CHAPTER 1

AN OVERVIEW

A certain heathen came to Hillel and said to him, "Make me a proselyte, on condition that you teach me the whole Torah in the time I can stand on one foot." Hillel said to him, "What is hateful to you, do not do to your neighbour: that is the whole Torah; all the rest is commentary."

The Talmud

1. IN A NUTSHELL

The law about the interpretation of contracts may be summarised in six principles.

Shortly after the second edition of this book was published, Lord Hoffmann gave his speech in *Investors Compensation Scheme v West Bromwich Building Society*.[1] In what became the starting point for disputes about contractual interpretation he said: **1.01**

> "I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v Simmonds*[2] and *Reardon Smith Line Ltd v Hansen-Tangen, Hansen-Tangen v Sanko Steamship Co*,[3] is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of 'legal' interpretation has been discarded. The principles may be summarised as follows.
>
> (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
> (2) The background was famously referred to by Lord Wilberforce as the 'matrix of fact', but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything[4] which would have affected the way in which the language of the document would have been understood by a reasonable man.

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1 [1998] 1 W.L.R. 896.
2 [1971] 1 W.L.R. 1381 at 1384–1386.
3 [1976] 1 W.L.R. 989.
4 In *BCCI v Ali* [2002] 1 A.C. 251 at 269 Lord Hoffmann qualified this. He said:

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.[5]

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd*).[6]

(5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios*[7]:

> '... if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'"

To these five principles, a sixth should now be added. In *Re Sigma Finance*

"When ... I said that the admissible background included 'absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man', I did not think it necessary to emphasise that I meant anything which a reasonable man would have regarded as *relevant*. I was merely saying that there is no conceptual limit to what can be regarded as background. It is not, for example, confined to the factual background but can include the state of the law (as in cases in which one takes into account that the parties are unlikely to have intended to agree to something unlawful or legally ineffective) or proved common assumptions which were in fact quite mistaken. But the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage: '... we do not easily accept that people have made linguistic mistakes, particularly in formal documents.' I was certainly not encouraging a trawl through 'background' which could not have made a reasonable person think that the parties must have departed from conventional usage."

5 In *Chartbrook Ltd v Persimmon Homes Ltd* [2009] A.C. 1101 the House of Lords reaffirmed this exclusionary rule.

6 [1997] A.C. 749.

7 [1985] A.C. 191 at 201.

8 Professor J.W. Carter subjects Lord Hoffman's five principles to sustained criticism in *The Construction of Commercial Contracts* [5–05] to [5–17].

Corp,[9] Lord Mance, approving Lord Neuberger's dissenting judgment in the Court of Appeal, said at [12]:

> "Lord Neuberger was right to observe that the resolution of an issue of interpretation in a case like the present is an iterative process, involving 'checking each of the rival meanings against other provisions of the document and investigating its commercial consequences.'."

In *BCCI v Ali*,[10] Lord Bingham of Cornhill summarised the principles as follows:

> "To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties' relationship and all the relevant facts surrounding the transaction so far as known to the parties. To ascertain the parties' intentions the court does not of course inquire into the parties' subjective states of mind but makes an objective judgment based on the materials already identified."

The lazy reader may stop here.[11]

In *Pratt v Aigaion Insurance Company SA*,[12] Sir Anthony Clarke M.R. warned against over-elaboration of the relevant principles,[13] and said that they were to be found in *Investors Compensation Scheme Ltd v West Bromwich Building Society*.[14] In *Bull v Nottingham and Nottinghamshire Fire and Rescue Authority*,[15] Buxton L.J. also warned against "a degree of elaboration that the case does not require" even by reference to Lord Hoffmann's five principles themselves.

In *Reilly v National Insurance & Guarantee Corporation Ltd*,[16] Moore-Bick L.J. said:

> "The principles to be applied in the construction of a clause of this kind were not in dispute. ... It is unnecessary to repeat them here, but it is worth noting that they include the following: a presumption that the words in question should be construed in their ordinary and popular sense; that a commercial document, such as an insurance policy, should be construed in accordance with sound commercial principles and good business sense; that the commercial object of the contract as a whole, or the particular clause in question, will be relevant in resolving any ambiguity in the wording; and that in a case of true ambiguity, the construction which produces the more reasonable result is to be preferred. I would only add by way of comment that difficulty of construction is not the same thing as ambiguity."

9 [2009] UKSC 2; [2010] 1 All E.R. 571; *MT Højgaard A/S v E.On Climate and Renewables UK Robin Rigg East Ltd* [2015] EWCA Civ 407.

10 [2002] 1 A.C. 251.

11 The reader who wants an even shorter summary of the principles may find it in *Rank Enterprises Ltd v Gerard* [2000] 1 All E.R. (Comm) 449 or *Absalom v TRCU Ltd* [2006] 2 Lloyd's Rep. 129 CA, applied in *Coromin Ltd v AXA Re* [2008] Lloyd's Rep. I.R. 467; *Lediaev v Vallen* [2009] EWCA Civ 156.

12 [2009] 1 Lloyd's Rep. 225.

13 An exhortation that the reader may think has been flagrantly disregarded by this book.

14 [1998] 1 W.L.R. 896.

15 [2007] L.G.R. 439.

16 [2009] 1 All E.R. (Comm) 1166.

The principles were restated by the Supreme Court in *Rainy Sky SA v Kookmin Bank*,[17]—Lord Clarke said:

"For the most part, the correct approach to construction of the bonds, as in the case of any contract, was not in dispute. The principles have been discussed in many cases, notably of course, as Lord Neuberger of Abbotsbury MR said in *Pink Floyd Music Ltd v EMI Records Ltd*, by Lord Hoffmann in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* in *Investors Compensation Scheme Ltd v West Bromwich Building Society* and in *Chartbrook Ltd v Persimmon Homes Ltd (Chartbrook Ltd Part 20 defendants)*. I agree with Lord Neuberger … that those cases show that the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant. As Lord Hoffmann made clear in the first of the principles he summarised in the *Investors Compensation Scheme* case … the relevant reasonable person is one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract."

Later in his judgment he said:

"The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other."

But he also added:

"Where the parties have used unambiguous language, the court must apply it."

These passages from *Rainy Sky SA v Kookmin Bank* in addition to Lord Hoffmann's five principles are becoming the accepted starting point for the interpretation of a written contract.[18] Scottish courts adopt the same approach.[19]

[17] [2011] UKSC 50; [2011] 1 W.L.R. 2900, reversing the Court of Appeal. See O'Sullivan, "Absurdity and ambiguity—making sense of contractual construction" (2012) C.L.J. 34. Lord Clarke repeated this description in *Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56; [2012] S.L.T. 205.

[18] See, for example, *Hyundai Merchant Marine Co Ltd v Daelim Corp The Gaz Energy* [2011] EWHC 3108 (Comm); [2012] 1 Lloyd's Rep. 211; *Family Mosaic Housing Association v Pimlico School Housing Association Ltd* [2011] EWHC 3561 (Ch); *Spencer v Secretary of State for Defence* [2012] EWHC 120 (Ch); [2012] 2 All E.R. (Comm) 480 (on appeal [2012] EWCA Civ 1368; [2013] 1 All E.R. (Comm) 287 where the point did not arise); *McKillen v Misland (Cyprus) Investments Ltd* [2012] EWCA Civ 179; *The Captain Stefanos* [2012] EWHC 571 (Comm); [2012] 2 Lloyd's Rep. 46; *Al Sanea v Saad Investments Co Ltd* [2012] EWCA Civ 313; *PCE Investors Ltd v Cancer Research UK* [2012] EWHC 884 (Ch); *Attrill v Dresdner Kleinwort Ltd* [2012] EWHC 1189 (QB); [2012] I.R.L.R. 553; *Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56; [2012] S.L.T. 205; *Aston Hill Financial Inc v African Minerals Finance Ltd* [2012] EWHC 2173 (Comm); *Procter & Gamble Co v Svenska Cellulosa Aktiebolaget SCA* [2012] EWHC 498 (Ch); *British Telecommunications Ltd v Rail Safety and Standards Board Ltd* [2012] EWCA Civ 553; *The Princess of the Stars* [2013] EWHC 2380 (Comm); [2013] 2 Lloyd's Rep. 523; *Ageas (UK) Ltd v Kwik-Fit (GB) Ltd* [2013] EWHC 3261 (QB); *Cottonex Anstalt v Patriot Spinning Mills Ltd* [2013] EWHC 236 (Comm); [2014] 1 Lloyd's Rep. 615; *Barclays Bank Plc v Landgraf* [2014] EWHC 503 (Comm); *Fujitsu Services Ltd v IBM United Kingdom Ltd* [2014] EWHC 752 (TCC); (2014) 153 Con. L.R. 147; *NYK Bulkship (Atlantic) NV v Cargill International SA* [2014] EWCA Civ 403; [2014] 2 Lloyd's Rep. 103; *Starbev GP Ltd v Interbrew Central European Holdings BV* [2014] EWHC 1311 (Comm); *MT Højgaard A/S v E.On Climate And Renewables* [2014] EWHC 1088 (TCC); *L Batley Pet Products Ltd v North Lanarkshire Council* [2014] UKSC 27; [2014] Bus L.R. 615; *BNY Mellon Corporate Trustee Services Ltd v LBG Capital No.1 Plc* [2015] EWHC 1560 (Ch); *Boufoy-Bastick v The University of the West Indies* [2015] UKPC 27.

[19] *Lloyds TSB Foundation for Scotland v Lloyds Banking Group Plc* [2011] CSIH 87 (but reversed by the UKSC: [2013] UKSC 3; [2013] 1 W.L.R. 366); *Soccer Savings (Scotland) Ltd v Scottish Building Society* [2012] CSOH 104.

In *Al Sanea v Saad Investments Co Ltd*,[20] Gross L.J. gave the following summary of the correct approach in the light of the decision of the Supreme Court in *Rainy Sky SA v Kookmin Bank*:

"i) The ultimate aim of contractual construction is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant. The reasonable person is taken to have all the background knowledge which would reasonably have been available to the parties in the situation in which they were in at the time of the contract.

ii) The Court has to start somewhere and the starting point is the wording used by the parties in the contract.

iii) It is not for the Court to rewrite the parties' bargain. If the language is unambiguous, the Court must apply it.[21]

iv) Where a term of a contract is open to more than one interpretation, it is generally appropriate for the Court to adopt the interpretation which is most consistent with business common sense. A Court should always keep in mind the consequences of a particular construction and should be guided throughout by the context in which the contractual provision is located.

v) The contract is to be read as a whole and an 'iterative process' is called for: '… involving checking each of the rival meanings against other provisions of the document and investigating its commercial consequences.'"

In *Marley v Rawlings*,[22] Lord Neuberger said:

[20] [2012] EWCA Civ 313. See also *Cottonex Anstalt v Patriot Spinning Mills Ltd* [2013] EWHC 236 (Comm); [2014] 1 Lloyd's Rep. 615; *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 B.V.* [2014] EWCA Civ 984. Useful summaries of principle are also contained in *BMA Special Opportunity Hub Fund Ltd v African Minerals Finance Ltd* [2013] EWCA Civ 416; *Jackson v Dear* [2012] EWHC 2060 (Ch); reversed on appeal: [2013] EWCA Civ 89; [2014] 1 BCLC 186 (but without significantly affecting the statement of principle); *Ardagh Group SA v Pillar Property Group Ltd* [2013] EWCA Civ 900, [2014] S.T.C. 26. See also *Tokio Marine Europe Insurance Ltd v Novae Corporate Underwriting Ltd* [2013] EWHC 3362 (Comm).

[21] The Court of Appeal has repeated the point that the court cannot rewrite an agreement to accord with what it might think fair: *Ilott v Williams* [2013] EWCA Civ 645. The same point was made by Etherton C. in *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 B.V.* [2014] EWHC 1083 (Ch), although the actual decision was reversed on appeal.

[22] [2014] UKSC 2; [2014] 2 W.L.R. 213. See also *Honda Motor Europe Ltd v Powell* [2014] EWCA

"When interpreting a contract, the court is concerned to find the intention of the party or parties, and it does this by identifying the meaning of the relevant words, (a) in the light of (i) the natural and ordinary meaning of those words, (ii) the overall purpose of the document, (iii) any other provisions of the document, (iv) the facts known or assumed by the parties at the time that the document was executed, and (v) common sense, but (b) ignoring subjective evidence of any party's intentions."

He repeated this summary in *Arnold v Britton*.[23]

2. A NEW BEGINNING?

The six principles do not represent a new departure in the interpretation of contracts. They are a restatement with differences of emphasis.

1.02 As long ago as 1905, Wigmore[24] described the history of the law of interpretation as "a progress from a stiff and superstitious formalism to a flexible rationalism". Lord Hoffmann's summary of principle has been seen by some judges, including himself, as no more than a step along the same road.

Lord Bingham, speaking extra-judicially, has commented that Lord Hoffmann's five principles are more a change of emphasis than a fundamental change.[25]

In *Chartbrook Ltd v Persimmon Homes Ltd*[26] Lord Hoffmann himself said:

"As Lord Bingham pointed out, there was little in that statement of principle which could not be found in earlier authorities. The only points it decided that might have been thought in the least controversial were, first, that it was not necessary to find an 'ambiguity' before one could have any regard to background and, secondly, that the meaning which the parties would reasonably be taken to have intended could be given effect despite the fact that it was not, according to conventional usage, an 'available' meaning of the words or syntax which they had actually used."

In *Bromarin v IMD Investments Ltd*,[27] Chadwick L.J. said:

"But, for my part, I am not persuaded that Lord Hoffmann intended, in the passage in the *Investors Compensation Scheme* case which is so often relied upon, to propound any novel principle.[28] To my mind, he was doing no more than emphasising that words are to be construed in the context of the agreement which the parties are making, having regard to the other provisions in the agreement, and the commercial purpose for which the agreement is made. What is, of course,

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23 [2015] UKSC 36; [2015] 2 W.L.R. 1593 at [15].

24 *Wigmore on Evidence*, Vol.4, para.2462.

25 A New Thing under the Sun? (2008) Edin L.R. 374. Paul S. Davis discusses the impact of Lord Hoffmann's five principles in The Meaning of Commercial Contracts in *The Jurisprudence of Lord Hoffmann*.

26 [2009] A.C. 1101.

27 [1998] S.T.C. 244.

28 See also *Den Danske Bank v Skipton Building Society* [1988] 1 E.G.L.R. 155 at 164 per Thomas J. ("These are not, I think, new principles"); *Kenecott Utah Copper Corp v Cornhill Insurance Plc* [2000] C.L.C. 273 at 309, per Langley J. ("a helpful re-statement of the basic principles of construction").

essential is that the court can be confident, from the other provisions of the agreement and an understanding of its commercial purpose, what meaning the parties did intend the words to bear. That may lead to the conclusion that the words used do not express the meaning which the parties intended; but that will be an exceptional case."[29]

Similarly, in *The BOC Group v Centeon*,[30] Evans L.J. said:

"The old intellectual baggage has been discarded but the courts are not travelling light. The cabin trunks have been replaced by airline suitcases; the contents are much the same, though they are expressed in more modern language."

In *WRM Group v Woods*,[31] Morritt L.J. described Lord Hoffmann as having restated "well-established" principles and in *New Hampshire Insurance Co Ltd v Phillips Electronic North America Corp*[32] Clarke J. said that:

"I do not think that he[33] intended to alter the principles of construction which have been developed in recent years."

And in *Mora Shipping Inc of Monrovia, Liberia v Axa Corporate Solutions Assurance SA*[34] Clarke L.J. said that:

"[The] principles have been restated in a number of well-known cases in recent years with somewhat differing emphases without, to my mind, changing the underlying approach."

Similarly, in *Zeus Tradition Marine v Bell*,[35] Colman J. said that Lord Hoffmann's first principle was:

"merely another and familiar way of expressing the judicial process of inference from admissible primary evidence."

Lord Hoffmann's five principles are now the routine starting point for a consideration of the principles of interpretation.[36]

29 See also *Credit Lyonnais Bank Nederland v ECGD* [1999] C.L.C. 823 (Hobhouse L.J.); *Gehe v NBTY* [1999] C.L.C. 1949 (Moore-Bick J.).

30 [1999] 1 All E.R. (Comm) 970. Professor McMeel traces this joke to a COMBAR lecture by Christopher Clarke Q.C. in 1998: see *The Construction of Contracts*, 2nd edn (Oxford: Oxford University Press, 2011), para.1.115.

31 [1998] C.L.C. 189.

32 [1998] C.L.C. 1244.

33 i.e. Lord Hoffmann.

34 [2005] 2 Lloyd's Rep. 769 CA.

35 [1999] C.L.C. 391 (reversed on other grounds [2000] C.L.C. 1705).

