of two types, (i) those implied by law into certain classes of contract (eg the requirement of good faith in employee-employer contracts), and (ii) those implied into a particular contract essentially as a matter of fact. In this talk I am concentrating on the latter type.

²³ *Luxor (Eastbourne) Ltd v Cooper* [1941] AC 108

a term which they have not expressly agreed. As the common law gives so much weight to the way in which the parties have expressed themselves when deciding what the contract means, it seems logical that it should be very slow to confer benefits or impose duties on them by reference to words which they have not included.

22. Traditionally, implication has been seen as a different exercise from interpretation. The point has never been better made than by Sir Thomas Bingham MR in the 1995 *Philips Electronique* case²⁴ where he contrasted interpretation with implication in these words:

“The courts’ usual role in contractual interpretation is, by resolving ambiguities or reconciling apparent inconsistencies, to attribute the true meaning to the language in which the parties themselves have expressed their contract. The implication of contract terms involves a different and altogether more ambitious undertaking: the interpolation of terms to deal with matters for which, ex hypothesis, the parties themselves have made no provision.”

23. More specifically, the traditional view developed more than a century ago was that a term could only be implied into a contract if it satisfied the “officious bystander” test²⁵. More recently, the law was developed and refined so that there were five requirements which had to be satisfied by a proposed implied term, namely that (a) it does not conflict with any express term, (b) it is necessary to give the contract business efficacy, (c) it is so obvious that it must have gone without saying, (d) it is reasonable, and (e) it is capable of clear expression. It was generally thought that these requirements were cumulative, except that requirements (b) and (c) - business efficacy and obviousness – were alternatives. However, in the *BP Westernport* case²⁶ in the Privy Council, Lord Simon, at least if his judgment is read literally, seems to have suggested that all five requirements have to be satisfied.

²⁴ *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472, 481

²⁵ In *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 206, 227, having said that “[p]rima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying”, MacKinnon LJ famously added that a term would only be implied “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!’”.

²⁶ *BP Refinery (Westernport) Pty Limited v Shire of Hastings* (1977) 180 CLR 266, 282-283

24. In the *Belize Telecom* case in the Privy Council²⁷, Lord Hoffmann gave a characteristically virtuoso judgment which appeared, at least to some people, to make two innovative suggestions. The first was to suggest that the five tests proposed in *BP Westport* were not five separate requirements which an implied term had to satisfy before it could be accepted. The second was that implying a term was not a separate exercise from interpretation, but was part of the interpretative exercise.
25. Thus, Lord Hoffmann said that “the implication of the term is not an addition to the instrument. It only spells out what the instrument means”²⁸. And later he stated that “[t]here is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?”²⁹ And a little later, he said that the five tests should be “regarded not as independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means to suggest that the implication of a term into a contract was part of the exercise of interpretation”³⁰.
26. These observations received mixed reactions in the academic world³¹. And there have also been different views expressed about Lord Hoffmann’s analysis in the judicial world. In the 2012 *Foo Jong Peng* case³², the Singapore Court of Appeal refused to follow the reasoning in *Belize Telecom* case 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 same view was expressed in a subsequent judgment given by Chief Justice Menon in the 2013 *Sembcorp* case³³. He expressed real doubts about Lord Hoffmann’s approach, and preferred the Bingham approach in *Phillips Electronique*, stating that “the business efficacy and officious bystander tests used in conjunction and complementarily remain the

²⁷ *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988, paras 16-27

²⁸ *ibid*, para 18

²⁹ *ibid*, para 21

³⁰ *Ibid*, para 26

³¹ Eg C Peters *The implication of terms in fact* [2009] CLJ 513, P Davies, *Recent developments in the Law of Implied Terms* [2010] LMCLQ 140, J McCaughran *Implied terms: the journey of the man on the Clapham Omnibus* [2011] CLJ 607, and JW Carter and W Courtney, *Belize Telecom: a reply to Professor McLauchlan* [2015] LMCLQ 245

