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## CASE COMMENT

### A NEW FRAMEWORK FOR THE IMPLICATION OF TERMS IN FACT

GOH, YIHAN\*

In *Sembcorp Marine Ltd v PPL Holdings Pte Ltd*,<sup>1</sup> the Court of Appeal of Singapore once again reaffirmed the Singaporean courts' rejection of the approach adopted by Lord Hoffmann in *Attorney General of Belize v Belize Telecom Ltd*,<sup>2</sup> which characterised the implication of a term in fact as a process of contractual interpretation. What may be of interest to practitioners and academics of common law jurisdictions wrestling with the implications of the *Belize* approach is the Court of Appeal's prescription of 'a three-step process' for the implication of terms in fact,<sup>3</sup> which is accompanied by an in-depth discussion of various conceptual aspects of this area of law. These observations provide a different insight into this area, and suggest a test that is more practically applicable than the *Belize* approach.

The facts in *Sembcorp* were complex but may be summarised for present purposes as follows. Sembcorp Marine Ltd (Sembcorp) entered into a joint venture with PPL Holdings Pte Ltd (PPL Holdings). The joint venture vehicle was PPL Shipyard Pte Ltd (PPL Shipyard), the shares of which were equally owned by Sembcorp and PPL Holdings. Subsequently, Sembcorp purchased a further 35% of the shares in PPL Shipyard from PPL Holdings pursuant to a Supplemental Agreement, bringing its share in PPL Shipyard to 85%. Following PPL Holdings' attempted sale of its remaining shares in PPL Shipyard to a third party, Sembcorp sued PPL Holdings, alleging that it had breached, inter alia, several implied terms. On appeal, the only implied term still at issue was the so-called 'Equality Premise Clause', which Sembcorp alleged provided that the provisions in the Joint Venture Agreement and the Supplemental Agreement that were premised on equal shareholding would cease to subsist once either party acquired a majority shareholding. Chief amongst these affected provisions was

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<sup>1</sup> [2013] 4 SLR 193 (Singapore Court of Appeal (SGCA)).

<sup>2</sup> [2009] UKPC 10, [2009] 1 WLR 1988 (Privy Council).

<sup>3</sup> *Sembcorp* (n 1) [101].

clause 5.1, entitling both parties to appoint three directors each to PPL Shipyard's board 'so long as they shall hold such number of shares . . . as are not less than the proportions set out herein',<sup>4</sup> the proportions being the original equal shareholding. There were other provisions in the Agreement that built upon this clause, providing for the quorum requirement for meetings, etc. Sembcorp's aim in arguing that PPL Holdings had breached these terms was to exert effective control over PPL Shipyard.

Writing for a unanimous Court, Sundaresh Menon CJ prescribed a three-step process to guide the implication of terms in fact.<sup>5</sup> The first step requires the court to ascertain that a gap in the contract has arisen because the parties had not contemplated the gap at the time of entering into the contract; it is only in such a situation that a term can be implied. Next, the court is to consider whether 'it is necessary in the business or commercial sense to imply *a* term in order to give the contract efficacy.'<sup>6</sup> Finally, the court is to consider 'the *specific* term to be implied.'<sup>7</sup> A term is only to be implied if it passes the 'officious bystander' test—that is, the contracting parties, having regard to the need for business efficacy, would have responded positively to the suggestion of the term to be implied. This three-step process, being founded on the traditional 'business efficacy' and 'officious bystander' tests and making no mention of any process of interpretation, is necessarily premised on a rejection of the *Belize* approach. Applying this test, the Court allowed the implication of the Equality Premise Clause into the Joint Venture Agreement.

The Singaporean courts' rejection of the *Belize* approach is not new and was in fact determinatively arrived at after a comprehensive survey of the judicial and academic authorities in *Foo Jong Peng v Phua Kiah Mai*.<sup>8</sup> The Singapore Court of Appeal's reasons for rejection need not be repeated here in detail;<sup>9</sup> it suffices to say that the Court's principal disagreement with the *Belize* approach centred on its view that the process of implication is to be kept separate from that of interpretation, and on the lack of practical guidance afforded by the *Belize* approach as to when a particular term ought to be implied. In this regard, the Court preferred the traditional 'business efficacy' and 'officious bystander' tests. This partially reflects the mixed reception that the *Belize* approach has had in England, with some cases citing *Belize* without actually applying it. Indeed, some cases purport to endorse *Belize*, but end up citing authorities that undermine the reasoning within. A good example of such a case is *Mediterranean Salvage & Towing*

<sup>4</sup> *ibid* [7].