36 They were applied in (among other cases) *Don King Promotions Ltd v Warren* [1998] 2 All E.R. 608; *Barclays Bank v Weeks Legg & Dean* [1999] Q.B. 309; *Kumar v AGF Insurance Ltd* [1999] 1 W.L.R. 1747; *The Kalma* [1999] 2 Lloyd's Rep. 374; *Oceanic Village Ltd v United Attractions Ltd* [2000] 1 All E.R. 975; *Philip Collins Ltd v Davis* [2000] 3 All E.R. 808; *Breadner v Granville-Grossman* [2000] 4 All E.R. 705; *Sinochem International Oil (London) Co Ltd v Mobil Sales and Supply Corporation* [2000] 1 Lloyd's Rep. 339 CA; *Bank of Credit and Commerce International SA v Ali* [2002] 1 A.C. 251; *Eridiana v Oetker* [2000] 2 Lloyd's Rep. 191; *Rank Enterprises v Gerard* [2000] C.L.C. 637 CA; *Oxford Gene Technology Ltd v Affymetrix Inc* [2001] IP & T 93; *Zoan v Rouamba* [2001] 1 W.L.R. 1509; *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd* [2001] C.L.C. 1103 CA; *Portsmouth City Football Club Ltd v Sellar Properties (Portsmouth) Ltd* [2004] EWCA

Lord Hoffmann's five principles have been adopted by the courts in Scotland,[37] Ireland (with some qualification),[38] Hong Kong,[39] New Zealand[40] and Singapore,[41] although the High Court of Australia has taken a more cautious view.[42]

In *ICDL GCC Foundation FZ LLC v European Computer Driving Licence Foundation Ltd*, the Supreme Court of Ireland, while approving Lord Hoffmann's five principles, has stressed that although evidence of surrounding circumstances is admissible it "will not normally be allowed to alter the plain meaning of words."[43] In addition the court said that the fourth principle:

> "should not be misunderstood as advocating a loose and unpredictable path to interpretation. A court will always commence with an examination of the words used in the contract."[44]

In *Marlan Holmes Ltd v Walsh*,[45] the Supreme Court of Ireland also adopted this theme. It said:

> "It is important however to note that where the parties have committed their responsibilities to written form, in a particular manner, it must be assumed that they have intended to give effect to their obligations in that way. Such must be recognised as their right, both commercially and under contract law. Accordingly it is important that, when faced with a construction issue, a court should focus its mind on the language adopted by the parties being that which they have chosen to best reflect their intentions. It is not for the court, either by means of giving business or commercial efficacy or otherwise, to import into such arrangement a meaning, that might also be available from an understanding of the more general context in which the document came to exist, but is one not deducible by the use of the interpretive rules as mentioned."

The High Court of Australia has accepted Lord Hoffmann's description of the nature of interpretation (i.e. the first principle).[46] In *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*,[47] their Honours said:

> "References to the common intention of the parties to a contract are to be understood as referring to what a reasonable person would understand by the

Civ 760; *Weston v Dayman* [2006] B.P.I.R. 1549; *Forrest v Glasser* [2006] 2 Lloyd's Rep. 392; *Phillips v Rafiq* [2007] 1 W.L.R. 1351.

37 *City Wall Properties (Scotland) Ltd v Pearl Assurance Plc* [2007] CSIH 79; *Inveresk Plc v Papermakers Ltd* [2010] UKSC 19.

38 *Analog Devices BV v Zurich Insurance Company* [2005] IESC 12.

39 *Jumbo King Ltd v Faithful Properties Ltd* (1999) H.K.C.F.A.R. 279.

40 *Boat Park Ltd v Hutchinson* [1999] 2 N.Z.L.R. 74; *Yoshimoto v Canterbury Golf International Ltd* [2001] 1 N.Z.L.R. 523, reversed by the Privy Council [2004] 1 N.Z.L.R. 1 (but not on these principles); *Firm PI 1 Ltd v Zurich Australian Insurance and Body Corporate 398983* [2014] NZSC 147.

41 *Sandar Aung v Parkway Hospitals Singapore Pte Ltd* [2007] 2 S.L.R. 891; *China Insurance Co (Singapore) Pte Ltd v Liberty Insurance Pte Ltd* [2005] 2 S.L.R. 509; *Seiko Epson Corp v Sepoms Technology Pte Ltd* [2008] F.S.R. 14.

42 *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2001) 76 A.J.L.R. 436.

43 [2012] IESC 55. This appears to be a less than whole-hearted acceptance of Lord Hoffmann's fifth principle.

44 More recent cases in England and Wales favour an iterative approach.

45 [2012] IESC 23.

46 *Maggbury Pty Ltd v Hafele Australasia Pty Ltd* (2000) 216 C.L.R. 451.

47 (2004) 219 C.L.R. 165.

language in which the parties have expressed their agreement. The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction."

In *Synergy Protection Agency Pty Ltd v North Sydney Leagues' Club Ltd*,[48] the New South Wales Court of Appeal held that there was no need to find an ambiguity in a contract before resorting to background. This is the predominant view of intermediate appellate courts in Australia although the position of the High Court remains uncertain.[49]

It is also not clear whether the High Court of Australia has also accepted Lord Hoffmann's more controversial description of the admissible background (i.e. the second principle).[50] In *Western Export Services Inc v Jireh International Pty Ltd*,[51] the High Court of Australia held that the law in Australia is still represented by *Codelfa*.[52] It seems, therefore, that Lord Hoffmann's second principle is not yet accepted in Australia.[53] The most recent decision of the High Court of Australia in *Electricity Generation Corp v Woodside Energy Ltd*[54] does not expressly refer to this principle, although it did say that interpretation "will require" consideration of surrounding circumstances; so the position remains to some extent uncertain.[55] In other respects, however, the statement of principle by the High Court appears to coincide with the approach in England and Wales.

The remainder of this chapter considers the five principles in more detail.

48 [2009] NSWCA 140.

49 The authorities are surveyed in *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407 and *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* [2009] NSWCA 234.

50 In *Pacific Carriers Ltd v BNP Paribas* (2004) C.L.R. 451, the court referred in a footnote to the *Investors Compensation Scheme* case, but the text of the judgment refers only to "surrounding circumstances". See J.J. Spigelman, "*From Text to Context*" (Address to the Risky Business Conference March 21, 2007); Peden and Carter, Taking Stock: The High Court and Contract Construction (2005) 21 J.C.L. 172; *International Air Transport Association v Ansett Australia Holdings Ltd* [2008] HCA 3.

51 [2011] HCA 45. See also *Velvet Glove Holdings Pty Ltd v Mount Isa Mines Ltd* [2011] QCA 312; *McCourt v Cranston* [2012] WASCA 60; *Pepe v Platypus Asset Management Pty Ltd* [2013] VSCA 38; *Canberra Hire Pty Ltd v Koppers Wood Products Pty Ltd* [2013] ACTSC 162; *W & K Holdings (NSW) Pty Ltd v Mayo* [2013] NSWSC 1063; McLauchlan and Lees, More Construction Controversy (2012) J.C.L. 97.

52 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 C.L.R. 337. On the difference between the approach in England and Wales and the approach in Australia see also Spigelman, "Extrinsic Material and the interpretation of insurance contracts" (2011) 22 *Insurance Law Journal* 143; *W & K Holdings (NSW) Pty Ltd v Mayo* [2013] NSWSC 1063. The differences are also highlighted in Lewison and Hughes, *The Interpretation of Contracts* in Australia.

53 Whether ambiguity is a necessary pre-condition to recourse to extrinsic evidence is still a matter of controversy in Australia: see *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd* [2012] NSWCA 184; *W & K Holdings (NSW) Pty Ltd v Mayo* [2013] NSWSC 1063; *Canberra Hire Pty Ltd v Koppers Wood Products Pty Ltd* [2013] ACTSC 162. However, Australian judges are, perhaps, more ready to find ambiguities sufficient to let in extrinsic evidence than their English counterparts.

54 [2014] HCA 7.

55 Subsequent cases tend to hold that context must be examined in every case, whether or not there is an ambiguity: *Mainteck Services Pty Ltd v Stein Heurtey SA* [2014] NSWCA 184; *Stratton Finance Pty Ltd v Webb* [2014] FCAFC 110; *Newey v Westpac Banking Corp* [2014] NSWCA 319.

3. The Meaning Which the Document Would Convey

Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

1.03 In *Zeus Tradition Marine Ltd v Bell*,[56] Colman J. said:

> "References to the meaning which would be conveyed to a 'reasonable person' … are merely another and familiar way of expressing the judicial process of inference from admissible primary evidence."

In *Equitable Life Assurance Society v Hyman*,[57] Lord Steyn said:

> "The purpose of interpretation is to assign to the language of the text the most appropriate meaning which the words can legitimately bear."

Beguilingly simple though the formulation of Lord Hoffmann's first principle is, it contains the fundamental philosophy underlying the English approach to the interpretation of contracts. That is that interpretation does not involve the search for the actual intentions of the parties, but for an objective meaning. The purpose of interpretation is not to find out what the parties intended, but what the language of the contract would signify to a properly informed ordinary speaker of English.[58] The refocusing of attention on the impression made by the words on the reader, rather than on the intended message of the writer, is a departure from the traditional formulation of the aim of interpretation, namely to ascertain the presumed intention of the parties.[59] Although some judges continue to describe the object of interpretation as the ascertainment of the intention of the parties,[60] this is a distraction from the real question, which is: what does the contract mean?[61] It is this philosophy that explains the rationale for such of the exclusionary rules of evidence

[56] [1999] C.L.C. 391 (reversed on other grounds [2000] C.L.C 1705).

[57] [2000] 3 All E.R. 961 at 969.

[58] See Steyn, "Written Contracts: To What Extent May Evidence Control Language" [1998] C.P.L. 23; Steyn, "The Intractable Problem of the Interpretation of Legal Texts" (2003) Syd L. Rev. 1; Hoffmann, "The Intolerable Wrestle with Words and Meanings" (1997) 114 S. A.L.J. 656; Stevens, "*Contract Interpretation: What it says on the tin*" (Inner Temple Reading, 2014). The interpretation of utterances is that branch of linguistics called "pragmatics". For an introduction see P. Grundy, *Doing Pragmatics*, 2nd edn. Many of the classic papers are also reprinted in A.P. Martinich (ed.), *The Philosophy of Language*, 3rd edn (New York: Oxford University Press, 1996). Studies of legal interpretation from an American perspective may be found in L. Solan, *The Language of Judges* and S. Levinson and S. Mailloux (eds), *Interpreting Law and Literature* (Evanston: Northwestern University Press, 1988). Professor McMeel introduces the subject in *The Construction of Contracts*, 2nd edn, Ch.2. For discussions of the theory of language in articles accessible for lawyers, see also Gerard McMeel, "Language and the Law Revisited: an Intellectual History of Contractual Interpretation" (2005) C.L.W.R. 343 and Adam Kramer, "Common Sense Principles of Contract Interpretation" (2003) O.J.L.S. 23.

[59] See Collins: *Objectivity and Committed Contextualism in Interpretation* (reprinted in Worthington, *Commercial Law and Commercial Practice*).

[60] See for example *Marley v Rawlings* [2014] UKSC 2; [2014] 2 W.L.R. 213; *Arnold v Britton* [2015] UKSC 36; [2015] 2 W.L.R. 1593 at [15].

[61] Sir George Leggatt has argued that even this formulation is unsatisfactory, and that contract interpretation does not depend on what the parties to the contract actually meant or would have been understood by a reasonable person to have meant when the contract was made: Making sense of

as remain in English law. In this respect, as Lord Hoffmann acknowledged, the five principles do not follow the way in which serious utterances are interpreted in ordinary life.[62]

It may be thought that there are other respects in which the interpretation of contracts differs from the interpretation of utterances in ordinary life.[63] In the case of a literary work, an ambiguity may enrich the text and may have been a deliberate technique on the part of the author. The interpreter of such a text may readily conclude that it is open to several interpretations each one of which is a reasonable one. In the case of a contested contractual interpretation, however, the court cannot usually content itself with the conclusion that a text is ambiguous.[64] Where there are competing interpretations, it must choose between them and declare one of them to be the correct (and hence the only) interpretation.[65] As Diplock L.J. pointed out in *Slim v Daily Telegraph Ltd*[66]:

> "the argument between lawyers starts with the unexpressed major premise that any particular combination of words has one meaning, which is not necessarily the same as that intended by him who published them or understood by any of those who read them, but is capable of ascertainment as being the 'right' meaning by the adjudicator to whom the law confides the responsibility of determining it."

The reference in the five principles to the "reasonable person" or "reasonable man" does not expunge this unexpressed premise, as is demonstrated by innumerable cases in which judges disagree on the meaning of a contract.

Secondly, an utterance in ordinary life is made by a single person whose personality may provide part of the context for interpreting it. In the case of a contract, there is no real flesh and blood person who is making the utterance, and the parties themselves are depersonalised.[67]

Thirdly, in ordinary life an utterance is made in a specific context by a specific person for a specific purpose. A written contract is often designed to be read by a

contracts: the rational choice theory (2015) L.Q.R. 454. See also Stevens, "*Contract Interpretation: What it says on the tin*" (Inner Temple Reading, 2014).

[62] In "The Intolerable Wrestle with Words and Meanings", Lord Hoffmann argues that any interpretation, even in everyday life, is necessarily objective since the interpreter does not have a window into the speaker's mind, and hence cannot know his subjective intention. However, in everyday life a listener may ask for clarification in cases of ambiguity; whereas it is precisely in those cases that the court is called upon to interpret a contract, with no possibility of seeking clarification. In addition, in everyday life a speaker whose words are interpreted in a way he did not intend may legitimately say that he has been misunderstood. It would be a churlish response to say that he has not, simply because his words conveyed a different meaning to a reasonable listener.

[63] See also J.J. Spigelman, "*Contractual Interpretation: A Comparative Perspective*", a paper presented to the Third Judicial Seminar On Commercial Litigation March 23, 2011, Carter, *The Construction of Commercial Contracts* [5–05] to [5–17].

[64] Ambiguity is considered in Ch.8 below.

[65] See para.2.04, below.

[66] [1968] 2 Q.B. 157 CA. See para.5.01 for a fuller quotation.

[67] Lord Hoffmann acknowledges this in "*The Intolerable Wrestle with Words and Meanings*". He says that the parties to a contract are depersonalised and that this is part of the substantive definition of the legal institution of a contract. As he puts it: "A written contract is a document which binds the parties according to the interpretation it would be given by a reasonable person possessed of the legally admissible background knowledge. That is the substantive nature of a contract, a legal institution designed to create enforceable promises with the necessary degree of reliability and precision". As Judge Learned Hand said in *Hotchkiss v National City Bank (200 F287 at 293)*:

Accordingly, he concluded the court was not only entitled but bound to inquire into the contemporaneous meaning of the words used. In the same case Tindal C.J. held[604] that evidence "dehors the instrument itself" might be admitted:

> "where by lapse of time and change of manners, the words have acquired in the present age a different meaning from that which they bore when originally employed."

In *Schuler (L) AG v Wickman Machine Tool Sales Ltd*,[605] Lord Wilberforce said:

> "In the case of ancient documents, contemporaneous or subsequent action may be adduced in order to explain words whose contemporary meaning may have become obscure."

In addition to (or in lieu of) evidence, the court may inform itself "from history, and other general sources of information, of the meaning of the language used at that particular time".[606] A more modern example of this process may be seen in *Earl of Lonsdale v Att.-Gen*.[607] Chapter 5 will consider further the extent to which evidence is admissible to explain the meaning of words.

If, despite the reception of evidence, an ancient document remains ambiguous the court is entitled to look at acts done under the instrument, particularly those done at or shortly after its execution. This is known as *contemporanea expositio*. If the instrument is not ambiguous, evidence of contemporaneous acts is not admissible.[608] As Vaughan Williams L.J. said in *Lord Hastings v North Eastern Railway Co*[609]:

> "There can be no doubt that contemporaneous usage may be resorted to for the purpose of explaining any uncertainty or ambiguity in an ancient grant; but then there must be uncertainty or ambiguity."

An ancient document for this purpose is one that dates from before living memory.[610] Even so, it must, however, be shown that the lapse of time since the execution of the instrument is such that the words may have changed their meaning in the interval.[611]

Whether the post-contractual acts of the parties under modern instruments may be relied on as an aid to construction has already been discussed in para.3.19.

[604] (1842) 9 Cl. & Fin. 355 at 566.
[605] [1974] A.C. 235.
[606] [1974] A.C. 235 at 557, per Parke B.
[607] [1982] 1 W.L.R. 887.
[608] *Earl De La Warr v Miles* (1881) 17 Ch. D. 535.
[609] [1899] 1 Ch. 656.
[610] *North Eastern Railway Co v Lord Hastings* [1900] A.C. 260 at 269, per Lord Davey. However, it is considered that to the extent that this remains a rule of law, it does not preclude the court from admitting evidence of contemporaneous usage of words (as opposed to contemporaneous acts) even where the contract in question was made within living memory.
[611] *Lord Hastings v North Eastern Ry Co* [1899] 1 Ch. 656, per Lindley M.R.

CHAPTER 4

LAW AND PRECEDENT

As to precedents, to be sure they will increase in course of time; but the more precedents there are, the less occasion is there for law; that is to say, the less occasion is there for investigating principles.

Boswell: *Life of Dr Johnson*

1. LAW AND FACT

The proper construction of a written contract is a question of law. However, the ascertainment of the meaning of a particular word is a question of fact.[1]

4.01 The division between what is a question of law and what is a question of fact is extremely difficult to draw.[2] However, it has been said on many occasions that the proper interpretation of a contract is a question of law. Thus it is for the judge to interpret the contract, even when he is assisted by a jury,[3] and the jury is bound to accept the judge's direction upon the construction of the contract. Indeed, it is largely because trials were heard by juries that the construction of a contract is classified as a question of law at all. As Lord Diplock pointed out in *Pioneer Shipping Ltd v BTP Tioxide Ltd*[4]:

> "... in English jurisprudence, as a legacy of the system of trial by juries who might not all be literate, the construction of a written agreement, even between private parties, became classified as a question of law ... A lawyer nurtured in a jurisdiction which did not owe its origin to the common law of England would not regard it as a question of law at all ... Nevertheless, despite the disappearance of juries, literate or illiterate, in civil cases in England, it is far too late to change the technical classification of the ascertainment of the meaning of a written contract between private parties as being 'a question of law' for the purposes of judicial review?...".

