

LESSONS TO BE LEARNED FROM M&S

1. *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited* [2015] UKSC 72 is set to be the leading authority on (i) the law of implied terms, (ii) the operation of break clauses, and (iii) apportionment of rent payable in advance, for some time to come. In particular, the Supreme Court confirmed that the more restrictive test of strict necessity remained applicable for implying terms into contracts in all cases. All practitioners must understand the full impact of the decision both for the drafting of instruments, the exercise of contractual rights and before commencing potentially costly litigation.
2. This note will discuss (A) the development of the test for implied terms, (B) the impact of *Belize*, (C) the post-*Belize* era, (D) the decision in *M&S*, (E) the lessons to be learned from *M&S*, in relation to, first, implied terms and, secondly, break clauses. The reader short of time ought to skip to sections (D) and (E) where I set out what I now believe to be the test for implied terms post-*M&S* and the other lessons to be learned from the decision.

(A) The Development of the Test for Implied Terms

3. Although the origins of the implication of terms into contracts are probably as ancient as contracts themselves, the search for the formulation of the test for implication preceding *Belize* may start with *The Moorcock (1889) 14 PD 64*. In that case, Bowen LJ stated that the objective of the implication of a term was:

“to give such *business efficacy* to the transaction *as must have been intended* at all events by both parties who are business men; not to impose on one side all the perils of the transaction, or to emancipate one side from all the chances of failure, but to make each party promise in law as much, at all events, as it must have been in the contemplation of both parties that he should be responsible for in respect of those perils or chances.” (*emphasis added*).

4. The requirement of business efficacy began to be expressed as a test in *Reigate v Union Manufacturing Co [1918] 1 KB 592*, in which Scrutton LJ held that:

“A term can only be implied if it is *necessary in the business sense to give efficacy to the contract*; that is, if it is such a term that it can confidently be said that if at the time the contract was being negotiated someone had said to the parties, “What will happen in such a case,” they would both have replied, “Of course, so and so will happen; we did not trouble to say that; it is too clear.” Unless the Court comes to some such conclusion as that, it ought not to imply a term which the parties themselves have not expressed.” (*emphasis added*).

5. The business efficacy requirement began to be accompanied by the officious bystander test with effect from the judgement of MacKinnon LJ in *Shirlaw v Southern Foundaries Ltd* [1939] 2 KB 206:

“Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common ‘Oh, of course!’”.

The officious bystander test has been applied routinely, and perhaps most recently by Moore-Bick LJ in *Powell v Lowe* [2010] EWCA Civ 1419.

6. The test was always that: (a) the officious bystander asked the question and (b) the answer must be obvious to *both* parties (*Mediterranean Salvage & Towage Ltd v Seamar Trading & Commerce Inc (The Reborn)* [2010] 1 All ER (Comm) 1). Therefore, where a number of possible answers reasonably presented themselves, no term could be implied as the answer would not be ‘of course’ (*Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601).

7. However, the test was also much criticised for confusion; especially:

(a) Although the parties’ response was referred to, it was in fact the *reasonable parties’* response which mattered. There was no suggestion that it was the subjective intention of the parties to be ascertained (*Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 at 459). Indeed the court has held that the reasonable response might be yes even when a particular party may well have said ‘no’ (*Arla Foods UK Plc v Barns* [2009] BCLC 699; [59]).

(b) At times the test has been applied as if the officious bystander were *answering* the question rather than posing it (*Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56).

8. Reverting to the business efficacy test, in *Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601, Lord Pearson said:

“An unexpressed term can be implied if and only if the court finds that *the parties must have intended* that term to form part of their contract: it is *not enough* for the court to find that *such a term would have been adopted by the parties as reasonable men if it had been suggested to them*: it must have been a term that *went without saying*, a term *necessary to give business efficacy to the contract*, a term

which, though tacit, formed *part of the contract which the parties made for themselves.*" (emphasis added).

9. In *Liverpool City Council v Irwin* [1977] AC 239, Lord Wilberforce held:

"In my opinion such obligation should be read into the contract as the nature of the contract itself implicitly requires, no more or less, in other words of necessity".

