Defining necessity: implied terms revisited

By Rachel Tandy

The Supreme Court has handed down judgment in *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited* [2015] UKSC 71. The case provided the court with a welcome opportunity to revisit and clarify the test for implied terms. Their Lordships have confirmed that the basic test remains that of strict necessity, and that that test was unchanged by Lord Hoffman's speech in *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988.

THE FACTS

1. The appellant tenant ("**M&S**") had been granted a sub-underlease (the "**Lease**") by the respondent landlord ("**BNP**"). Rent was paid quarterly in advance. M&S was entitled terminate the Lease early under a break clause by giving notice to BNP. Any such notice would be valid as long as on the date the Lease had come to an end (i) there were no arrears of rent and (ii) M&S had paid an additional £919,800 to BNP.

2. M&S gave notice in July 2011 to terminate the Lease on 24 January 2012. Quarterly rent was due on 25 December 2011, for the period up to and including 24 March 2012. M&S duly paid that quarter's rent on time. On 18 January 2012, M&S paid the additional £919,800 to BNP. The Lease validly terminated on 24 January 2012.

3. M&S then issued proceedings against BNP seeking the return of the proportion of the rent relating to the period 25 January 2012 to 24 March 2012. It argued that there was an implied term in the lease that any such sum would be repaid.

4. M&S was successful at first instance, but that judgment was reversed in the Court of Appeal. M&S appealed to the Supreme Court.

THE PRINCIPLES OF INTERPRETATION

5. Lord Neuberger carefully summarised the existing authorities on the interpretation of contracts.

6. He specifically referred to the judgment of Lord Simon in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 52 ALJR 200, confirming that the conditions required for an implied term were *"(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."* He also referred to comments by Sir Thomas Bingham to the effect that, where a complex contract has been negotiated between parties, the courts ought to be slow to interfere because the omission of terms may well be deliberate.

7. Lord Neuberger then added six key points (at **[21]**):

    a. There is no need for proof of the parties' actual intention in order to imply a term; instead, the question is what reasonable people in their position *would* have agreed.

    b. A term should not be implied merely because it is fair, or because the parties would have agreed it if it had been suggested. Those criteria are necessary but not sufficient.

    c. Lord Simon's first criterion, of reasonableness, will rarely add anything; if a term satisfies the other requirements for implication it will usually be reasonable by definition.

    d. Lord Simon's second and third criteria, being business necessity and obviousness, could conceptually be alternative rather than cumulative requirements. However, a case that would satisfy one without the other is likely to be rare.

e. When applying the "officious bystander" test, it is *"vital to formulate the question to be posed by [the officious bystander] with the utmost care."*

f. The test is one of strict, but not absolute, necessity; essentially, a term can only be implied if the contract would lack commercial or practical coherence without it.

8. The court was at pains to emphasise that *Belize Telecom* had not changed or diluted the test for the implication of terms. Although Lord Hoffman had said in that case that the only question for the court was *"what the instrument... would reasonably be understood to mean,"* that should not be construed as meaning that "reasonableness" is a sufficient ground for implying a term (at **[23]**).

9. In this case, it was relevant that rent paid in advance cannot be apportioned at common law or under statute. The contract in question was a long and complex one negotiated against that legal background by two commercial parties with professional assistance.

10. The term argued for by M&S essentially was essentially one which abandoned those legal principles and allowed for the apportionment of the rent paid in advance for the period ending on 24 March 2012. Their Lordships concluded that in such circumstances, the test for strict necessity had not been met and accordingly that term could not be implied.

COMMENTARY

11. The key point here is the impact of *Belize Telecom*. Past interpretations of that judgment have given rise to a "drift" towards a tendency to allege implied terms where they are reasonable, rather than strictly necessary; for example, if they are desirable and make commercial sense. The Supreme Court has resolutely sought to stamp out that tendency. While Lord Neuberger's judgment gives a number of different factors to consider, the basic touchstone for implication is clearly necessity and nothing less.

12. This may also inform the discussion on the division between the exercise of construction and that of implying terms into contracts. Lord Neuberger (with whom Lord Sumption and Lord Hodge agreed) emphasised these were two very different exercises. It is of note that the jurisprudence on contractual construction increasingly takes account of "business common sense" (for example, in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50). It might therefore be that Lord Neuberger sought to keep construction and implication separate to avoid the principle of "business common sense" or reasonableness creeping into any consideration of implied terms, which ought to be done on a necessity basis only.

13. Finally, it is evident that tenants will not, as a general rule, be entitled to any refund of rent paid in advance if they exercise a break clause in a lease. It would need to be very clear that such a refund was intended by both parties if the lease were to escape the common law rule against apportionment, even where (as here) the failure to refund resulted in something of a windfall for the landlord. Accordingly, tenants – and their legal representatives – would be well advised to insist upon a specific, clear, and carefully-drafted clause in their lease allowing for apportionment to take place.

Rachel Tandy