[1] This paragraph was referred to with approval in *Canada (Attorney General) v Rostrust Investments Inc* [2007] Can. LII 1878. However, the Supreme Court of Canada has now abandoned this historical approach in favour of the view that the interpretation of a contract is a mixed question of fact and law: *Sattva Capital Corp v Creston Moly Corp* 2014 SCC 53.
[2] The problem notably arose in connection with the law of mistake: see *Midland Great Western Railway of Ireland v Johnson* (1858) 6 H.L. Cas. 798; *Cooper v Phibbs* (1867) L.R. 2 H.L. 149; *Solle v Butcher* [1950] 1 K.B. 671. The distinction between law and fact in that context is nowadays of little, if any, importance.
[3] For example, to determine whether a trade custom has been proved, or whether a word bears a secondary trade meaning. In *Turner v Sawdon & Co* [1901] 2 K.B. 653, the trial judge left a question of construction to the jury. The Court of Appeal held that he was wrong to do so, as there was no question proper to be left to the jury. See also *Grenfell v E Meyrowitz Ltd* [1936] 2 All E.R. 1313.
[4] [1982] A.C. 724.

In *Carmichael v National Power Plc*,[5] Lord Hoffmann, while agreeing with Lord Diplock's account of the original reason for the classification, added a further historical gloss:

> "[T]he rule was adopted in trials by jury for purely pragmatic reasons. In mediaeval times juries were illiterate and most of the documents which came before a jury were deeds drafted by lawyers. In the eighteenth and nineteenth centuries the rule was maintained because it was essential to the development of English commercial law. There could have been no precedent and no certainty in the construction of standard commercial documents if questions of construction had been left in each case to a jury which gave no reasons for its decision."

In *Khan v Khan*,[6] Arden L.J. said that there can be no difference in principle between the rules which apply to the interpretation of contractual documents and those which apply to oral contracts.[7]

However, in *Thorner v Majors*,[8] in the context of a discussion of proprietary estoppel rather than contract, Lord Neuberger of Abbotsbury said:

> "(a) the interpretation of a purely written contract is a matter of law, and depends on a relatively objective contextual assessment, which almost always excludes evidence of the parties' subjective understanding of what they were agreeing, but (b) the interpretation of an oral contract is a matter of fact (I suggest inference from primary fact), rather than one of law, on which the parties' subjective understanding of what they were agreeing is admissible."

Apart from the historical origins of the rule (trial by jury) Lord Neuberger suggested that the dichotomy was underpinned by practical reasons. He said:

> "If the contract is solely in writing, the parties rarely give evidence as to the terms of the contract, so it is cost-effective and practical to exclude evidence of their understanding as to its effect. On the other hand, if the contract was made orally, the parties will inevitably be giving evidence as to what was said and done at the relevant discussions or meetings, and it could be rather artificial to exclude evidence as to their contemporary understanding. Secondly, and perhaps more importantly, memory is often unreliable and self-serving, so it is better to exclude evidence of actual understanding when there is no doubt as to the terms of the contract, as when it is in writing. However, it is very often positively helpful to have such evidence to assist in the interpretation of an oral contract, as the parties will rarely, if ever, be able to recollect all the details and circumstances of the relevant conversations."

The practical considerations to which he referred do not appear to differentiate

[5] [1999] 1 W.L.R. 2024.

[6] [2008] Bus. L.R. D73. *Khan v Khan* was followed in *Kahn v Dunlop Haywards (DHL) Ltd* [2007] EWHC 2659 (QB). This corresponds with the view expressed in a previous edition of this book. That edition referred to *Torbett v Faulkner* [1952] 2 T.L.R. 659, in which Romer L.J. said that the ascertainment of the effect of an oral contract was "entirely a question of fact and no question of construction arises". Cf. *Yorkshire Insurance Co Ltd v Campbell* [1917] A.C. 218 at 221, per Lord Sumner. In the author's view this approach conflates the identification of contract terms and their interpretation.

[7] See also *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* [2009] NSWCA 234.

[8] [2009] 1 W.L.R. 776.

between identifying the terms of an oral contract (upon which oral evidence is admissible) and interpreting those terms once they have been identified. In the penultimate sentence of the cited passage Lord Neuberger refers to a written contract where "there is no doubt as to the terms". This can only mean that there is no doubt about what terms were agreed, rather than no doubt about what they mean. The final sentence, however, refers to admitting evidence of subjective intention, not for the purpose of identifying the terms of the contract (what terms were agreed?) but for the purpose of interpreting it (what do the agreed terms mean?). It is submitted that this would be a major departure from the objective nature of contractual interpretation, and indeed seems at variance with the actual decision in the case itself, which was that a representation or assurance should be objectively interpreted, albeit in the context of the particular relationship between the representor and the representee.

Since the proper construction of a written contract is a question of law, the court is not bound by concessions about its meaning made by counsel in the course of argument. In *Bahamas International Trust Co Ltd v Threadgold*,[9] Lord Diplock said:

> "In a case which turns, as this one does, on the construction to be given to a written document, a court called on to construe the document in the absence of any claim to rectification, cannot be bound by any concession made by any of the parties as to what its language means. That is so even in the court before which the concession is made; a fortiori in the court to which an appeal from the judgment of the court is brought. The reason is that the construction of a written document is a question of law. It is for the judge to decide for himself what the law is, not to accept it from any or even all of the parties to the suit; having so decided it is his duty to apply it to the facts of the case. He would be acting contrary to his judicial oath if he were to determine the case by applying what the parties conceived to be the law, if in his own opinion it were erroneous."

In *Singapore Airlines Ltd v Buck*,[10] Arden L.J. confirmed that a court "cannot be bound by the parties' agreement on the matter of the true interpretation of a document." Likewise in *Ross v Bank of Commerce (Saint Kitts Nevis) Trust and Savings Association Ltd*[11] the Privy Council held that "on an issue of construction the Board is not bound by counsel's concession."

However, in *HLB Kidsons v Lloyd's Underwriters*,[12] Rix L.J. said that "a judge should be very sure of his ground" before rejecting a concession about a one-off document, affecting only the parties to the contract, where the party making the concession was as experienced in reading and evaluating such documents as anyone.

For the same reason, the court is not restricted to an interpretation which has been advanced by counsel. Since the question of construction is one of law, it is at large.[13] One further consequence of the principle that the interpretation of a contract is a

[9] [1974] 1 W.L.R. 1514 HL, applied in *Biggin Hill Airport Ltd v Bromley LBC* [2001] EWCA Civ 1089, CA.

[10] [2011] EWCA Civ 1542; [2012] Pens. L.R. 1.

[11] [2012] UKPC 3.

[12] [2009] 1 Lloyd's Rep. 8 at [84].

[13] *Charter Reinsurance Co Ltd v Fagan* [1997] A.C. 313 CA (reversed by HL on different grounds).

question of law is that there is no evidential burden on either party to establish its preferred interpretation.[14]

Although the ascertainment of the meaning of a written contract is a question of law, many steps in the process of ascertaining that meaning are classified as questions of fact.[15] In *Brutus v Cozens*,[16] an appeal concerned the meaning of the word "insulting" as applied to the phrase "insulting behaviour" in the Public Order Act 1936. Lord Reid said:

> "It is not clear to me what precisely is the point of law which we have to decide. The question in the case stated for the opinion of the court is 'Whether, on the above statement of facts, we came to a correct decision in point of law.' This seems to assume that the meaning of the word 'insulting' in s.5 is a matter of law. And the Divisional Court appear to have proceeded on that footing. In my judgment that is not right. The meaning of an ordinary word of the English language is not a question of law. The proper construction of a statute is a question of law. If the context shows that a word is used in an unusual sense the court will determine when that unusual sense is. But here there is in my opinion no question of the word 'insulting' being used in any unusual sense."

This distinction applies to written contracts in the same way.[17]

Nor is this approach confined to "ordinary" words. The ascertainment of a technical term is equally a question of fact. So in *Hill v Evans*,[18] Lord Westbury L.C. said:

> "It is true, as a proposition of law, that the construction of a specification (like the construction of all other written instruments) belongs to the Court; but the specification of an invention contains generally, if not always, some technical terms, some phrases of art, some description of processes which require the light to be derived from what are called the surrounding circumstances. It is therefore an admitted rule of law, that the explanation of the words or technical terms of art, the phrases used in commerce and the proof and results of the processes which are described (and in a chemical patent, the ascertainment of chemical equivalents) that all these are matters of fact upon which evidence may be given, contradictory testimony may be adduced, and upon which it is the province and the right of a jury to decide."

The process of construction or interpretation, therefore, consists of at least two elements, one element of which is factual, and the other legal. The two stage process was summarised by Lindley L.J. in *Chatenay v Brazilian Submarine Telegraph Co*

[14] *Redrow Regeneration (Barking) Ltd v Edwards* [2012] UKUT 373 (LC); [2013] L. & T.R. 8. By contrast there is an evidential burden to establish facts that are relied upon as relevant background.

[15] In *Torbett v Faulkner* [1952] 2 T.L.R. 659, Romer L.J. said that the ascertainment of the effect of an oral contract was "entirely a question of fact and no question of construction arises". Cf. *Yorkshire Insurance Co Ltd v Campbell* [1917] A.C. 218 at 221, per Lord Sumner. These views seem to conflate two stages in the overall question of interpretation.

[16] [1973] A.C. 854.

[17] *Commonwealth Smelting Ltd v Guardian Royal Exchange Assurance Ltd* [1986] 1 Lloyd's Rep. 121; *Belgravia Navigation Co SA v Cannor Shipping Inc, The Times,* April 18, 1988; *Norwich Union Life Insurance Society v P&O Property Holdings Ltd* [1993] 1 E.G.L.R. 164 CA; *Fitzroy House Epworth Street (No. 1) Ltd v The Financial Times Ltd* [2006] 2 All E.R. 776; *Giles v Tarry* [2012] EWCA Civ 837; [2012] 2 P. & C.R. 12.

[18] (1862) 4 De G.P. & J. 288 (a case of interpretation of patents).

Ltd[19] as follows:

> "The expression 'construction,' as applied to a document, at all events as used by English lawyers, includes two things: first the meaning of the words; and secondly their legal effect, or the effect to be given to them. The meaning of the words I take to be a question of fact in all cases, whether we are dealing with a poem or a legal document. The effect of the words used is a question of law."

Thus in a criminal trial it is the function of the judge to rule on the interpretation of a contract, rather than the function of the jury to decide what it means as a question of fact.[20] However, in a libel action although the question whether words are *capable* of bearing a defamatory meaning is a question of law of the judge, whether they *do* bear such a meaning is a question of fact for the jury.[21]

Most questions of fact cannot be determined by the court without evidence to prove them. Sometimes, however, the court may take judicial notice of facts, in which case they may be regarded as proved without the necessity of evidence. Even in such a case, however, it seems unlikely that a party could be prevented from leading evidence on such a fact. In the case of the determination of the meaning of an ordinary English word, evidence of meaning is positively inadmissible. Thus in *Lovell and Christmas Ltd v Wall*,[22] Fletcher Moulton L.J. said:

> "I think that it is arguable that evidence may be taken as to the meaning of the word 'provision merchants'. I say that it is arguable because it must not be thought that the court cannot take judicial cognisance of the fact that the words have different meanings in different contexts. For instance I doubt very much whether the court ought to take evidence as to the meaning of the word 'chair'. That word in connection with domestic furniture has one meaning. But 'chair' in connection with a railway has another. I very much doubt whether a court would consider itself perfectly entitled to take cognisance of the fact that 'chair' used in connection with a railway, means a mode of fastening a rail to a sleeper."

It is, therefore, a curiosity that the ascertainment of the meaning of an ordinary English word is a question of fact which cannot be proved by any admissible evidence.[23]

[19] [1892] 1 Q.B. 79. See also *Neilson v Harford* (1841) 8 M. & W. 806 at 823, per Parke B.

[20] *R. v Spens* [1991] 1 W.L.R. 624 CA.

[21] *Slim v Daily Telegraph* [1968] 2 Q.B. 157.

[22] (1911) 104 L.T. 85. See also *Marquess Camden v IRC* [1913] 1 K.B. 641. In 1977 the word "supermarket" was sufficiently out of the ordinary for evidence to be admissible to explain it: *Calabar (Woolwich) Ltd v Tesco Stores Ltd* [1978] 1 E.G.L.R. 113.

[23] The logic of the rule has been questioned in Australia: *Pepsi Seven-Up Bottlers Perth Pty Ltd v Commissioner of Taxation* (1995) 62 F.C.R. 289; *Dyson v Pharmacy Board* (2000) 50 N.S.W.L.R. 523.

2. FACT

The ascertainment of the terms of a contract which is partly written and partly oral or which is wholly oral is a question of fact.[24]

4.02 Whether the parties intended their contract to be wholly written is a question of fact. If they did not, then the ascertainment of the full terms of the contract is also a question of fact.[25]

In *Moore v Garwood*,[26] Pollock C.B. directed the jury that:

> "... the nature of the contract into which the parties had entered was rather a question of fact than of law, because it did not consist of one distinct contract between the parties, but of a series of acts and things done, from which the jury were to determine what was the real intention and meaning of the parties when they entered into the mutual relation in which they stood ...".

His direction was upheld on appeal. Similarly, in *Maggs v Marsh*,[27] Smith L.J. said:

> "Determining the terms of an oral contract is a question of fact. Establishing the facts will usually, as here, depend upon the recollections of the parties and other witnesses. The accuracy of those recollections may be tested and elucidated by things said and done by the parties or witnesses after the agreement has been concluded."

Similarly, in *BVM Management Ltd v Yeomans*,[28] Aikens L.J. said:

> "When the terms of a contract have to be ascertained from oral exchanges and conduct that is a question of fact... [m]oreover, in the case of a contract which is entirely oral or partly oral, evidence of things said and done after the contract was concluded are admissible to help decide what the parties had actually agreed."

However, in *Keeley v Fosroc International Ltd*,[29] Auld L.J. pointed out that:

> "[W]here document A, acknowledged to have contractual effect, expressly incorporates by reference document B, and there are no other candidates for contractual contribution to the agreement, the construction of a particular provision in document B does not become a fact-finding exercise on the strength of extraneous evidence as to the true intention of the parties, any more than it would have done if the provision had originally appeared in document A. It simply becomes a matter of construction of the two documents read together."

In *Torbett v Faulkner*,[30] Romer L.J. said that the ascertainment of the effect of an oral contract was "entirely a question of fact and no question of construction

[24] This proposition was approved in *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* (2009) 261 A.L.R. 382.
[25] *Carmichael v National Power Plc* [1999] 1 W.L.R. 2024.
[26] (1849) 4 Exch. 681.
[27] [2006] B.L.R. 395.
[28] [2011] EWCA Civ 1254.
[29] [2006] I.R.L.R. 961.
[30] [1952] 2 T.L.R. 659.

arises." It is thought, however, that this bald statement goes too far. While the ascertainment of the terms of an oral contract is a question of fact, the determination of the legal effect of those terms is a question of law. In that sense the construction of a contract is always a question of law. As Arden L.J. put it in *Khan v Khan*[31]:

> "[T]here can be no difference in principle between the rules which apply to the interpretation of contractual documents and those which apply to oral contracts."

3. CATEGORISATION AND CONSTRUCTION

The legal effect of a written contract may involve a two stage process: first to ascertain what rights and obligations the contract creates; and second to determine what kind of contract has been made.

4.03 Many substantive legal rules apply only to contracts of a particular kind. In *A1 Lofts Ltd v HMRC*,[32] Lewison J. said:

> "The court is often called upon to decide whether a written contract falls within a particular legal description. In so doing the court will identify the rights and obligations of the parties as a matter of construction of the written agreement; but it will then go on to consider whether those obligations fall within the relevant legal description."

The latter process is conveniently referred to as categorisation.[33] During the 1970s and 1980s, for example, the courts were frequently required to determine whether a contract created a licence or a tenancy. Whether the occupier of residential property acquired security of tenure depended on the answer to that question. As Lord Templeman put it in *Street v Mountford*[34]:

> "Both parties enjoyed freedom to contract or not to contract and both parties exercised that freedom by contracting on the terms set forth in the written agreement and on no other terms. But the consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence. The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade."

Likewise, in *McEntire v Crossley*,[35] Lord Herschell L.C. said:

> "Coming then to the examination of the agreement, I quite concede that the

[31] [2008] Bus. L.R. D73. See also *Masterton Homes Pty Ltd v Palm Assets Pty Ltd* [2009] NSWCA 234.
[32] [2010] S.T.C. 214. This statement was approved by the Supreme Court in *Revenue and Customs v Secret Hotels2 Ltd* [2014] UKSC 16; [2014] 2 All E.R. 685. See also *IIG Capital LLC v Van Der Merwe* [2008] 2 Lloyd's Rep. 187, per Waller L.J. ("It was common ground before us that it ultimately depends on the true construction of the agreement whether a particular label is the right one to apply to any instrument".)
[33] *Progress Property Co Ltd v Moorgarth Group Ltd* [2011] 2 All E.R. 432.
[34] [1985] A.C. 809. See also *Progress Property Co Ltd v Moorgarth Group Ltd* [2011] 2 All E.R. 432.
[35] [1895] A.C. 457. See also *Welsh Development Agency v Export Finance Co Ltd* [1992] B.C.L.C.

agreement must be regarded as a whole—its substance must be looked at. The parties cannot, by the insertion of any mere words, defeat the effect of the transaction as appearing from the whole of the agreement into which they have entered. If the words in one part of it point in one direction and the words in another part in another direction, you must look at the agreement as a whole and see what its substantial effect is. But there is no such thing, as seems to have been argued here, as looking at the substance, apart from looking at the language which the parties have used. It is only by a study of the whole of the language that the substance can be ascertained."