³² *Foo Jong Peng v Phua Kiah Mai* [2012] 4 SLR 1267, paras 34-36

³³ *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] SGCA 43

prevailing approach for the implication of terms under Singapore law”³⁴. Chief Justice Menon then laid down three rules which had to be satisfied if a term is to be implied into a contract³⁵. First, a term will only be implied to fill a gap which “arose because the parties did not contemplate the gap”. Secondly, a term will only be implied if “it is necessary in the business or commercial sense to imply a term in order to give the contract efficacy.”. Thirdly, the term sought to be implied “must be one which the parties, having regard to the need for business efficacy, would have responded ‘Oh, of course!’ had [it] been put to them at time of the contract”.

27. This approach was very similar to that subsequently adopted by the UK Supreme Court in the *Marks and Spencer* case³⁶ in December last year. In that case, a tenant who paid rent quarterly in advance was entitled to determine his lease in the middle of a quarter, and the issue was whether the court should imply a term that, as he had served such a notice, he could recover an apportioned part of the quarter’s rent. While there were various arguments in favour of the tenant’s case, we held that the high hurdle which a proposed implied term had to cross was not satisfied. When it came to the five requirements identified in *BP Westenport*, we agreed with the Singapore Court of Appeal that business efficacy and obviousness were two alternative requirements, but that that they normally amounted to the same thing³⁷. We also doubted that reasonableness added anything, because a term is very unlikely to be unreasonable if it is either so obvious that it goes without saying or necessary for business efficacy³⁸.

28. In *Marks and Spencer*, we went on to consider, and to express concern about, Lord Hoffmann’s apparent notion that implication was part of the interpretation process (I say “apparent notion”, because I am not entirely clear whether he really was saying that). Although we accepted that interpretation and implication both “involve determining the scope and meaning of the contract”, and both involved many of the same considerations³⁹, we rejected as unhelpful the notion that interpretation and implication were part of the same process. We agreed with the Bingham formulation in *Phillips*

³⁴ *ibid*, para 72

³⁵ *Ibid*, para 76

³⁶ *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742

³⁷ *Ibid*, para 21

³⁸ *ibid*

³⁹ *Ibid*, paras 26-27

*Electronique*⁴⁰, and explained, “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”. We also pointed out that “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”⁴¹.

29. To be fair to Lord Hoffmann, one can well see that it can be said that, even though an implication argument can only be addressed after the interpretation of the expressed contract has been completed, that does not mean that implication cannot, as a matter of language or categorisation, be treated as part of the overall interpretation exercise. In the end, therefore, it may appear that the argument as to whether Lord Hoffmann was right is an arid one, as it simply depends on what one means by “interpretation”. However, that misses the point that we were making in *Marks and Spencer*: we were concerned that if it was thought that implication was part of interpretation, judges would carry out the two exercises together, or would fail to bear in mind the very different legal requirements of the two exercises.

30. In a recent note on the *Marks and Spencer* case⁴², Dr Janet O’Sullivan suggests that another problem with assimilating interpretation and implication is that, while evidence of pre-contractual negotiations is not admissible when a question of contractual interpretation arises, it “must surely be admitted when considering implied terms”. My immediate reaction was that her assumption that pre-contractual negotiations are admissible in relation to an argument whether a term should be implied into a contract was incorrect: when considering whether to imply a term, it seemed to me that one cannot look beyond the terms of the contract and the other factors which can be looked at on an issue of interpretation. Thus, in *Marks and Spencer* itself, we said, approving a dictum of Lord Steyn⁴³, “the implication of a term was ‘not critically dependent on proof of an actual

⁴⁰ *Ibid*, para 29

⁴¹ *Ibid*, para 28

⁴² (2016) 75 Cambridge Law Journal, July 2016, p 199-202

⁴³ In *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, 459

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 actual parties, but with that of notional reasonable people in the position of the parties at the time at which they were contracting"⁴⁴.