Lord Edmund-Davies confirmed that '*the touchstone is always necessity and not merely reasonableness*'.

10. In the Privy Council case *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, Lord Simon said that:

"for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract."

11. Lord Bingham MR added in relation to the test in *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472:

"The question of whether a term should be implied, and if so what, almost inevitably arises after a crisis has been reached in the performance of the contract. So the court comes to the task of implication with the benefit of hindsight, and it is tempting for the court then to fashion a term which will reflect the merits of the situation as they then appear. Tempting, but wrong.

"A term can only be implied if it is necessary in the business sense to give efficacy to the contract; that is, if it is such a term that it can confidently be said that if at the time the contract was being negotiated someone had said to the parties, 'What will happen in such a case', they would both have replied, 'Of course, so and so will happen; we did not trouble to say that; it is too clear'. Unless the Court comes to some such conclusion as that, it ought not to imply a term which the parties themselves have not expressed

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

12. However, in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, Lord Steyn characterised the test as follows:

“The implication is essential to give effect to the reasonable expectations of the parties”.

13. In *The Interpretation of Contracts*, 5th Ed, para 6.08, Sir Kim Lewison commented of this statement:

“It seems that what his Lordship had in mind is that the question what is necessary is not to be determined simply by asking whether the contract would work at all without the implied term, but whether, without the implied term, it would work in the way that the parties might reasonably have expected it to”.

14. It is worth remarking at this stage that this approach appeared to not be a departure from the orthodox, but rather a reversion to the test originally propounded in *The Moorcock*. This approach informed that of the Privy Council in *Belize*.

15. In summary, therefore, prior to *Belize* there were two competing versions of the same test. On the one hand, the strict requirement for necessity had been reaffirmed for many years and on a plethora of occasions; for example, in *Liverpool City Council v Irwin* [1977] AC 239 where Lord Edmund-Davies confirmed that ‘*the touchstone is always necessity and not merely reasonableness*’. See also Lord Bingham MR in *Philips Electronique Grand Public SA and Another v British Sky Broadcasting Limited* above.

16. On the other hand, there had been a movement away from such a strict approach perhaps originated in *Trollope & Colls Ltd. v North West Metropolitan Regional Hospital Board* and culminated in Lord Steyn’s comments in *Equitable Life Assurance Society v Hyman* that “*The implication is essential to give effect to the reasonable expectations of the parties*”.

17. Put simply, no-one doubted that the test was one of necessity; **but necessary for what?** (1) To make the contract workable (in a commercially efficacious way), or (2) to make it work in accordance with the reasonable expectation of the parties.

(B) The impact of *Belize*

18. In *Attorney General of Belize and others v Belize Telecom Ltd* [2009] 1 W.L.R. 1988 Lord Hoffmann appeared to adopt the latter approach; i.e. that it was a test of necessity to give effect to the reasonable expectations of the parties. Briefly, His Lordship reasoned:

- (1) The court has no power to improve upon the instrument. It is only concerned to discover what the instrument means (para 16).
- (2) That meaning 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”; it is not necessarily the meaning intended by the parties (para 16).
- (3) The question of implication only arises when the instrument does not expressly provide for what is to happen when some event occurs (para 17).
- (4) 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 (para 17).
- (5) In some cases, “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 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” (para 18).
- (6) Citing *Equitable Life*, “The danger lies, however, in detaching the phrase “necessary to give business efficacy” from the basic process of construction of the instrument. It is frequently the case that a contract may work perfectly well in the sense that both parties can perform their express obligations, but the consequences would contradict what a reasonable person would understand the contract to mean” (para.27).
- (7) Nonetheless reasonableness, whilst a requirement, is insufficient. The court must be satisfied that it is what the contract actually means (para 22).
- (8) Therefore, the Belize test is:

“whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean” (para 21).