<sup>5</sup> *ibid* [101].

<sup>6</sup> *ibid* (emphasis added).

<sup>7</sup> *ibid* (emphasis added).

<sup>8</sup> [2012] 4 SLR 1267 (SGCA).

<sup>9</sup> For comment, see Yihan Goh, 'Terms Implied in Fact Clarified in Singapore' [2013] *Journal of Business Law* 237.

*Ltd v Seamar Trading & Commerce Inc.*<sup>10</sup> As Davies has pointed out,<sup>11</sup> although Lord Clarke MR predicted in that case that Lord Hoffmann's analysis in *Belize* will often be referred to, his Lordship nonetheless referred approvingly to the judgment of Sir Thomas Bingham MR in *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd*,<sup>12</sup> which, contrary to *Belize*, drew a clear distinction between the interpretation and implication of terms. The Singapore Court of Appeal's three-step process in *Sembcorp* thus affords an opportunity to re-examine this area of law and represents a continuing refinement of the applicable test in Singapore.

The first step in the Singapore Court of Appeal's three-step process in *Sembcorp* raises some conceptual considerations. According to the Court, only those gaps that arise because the parties had not contemplated the issue (in the Court's words, a 'true' gap<sup>13</sup>) can be remedied by the implication of a term. This, however, presupposes that there is *already* a gap since the enquiry is about the nature of such a gap, rather than its existence. The existence of a gap is dealt with by the second step of the enquiry, that is, whether it is necessary in the business or commercial sense to imply a term in order to give the contract efficacy. In the light of this, it may be more logical to place the second step ahead of the first step.<sup>14</sup>

More substantively, it is clear that implication is appropriate where the parties did not contemplate the issue at all, but this must be subject to some constraints lest the court rewrite the contract for the parties. As Sir Thomas Bingham MR said in *Philips Electronique*, where the contract is a novel one, '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'.<sup>15</sup> Instead, what is needed to imply a term is to show that 'one of several possible solutions would without doubt have been preferred.'<sup>16</sup> Indeed, in certain cases, the fact that the parties had *not* contemplated the issue is actually a reason against the implication of a term, the reason being that this might go against the parties' intentions. An example is the old case of *Hamlyn & Co v Wood & Co*,<sup>17</sup> where the plaintiffs argued for the implication of a term that the defendants would not voluntarily prevent themselves from continuing the sale of grains to the plaintiffs for a specified period. Lord Esher MR, with whom the other judges agreed, held that the term could not be implied because the defendant never contemplated such an outcome.<sup>18</sup> In that case, the novel nature of the contract (that is, a negotiated contract between parties not coming within any predefined class), coupled with the finding that the

<sup>10</sup> [2009] EWCA Civ 531, [2010] 1 All ER (Comm) 1.

<sup>11</sup> Paul S Davies, 'Recent Developments in the Law of Implied Terms' [2010] Lloyd's Maritime and Commercial Law Quarterly 140, 146, citing *ibid* [8], [17].

<sup>12</sup> [1995] EMLR 472 (CA) 481.

<sup>13</sup> *Sembcorp* (n 1) [94].

<sup>14</sup> This point arose from a discussion with a colleague, for which the author is grateful.

<sup>15</sup> *Philips Electronique* (n 12) 482.

<sup>16</sup> *ibid*.

<sup>17</sup> [1891] 2 QB 488 (CA).

<sup>18</sup> *ibid* 493.

defendant did not contemplate the outcome contended for, led to a denial of implication. Therefore, the fact that the parties did not contemplate the issue at and may not *always* result in implication. To be fair, the three-stage process in *Sembcorp* considers the parties' contemplation (or the lack thereof) only as an initial stage; whether a term will actually be implied seems to be dealt with by the other stages of the Court's three-stage process. It is conceivable that, applied to the facts of *Hamlyn & Co*, the term concerned would still not be implied, albeit not due to the first stage.