31. However, on further reflection, while I remain sceptical about it, I do not think that I can confidently say that Dr O'Sullivan's assumption is wrong⁴⁵. If one party is arguing for an implied term, it might appear to be rather unsatisfactory if the other party was precluded from establishing that the parties had specifically discussed and rejected the notion of including such a term in the contract. If the assumption is incorrect, and negotiations cannot be relied on when deciding whether to imply a term, it would appear to follow that, if the court would otherwise imply a term but it can be shown that the parties had agreed not to include such a term in the contract, the party resisting the implication would have to seek rectification of the contract to exclude the term which the court would otherwise have implied.

Rectification of contractual provisions

32. That brings me rather neatly to the third topic I want to cover, albeit more briefly, namely rectification. While a common law court will not look at pre-contractual negotiations when the issue is contractual interpretation, it will, indeed it normally must, look at such negotiations when the issue is contractual rectification. Rectification can be obtained where one party can show that the contract, on its true interpretation, does not reflect what the parties intended: in such a case, unless it is unjust to do so, the court will rectify the contract – ie re-write it so that it reflects what was intended. The hurdle which a successful claim for rectification must cross is, unsurprisingly, high. It must be shown that both parties not merely intended that the contract should say something different from what it says, but it must be shown that the parties shared a common intention or understanding as to what it should say, that they had in some way mutually communicated that intention or understanding between themselves, and that there is no reason to

⁴⁴ *Marks and Spencer*, para 21

⁴⁵ And on one view it receives a degree of support from Chief Justice Menon's first point in para 76 of his judgment in *Sembcorp*— see para 26 above

conclude that either of them resiled from that understanding or intention prior to the contract being executed. (Rectification can also be exceptionally be granted in some circumstances where one party realises that the other party is mistaken as to what the contract means, but I am not concerned with that sort of case here).

33. The existence of rectification shows the subtle genius of the common law at its best. Unlike civilian law, where, as I have explained, every contractual interpretation dispute can involve the parties and the court in the expense and delay of examining all the pre-contractual negotiations, common law routinely excludes such material from admissibility. As I have said, in most cases, that seems very sensible not least because the likely value of such potentially expensive and time-consuming evidence is low, so the common law gives such evidence a red light. However, where such negotiations can be said to reveal a clear mutually held and mutually communicated understanding, so that there is a reasonable chance that the value of such evidence will be high, the common law gives it a green light through the remedy of rectification. The relatively strict requirements of a rectification claim thus ensures that there is in practice a filter which excludes negotiation evidence from the great majority of contractual dispute cases, and permits it to come in only where there is a reasonably pleadable rectification claim.
34. Interestingly, Lord Hoffmann has not merely been perceived as blurring the line between interpretation and implication: he has also been criticised for blurring the line between interpretation and rectification in the 2012 *Chartbrook* case⁴⁶ (and indeed he has also been criticised for his analysis in that case of the law of rectification⁴⁷).
35. So far as overlap is concerned, Lord Hoffmann said that, when it comes to correcting mistakes in contracts as a matter of interpretation “there is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant”⁴⁸. This is in potential conflict with the approach of the Australian High

⁴⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101

⁴⁷ see eg R Buxton *Construction and Rectification after Chartbrook* [2010] Cambridge Law Journal 253, and Paul Davies, *Rectification versus Interpretation: the Nature and Scope of the Equitable Jurisdiction* [2016] 75(1) Cambridge Law Journal 62

⁴⁸ *Chartbrook*, para 25

Court⁴⁹ and indeed with what was said in the 2011 UK Supreme Court case of *Rainy Sky*⁵⁰, namely “[w]here the parties have used unambiguous language, the court must apply it”. There is obvious force in the criticism that correcting mistakes through the medium of interpretation dilutes that important quality of certainty when it comes to interpretation of contracts⁵¹. Furthermore, the more one takes into account extraneous material when interpreting a contract, the less respect there is for party autonomy – a point which is reinforced by the fact that before a court will grant a rectification claim, it will require strong evidence to establish it.