(C) The post-Belize era

19. There followed numerous decisions differing on the impact, if any, of Lord Hoffmann's contribution in *Belize* (as a Privy Council decision). The test of strict necessity for the contract to 'work' or 'operate' was supported in:
- a. *The Reborn [2010] 1 All E.R. (Comm) 1* – the test is stated as being: “Is the proposed implied term necessary to make the contract work?”.
 - b. *Aberdeen City Council v Stewart Milne Group Ltd [2011] UKSC 56* – the test is: ‘such a term is necessary to make the contract work or to give it business efficacy’.
 - c. *Consolidated Finance Limited v McCluskey [2012] C.T.L.C. 133* – the test is whether: ‘the agreement cannot work perfectly well without it’.
 - d. *Chantry Estates (South East) Ltd v Anderson [2010] EWCA Civ 316* – the implied term was rejected as the agreement worked perfectly well without it.

By contrast, the following cases, following *Belize*, applied a necessity test but by reference to what is necessary to achieve the reasonable expectations of the parties:

- a. *Lancashire Insurance Co Ltd v MS Frontier Reinsurance Ltd [2012] UKPC 42* - In order to give business efficacy to the *bargain which the parties have made* it is necessary to imply a term.
- b. *Eastleigh BC v Town Quay Developments Ltd [2010] 2 P. & C.R. 2* - the implied term is necessary as a matter of business efficacy and that the term is obviously required to give effect to the party's intention having regard to the reasonable expectations of the parties.
- c. *Crema v Cenkos Securities Plc [2011] 1 W.L.R. 2066* – the test was: “*what would the meaning of the contract be to the “reasonable addressee” who had all the background knowledge which would reasonably be available to the two parties who concluded the contract at the time when they did so*”.
- d. *Jackson v Dear [2013] EWCA Civ 89* (and at first instance per Briggs J [2012] EWHC 2060) - the proper touchstone of that proposition to be the consequences would contradict what “any” (rather than “a”) reasonable person would understand the contract to mean. As for commercial common sense enabling a choice between alternative interpretations, opinions as to commercial common sense in any given situation may also differ between reasonable people. In such circumstances, there is no room for implication

(D) M&S

20. Briefly, the appeal concerned a tenant's break clause in four identical commercial leases. The leases had been granted for a fixed term expiring on 2 February 2018, and the rent was payable in advance on the usual quarter days. The tenant, M&S, exercised its right under the break clause to determine the lease on 24 January 2012, after it had paid the full quarter's rent due on 25 December 2011. The break clause contained only two pre-conditions: (i) the payment of a break premium equivalent to one year's rent, and (ii) 'on the break date there were no arrears of Basic Rent or VAT on Basic Rent'.
21. The key issue before the Supreme Court was whether the tenant could recover from the landlords the apportioned rent in respect of the period after the break date – i.e. from 24 January to 24 March 2012. Put another way, the key issue was whether such a term for repayment could be implied into the four leases, given that there was no such express provision. A necessary pre-requisite was for the Supreme Court to determine the applicable test for the implication of such a term.
22. In *M&S* the Supreme Court rejected the dilution of the strict test of necessity for an implied term. *Belize* was relegated to the status of an 'inspired discussion rather than authoritative guidance on the law of implied terms'. The test remains that of strict necessity for business efficacy. The court also confirmed that the iterative process of implication is distinct from the process of construction and that the former can only arise after the latter has been considered.
23. In summary, the Supreme Court made the following observations on the law of the implication of terms:
- a. The process of implication is distinct from the process of construction. It is only after the question of construction has been considered that the question of implication can arise.
 - b. There is a clear, consistent and principled approach to the law of implied terms which requires that a term will only be implied where it is strictly necessary for business efficacy. There has been no dilution of the requirements which have to be satisfied before a term will be implied.
 - c. It is not enough that the parties would have agreed to it had it been suggested to them. That is a necessary but insufficient ground for implying a term.