In *Agnew v Commissioner of Inland Revenue*,[36] the Privy Council considered whether an agreement created a fixed charge or a floating charge. Lord Millett explained:

"In deciding whether a charge is a fixed charge or a floating charge, the court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it. A similar process is involved in construing a document to see whether it creates a licence or tenancy."

Equally the classification of a contract may bring with it particular non-statutory legal rights and obligations. In *Socimer International Bank Ltd v Standard Bank London Ltd*,[37] Lloyd L.J. said:

"If parties enter into a transaction which is a mortgage, then the law imposes certain obligations on the mortgagee, and confers certain rights on the mortgagor, which go back to the intervention of equity in the early development of mortgages. Although a mortgage is a contractual transaction, the imposition of such duties has nothing to do with the implication of terms in a contract under the general law of contracts … Whether these duties are imposed on a given party depends only on whether, on the true analysis of the transaction, it is or is not a mortgage."

Similarly, because of the different legal consequences that may attach to a guarantee on the one hand and an indemnity on the other, it may be important to classify the document as one or the other.[38]

In each case there is a public interest which overrides unrestrained freedom of contract, namely to ensure that the substantive law is properly applied. Lord Walker

148.

[36] [2001] 2 A.C. 710.

[37] [2008] 1 Lloyd's Rep. 558.

[38] *Associated British Ports v Ferryways NV* [2009] 1 Lloyd's Rep. 595.

explained this in *Re Spectrum Plus Ltd*[39]:

"it is the court's duty to characterise the document according to the true legal effect of its terms … In each case there is a public interest which overrides unrestrained freedom of contract. On the lease/licence issue, the public interest is the protection of vulnerable people seeking living accommodation. On the fixed/floating issue, it is ensuring that preferential creditors obtain the measure of protection which Parliament intended them to have."

In considering how to classify a contract, "the task is to decide the nature of the instrument by looking at it as a whole without any preconceptions as to what it is".[40]

In the case of a composite transaction, the court will assess the substance of the transaction taken as a whole.[41]

The question of false labels is considered further in para.9.07, below.

4. PRINCIPLES OF INTERPRETATION ARE NOT RULES OF LAW

A principle of interpretation is a guideline rather than a rule of law; and accordingly will only be applied in the absence of a contrary intention expressed in the contract.

4.04 The court often construes contracts with the assistance of principles of interpretation (often called canons of construction). Over time a particular interpretation may develop into a principle, as a judicial consensus grows.[42] In *Mitchell (George) (Chesterhall) Ltd v Finney Lock Seeds Ltd*,[43] Kerr L.J. pointed out that:

"Rules of construction are not rules of law; they are merely guidelines to the presumed intention of the parties in the light of events which have occurred."

In some cases these principles of interpretation become rebuttable presumptions of substantive law. But the parties are free to modify or exclude any principle of interpretation. For example, it is a principle of interpretation that a timetable in a rent review clause in a lease need not be strictly adhered to.[44] However, the parties may provide expressly, or by implication from contra-indications in the lease, that such a timetable is of the essence of the contract. Nevertheless, the existence of a principle of interpretation or guideline does not absolve the court from its duty of construing the actual agreement which the parties made, and not the agreement which they would have made if they had been wiser.[45]

By contrast, a rule of law operates irrespective of the intention of the parties, and may sometimes controvert it. Thus the grant of exclusive possession of residential accommodation for a term at a rent, where the landlord does not provide services or attendance, results in the creation of a tenancy, whatever the actual intention of

[39] [2005] 2 A.C. 680.

[40] *Gold Coast Ltd v Caja de Ahorros del Mediterraneo* [2002] 1 Lloyd's Rep. 617.

[41] *Brighton & Hove City Council v Audus* [2009] EWHC 340 (Ch).

[42] *The Mercini Lady* [2010] EWCA Civ 1145.

[43] [1983] Q.B. 284. See also *Sabah Flour and Feedmills v Comfez Ltd* [1988] 2 Lloyd's Rep. 647.

[44] *United Scientific Holdings v Burnley Borough Council* [1978] A.C. 904.

[45] *Equity and Law Life Assurance Society Plc v Bodfield Ltd* [1987] 1 E.G.L.R. 124, cited in para.2.04, above.

the parties was.[46] Whether a substantive legal rule applies is a question of classification of the contract, once the rights and obligations that it creates have been determined as a question of interpretation.[47]

5. INTERPRETATION NOT TO BE AFFECTED BY LEGAL RESULT

The interpretation of a contract should not be influenced by the question of whether interpretation in one way as opposed to another would produce a different legal result. However, if one interpretation will result in the contract (or clause) being invalid that may be taken into account.

4.05 Questions of interpretation often arise against the background of substantive law. Answering the question of interpretation in one way will produce a different legal result from answering it in another way. In theory at least, the court should be uninfluenced in interpreting a contract by what the legal result will be. Thus it has been said that in interpreting a covenant in restraint of trade, the court should not approach the task with a prima facie assumption that the covenant is illegal. "You are to construe the contract, and then see whether it is legal."[48] Similarly, in *Moenich v Fenestre*,[49] Lindley L.J. said:

> "The true principle to be applied in construing agreements in restraint of trade is … that the agreement must be approached without reference to the question of its legality or illegality."

In the same case Lopes L.J. said:

> "… you must construe the agreement according to the reasonable meaning of the words used, without regard to what may be the effect of such construction."

Similarly, in considering the effect of a document for the purposes of tax, the court should not approach the problem with any predisposition that the document should, or should not attract tax. In *IRC v Wesleyan and General Assurance Society*,[50] Lord Greene M.R. said:

> "In considering tax matters a document is not to have placed upon it a strained or forced construction in order to attract tax, nor is a strained or forced construction to be placed upon it in order to avoid tax. The document is to be construed in the ordinary way and the provision of the tax legislation then applied to it. If on its true construction, it falls within a certain taxing category, then it is taxed. If, on its true construction, it falls outside the taxing category, then it escapes tax."

The same approach applies when considering whether a document creates a

46 *Street v Mountford* [1985] A.C. 809.
47 See para.4.03, above.
48 *Mills v Dunham* [1893] 1 Ch. 577, per Lindley L.J.
49 (1892) 67 L.T. 602 CA; *Littlewoods Organisation Ltd v Harris* [1977] 1 W.L.R. 1472 CA; *Clarke v Newland* [1991] 1 All E.R. 397 CA; *Arbuthnot Fund Managers v Rawlings* [2003] All E.R. (D) 181 (Mar); *Beckett Investment Management Group Ltd v Hall* [2007] I.C.R. 1539.
50 [1946] 2 All E.R. 749, affirmed [1948] 1 All E.R. 555; *Reed Employment Plc v HMRC* [2015] EWCA Civ 805.

licence or a tenancy. In *Shell-Mex and BP Ltd v Manchester Garages Ltd*,[51] Buckley L.J. said:

> "One has first to find out the true nature of the transaction and then see how the Act operates on that state of affairs. One should not approach the problem with a tendency to attempt to find a tenancy because unless there is a tenancy the case will escape the effects of the statute."

Similarly, in *Street v Mountford*,[52] Lord Templeman said:

> "I accept that the Rent Acts are irrelevant to the problem of determining the legal effect of the rights granted by the agreement. Like the professed intention of the parties the Rent Acts cannot alter the effect of the agreement."

Likewise in deciding whether a clause was a penalty clause, the High Court of Australia said in *Gumland Property Holdings Pty Ltd v Duffy Bros Fruit Market (Campbelltown) Pty Ltd*[53]:

> "if the contractual words clearly have one meaning, the consequence that in that meaning they create a penalty cannot cause them to be given another meaning."

These cases concern the effect of statutes or substantive rules of law on the parties' rights and obligations. Public policy is not treated in quite the same way. So in *Nickerson v Barraclough*,[54] Brightman L.J. said:

> "… I cannot accept that public policy can play any part at all in the construction of an instrument; in construing a document the court is endeavouring to ascertain the expressed intention of the parties. Public policy may require the court to frustrate that intention where the contract is against public policy, but in my view public policy cannot help the court to ascertain what that intention was."

This is, however, too dogmatic a view. If a contract admits of two interpretations, one of which is legal and the other illegal, the courts prefer that which leads to a legal result.[55] Likewise, if a contract admits of two interpretations, one of which makes the contract valid, and the other makes it invalid, the courts prefer that which makes it valid.[56]

In relation to wills Lord Hoffmann explained the position as follows in *Charles v Barzey*[57]:

> "They are substantive rules of public policy which prohibit certain kinds of dispositions or the imposition of certain kinds of conditions. In principle, the application of these rules of public policy comes after the question of construction. One first ascertains the intention of the testator and then decides whether it can be given effect. But nowadays the existence of the rules of public policy may influence the question of construction. If the testator's words can be construed in two different ways, one of which is valid and the other void, then unless the

51 [1971] 1 W.L.R. 612.
52 [1985] A.C. 809.
53 (2008) 234 C.L.R. 237 at [60].
54 [1981] Ch. 426.
55 See para.7.11, below.
56 See para.7.16, below.
57 [2003] 1 W.L.R. 437.

Illustrations

1. An insurance policy covered loss caused by "theft … committed by persons present on the premises". It was held that notwithstanding section 61 of the Law of Property Act 1925 the word "person" meant a natural person and not an artificial person such as a limited company.
Deutsche Genossenschaftsbank v Burnhope[329]

2. A partnership deed provided that if "any partner" committed certain breaches of the agreement then "the other partners" could expel him from the partnership. It was held that notwithstanding s.61 of the Law of Property Act 1925 "the other partners" meant all the other partners, and that one partner could not act alone.
Re a Solicitors' Arbitration[330]

3. A restrictive covenant prohibited use of the burdened land except for the purposes of "a private dwellinghouse". It was held that notwithstanding s.61 of the Law of Property Act 1925 this prevented the use of the land for two or more dwellinghouses.
Crest Nicholson Residential (South) Ltd v MacAllister[331]

[329] [1995] 1 W.L.R. 1580 HL.
[330] [1962] 1 W.L.R. 353.
[331] [2003] 1 All E.R. 46, criticised in *Martin v David Wilson Homes Ltd* [2004] 3 E.G.L.R. 77.

CHAPTER 6

IMPLIED TERMS

Do not expect a work of the classic canon.
Take binoculars to these nests of camouflage—
Spy out what is half there—the page under the page

Wyndham Lewis: *The Song of the Militant Romance*

1. THE NATURE OF IMPLIED TERMS

Implied terms fall broadly into two classes. The first class consists of default rules brought into operation where the parties enter into a particular kind of contractual relationship. The second class consists of elucidating what a particular contract must mean when read in the light of its purpose and the admissible background.

The expression "implied term" is used by lawyers in a wide variety of senses, and a wider variety of circumstances. In *Luxor (Eastbourne) Ltd v Cooper*,[1] Lord Wright said: **6.01**

> "The expression 'implied term' is used in different senses. Sometimes it denotes some term which does not depend on the actual intention of the parties but on a rule of law, such as the terms, warranties or conditions which, if not expressly excluded, the law imports, as for instance under the Sale of Goods Act and the Marine Insurance Act. But a case like the present is different because what it is sought to imply is based on an intention imputed to the parties from their actual circumstances."

In this passage Lord Wright distinguishes between two types of implied term; those which are rules of law, and those which are based on an intention imputed to the parties from their actual circumstances. The rules of law arise because of the nature of the contract into which the parties have entered. In other words the parties have manifested an intention to enter into a relationship of employer and employee, or buyer and seller, or landlord and tenant, and in consequence the law imputes to them a certain intention by virtue of their express intention to enter into that relationship. Similarly, in *Société Générale, London Branch v Geys*,[2] Lady Hale said that it was:

> "… important to distinguish between two different kinds of implied terms. First, there are those terms which are implied into a particular contract because, on its

[1] [1941] A.C. 108 at 137.
[2] [2012] UKSC 63; [2013] 1 A.C. 523; *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch).

proper construction, the parties must have intended to include them.[3] Such terms are only implied where it is necessary to give business efficacy to the particular contract in question. Second, there are those terms which are implied into a class of contractual relationship, such as that between landlord and tenant or between employer and employee, where the parties may have left a good deal unsaid, but the courts have implied the term as a necessary incident of the relationship concerned, unless the parties have expressly excluded it."[4]

Implied terms of the first kind operate as "default rules"[5] as opposed to "ad hoc gap fillers".[6] Where the default rules are those imposed by the common law, it is thought that the parties can in general exclude them by express words.[7] But where they are imposed by statute, it is a question of interpretation of the statute whether they can be excluded. The distinction between standardised implied terms and individual implied terms arising out of a particular contract has become more pronounced over the years. The distinction was drawn by Viscount Simonds and Lord Tucker in *Lister v Romford Ice and Cold Storage Co Ltd*.[8] However, it was not clearly developed until the decision of the House of Lords in *Liverpool City Council v Irwin*.[9] In that case, the House of Lords held that there was to be implied into a contract of tenancy of a flat in a high rise block an obligation on the part of the landlord to take reasonable care to keep in repair and lit essential means of access and rubbish chutes. The clearest expression of the distinction between the two types of implied term is to be found in the speech of Lord Cross of Chelsea who said:

"When it implies a term in a contract the court is sometimes laying down a general rule that in all contracts of a certain type—sale of goods, master and servant, landlord and tenant, and so on—some provision is to be implied unless the parties have expressly excluded it. In deciding whether or not to lay down such a prima facie rule the court will naturally ask itself whether in the general run of such cases the term in question would be one which it would be reasonable to insert. Sometimes, however, there is no question of laying down any prima facie rule applicable to all cases of a defined type but what the court is being in effect asked to do is to rectify a particular—often a very detailed—contract by inserting in it a term which the parties have not expressed. Here it is not enough for the court to say that the suggested term is one the presence of which would make the contract a better or fairer one; it must be able to say that the insertion of the term is necessary to give—as it is put—business efficacy to the contract and that if its absence had been pointed out at the time both parties assuming them to have been reasonable men—would have agreed without hesitation to its insertion."

A similar distinction was also drawn by Lords Wilberforce, Edmund-Davies and

3 *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10; [2009] 1 W.L.R. 1988.
4 *Lister v Romford Ice and Cold Storage Co Ltd* [1957] A.C. 555; *Liverpool City Council v Irwin* [1977] A.C. 239.
5 *Mahmud & Malik v BCCI* [2000] A.C. 20 at 45 per Lord Steyn.
6 *Equitable Life Assurance Society v Hyman* [2002] 1 A.C. 408 at 459 per Lord Steyn.
7 *Photo Productions Ltd v Securicor Transport Ltd* [1980] A.C. 827 at 848 per Lord Diplock.
8 [1957] A.C. 555.
9 [1977] A.C. 239. See also *Duke of Westminster v Guild* [1985] Q.B. 688.

Fraser of Tullybelton.[10] This approach was repeated by Lord Denning M.R. in *Shell UK Ltd v Lostock Garage Ltd*,[11] in which he distinguished between:

"all those relationships which are of common occurrence, such as the relationship of seller and buyer, owner and hirer, master and servant, landlord and tenant, carrier by land and by sea, contractor for building works, and so forth."[12]

and:

"cases, not of common occurrence in which from the particular circumstances a term is to be implied."

Where the court is concerned with a tailor-made implied term, the general test is that of necessity, in the sense that it is what the contract must mean.[13] Where, however, the term in question is said to be a standard term in a contract of a particular nature, wider questions arise. In *Crossley v Faithful & Gould Holdings Ltd*,[14] Dyson L.J. said:

"It seems to me that, rather than focus on the elusive concept of necessity, it is better to recognise that, to some extent at least, the existence and scope of standardised implied terms raise questions of reasonableness, fairness and the balancing of competing policy considerations."[15]

In *Mackers UK Ltd v Camden London Borough Council*,[16] Akenhead J. considered the judgment of Dyson L.J. in *Crossley v Faithful & Gould Holdings Ltd*,[17] where a term was implied as an incident of a legal relationship. He said:

"I do not consider that Dyson LJ was rejecting the 'necessity' element of the implication of terms; that is too well established in English law. He found it simpler to concentrate in that case on the other elements."[18]

It may well be that all circumstances in which the court implies terms (and hence the nature of the terms implied) are but "shades on a continuous spectrum".[19] Professor Glanville Williams observes[20] that there are at least three kinds of implied terms:

(i) terms that the parties probably had in mind but did not trouble to express;

10 Lord Wilberforce described the term as arising as a matter of necessity from the relationship which the parties had agreed upon. The latter two described the term as a "legal incident" of the kind of contract.
11 [1976] 1 W.L.R. 1187.
12 He declined to hold, although tempted, that a "solus" agreement, under which a petrol filling station operator agreed to buy all petrol from a single supplier, was of sufficiently common occurrence to fall within the first category.
13 For different formulations of the test see para.6.05, below.
14 [2004] 4 All E.R. 447. The High Court of Australia has retained the concept of "necessity" even in this class of case: *Commonwealth Bank of Australia v Barker* [2014] HCA 32.
15 See E. Peden, "Policy concerns behind implication of terms in law" (2001) 117 L.Q.R. 459.
16 (2008) 120 Con. L.R. 161.
17 [2004] 4 All E.R. 447.
18 The author is not convinced that this observation is correct.
19 *Liverpool City Council v Irwin* [1977] A.C 239 at 253, per Lord Wilberforce.
20 Professor Glanville Williams in his justly celebrated article "Language and the Law" (1945) 61 L.Q.R. 71 at 401.