In saying that only 'true' gaps are remediable by implication, the Court necessarily presupposes that other gaps are not so remediable. The Court identifies two possible instances of such 'false' gaps: first, where the parties contemplated the issue 'but mistakenly thought that the express terms had adequately addressed it' when in fact they did not; and second, where the parties 'contemplated the issue' but did 'not agree on a solution' and hence did not make any provision for it.<sup>19</sup> This latter situation is uncontroversial: were a court to imply a term despite finding that the parties had considered but omitted to provide for a given issue, it would certainly be making the contract for the parties.<sup>20</sup>

The first 'false' gap—that is, where the parties had contemplated the issue but 'chose not to provide a term for it because they mistakenly thought that the express terms of the contract had adequately addressed it'<sup>21</sup>—deserves further comment. First, to be more precise, the parties in such a situation *both* contemplated *and* chose to provide a term for the issue; the problem is that the provided terms do not reflect such an intention. The parties' *intention* to provide a term is important as it is indicative of an actual common intention in relation to the issue. Furthermore, the Court regarded implication as being irrelevant in this situation, preferring instead the 'proper remedy' of rectification of the instrument in equity.<sup>22</sup> In adopting such a view, the Court is probably echoing the very clear distinction Mason J drew between implication and rectification in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*.<sup>23</sup> While this accords with theoretical neatness, one should not lose sight of the fact that implication can also be relevant. A case may be better framed in terms of implication where it is difficult to show that the parties had mistakenly thought the express terms of the contract covered an issue they had intended to be dealt with. In other cases, certain documents cannot be rectified even though their terms do not accord with the parties' intentions. The best example is provided by *Belize*, where the document at issue was the articles of association of a company, which had previously been held not to be rectifiable,<sup>24</sup> thus explaining the Privy Council's recourse to

<sup>19</sup> *Sembcorp* (n 1) [94]–[95].

<sup>20</sup> *ibid* [95]. See also *Philips Electronique* (n 12) 482.

<sup>21</sup> *Sembcorp* (n 1) [94].

<sup>22</sup> *ibid* [96].

<sup>23</sup> [1982] HCA 24, (1982) 149 CLR 337 (High Court of Australia) 346.

<sup>24</sup> *Scott v Frank F Scott (London) Ltd* [1940] Ch 794 (CA).

implication. This shows that implication is a necessary counterpart to rectification even on the same facts, notwithstanding the theoretical division that exists between the two.

The Singapore Court of Appeal's desire to identify 'true' gaps which can be resolved by implication is perhaps motivated by an understandable desire to provide conceptual guidance in a difficult area of law. However, the distinction between a 'true' and 'false' gap may be very thin in practice. For example, the Court found that clause 5.1 fell within the second of the 'false' gaps: the parties *had* contemplated that, if they no longer had equal shareholding, then their rights to the stipulated board representation would no longer apply.<sup>25</sup> There was thus no need to imply the Equality Premise Clause in respect of clause 5.1.<sup>26</sup> However, this was not expressly spelt out in the clause. In saying that clause 5.1 embodied an express contemplation of the issue, the Court arguably imputed an intention to the parties in this respect—the very thing it said it was not supposed to do. As for the other clauses dependent on clause 5.1, the Court found that they were silent as to how the rights given under those clauses would be affected by a change in shareholding. The Court therefore found that the parties had not turned their minds to these issues,<sup>27</sup> thereby giving rise to a 'true' gap. However, adopting the reasoning for clause 5.1, it could equally be said that parties had contemplated that these clauses must *necessarily* be tied to equal shareholding, thereby bringing this within one of the 'false' gaps incapable of being remedied by implication. These possibilities show that the distinction between 'true' and 'false' gaps, while doctrinally attractive, may not be easy to apply in practice.<sup>28</sup> In particular, the parties' pleadings and the available evidence will dictate where a particular case falls. Ultimately, the Court's distinction, between a gap that is perceived as remediable by implication and a gap that is not, rests on the perceived difference between actual and presumed intentions<sup>29</sup>—a distinction that is notoriously fine.