- d. The five tests set out by Lord Simon in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings (1977) 52 ALJR 20* remain useful tests which are not to be applied too rigidly. For example, business efficacy and obviousness are alternative requirements.
 - e. The test is not one of absolute necessity but **whether, without the term, the contract would lack commercial or practical coherence.**
 - f. The settled law as at the date of execution will continue to inform the reasonable man's view of the contract. The Supreme Court found that the settled law on apportionment upon forfeiture as at the date of the grant was equally applicable to apportionment upon the exercise of a break clause.
 - g. A term will not be implied where it 'lies uneasily' with the express terms in the contract (approving Bingham LJ in the earlier case *The APJ Priti [1987] 2 Lloyd's Rep 37*).
24. The Supreme Court also considered for the first time the decision in *Ellis v Rowbotham [1900] 1 QB 740*, in which the Court of Appeal held that the Apportionment Act 1870 did not apply to rent payable in advance. The Supreme Court confirmed:
- a. The decision in *Ellis* was correct. Rent payable in advance was not apportionable under the Apportionment Act 1870.
 - b. Therefore, rent payable in advance could only ever be apportionable as a result of a clear and unambiguous clause in the contract.
 - c. Had the Supreme Court considered that the decision in *Ellis* was definitely incorrect then it would have been appropriate to overrule the decision despite its longevity. However, if the Supreme Court had been merely doubtful of the decision it would be appropriate to uphold the earlier decision given its longevity.

(E) The test for implied terms post M&S

Implied Terms

25. First, the test for implied terms has been clarified as being one of strict necessity. Necessary for what? To make the contract workable (presumably, in a commercially efficacious way) or to make it internally coherent. Therefore, following *M&S*, the question of the court will be: is the term necessary to make the contract workable? That question is to be answered in the light of the following principles:

- (1) The implication of terms is part of the process of ascertaining the meaning of an agreement. It is an iterative process. Implication can only arise once the process of construction has been completed.
 - (2) The court has no power to improve upon the instrument.
 - (3) The usual starting point is that the absence of an express term means that nothing has been agreed to happen in relation to that event.
 - (4) The test is not one of “absolute necessity”; but one of necessity for business efficacy. The Supreme Court suggested that a helpful formulation is to say that **a term can only be implied if, without the term, the contract would lack commercial or practical coherence.**
 - (5) The five tests of Lord Simon continue to be relevant and are culminative requirements to a degree but not all are required (e.g. business necessity and obviousness, his second and third requirements, can be alternatives).
 - (6) Such a term will only be implied where:
 - a. It is a reasonable term; and
 - b. It can be clearly formulated to meet the lacuna in the express terms; and
 - c. It is not inconsistent with, or does not lie uneasily with, the express terms of the contract.
26. Irrespective of the confirmatory language employed by the Supreme Court, there is no mistaking the shift in emphasis. Their Lordships reasoned that such a term could not be implied as it was not necessary to make the contract ‘workable’ or for its ‘commercial or practical coherence’. Implied terms are oft-pleaded. Very few contracts are unworkable. Most, if not all, will be sufficiently internally coherent to be workable.
27. The decision represents a step change; foreshadowed to a degree in the previous decision of the Supreme Court in *Arnold v Britten* [2015] UKSC 36. The message is clear: the test for implied terms will be even more strictly applied in the years to come.

28. In *M&S* the court accepted that it was a curious outcome that the landlord could retain almost £1 million overpaid rent for a period in which the tenant was not in occupation. The court rejected the tenant's submissions for three principal reasons:
- i. The leases were between commercial parties.
 - ii. The leases made provision for the repayment of rent by the landlord in circumstances where the tenant had not exercised the break – and therefore such an implied term would 'sit uneasily' with this express provision.
 - iii. The reasonable man is taken to know the law when reading the lease and the law on apportionment of rent was clear.
29. Clearly, therefore, it is never enough that the parties would have agreed to it had it been suggested to them. That is a necessary but insufficient pre-condition to the implication of a term.

(F) Lessons to be learned from *M&S*

Implied Terms

30. In practice, primarily there are three lessons on implied terms to be taken from *M&S*:
1. When drafting a contract, nothing should be left as 'unsaid', however obvious it may seem to the parties' lawyers. It can no longer be presumed that a court will imply even such obvious terms as it may well be that the contract remains perfectly internally coherent or workable (in a commercially practicable way) without it.
 2. When pleading in litigation it is common practice for drafters to include the averment of an implied term, in the alternative to an express term, without justification. In the light of the stricter approach in *M&S* that approach may need to change; otherwise parties may be at risk of successful strike out applications in respect of the implication element to the claim.
 3. Lawyers will be taken to know all of the law as at the date of the relevant instrument. In *M&S*, there had been no decision in relation to break clauses and apportionment of rent prior to the leases being granted in 2006. Even the most diligent conveyancers in 2006 would have found no reference to apportionment in the break condition section of *Woodfall: The Law of Landlord and Tenant* at the date of grant; and yet the

Supreme Court held that the reasonable man had this principle in mind when reading the lease.