(ii) terms that the parties, whether or not they actually had them in mind, would probably have expressed if the question had been brought to their attention; and

(iii) terms that, whether or not the parties had them in mind or would have expressed them if they had foreseen the difficulty, are implied by the court because of the court's view of fairness or policy or in consequence of rules of law.

He points out that of these three kinds of implied term: (i) is an effort to arrive at actual intention; (ii) is an effort to arrive at hypothetical or conditional intention—the intention that the parties would have had if they had foreseen the difficulty; and (iii) is not concerned with the intention of the parties except to the extent that the term implied by the court may be excluded by an expression of positive intention to the contrary. However, as has been seen in Chapter 2, the actual intention of the parties is not what the court is trying to ascertain. What the court seeks to ascertain is the meaning that the contract would convey to a reasonable reader. It is, therefore, more accurate to describe case (i) as an effort to arrive at what the reasonable reader would understand the contract to mean.[21] Both case (i) and case (ii) involve a search for meaning, although case (ii) requires the further assumption that the subsequent difficulty was foreseen at the date of the contract. The contrast between actual and presumed intention in this context was explained by Mason J. in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*[22] as follows:

> "The implication of a term is to be compared, and at the same time contrasted, with rectification of a contract. In each case the problem is caused by a deficiency in the expression of the consensual agreement. A term which should have been included has been omitted. The difference is that with rectification the term which has been omitted and should have been included was actually agreed upon; with implication the term is one which the parties would have agreed had they turned their minds to it—it is not a term actually agreed upon. Thus, in the case of the implied term the deficiency in the expression of the consensual agreement is caused by the failure of the parties to direct their minds to a particular eventuality and to make explicit provision for it. Rectification ensures that the contract gives effect to the parties' actual intention; the implication of a term is designed to give effect to the parties' presumed intention."

Early expressions of the function of the court in implying terms repeatedly stressed the intention of the parties. Thus in *The Moorcock*,[23] Bowen L.J. said:

> "I believe that if one were to take all the instances, which are many, of implied warranties and covenants in law which occur in the earlier cases which deal with real property, passing through the instances which relate to the warranties of title and of quality, and the cases of executory sale and other classes of implied warranties like the implied authority of an agent to make contracts, it will be seen that in all these cases the law is giving to the transaction such efficacy as both parties must have intended it should have."

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21 *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 W.L.R. 1988.

22 (1982) 149 C.L.R. 337 at 346. See also *Liverpool City Council v Irwin* [1977] A.C. 239 at 266D, per Lord Edmund-Davies.

23 (1889) 14 P.D. 64 at 68. See also *Hamlyn & Co v Wood & Co* [1891] 2 Q.B. 488, per Kay L.J. ("the court ought not to imply a term in a contract unless there arises such an inference that the parties must have intended the stipulation in question that the court is necessarily driven to the conclusion that it must be implied").

In these and similar passages, the judges concentrated on the presumed intention of the parties. In later cases, however, the distinction drawn by Lord Wright[24] and Lady Hale[25] has come to the fore.

In practice, however, the court does not always adhere to any rigid division between different kinds of implied term; rather it treats them as shades on a continuous spectrum.[26] In the case of most commercial contracts, the implication of a term may be based either on textual considerations or on a combination of the text of the contract and the background facts. In some cases, however, the court will not imply a term on the basis of background facts. In *Bratton Seymour Service Co Ltd v Oxborough*,[27] Steyn L.J. said of a company's articles of association:

> "I will readily accept that the law should not adopt a black-letter approach. It is possible to imply a term purely from the language of the document itself: a purely constructional implication is not precluded. But it is quite another matter to seek to imply a term into articles of association from extrinsic circumstances. Here, the company puts forward an implication to be derived not from the language of the articles of association but purely from extrinsic circumstances. That, in my judgment, is a type of implication which, as a matter of law, can never succeed in the case of articles of association. After all, if it were permitted, it would involve the position that the different implications would notionally be possible between the company and different subscribers."

This dictum has been approved by the Privy Council.[28]

In *Mosvolds Rederi A/S v Food Corp of India*,[29] however, Steyn J. spoke of three categories of implied term. He said:

> "Sometimes it is said that a term is implied into the contract when in truth a positive rule of law of contract is applied because of the category in which a particular contract falls. Another type of implied term is a term in order to give business efficacy to the contract. The basis of such an implication is that the contract is unworkable without it. There is, however, another form of implication. It is not permissible to imply a term simply because the court considers it to be reasonable. On the other hand, it is possible to imply a term, if the court or arbitrator, as the case may be, is satisfied that reasonable men, faced with the suggested term which *ex hypothesi* was not expressed in the contract, would without hesitation say: 'yes, of course that is so obvious that it goes without saying.'"

To these may be added certain "implied terms" imposed upon the parties irrespective of the express terms of their contract, and sometimes in contradiction of those terms (for example the implied repairing obligations imposed upon a landlord under the Landlord and Tenant Act 1985). These are not really implied terms at all, but are imposed obligations, and stand on a somewhat different footing to terms implied under the Sale of Goods Act 1979 which originate in a statutory codification of the common law. Legislation may also insert implied terms into contracts,

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24 *Luxor (Eastbourne) Ltd v Cooper* [1941] A.C. 108.

25 *Société Générale, London Branch v Geys* [2012] UKSC 63; [2013] 1 A.C. 523.

26 *Liverpool City Council v Irwin* [1977] A.C. 239 at 253, per Lord Wilberforce.

27 [1992] B.C.L.C. 693.

28 *HSBC Bank Middle East v Clarke* [2006] UKPC 31; [2007] L.R.C. 544; *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 W.L.R. 1988.

29 [1986] 2 Lloyd's Rep. 68.

but allow the implied term to be excluded in defined circumstances;[30] but an express term does not negative a term implied by the Act unless inconsistent with it.[31]

In *Dalmare SpA v Union Maritime Ltd*,[32] Flaux J. held that this test would not be satisfied in a case where one obvious meaning of the term in question would not be inconsistent with the statutorily implied term, even though another obvious meaning was.

Where legislation covers a particular area the courts must be especially careful about implying a term covering the same general area.[33]

In addition, the image of "shades on a continuous spectrum" (which comes from the speech of Lord Wilberforce in *Liverpool City Council v Irwin*)[34] itself suggests that at least at some points on the spectrum, the process of implication is a facet of that of interpretation. At one end of the spectrum the court is doing no more than stating the logical corollary of a term expressly agreed.[35] This is clearly part of the process of interpretation. Towards the middle of the spectrum the court is making explicit that which is implicit, not in a logical sense, but in a practical or commercial sense, in the parties' bargain. And at the other end of the spectrum the court is filling gaps in the bargain as expressed.[36]

However, there are unresolved tensions in the notion of the "continuous spectrum". In construing the express terms of a contract the court often stresses the importance of the reasonableness of the construction selected or of the result achieved.[37] By contrast, in discussing the circumstances in which a term is to be implied, the court repeatedly stresses that the touchstone is necessity, not reasonableness. If the implication of terms is part of a continuous spectrum beginning with the construction of express terms, it would seem to follow that at some point in the spectrum there is a radical change in approach. The location of that point is uncertain. Hence some judges do not draw a rigid distinction between the process of interpretation and the process of implication. Thus in *Chaffe v Kingsley*,[38] Sedley L.J. said:

> "The distinction between the construction of documents and the implication of terms, which at the start seemed likely to occupy much of the argument, is often a mare's nest. Attempting the latter inevitably provokes the true but unhelpful response that words are being artificially introduced into a document; attempting the former almost as inevitably provokes the response, equally true and equally unhelpful, that the terms relied on are not visible. It has been helpful, therefore, to be conducted directly on the search for meaning."

It now seems clear that in England the implication of terms is part of the process

[30] For example the Late Payment of Commercial Debts (Interest) Act 1998.

[31] Sale of Goods Act 1979 s.55. This does not apply to a contract to which Ch.2 of Pt I of the Consumer Rights Act 2015 applies: s.55(2), inserted by Consumer Rights Act 2015 Sch.1 para.33.

[32] [2012] EWHC 3537 (Comm); [2013] 1 Lloyd's Rep. 509.

[33] *Johnson v Unisys Ltd* [2003] 1 A.C. 518; *Eastwood v Magnox Electric Plc* [2005] 1 A.C. 503.

[34] [1977] A.C. 239 at 253.

[35] See *Metropolitan Electric Supply Co Ltd v Ginder* [1901] 2 Ch. 799 (para.6.08, Illustration 2, below). This is an example of what Steyn L.J. described as "a purely constructional implication"; *Bratton Seymour Service Co Ltd v Oxborough* [1992] B.C.L.C. 693.

[36] Cited with approval in *The Rio Assu* [1989] 1 Lloyd's Rep. 115 at 120 (Clarke J. aff'd on appeal).

[37] See paras 2.07, above, and 7.17, below.

[38] [2000] 1 E.G.L.R. 104. See also *Legal & General Assurance Co Plc v Expeditors (UK) Ltd* [2007] 2 P. & C.R. 10, where Clarke and Sedley L.JJ. reached the same answer, the former by a process of implication, the latter by a process of construction.

of interpreting the contract, although there had previously been debate about that.[39] In *Mirador International LLC v MF Global UK Ltd*,[40] Lewison L.J. said:

> "Whether this is described as choosing the more commercially sensible of rival interpretations of express terms (*Rainy Sky SA v Kookmin Bank*)[41] or implying a term (*Attorney General of Belize v Belize Telecom Ltd*)[42] does not seem to me to matter; since the objective of both is to determine what the reasonable person with the background knowledge of the parties would have understood the contract to mean (*Rainy Sky* §14; *Belize Telecom* §18)."

Likewise, in *Aspect Contracts (Asbestos) Ltd v Higgins Construction Plc*,[43] Longmore L.J. said:

> "It does not matter much whether one calls this a process of construction or a process of implication because one is only trying to decide what the words mean."

As the Court of Appeal put it in *NRAM Plc v McAdam*[44]:

> "Following the judgment of the Privy Council in *Attorney General of Belize v Belize Telecom Ltd*,[45] the test for the implication of a term into a contract has been largely assimilated with the process of construing the contract."

Similarly, in *McKillen v Misland (Cyprus) Investments Ltd*,[46] Arden L.J. said that on the basis of Lord Hoffmann's approach:

> "... the underlying basis for the implication of a term is the interpretation of the document. Thus, the exercise becomes one of ascertaining the reasonable understandings and expectations of the parties. In other words, 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."

Thus in *Gateway Plaza Ltd v White*,[47] the Court of Appeal did not distinguish between interpretation of the agreement and the implication of terms.

[39] See para.6.03, below. This is the approach that the author adopted in previous editions of this book. In *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] SGCA 43; (2013) 151 Con. L.R. 170 the Singapore Court of Appeal drew a sharp distinction between "interpretation" on the one hand and "construction" on the other. Interpretation is concerned only with the meaning of the express words contained in the contract, whereas construction embraces wider considerations, such as the implication of terms to fill gaps in the contract for which the express terms make no provision. This is not a view to which the author subscribes. In the context of implied terms, it is little more than an arid semantic debate.

[40] [2012] EWCA Civ 1662; *Torre Asset Funding Ltd v The Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch).

[41] [2011] UKSC 50; [2011] 1 W.L.R. 2900.

[42] [2009] UKPC 10; [2009] 1 W.L.R. 1988.

[43] [2013] EWCA Civ 1541; [2014] 1 W.L.R. 1220.

[44] [2015] EWCA Civ 751.

[45] [2009] 1 W.L.R. 1988.

[46] [2013] EWCA Civ 781.

[47] [2014] EWCA Civ 555.

On the basis that the implication of a term is an exercise in interpreting the contract as a whole the "same background material that is admissible and relevant in aid of construction of the express terms of the charters may also be admitted in aid of the determination of the existence of an implied term."[48]

Illustrations

1. Employees of a health board had the right to buy additional years of pension entitlement on favourable terms provided that they exercised their right within a given time limit. It was held that where there was a relationship of employer and employee and: (1) the terms of the contract of employment were not negotiated with the individual employee but resulted from negotiation with a representative body or were incorporated by reference; (2) a particular term of the contract makes available to the employee a valuable right contingent on action being taken by him to avail himself of its benefit; and (3) the employee cannot reasonably be expected to be aware of the term unless it is drawn to his attention; it is an implied term of the contract that the employer will take reasonable steps to bring the relevant provision to the attention of the employee.
Scally v Southern Health and Social Services Board[49]

2. Where a contract of employment relates to an engagement of a class where it is the normal practice of employers to require a reference from a previous employer before offering employment, and the employee accepts employment on the basis that a full and frank reference will be provided at the request of a prospective employer, it is an implied term of the contract that the employer will, during the continuance of the employment or within a reasonable time thereafter, provide a reference based on facts revealed after making those reasonable inquiries which a reasonable employer would make.
Spring v Guardian Assurance Plc[50]

3. It is an implied term of an arbitration agreement that the arbitration is confidential.
Ali Shipping Corp v Shipyard Trogir[51]

4. A term precluding the arbitrary or irrational exercise of a contractual discretion falls into the first category of implied terms.
Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)[52]

5. The principle that a power (e.g. in articles of association) entitling a majority to bind a minority must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only, is a term generally implied by the law as an incident of contracts or arrangements of particular types.
Assenagon Asset Management SA v Irish Bank Resolution Corp Ltd[53]

[48] *Golden Fleece Maritime Inc v St Shipping and Transport Inc* [2007] EWHC 1890 (Comm), per Cooke J.
[49] [1992] 1 A.C. 294 HL.
[50] [1995] 2 A.C. 296 HL.
[51] [1998] 1 Lloyd's Rep. 643. This implied term has been described as a rule of law masquerading as an implied term: *Emmott v Michael Wilson & Partners Ltd* [2008] Bus. L.R. 1361.
[52] [2013] EWCA Civ 200.

2. Test for Implied Terms as Legal Incidents

Where the court is asked to imply a term as a legal incident of a particular legal relationship, the strict test of necessity need not be satisfied. The court is concerned with broader questions of policy.[54]

As has been seen, the court has recently isolated a special category of implied terms, namely those where the court is asked to imply a term as a legal incident of a particular relationship, as a default rule which will apply unless specifically excluded. These kinds of implied term are not based upon the intention of the parties, actual or presumed, in a given instance, although the provenance of a particular term may well have been the commonplace use of such a term in earlier times in contracts of that type, so establishing what later would become the default rule.[55] **6.02**

Where the court decides that a term should be implied as an incident of the legal relationship it is really deciding a question of substantive law. In *Emmott v Michael Wilson & Partners Ltd*,[56] Lawrence Collins L.J., speaking of the implied obligation of confidentiality in an arbitration agreement, said:

"The implied agreement is really a rule of substantive law masquerading as an implied term."

Is this of any legal significance, in terms of the criteria which must be satisfied before such a term will be implied?

In *Lister v Romford Ice and Cold Storage Co Ltd*,[57] the issue was whether there was an implied term in a contract of employment entitling an employee to be indemnified by his employer against liability for negligence in the course of his employment. Viscount Simonds said that the court was concerned, not with a particular contract but:

"with a general question, which if not correctly described as a question of status, yet can only be answered by considering the relation in which the drivers of motor-vehicles and their employers generally stand to each other."

He continued:

"If I were to try to apply the familiar tests where the question is whether a term should be implied in a particular contract in order to give it what is called business efficacy, I should lose myself in the attempt to formulate it with the necessary precision. But this is not conclusive, for as I have said, the solution of the

[53] [2012] EWHC 2090 (Ch); [2013] 1 All E.R. 495.
[54] See *Rosserlane Consultants Ltd v Credit Suisse International* [2015] EWHC 384 (Ch). The High Court of Australia has retained the concept of "necessity" even in this class of case: *Commonwealth Bank of Australia v Barker* [2014] HCA 32.
[55] *University of Western Australia v Gray* (2009) 179 FCR 346. This is an example of a growth of judicial consensus giving rise to a presumption of substantive law. See also *Commonwealth Bank of Australia v Barker* [2014] HCA 32.
[56] [2008] Bus. L.R. 1361.
[57] [1957] A.C. 555.

problem does not rest on the implication of a term in a particular contract but upon more general considerations."

The "more general considerations" are matters of general policy. It seems reasonably clear from this passage that different criteria apply to the implication of terms as legal incidents of particular types of contract. However, the water was muddied by the subsequent case of *Liverpool City Council v Irwin*.[58] Lord Wilberforce[59] treated the case as being simply one in which the court was concerned to complete an obviously incomplete contract. He did, however, recognise that whatever term was to be implied would be a legal incident of the relationship between the parties. He described the appropriate test as follows:

"… such obligation should be read into the contract as the nature of the contract itself implicitly requires, no more, no less; a test in other words of necessity."