36. Quite apart from this, correcting mistakes in documents by reference to extraneous material can, as already mentioned, be unfair to third parties who have subsequently acquired rights under the contracts. As the UK Supreme Court explained in a 2014 case, *Marley v Rawlings*⁵², “[i]f it is a question of interpretation, then the document in question has, and has always had, the meaning and effect as determined by the court, and that is the end of the matter. On the other hand, if it is a question of rectification, then the document, as rectified, has a different meaning from that which it appears to have on its face, and the court would have jurisdiction to refuse rectification or to grant it on terms (eg if there had been delay, change of position, or third party reliance).”
37. In practice, I think that, provided that interpretive correction is limited to corrections which are obvious once one reads and understands the contract as a whole and appreciates its commercial purpose, the dangers of interpretation as it were taking over rectification should be avoided. Having made that point, the Law Lords’ interpretation of the contract in *Chartbrook* can fairly be said to have involved a fair degree of violence to the language of the contract, as a number of academic writers have suggested⁵³.
38. The much more difficult question arising out of *Chartbrook* concerns the question whether Lord Hoffmann was right to suggest that, accepting that rectification depends on establishing a mistake, the issue as to whether there was in fact a mistake should be

⁴⁹ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337,352

⁵⁰ *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900, para 23

⁵¹ A point forcefully made by R Buxton – see fn 44

⁵² *Marley v Rawlings* [2014] UKSC 2, [2015] 1 AC 129, para 40

⁵³ see fn 44 and D McLauchlan, *Chartbrook Ltd v Persimmon Homes Ltd Commonsense Principles of Interpretation and Rectification?* (2010) 127 LQR 8 (the question mark says it all) and P Davies, *Finding the Limits of Contractual Interpretation* [2009] LMCLQ 420

assessed objectively rather than subjectively – ie by asking what a reasonable person who observed what passed between the parties up to the time that the contract was created would have thought, rather than by asking whether, as a matter of fact, the parties were in fact mistaken. This is not the occasion to go into this vexed question, but in one English Court of Appeal case in 2011, the *Daventry* case (itself a controversial and difficult decision)⁵⁴, Lord Toulson and I were both rather doubtful as to the correctness of the approach to rectification in *Chartbrook*.

39. However, I say no more about rectification today, as I am only concerned with its relationship with interpretation and implication.

Conclusion

40. I have now dealt with interpretation, implication and, in a limited way, rectification. Each is a topic which could justify a book, and each has been the subject of many recent judicial and academic observations. Perhaps I should end with an apt and characteristically well-judged comment from the present (sadly about to retire) Master of the Rolls. Last year in a speech⁵⁵ Lord Dyson said “It is extraordinary how many cases are still being reported in the law reports in the 21st century on how to interpret a contract. I cannot help thinking that the great Lord Mansfield, who was perhaps the founding father of modern commercial law, would have been disappointed and probably astounded too.” As one of the judges who has been as guilty as any of what Lord Dyson describes, perhaps I should follow the invitation given by Clement Attlee, the British Prime Minister in the late 1940s, to one of his more loquacious ministers: “A period of silence on your part would be welcome”⁵⁶. Indeed, I think that that applies to me now.

41. Thank you very much.

David Neuberger

Singapore

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⁵⁴ *Daventry District Council v Daventry and District Housing Ltd* [2011] EWCA Civ 1153, [2012] 1 WLR 1333

⁵⁵ Lord Dyson MR, *The Contribution of Construction Cases to the Common Law*, the 2015 Keating Lecture, 25 March 2015

⁵⁶ To Harold Laski, who talked too much about foreign affairs, which Attlee described as being “in the capable hands of Ernest Bevin” - David Butler and Gareth Butler, *Twentieth Century British Political Facts* (2005) p 289.