Break Clauses and apportionment

31. Secondly, the Supreme Court approved the decision in *Ellis v Rowbotham* [1900] 1 QB 740, in which the Court of Appeal held that the Apportionment Act 1870 did not apply to rent payable in advance. Therefore, rent payable in advance can only ever be apportionable as a result of a clear and unambiguous clause in the contract; it is difficult to conceive of a case where an implied term will be appropriate now.
32. Consequently, it is now imperative for tenants (where commercially possible) to include express apportionment provisions and/or clauses for the repayment of any overpaid rent upon the exercise of a break. *M&S* proves that such a precautionous approach is necessary and many more precedents now include such a provision in their sample break clauses.
33. Finally, of great interest to practitioners in this field will be the Court's treatment of the question whether a tenant with a break date that does not coincide with the end of a quarter may safely pay an apportioned rent, where there are no conditions precedent to be satisfied at the rent payment date. Although Lord Neuberger's judgment supported apportionment, his judgment did not finally settle this question of construction; accordingly it will remain an issue to be determined in the future.
34. Despite the Supreme Court's rejection of the implied term and retention of *Ellis*, a glimmer of hope was offered to tenants where the break is certain. Of great interest to practitioners in this field will be the Court's treatment of the question whether a tenant with a break date that does not coincide with the end of a quarter may safely pay an apportioned rent, where there are no conditions precedent to be satisfied at the rent payment date.
35. In *M&S* Lord Neuberger surmises that had the break premium been paid *before* the December quarter day the tenant would have been entitled to apportion the final rental payment as its payment was all that remained to satisfy the break conditions. Of course, those comments were strictly *obiter* and his judgment does not finally settle the question, which is ultimately one of construction of the terms of the break clause and lease in any given case.

36. In *M&S* the wording of the rent condition in the break was that: ‘on the break date there were no arrears of Basic Rent or VAT on Basic Rent’. This could have the somewhat capricious result that where the premium is paid before the break date the rent can be apportioned but where, as in *M&S*, it was paid afterwards it could not. The Supreme Court accepted that curious distinction on the basis that the remedy lay in a tenant’s hands.
37. Of course, even if Lord Neuberger’s comments are taken at their highest, they will only assist in cases where there are no further break conditions as at the final rent quarter day. As is common in many commercial leases, where there is a vacant possession condition there could never be apportionment (without clear express terms) given it would remain uncertain whether that condition would be satisfied on the break date.
38. That said, in the light of the decision in *M&S*, it would be a brave tenant who would risk the continuation of the lease and non-operation of the break based solely on these *obiter* comments. But tenants no know that if they do not take the risk then they must take the hit on the additional rent. There will be little scope now for recovery via an implied term.
39. Finally, Lord Neuberger also (at [47]) commented that “*It may well be that the mesne profits should run from the date of service of the writ, but nothing hangs on that for present purposes*”. This is a short point which is undoubtedly correct (and already in practice in many county courts). Mesne profits are damages for use and occupation. Once a lease is forfeit (which occurs at the date of issue, subject to the court’s confirmation) the landlord is immediately entitled to possession and, consequently, to the extent s/he is kept out of possession such damages are payable. There is no double recovery (even where rent is payable in advance). The rent was the contractual payment for the lease which has terminated. The damages are for the period in which the landlord has been kept out of possession. After *M&S* (though clearly *obiter* on this point) there can be little doubt that this does not constitute double recovery.¹

KESTER LEES

¹ However, many judges may at first find this difficult to comprehend; especially where they predominantly deal with Assured Tenancies; where no mesne profits are ever payable as the tenancy only determines upon execution of the warrant for possession: s.5 of the Housing Act 1988.