Lord Cross of Chelsea took what seems to be a wholly different view. Dealing with the first category of implied term he said:

"In deciding whether or not to lay down such a prima facie rule the court will naturally ask itself whether in the general run of such cases the term in question would be one which it would be reasonable to insert."[60]

Lord Edmund-Davies said that he would have rejected the alleged implied term on the test of necessity, but upheld it as a "legal incident" of the contract. Clearly, therefore, in his Lordship's opinion the criterion to be satisfied before a term can be implied as a legal incident of a legal relationship falls short of necessity.[61]

In *Shell UK Ltd v Lostock Garages Ltd*,[62] Lord Denning M.R. said that in such cases the problem:

"… is to be solved by asking: has the law already defined the obligation or the extent of it? If so, let it be followed. If not, look to see what would be reasonable in the general run of cases … and then say what the obligation shall be."

At this stage the position seems reasonably clear. The views of Lord Cross of Chelsea and Lord Edmund-Davies represent the law. However, a different view was taken in *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd*.[63] In that case, a bank argued that the contract between it and its customer contained an implied term to the effect that the customer would take reasonable care to ensure that in the operation of the bank account the bank was not injured. The Privy Council held that:

[58] [1977] A.C. 239.

[59] With whom Lord Fraser of Tullybelton agreed. This view was adopted by the Court of Appeal in *Mears v Safecar Security Ltd* [1983] Q.B. 54.

[60] Lord Cross contrasted this situation with one where the court is asked to add a term to a particular contract, in which event the appropriate test is necessity. Since Lord Cross gave no other criterion for the implication of terms in cases falling within the first category, it seems that "reasonableness in the general run of cases" is the only one. The distinction drawn by Lord Cross was approved in *J H Ritchie Ltd v Lloyd Ltd* [2007] 1 W.L.R. 670.

[61] This was the view of the Court of Appeal in *Duke of Westminster v Guild* [1985] Q.B. 688 (saying that in respect of the category of case now under consideration Lord Cross stated that "a quite different test" is applicable; and referring to the test for other cases as being "less favourable" to the party asserting the existence of the implied term).

[62] [1976] 1 W.L.R. 1187.

[63] [1986] A.C. 80.

"the relationship between banker and customer is contractual and its incidents, in the absence of express agreement, are such as must be implied into the contract because they can be seen to be obviously necessary."

Accordingly, the alleged term was rejected on the ground that it was not necessary to give business efficacy to the contract. The test adopted by the Privy Council was applied (obiter) by the Court of Appeal in *The Maira*[64] and again in *National Bank of Greece SA v Pinios Shipping Co (No.1)*[65] and *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd*.[66]

In *Scally v Southern Health Board*,[67] Lord Bridge held that an alleged implied term could not be justified as necessary for the business efficacy of an employment contract, but went on to draw a clear distinction:

"between the search for an implied term necessary to give business efficacy to a particular contract and the search, based on wider considerations, for a term which the law will imply as a necessary incident of a definable category of contractual relationship."

Although the second test involves wider considerations, Lord Bridge's formulation suggests that an implied term must still be a *necessary* incident of the relationship. In *Crossley v Faithful & Gould Holdings Ltd*,[68] Dyson L.J. drew the distinction between an implied term as a legal incident of a contractual relationship and a tailor-made implied term. He said:

"This would be a standardised term to be implied by law, that is to say a term which, in the absence of any contrary intention, is an incident of all contracts of employment. It is not a term implied to give business efficacy to the particular contract in question which is dependent on an intention imputed to the parties from the express terms of the contract and the surrounding circumstances."

He rejected the submission that the test was one of necessity and concluded:

"It seems to me that, rather than focus on the elusive concept of necessity, it is better to recognise that, to some extent at least, the existence and scope of standardised implied terms raise questions of reasonableness, fairness and the balancing of competing policy considerations."[69]

In *Société Générale, London Branch v Geys*,[70] Lady Hale approved the approach of Dyson L.J.

In *Makers UK Ltd v Camden London Borough Council*,[71] Akenhead J. considered

[64] [1988] 2 Lloyd's Rep. 126 at 136, per Lloyd L.J. and at 146, per Nicholls L.J.

[65] [1990] 1 A.C. 637 CA (reversed on other grounds: loc. cit.).

[66] [1990] Q.B. 818 CA.

[67] [1992] 1 A.C. 294 HL.

[68] [2004] 4 All E.R. 447.

[69] In an article by Elizabeth Peden, "Policy concerns behind implication of terms in law" (2001) 119 L.Q.R. 459, the policy considerations are grouped under three broad categories: (i) how the implied term will sit with existing law; (ii) how the implied term will affect parties to the relationship; and (iii) wider issues of fairness and society. Dyson L.J. referred to this article with apparent approval in *Crossley v Faithful & Gould Holdings Ltd* [2004] 4 All E.R. 447.

[70] [2012] UKSC 63; [2013] 1 A.C. 523.

[71] (2008) 120 Con. L.R. 161.

the judgment of Dyson L.J. in *Crossley v Faithful & Gould Holdings Ltd*,[72] where a term was implied as an incident of a legal relationship. He said:

> "I do not consider that Dyson LJ was rejecting the 'necessity' element of the implication of terms; that is too well established in English law. He found it simpler to concentrate in that case on the other elements."[73]

A more relaxed approach to the implication of terms as legal incidents of a particular relationship was taken in *William Morton & Co v Muir Brothers & Co*[74] in which Lord McLaren said:

> "The conception of an implied condition is one with which we are familiar in relation to contracts of every description, and if we seek to trace any such implied conditions to their source, it will be found that in almost every instance they are founded either on universal custom or in the nature of the contract itself. If the condition is such that every reasonable man on the one part would desire for his own protection to stipulate for the condition, and that no reasonable man on the other part would refuse to accede to it, then it is not unnatural that the condition should be taken for granted in all contracts of the class without the necessity of giving it formal expression."

This approach was approved by the House of Lords in *J&H Ritchie Ltd v Lloyd Ltd*.[75] To the extent that necessity is the appropriate test in this class of case, a series of Australian decisions suggest that necessity is understood in a different sense. In *Renard Constructions (ME) Pty Ltd v Minister for Public Works*,[76] Priestly J.A. said:

> "It seems to me that the word necessity, when used in the cases analysed by Hope JA[77], was not being used in the absolute sense. In regard to classes of contract to which particular implications have been recognised as attaching, it is not possible to say that the implication was always necessary, in the sense that the contracts could not have worked without the implied term. Contracts of sale, contracts of employment, and leases are three classes of contract to which such terms have been attached. In all cases it would have been possible for the main purposes of the contracts to have been attained without the implications the judges have held they include. The rules in regard to each of them have come into existence not because in the particular cases giving rise to recognition of the implication it has been thought that it would be impossible for such contracts to be made and carried out without the implications, but because the Court decided it would be better or more appropriate or more reasonable in accordance with the contemporary thinking of the judges and parties concerned with such contracts that the term should be implied than that it should not. The idea is conveyed I think by Holmes's phrase 'The felt necessities of the time' where necessity has the sense of something required in accordance with current standards of what ought to be the case, rather than anything more absolute.

[72] [2004] 4 All E.R. 447.
[73] The author is not convinced that this observation is correct.
[74] [1907] S.C. 1211, 1224.
[75] [2007] 1 W.L.R. 670.
[76] (1992) 26 N.S.W.L.R. 234 at 261. This passage was approved in *Devefi Pty Ltd v Mateffy Pearl Nagy Pty Ltd* (1993) 113 A.L.R. 225 at 240.
[77] In *Castlemaine Tooheys v Carlton & United Breweries Ltd* (1987) 10 N.S.W.L.R. 468 at 489.

> This seems to me to be the approach that should be adopted when considering implication by law …".

And in *University of Western Australia v Gray*,[78] Lindgren, Finn and Bennett JJ. said:

> "What is clear is that necessity in this context has a different shade of meaning from that which it has in formulations of the business efficacy test … The principal reason for this is … that implication in law rests 'upon more general considerations' … Those more general considerations require that regard be had 'to the inherent nature of the contract and of the relationship thereby established' … But those very considerations themselves can raise issues of 'justice and policy' … as well as consideration, not only of consequences within the employment relationship, but also of social consequences …".

It must be recognised, however, that the relationship giving rise to the implication of a term as an incident of that relationship must be defined with care.[79] Sometimes the description is a general one. Thus the relation of employer and employee gives rise to an implied obligation not to destroy the trust and confidence that must subsist between the two parties to the employment contract if it is to work effectively.[80] On the other hand, sometimes the relationship is more narrowly defined. In *Scally v Southern Health and Social Services Board*,[81] the implied term required an employer to take reasonable steps to bring to the attention of the employee his entitlement to buy additional years of pension entitlement on favourable terms provided that they exercised their right within a given time limit. However, such a term is not implied into every relationship of employer and employee. It is only implied where the relation of employer and employee is one where: (1) the terms of the contract of employment were not negotiated with the individual employee but resulted from negotiation with a representative body or were incorporated by reference; (2) a particular term of the contract makes available to the employee a valuable right contingent on action being taken by him to avail himself of its benefit; and (3) the employee cannot reasonably be expected to be aware of the term unless it is drawn to his attention. Likewise in the case of the relation of landlord and tenant it is an implied term that the tenant will have quiet enjoyment of the demised property. In *Liverpool City Council v Irwin*,[82] the implied term required the landlord to take reasonable care to keep in repair and lit essential means of access and rubbish chutes. But this obligation is not implied into every relation of landlord and tenant. It applies only to a contract of tenancy of a flat in a high rise block. A planning agreement made under s.106 of the Town and Country Planning Act 1971 is not of such a character as to attract standardised implied terms.[83]

There has been some debate whether the approach to standardised implied terms

[78] [2009] FCAFC 116 at [142]. See also *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151 at 195.
[79] See E. Peden, "Policy concerns behind implication of terms in law" (2001) 117 L.Q.R. 459.
[80] The implied term of trust and confidence does not apply to a highway maintenance agreement (*Bedfordshire County Council v Fitzpatrick Contractors Ltd* [1998] 62 Con. L.R. 64) or to a franchise agreement (*Jani-King (GB) Ltd v Pula Enterprises Ltd* [2007] EWHC 2433 (QBD)).
[81] [1992] 1 A.C. 294 HL.
[82] [1977] A.C. 239.
[83] *Hampshire County Council v Beazer Homes Ltd* [2010] EWHC 3095 (QB).

enables the court to conclude that contracts generally contain an implied term of good faith. In *Yam Seng PTE Ltd v International Trade Corp Ltd*,[84] Leggatt J. said:

> "A paradigm example of a general norm which underlies almost all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically on trust. Yet it is seldom, if ever, made the subject of an express contractual obligation. Indeed if a party in negotiating the terms of a contract were to seek to include a provision which expressly required the other party to act honestly, the very fact of doing so might well damage the parties' relationship by the lack of trust which this would signify....
>
> As a matter of construction, it is hard to envisage any contract which would not reasonably be understood as requiring honesty in its performance. The same conclusion is reached if the traditional tests for the implication of a term are used. In particular the requirement that parties will behave honestly is so obvious that it goes without saying. Such a requirement is also necessary to give business efficacy to commercial transactions."

The judge discussed extensively the question whether English law recognised a general duty of good faith or fair dealing, and came to the conclusion that it did. As he put it:

> "In addition to honesty, there are other standards of commercial dealing which are so generally accepted that the contracting parties would reasonably be understood to take them as read without explicitly stating them in their contractual document. A key aspect of good faith, as I see it, is the observance of such standards. Put the other way round, not all bad faith conduct would necessarily be described as dishonest. Other epithets which might be used to describe such conduct include 'improper', 'commercially unacceptable' or 'unconscionable'."

There would be a breach of that duty if "in the particular context the conduct would be regarded as commercially unacceptable by reasonable and honest people."

However, in *TSG Building Services Plc v South Anglia Housing Ltd*,[85] Akenhead J. said that he "would not draw any principle from this extremely illuminating and interesting judgment which is of general application to all commercial contracts."[86] He went on to hold that even if there was an implied term of good faith it would not override a clear power to terminate the contract "for no, good or bad reason ...

[84] [2013] EWHC 111 (QB); [2013] 1 Lloyd's Rep. 526, applied in *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB).

[85] [2013] EWHC 1151 (TCC); followed by Andrews J. in *Greenclose Ltd v National Westminster Bank Plc* [2014] EWHC 1156 (Ch). See also *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch).

[86] The author agrees. Leggatt J.'s general analysis has not been enthusiastically received: *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200; *Hamsard 3147 Ltd v Boots UK Ltd* [2013] EWHC 3251 (Pat); *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch); *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch). See also S. Whittaker, "Good faith, implied terms and commercial contracts" (2013) L.Q.R. 463. A term of good faith is more readily implied in Australia: see Lewison and Hughes, *The Interpretation of Contracts in Australia*, 1st Australian edn, (Australia: Thomson Reuters, 2012), para.6.14; and a term to this effect was found to exist in *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB).

at any time." It is not considered that at least at present English law recognises a general implication of a term of good faith.[87]

On the other hand, in *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd*[88] Teare J. held that a term was to be implied into an alternative dispute resolution clause requiring the parties to act in good faith in resolving their disputes.

Illustrations

1. It is no part of the relationship between a building contractor and a subcontractor that the former will make sufficient work available to the latter to enable him to maintain reasonable progress or to execute his work in an efficient and economic manner. However, it is part of their relationship that they should co-operate, the degree of co-operation depending on the express terms of the contract. *Grant (Martin) & Co Ltd v Sir Lindsay Parkinson & Co Ltd*[89]

2. It is a necessary incident of an arbitration agreement that it is confidential to the parties. *Ali Shipping Corp v Shipyard Trogir*[90]

3. IMPLICATION OF TERMS AS INTERPRETATION

The court has no power to alter the terms of a contract. Thus the implication of a term is part of the process of interpreting the contract.

6.03 There has been debate in the past on the question whether the implication of a term is truly a question of interpreting the contract. In *Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board*,[91] Lord Pearson said that it had been convenient to contrast a "construction point" with an argument on the implication of a term:

> "without prejudice to the question whether as a matter of strict theory the implication of a term may properly be considered as an aspect of the construction of the contract."

Lord Steyn has given a negative answer to the question. In *National Commercial Bank Jamaica Ltd v Guyana Refrigerators Ltd*,[92] he said:

> "The processes of construction and implication of terms are closely linked, but as a matter of legal analysis they need to be kept separate."

[87] *Greenclose Ltd v National Westminster Bank Plc* [2014] EWHC 1156 (Ch). See also *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch).

[88] [2014] EWHC 2104 (Comm).

[89] (1984) 29 Build. L.R. 31.

[90] [1998] 1 Lloyd's Rep. 643 CA.

[91] [1973] 1 W.L.R. 601.

[92] (1998) 53 W.I.R. 229. In *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] SGCA 43; (2013) 151 Con. L.R. 170 the Singapore Court of Appeal drew a sharp distinction between "interpretation" on the one hand and "construction" on the other. Interpretation is concerned only with the meaning of the express words contained in the contract, whereas construction embraces wider considerations, such as the implication of terms to fill gaps in the contract for which the express terms make no provision. This is not a view to which the author subscribes. It is little more than an arid semantic debate.

In *Gordon & Gotch Australia Pty Ltd v Horwitz Publications Pty Ltd*,[93] Allsop P. and Sackville A.J.A. said:

> "That interpretation can shade into implication and, indeed, that both may perhaps be seen as part of the one process of the construction of words in a document to identify linguistic and legal meaning can be accepted. However, the distinction between interpretation and implication of terms is recognised (even if the limits of each are not capable of clear definition)."

However, an affirmative answer of a kind to the question was given by Mason J. in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*[94]:

> "When we say that the implication of a term raises an issue as to the meaning and effect of the contract we do not intend by that statement to convey that the court is embarking upon an orthodox exercise in the interpretation of the language of the contract, that is, assigning a meaning to a particular provision. Nonetheless, the implication of a term is an exercise in interpretation, though not an orthodox instance."

Other judges have been more positive. In *South Australia Asset Management Corp v York Montagu Ltd*,[95] Lord Hoffmann said:

> "As in the case of any implied term, the process is one of construction of the agreement as a whole in its commercial setting."

Writing extra-judicially,[96] Lord Hoffmann developed this thought. He said:

> "In fact, of course, the implication of a term into a contract is an exercise in interpretation like any other. It may seem odd to speak of interpretation when, by definition, the term has not been expressed in words, but the only difference is that when we imply a term, we are engaged in interpreting the meaning of the contract as a whole. For this purpose, we apply the ordinary rule of contractual interpretation by which the parties are depersonalised and assumed to be reasonable."

This is now the predominant view.[97] In *Meridian International Services Ltd v Richardson*,[98] the Court of Appeal approved the statement of the trial judge that:

> "The implication of terms is part of the process of interpretation of contracts, and even when dealing with an oral as opposed to a written contract, it is necessary to consider the matter in the light of the background."

93 [2008] NSWCA 257.

94 (1982) 149 C.L.R. 337. See also *Winter Garden Theatre (London) Ltd v Millennium Productions Ltd* [1948] A.C. 173 at 198, per Lord Uthwatt ("The question whether any such term can be properly implied is purely a question of the construction of the contract.").

95 [1996] 3 W.L.R. 87 at 93, HL. See also *Equitable Life Assurance Society v Hyman* [2002] 1 A.C. 408 at 459 per Lord Steyn. His Lordship did, however, say that it was necessary to distinguish between interpretation and implication.

96 Lord Hoffmann, "The Intolerable Wrestle with Words and Meanings" (1997) 114 S.A.L.J. 656.

97 The author advocated this view in previous editions of this book.

98 [2008] EWCA Civ 609.

Similarly, in *Transfield Shipping Inc v Mercator Shipping Inc*,[99] Lord Hoffmann said that the implication of a term was "a matter of construction of the contract as a whole in its commercial context".

In *Attorney General of Belize v Belize Telecom Ltd*,[100] giving the advice of the Privy Council, Lord Hoffmann said:

> "[16] Before discussing in greater detail the reasoning of the Court of Appeal, the Board will make some general observations about the process of implication. The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed: see *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912–913. It is this objective meaning which is conventionally called the intention of the parties, or the intention of Parliament, or the intention of whatever person or body was or is deemed to have been the author of the instrument.
>
> [17] The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.
>
> [18] In some cases, however, the reasonable addressee would understand the instrument to mean something else. He would consider that the only meaning consistent with the other provisions of the instrument, read against the relevant background, is that something is to happen. The event in question is to affect the rights of the parties. The instrument may not have expressly said so, but this is what it must mean. In such a case, it is said that the court implies a term as to what will happen if the event in question occurs. But the implication of the term is not an addition to the instrument. It only spells out what the instrument means."

In *Mediterranean Salvage & Towage Ltd v Seamar Trading & Commerce Inc*,[101] Sir Anthony Clarke M.R. predicted that this analysis would soon be as much

99 [2009] A.C. 61.

100 [2009] 2 All E.R. 1127.

101 [2009] EWCA Civ 531; [2010] 1 All E.R. (Comm) 1. It has been suggested that Lord Hoffmann's restatement was not adopted in this case as part of English law (See Davies (2010) L.M.C.L.Q. 140). In the author's view Lord Clarke M.R. treated it as authoritative. Although Rix L.J. reached his decision "whether or not" Lord Hoffmann's new formulation was the "ultimate test", he also adopted Lord Clarke's judgment "in full". Carnwath L.J. did not spell out the test that he adopted but he agreed with Lord Clarke. In the author's view Lord Hoffmann's formulation is (or will become) English law. Aikens L.J. expressed the same view in *Crema v Cenkos Securities Plc* [2010] EWCA Civ 1444; [2011] Bus. L.R. 943. However, in *Groveholt Ltd v Hughes* [2010] EWCA Civ 538 the CA said that the traditional test had not been altered. See also *Rosserlane Consultants Ltd v Credit Suisse International* [2015] EWHC 384 (Ch).

CHAPTER 12

EXEMPTION CLAUSES

A prince never lacks legitimate reasons to break his promise.

Niccolò Machiavelli: *The Prince*

1. CLASSIFICATION OF EXEMPTION CLAUSES

Exemption clauses are encountered in many different forms. Some clauses prevent one party from being liable to the other in the event of what would otherwise be a breach of their contract; some clauses limit the amount of compensation which would otherwise be payable upon a breach of contract; and other clauses require one party to indemnify the other against the consequences of that other's default. In addition clauses which limit the time in which one party may bring a claim against the other are treated in the same way as exemption clauses.

Many commercial contracts are made on standard forms, the majority of which contain provisions designed to eliminate or limit the liability of one contracting party to another.[1] In his work on *Exception Clauses*,[2] Professor Coote divides exception clauses into two classes: **12.01**

"Type A: exception clauses whose effect, if any, is upon the accrual of particular primary rights.

Thus where words relating to quality have been employed by a vendor of goods, an exclusion of conditions, warranties, or undertakings as to quality, helps determine the extent to which those words are contractually binding as, by the same token, would a stipulation by the vendor that he should not be required to make compensation for poor quality.

Type B: exception clauses which qualify primary or secondary rights without preventing the accrual of any particular primary right. Examples would be limitations on the time within which claims might be made, and limitations as to the amount which might be recovered on a claim. By contrast, a clause which purported to take away a buyer's right to reject goods would belong to Type A."

As will be seen, this classification was at variance with many dicta of high authority. However, Professor Coote's views have gained some judicial acceptance in more recent years.

A tripartite classification was made in *Kenyon, Son & Craven Ltd v Baxter Hoare*

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[1] See E. MacDonald, *Exemption Clauses, Penalty Clauses and Unfair Terms*, 2nd edn (London: Bloomsbury Professional, 2006) for comprehensive coverage if a little out of date.

[2] (1964) London.

& Co Ltd.[3] Donaldson J. said:

> "Protective conditions are of three distinct types: first those which limit or reduce what would otherwise be the defendants' duty; second, those which exclude the defendants' liability for breach of specified aspects of that duty, and third, those which limit the extent to which the defendant is bound to indemnify the plaintiff in respect of the consequences of breaches of that duty."

In terms of a classification, there is a considerable overlap between the first and second "distinct types", for there is little theoretical difference between limiting the defendant's duty and excluding liability for breach of duty.[4] In substance, therefore, this follows Professor Coote's classification.

In *Photo Productions Ltd v Securicor Transport Ltd*,[5] Lord Diplock analysed the obligations upon contracting parties created by the contract. He divided them into primary obligations (that is, what each party promised to do), general secondary obligations (that is, to pay damages in the event of a breach of a primary obligation) and anticipatory secondary obligations (that is, to pay damages for future non-performance of primary obligations in a case where the breach of the primary obligation has amounted to a repudiation of the contract accepted by the other party). Lord Diplock continued:

> "... an exclusion clause is one which excludes or modifies an obligation, whether primary, general secondary or anticipatory secondary, that would otherwise arise under the contract by implication of law. Parties are free to agree to whatever exclusion or modification of all three types of obligations they please within the limits that the agreement must retain the legal characteristics of a contract and must not offend against the equitable rule about penalties, that is to say it must not impose on the breaker of a primary obligation a general secondary obligation to pay to the other party a sum of money that is manifestly in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of the primary obligation."

This description assimilates all categories of exclusion clause. However, the strands of the description reveal a division of exclusion clauses into six categories:

(i) clauses which exclude primary obligations;
(ii) clauses which modify primary obligations;
(iii) clauses which exclude general secondary obligations;
(iv) clauses which modify general secondary obligations;
(v) clauses which exclude anticipatory secondary obligations;
(vi) clauses which modify anticipatory secondary obligations.

In essence categories (i) and (ii) are the same as Professor Coote's Type A, and categories (iii) to (vi), which themselves overlap conceptually, are comprehended in Professor Coote's Type B.

Timebar clauses were included in the following description given by Lord

[3] [1971] 1 W.L.R. 519.
[4] There may be a practical difference in the application of the Consumer Rights Act 2015. See especially s.66(4)(a) (defining "negligence" by reference to obligations express or implied of a contract).
[5] [1980] A.C. 827. Lord Diplock foreshadowed this analysis in *Ward (RV) Ltd v Bignall* [1967] 1 Q.B. 534 and *Moschi v Lep Air Services Ltd* [1973] A.C. 331.

Wilberforce in *Suisse Atlantique Societe D'Armement Maritime SA v NV Rotterdamsche Kolen Centrale*[6]:

> "I treat the words 'exceptions clause' as covering broadly such clauses as profess to exclude or limit, either quantitatively or as to the time within which action must be taken, the right of the injured party to bring an action for damages."

The principles of interpretation that apply to exemption clauses apply to other clauses of the same nature, such as a claims control clause in a reinsurance policy, or a condition precedent to reinsurers' liability.[7]

In *Dorset County Council v Southern Felt Roofing Ltd*,[8] a building contract expressly provided that the employer should bear the risk of loss caused by certain specified perils. The Court of Appeal held that although the clause was not in terms expressed as an exemption clause, it potentially had the effect of absolving one party from tortious liability to the other, and hence construed it in accordance with the principles developed in relation to exclusion clauses.

However, in *BHP Petroleum Ltd v British Steel Plc*,[9] it was held that an orthodox defects liability clause in a building contract was not an exemption clause. It operated for the benefit of both parties. The employer is entitled to have the defects rectified without having to engage and pay another contractor to carry out the rectification: the contractor or supplier is entitled to carry out the rectification himself which may normally be expected to be less expensive for him than having to reimburse the cost to the employer of having it done by others.

The distinction is one between clauses that exclude liability and clauses which define the terms upon which the parties are conducting their business; in other words, clauses which prevent an obligation from arising in the first place.[10] Courts are more receptive than hitherto about concluding that clauses define the scope of obligations rather than exclude liability for breach.

The importance of defining or classifying what an exclusion clause is lies in part in the traditional hostility of the courts to exclusion clauses, and in the development of principles of construction which are applied to exclusion clauses; and in part because exemption clauses are subject to statutory controls.

2. INTERPRETATION OF CONTRACT AS A WHOLE

In interpreting an exemption clause, it must be interpreted in the context of the contract as a whole, rather than in isolation.

12.02 For many years there was a strong body of judicial opinion suggesting that the correct approach to the interpretation of an exemption clause was to consider the remainder of the contract apart from the exemption clause, and then to consider whether the exemption clause affords a defence to what would otherwise be the legal liability of the party seeking to rely on the exemption clause. The foundation

[6] [1967] 1 A.C. 361.
[7] *Beazley Underwriting Ltd v Al Ahleia Insurance Co* [2013] EWHC 677 (Comm).
[8] (1989) 48 B.L.R. 96 CA.
[9] [2000] 2 Lloyd's Rep. 277; *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd* [2009] EWHC 1919 (TCC).
[10] *JP Morgan Chase Bank v Springwell Navigation* [2008] EWHC 1186 (Comm); *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd* [2009] EWHC 1919 (TCC). See also *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235 at [215].

of this approach is the celebrated judgment of Scrutton L.J. in *Rutter v Palmer*,[11] in which he said:

"In construing an exemption clause certain general rules may be applied:
First the defendant is not exempted from liability for the negligence of his servants unless adequate words are used; secondly, the liability of the defendant apart from the exempting words must be ascertained; then the particular clause in question must be considered; and if the only liability of the party pleading the exemption is a liability for negligence, the clause will more readily operate to relieve him."

So too in *Beaumont-Thomas v Blue Star Line Ltd*,[12] Scott L.J. said:

"In order to construe any exception of liability for events happening in the performance of a contract, where the words of the exception are not so clear as to leave no doubt as to their meaning, it is essential first to ascertain what the contractual duty would be if there were no exception."

A similar statement was made by Denning L.J. in *Karsales (Harrow) Ltd v Wallis*[13]:

"It is necessary to look at the contract apart from the exempting clauses and see what are the terms, express or implied, which impose an obligation on the party. If he has been guilty of a breach of those obligations in a respect which goes to the very root of the contract, he cannot rely on the exempting clauses."

Such an approach would treat exemption clauses in a markedly different way from other clauses in a contract, for it is a basic principle of interpretation that any contract must be construed as a whole.[14] The divergent approaches appear in a single judgment of Scrutton L.J. in *Calico Printers' Association v Barclays Bank Ltd*.[15] In that case he said:

"First of all, in my view, you do not take part of the document and consider it by itself; you are to construe the whole document. The parties have used a set of words to express their legal relations to each other and it is no good saying: 'Here I find in sentence A clear words, so I need not trouble about sentence B, because sentence B, if it contradicts sentence A, I will reject as repugnant, and I will … assume that these parties used these words not meaning anything by them, and therefore I need not trouble about them because they do use clear language in sentence A."

However, later in his judgment he said:

"First of all, you construe the whole words that are used and not a portion of them. Then you look to see what could be the suggested liability without the clause which purports to exempt from liability."

[11] [1922] 2 K.B. 87.
[12] [1939] 3 All E.R. 127.
[13] [1956] 1 W.L.R. 936. In so far as Lord Denning M.R. suggested that a party in fundamental breach cannot rely on an exemption clause, he was in error: see *Photo Production Ltd v Securicor Ltd* [1980] A.C. 827.
[14] See para.7.02, above.
[15] (1931) 145 L.T. 51.

The second passage seems to be somewhat at variance with the first, and indeed the tenor of the judgment was to the effect that the clause in question limited the primary obligation of the party seeking to rely on it. The approach outlined in the first of the quoted passages is the correct one. The second approach treats all exemption clauses as being in the nature of defences only, whereas exemption clauses may operate before any question of defence arises by limiting the parties' primary obligations themselves. This point of view was convincingly advanced by Professor Coote,[16] and now seems to have gained judicial acceptance.[17]

Thus in *Swiss Bank Corp v Brink's Mat Ltd*,[18] Bingham J. said of an exclusion clause (cl.13):

"My task, therefore, is to construe cl. 13 (i) and (iii) in the context of the contract as a whole and of the business relationship between these parties."

Likewise, in *National Westminster Bank v Utrecht-America Finance Co*,[19] Clarke L.J. said of an exclusion clause (cl.8.2(d)):

"like any clause, clause 8.2 (d) must be construed in its context and in the context of the contract as a whole having regard to its factual matrix or surrounding circumstances."

More recently, in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*,[20] Lord Hoffmann, discussing whether a clause excluded liability for negligence, said:

"The question, as it seems to me, is whether the language used by the parties, construed in the context of the whole instrument and against the admissible background, leads to the conclusion that they must have thought it went without saying that the words, although literally wide enough to cover negligence, did not do so. This in turn depends upon the precise language they have used and how inherently improbable it is in all the circumstances that they would have intended to exclude such liability."

Similarly, in *Dairy Containers Ltd v Tasman Orient Line CV*,[21] Lord Bingham of Cornhill said of an exemption clause:

"This clause must be construed in the context of the contract as a whole."

So also in *Renton (GH) & Co Ltd v Palmyra Trading Corp of Panama*,[22] a bill of lading provided for the transport of cargo from Canada to London and Hull "or so near thereunto as the vessel may safely get". A further clause stated that in the event of strikes preventing the vessel from entering the port of discharge the master

[16] Coote B. "Exemption Clauses". In John Bell (ed), *The Cambridge Law Journal* (London: Sweet & Maxwell, 1964), pp.7–14.
[17] *JP Morgan Chase Bank v Springwell Navigation* [2008] EWHC 1186 (Comm); *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd* [2009] EWHC 1919 (TCC). See also *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235 at [215]. Contra see Adams (1978) 41 M.L.R. 703; Adams and Brownsword (1988) 104 L.Q.R. 94.
[18] [1986] 2 Lloyd's Rep. 79.
[19] [2001] 3 All E.R. 733 CA.
[20] [2003] 2 Lloyd's Rep. 61.
[21] [2005] 1 W.L.R. 215.
[22] [1957] A.C. 149.

might discharge the cargo at port of loading or any other safe and convenient port, and that such discharge was to be deemed due fulfilment of the contract. In consequence of a strike at the ports of discharge the cargo was discharged at Hamburg. The shipowners were held not to be liable for failure to discharge at the named ports. The latter clauses were treated as modifying the primary obligations created by the earlier clause. Lord Morton of Henryton said:

> "The contract contained in the bill of lading must be read as a whole. So read, it provides, in effect, that the goods must be carried to London unless there occurs an event specified in one or other of the provisos already mentioned; but if such event happens, the goods may be discharged elsewhere, and such discharge is to be deemed to be due fulfilment of the contract. No conflict arises when an obligation in a contract, unqualified in its terms as it is first stated, is subsequently qualified by a proviso modifying or altering the obligation if certain events happen which are outside the control of either party. The original obligation and the qualification of it both form part of the intention of the parties and neither part is repugnant to the other."

In *Farstad Supply A/S v Enviroco Ltd*,[23] the question was whether cl.33.5 of a charterparty excluded the charter's liability for negligence. Lord Clarke said:

> "Like any other term in a contract, clause 33.5 must be construed in its context as part of clause 33 as a whole, which must in turn be set in its context as part of the charterparty, which in its own turn must be considered against the relevant surrounding circumstances or factual matrix."

Similarly, the tripartite classification of exemption clauses by Donaldson J. in *Kenyon, Son & Craven v Baxter Hoare & Co*[24] recognises that such clauses may "limit or reduce what would otherwise be the defendant's duty".

A similar approach was adopted by Kerr J. in *The Angelia*.[25] In that case cl.2 of a charterparty provided that unavoidable hindrances in transporting, loading or receiving the cargo, restraints of established authorities and any other causes or hindrances happening without the fault of the charterers, shippers or suppliers of cargo, preventing or delaying the supplying, loading or receiving of the cargo were excepted. Kerr J. said:

> "It is true that on the basis of its wording clause 2 is properly to be described as an exception clause. This has the consequence, for instance, that it must be strictly construed. But its effect in the context of the question whether or not it can be relied on as an answer to an allegation of fundamental breach cannot depend on the semantic question whether the charterparty says: 'I promise to supply a cargo but shall not be liable if I do not do so due to unavoidable hindrances,' or 'I promise to supply a cargo unless prevented by unavoidable hindrances.' The conclusive answer to any allegation of fundamental breach is in my view that the relevant provision (whether it be properly described as an exception clause or as a qualification of the obligation) excuses non-performance due to circumstances which are not the fault of the charterers."

This approach was confirmed by Lord Diplock in *Photo Production Ltd v*

[23] [2010] 2 Lloyd's Rep. 387.
[24] [1971] 1 W.L.R. 519. See para.12.01, above.
[25] [1973] 1 W.L.R. 210.

Securicor Ltd.[26] In his description of the nature of exclusion clauses[27] he clearly recognises that an exclusion clause may exclude or modify the primary obligations of a contracting party; that is to say that an exclusion clause may prevent a breach from arising at all. Whether it does so is, it is suggested, a question of interpretation of the contract as a whole.

Similarly, in *Smith v South Wales Switchgear Ltd*,[28] Lord Fraser of Tullybelton said that the indemnity clause considered in that case could not be read in isolation from its context in the clause as a whole and in the context of the general conditions of the contract.

Thus in *E.E. Caledonia Ltd v Orbit Valve Co Europe*,[29] Steyn L.J. said:

> "It is sometimes right to take into account an obligation to insure in construing an indemnity or exemption clause. That is so because that context may reveal an allocation of risks which are insurable and expected to be insured."

As Basten J.A. pointed out in *Gardiner v Agricultural and Rural Finance Pty Ltd*[30]:

> "If the contract is read as a whole, one is, perhaps, more likely to reach the conclusion that what might otherwise be seen as an exception which excuses liability for failure to perform, will rather be construed as a limitation on the scope of performance."[31]

But although the exemption clause is construed in its context in the whole of the contract, that context may itself give grounds for limiting the literal meaning of the exclusion. In *Morley v United Friendly Society Plc*[32] an insurance policy against personal injury excluded liability for injury resulting from "wilful exposure to needless peril". Beldam L.J. said:

> "An exclusion clause in an insurance policy has to be construed in a manner consistent with and not repugnant to the purpose of the policy. To construe the words 'wilful exposure to needless peril' so as to deprive the insured of benefit under the policy whenever it could be shown that his intentional acts had exposed him to substantial risk would severely restrict the scope of the indemnity against accidental bodily injury. To avoid liability insurers must show that the exposure to needless peril was wilful, not merely that intentional acts done by the deceased resulted in his being exposed to such peril."

In *A Turtle Offshore SA v Superior Trading Inc*,[33] Teare J. said:

> "However, contracts are not construed literally but, as it has been put in the past, with regard to the main purpose of the contract or, as it is now frequently put, in the context of the contract as a whole. Thus, however wide the literal meaning

[26] [1980] A.C. 827.
[27] See para.12.01, above.
[28] [1978] 1 W.L.R. 165.
[29] [1994] 1 W.L.R. 1515 CA.
[30] [2007] NSWCA 235 at [215], referring to this paragraph in a previous edition.
[31] See also *JP Morgan Chase Bank v Springwell Navigation* [2008] EWHC 1186 (Comm); *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd* [2009] EWHC 1919 (TCC).
[32] [1993] 1 Lloyd's Rep. 490 CA.
[33] [2009] 1 Lloyd's Rep. 177 at [109].

of an exemption clause, consideration of the main purpose of the contract or of the context of the contract as a whole may result in the apparently wide words of an exemption clause being construed in a manner which does not defeat that main purpose or which reflects the contractual context."

The same approach applies to a clause in a contract which allocates risk as between the parties.[34]

3. GENERAL APPROACH TO EXEMPTION CLAUSES

The courts' traditional hostility to exclusion clauses has diminished in modern times, and it may vary with the extent of protection which the clause in question seeks to afford.[35]

12.03 In *Tradigrain SA v Intertek Testing Services (ITS) Canada Ltd*,[36] Moore-Bick L.J. said:

"It is certainly true that English law has traditionally taken a restrictive approach to the construction of exemption clauses and clauses limiting liability for breaches of contract and other wrongful acts. However, in recent years it has been increasingly willing to recognise that parties to commercial contracts are entitled to apportion the risk of loss as they see fit and that provisions which limit or exclude liability must be construed in the same way as other terms."

Similarly, in *Frans Maas (UK) Ltd v Samsung Electronics (UK) Ltd*,[37] Gross J. said that:

"words, even in exclusion clauses, mean what they say and the parties will be held to the bargain into which they have entered. Further, it is a matter of construction rather than law as to whether liability for deliberate acts will be excluded, though of course the wording must be clear."

In *Mitchell (George) (Chesterhall) Ltd v Finney Lock Seeds Ltd*,[38] Lord Denning M.R. traced the history of the court's approach to the interpretation of exclusion clauses.[39] He concluded that the court has only permitted reliance on exclusion clauses where to do so was fair and reasonable, and that in other cases judges have used a variety of devices to prevent reliance on the clause. In *Photo Production Ltd v Securicor Ltd*,[40] Lord Salmon said:

"Clauses which absolve a party to a contract from liability for breaking it are no doubt unpopular, particularly when they are unfair."

So too in *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd*,[41] Lord Wilberforce, considering a clause which attempted to limit the liability of one party

[34] Above.
[35] This paragraph was referred to with apparent approval in *Air Transworld Ltd v Bombardier Inc* [2012] EWHC 243 (Comm); [2012] 1 Lloyd's Rep. 349.
[36] [2007] 1 C.L.C. 188.
[37] [2004] 2 Lloyd's Rep. 251.
[38] [1983] Q.B. 284.
[39] The passage is quoted in para.2.11, above.
[40] [1980] A.C. 827.
[41] [1983] 1 W.L.R. 964.

to a fixed financial amount, said:

"Clauses of limitation are not regarded by the courts with the same hostility as clauses of exclusion; this is because they must be related to other contractual terms, in particular to the risks to which the defendant party may be exposed, the remuneration which he receives and possibly also the opportunity of the other party to insure."

As Lord Denning M.R. demonstrated in the passage referred to above, the court's hostility to exclusion clauses manifested itself in the court's tendency to adopt a strained and artificial construction in order to strike down the clause. This practice has now been disapproved by the House of Lords. The catalyst which prompted this far reaching change in judicial attitude was undoubtedly the enactment of the Unfair Contract Terms Act 1977. Since then, the Unfair Terms in Consumer Contracts Regulations 1999 and now the Consumer Rights Act 2015 have carried the process further. The effect of these Acts, and the Regulations, except in so far as they affect the interpretation of contracts, is outside the scope of this book.[42]

In *Photo Production Ltd v Securicor Ltd*,[43] Lord Diplock said:

"... The reports are full of cases in which what would appear to be very strained constructions have been placed upon exclusion clauses, mainly in what today would be called consumer contracts and contracts of adhesion. As Lord Wilberforce has pointed out, any need for this kind of judicial distortion of the English language has been banished by Parliament's having made these kinds of contracts subject to the Unfair Contract Terms Act 1977. In commercial contracts negotiated between businessmen capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction on words in an exclusion clause which are clear and fairly susceptible of one meaning only even after due allowance has been made for the presumption in favour of the implied primary and secondary obligation."[44]

The sentiment was repeated by Lord Wilberforce in *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd*,[45] in which he said that "one must not strive to create ambiguities by strained construction," and in *Mitchell (George) (Chesterhall) Ltd v Finney Lock Seeds Ltd*[46] by Lords Diplock and Bridge of Harwich. It may safely be said that the court will no longer give a strained interpretation to an exclusion clause.

An expression of the new balance may be found in the judgment of the High Court of Australia in *Darlington Futures Ltd v Delco Australia Pty Ltd*[47] in which it was said:

"... the interpretation of an exclusion clause is to be determined by construing

[42] See E. MacDonald, *Exemption Clauses, Penalty Clauses and Unfair Terms*, 2nd edn (London: Bloomsbury Professional, 2006) for comprehensive coverage.
[43] [1980] A.C. 827.
[44] For the meaning of these terms see para.12.01, above.
[45] [1983] 1 W.L.R. 964.
[46] [1983] 2 A.C. 803.
[47] (1986) 61 A.L.J.R. 76.

the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the contract and, where appropriate, construing the clause *contra proferentem* in case of ambiguity."

Thus in *Nissho Iwai Australia Ltd v Malaysian National Shipping Corp Bhd*,[48] it was argued that in a contract for the carriage of goods an exclusion clause should not be construed as covering non-delivery of the goods, since that would defeat the main object of the contract. The High Court of Australia said:

"But, relevant as that object is in the construction of clause 8(2), the meaning of that provision ultimately depends on its language, read in context, and not on any a priori notion that the non-delivery of goods was not intended to be protected. In determining whether an exemption clause should be construed so as to apply to an event which has defeated the main object of the contract, much must depend on the nature of the events which the clause identifies as giving rise to the exemption from liability. If the happening of a stipulated event will always result in the defeat of the main object of the contract, there will be no scope for holding that that object requires the conclusion that the exempting clause is not applicable to that event. But even in cases where the occurrence of the events stipulated in an exemption clause will not always defeat the main object of the contract, the nature of those events may nevertheless give rise to the inference that the clause was intended to apply to those events even when they occur in circumstances which defeat the main object of the contract."

In *Whitecap Leisure Ltd v John H Rundle Ltd*,[49] Moore-Bick L.J. said:

"One can find in the authorities many statements to the effect that exclusion clauses must be clear and unambiguous if they are to operate effectively, many of which date from a period when courts took a more literal approach to the construction of commercial documents in general than is now generally the case. The modern approach to construction, which applies as much to exclusion and limitation clauses as to other contractual terms, is to ascertain the objective intention of the parties from the words used and the context in which they are found, including the document as a whole and the background to it: see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd*,[50] and *Investors Compensation Scheme v West Bromwich Building Society*. However, in cases where there is uncertainty about the parties' intention, and therefore about the meaning of the clause, such uncertainty will be resolved against the person relying on the clause and the more significant the departure is said to be from what are accepted to be the obligations ordinarily assumed under a contract of the kind in question, the more difficult it will be to persuade the court that the parties intended that result."

In *Stocznia Gdynia SA v Gearbulk Holdings Ltd*,[51] Burton J. said:

"I would venture only with reluctance into this narrow causeway between the

[48] (1989) 167 C.L.R. 219; *Glebe Island Terminals Pty Ltd v Continental Seagram Pty Ltd* [1994] 1 Lloyd's Rep. 213 (Supreme Court of New South Wales).
[49] [2008] 2 Lloyd's Rep. 216; applied in *University of Wales v London College of Business Ltd* [2015] EWHC 1280 (QB).
[50] [1997] A.C. 749.
[51] [2008] 2 Lloyd's Rep. 202.

Scylla of *clear words* and the Charybdis of *natural plain meaning*, particularly when it is difficult to see by whose dicta, if any, I am bound. However, it does seem to be common ground that what is now disapproved is any approach which requires a strained interpretation in order to oust the natural meaning of the words: but that it is still necessary to recognise that courts must be persuaded that it was indeed the intention of the parties that a wrongdoer's liability be wholly ousted. In the event, I have not found it necessary to elect for either of the suggested canons of construction or, put another way, I am satisfied that, whichever of the two is adopted, the answer would be the same in this case."

When that case reached the Court of Appeal[52] Moore-Bick L.J. accepted the submission that the approach of the courts to the construction of exclusion clauses has developed in favour of a greater willingness to give them the meaning which the words used would naturally bear. However, he did not accept the submission that:

"as the law stands today there are two competing approaches struggling for supremacy: one requiring clear express words, the other favouring the natural meaning of the words used."

He said that:

"It is important to remember that any clause in a contract must be construed in the context in which one finds it, both the immediate context of the other terms and the wider context of the transaction as a whole. The court is unlikely to be satisfied that a party to a contract has abandoned valuable rights arising by operation of law unless the terms of the contract make it sufficiently clear that that was intended. The more valuable the right, the clearer the language will need to be."

In *Bikam OOD v Adria Cable Sarl*,[53] Simon J. rejected a submission that exclusion and limitation clauses are to be construed restrictively; and also held that no residual hostility applies to clauses which attempt to limit the liability of parties to a fixed financial amount. Likewise, in *Fujitsu Services Ltd v IBM United Kingdom Ltd*,[54] Carr J. said:

"There is no reason to approach the exercise of construing an exemption or limitation of liability clause in any way different to any other term in a contract."

However, in *Newman v Framewood Manor Management Co Ltd*,[55] Arden L.J. said:

"As the exoneration clause has to be interpreted *contra proferentem*, it is only right to give it its narrower meaning."

[52] [2009] 1 Lloyd's Rep. 461.
[53] [2012] EWHC 621 (Comm); [2012] Bus. L.R. D109.
[54] [2014] EWHC 752 (TCC).
[55] [2012] EWCA Civ 159; [2012] 2 E.G.L.R. 45; *The Financial Services Authority v Asset LI Inc* [2013] EWHC 178 (Ch); *Great Elephant Corp v Trafigura Beheer BV* [2013] EWCA Civ 905; [2014] 1 Lloyd's Rep. 1 (a force majeure clause).

4. STRICT CONSTRUCTION

Exemption clauses in contracts are construed strictly, but the degree of strictness may vary with the extent of the exemption conferred by the clause.

12.04 Parties who enter into contracts tend to assume that contractual promises will be performed and to concern themselves less with what the consequences of non-performance will be. Moreover commercial considerations militate against making explicit the refusal of one party to accept liability for non-performance. In *Hollier v Rambler Motors (AMC) Ltd*,[56] Salmon L.J. said:

> "It is well settled that a clause excluding liability for negligence should make its meaning plain on its face to an ordinarily literate and sensible person. The easiest way of doing that, of course, is to state expressly that the garage, tradesman or merchant, as the case may be, will not be responsible for any damage caused by his own negligence. No doubt merchants, tradesmen, garage proprietors and the like are a little shy of writing in an exclusion clause quite so blunt as that. Clearly it would not attract customers, and might even put many off."

The same point was pithily made by Lord Halsbury in *Nelson Line (Liverpool) Ltd v James Nelson & Sons Ltd*[57]:

> "Lord Blackburn used to say that the contest between commercial men and lawyers was that the commercial men always wished to write it short and the lawyers always wished to write it long; but a mixture of the two renders the whole thing unintelligible."

The court has therefore insisted that a party who wishes to relieve himself from a legal liability must do so in clear words.[58] Thus in *Szymonowski & Co v Beck & Co*,[59] Scrutton L.J. said:

> "Now I approach the consideration of that clause applying the principle repeatedly acted upon by the House of Lords and this Court-that if a party wishes to exclude the ordinary consequences that would flow in law from the contract he is making he must do so in clear words."

And in *White v Warwick (John) & Co Ltd*,[60] Denning L.J. said:

> "In this type of case, two principles are well settled. The first is that, if a person desires to exempt himself from a liability which the common law imposes on him, he can do so by a contract freely and deliberately entered into by the injured party in words that are clear beyond the possibility of misunderstanding."

These principles have survived the five principles of interpretation formulated in

[56] [1972] 2 Q.B. 71.
[57] [1908] A.C. 16.
[58] *Alison (J) Gordon & Co Ltd v Wallsend Shipway and Engineering Co Ltd* (1927) 44 T.L.R. 323, per Scrutton L.J.
[59] [1923] 1 K.B. 457.
[60] [1953] 1 W.L.R. 1285.

Investors Compensation Scheme v West Bromwich Building Society,[61] although they are not to be applied as rigid rules. Lord Bingham of Cornhill reiterated[62]:

> "This clause must be construed in the context of the contract as a whole. The general rule should be applied that if a party, otherwise liable, is to exclude or limit his liability or to rely on an exemption, he must do so in clear words; unclear words do not suffice; any ambiguity or lack of clarity must be resolved against that party."

The courts have therefore consistently interpreted exemption clauses strictly.[63] Thus the exemption clause must cover exactly the nature of the liability in question. So a clause which excludes liability for breach of warranty will not exclude liability for a breach of condition; and a clause which excludes liability for breach of implied terms will not exclude liability for breach of express terms. In *Air Transworld Ltd v Bombardier Inc*,[64] Cooke J. held that the clause in that case successfully excluded liability for alleged breach of implied conditions arising under the Sale of Goods Act 1979 despite the fact that the exclusion clause did not use the word "condition". The clause made it clear that every promise implied by law was excluded and those promises included conditions that would otherwise have arisen under the Act. However, if the words of the contract are not clear then the implied conditions are not excluded.[65]

The degree of strictness may vary according to the extent of the exemption sought to be conferred by the clause.[66] In *Photo Production Ltd v Securicor Ltd*,[67] Lord Diplock said:

> "Since the presumption is that the parties by entering into the contract intended to accept the implied obligations,[68] exclusion clauses are to be construed strictly and the degree of strictness appropriate to their construction may properly depend on the extent to which they involve departure from the implied obligations. Since the obligations implied by law in a commercial contract are those which, by judicial consensus over the years or by Parliament in passing a statute, have been regarded as obligations which a reasonable businessman would realise that he was accepting when he entered into a contract of a particular kind, the court's view of the reasonableness of any departure from the implied obligations which would be involved in construing the express words of an exclusion clause in one sense that they are capable of bearing rather than another is a relevant consideration in deciding what meaning the words were intended by the parties to bear. But this does not entitle the court to reject the exclusion clause, however unreasonable the court itself may think it is, if the words are clear and fairly susceptible of one meaning only."

Photo Production Ltd v Securicor Ltd was the first of the cases in the House of

[61] [1998] 1 W.L.R. 898.
[62] *Dairy Containers Ltd v Tasman Orient Line CV* [2005] 1 W.L.R. 215.
[63] See para.2.10, above.
[64] [2012] EWHC 243 (Comm); [2012] 1 Lloyd's Rep. 349.
[65] *Dalmare SpA v Union Maritime Ltd* [2012] EWHC 3537 (Comm); [2013] 1 Lloyd's Rep. 509.
[66] *BHP Petroleum Ltd v British Steel Plc* [2000] 2 Lloyd's Rep. 277 per Evans L.J.; *Stocznia Gdynia SA v Gearbulk Holdings Ltd* [2009] 1 Lloyd's Rep. 461, per Moore-Bick L.J.
[67] [1980] A.C. 827.
[68] For example to pay damages in the event of non-performance of primary obligations; see para.12.02, above.