The second step of the three-step process in *Sembcorp* reveals the Court's understanding of the 'business efficacy' test. First, the Court said that there might be another external normative basis—quite apart from business efficacy—which could guide the implication of terms in a non-commercial context.<sup>30</sup> In this regard, Bowen LJ's statement of law in *The Moorcock*<sup>31</sup> is worth setting out in some detail:

<sup>25</sup> *Sembcorp* (n 1) [114]–[115].

<sup>26</sup> *ibid* [116].

<sup>27</sup> *ibid* [118].

<sup>28</sup> Lord Hoffmann's approach in *Belize* addresses this issue as well: *Belize* (n 2) [17]. If the contract is silent on an issue, then it is generally the case that the parties intended it to be silent: '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.'

<sup>29</sup> *Sembcorp* (n 1) [29], [93].

<sup>30</sup> *ibid* [85], [99].

<sup>31</sup> (1889) 14 PD 64 (CA).

The implication which the law draws from what must obviously have been the intention of the parties, the law draws with the object of giving efficacy to the transaction and preventing such a failure of consideration as cannot have been within the contemplation of either side . . . [T]he law is raising an implication from the presumed intention of the parties with the object of giving to the transaction such efficacy as both parties must have intended that at all events it should have.<sup>32</sup>

It is worth noting that Bowen LJ spoke in general terms and was certainly not restricting efficacy to only *business* efficacy. The general principle is that a term is to be implied to make the contract more efficacious; if it is a commercial contract, then it is only natural that its efficaciousness would be measured in a business sense. Thus, in *Equitable Life Assurance Society v Hyman*,<sup>33</sup> the test was framed in a commercial way only because the nature of the contract was commercial. Perhaps the reason why the textbooks are replete with commercial examples is because commercial cases dominate the cases, but this should not detract from the general point that what is of concern is the efficaciousness of the contract, which need not be in the business sense. In any event, on the facts of *Sembcorp*, this was not in issue as the transaction was a commercial one.<sup>34</sup>

The Court also questions just how efficacious the contract must be made before the ‘business efficacy’ test is fulfilled.<sup>35</sup> On this matter, Bowen LJ in *The Moorcock* stated that ‘a minimum of efficacy should be secured for the transaction, as both parties must have intended it to bear’.<sup>36</sup> This is unsurprising and bears out the strict nature of implication. Drawing upon this, and because of the imprecision of ‘business efficacy’ as a normative concept, the Singapore Court stated that the role of the ‘business efficacy’ test in the implication of terms is only to identify a gap, but ‘it cannot supply the answer to whether a *specific* term should be implied.’<sup>37</sup> However, this may overstate the case. Sometimes, the identification of the gap involves a simultaneous identification of the term used to plug that gap. Take, for example, the facts of *The Moorcock*, where the contract was regarded as unworkable if a term were not implied that it was safe for a ship to ground at the wharf. There is no need to have recourse to an alternative test to imply this specific term in this case. The ‘business efficacy’ test both identifies the gap *and* supplies the normative reason why a particular term should be implied, as guided by the restrictive criterion of necessity.

<sup>32</sup> *ibid* 68.

<sup>33</sup> [2000] UKHL 39, [2002] 1 AC 408 (HL).

<sup>34</sup> *Sembcorp* (n 1) [119]. Lord Hoffmann in *Belize* warns of the danger of ‘detaching the phrase “necessary to give business efficacy” from the basic process of construction of the instrument’: *Belize* (n 2) [23]. This means that his Lordship regarded the implication process as necessarily contextual and dependent on what a reasonable person would understand the contract to mean. However, what is being suggested here by the Singapore Court of Appeal is that it is only the more limited business efficacy test that is contextual, and not a wider approach premised on construction.

<sup>35</sup> *Sembcorp* (n 1) [86].

<sup>36</sup> *The Moorcock* (n 31) 69.

<sup>37</sup> *Sembcorp* (n 1) [88] (emphasis in original).

Finally, the third step of the three-step process in *Sembcorp* reveals the Court's view of the relationship between the 'business efficacy' and 'officious bystander' tests. Adopting one commentator's view, the Court found that the 'officious bystander' test is the device that enables the court to define the terms which can be said to reflect the parties' presumed intention in relation to the gap in the contract.<sup>38</sup> In contrast, the 'business efficacy' test operates at a more general level; its role is to identify a gap in the contract that exists because the contract can be made more efficacious.<sup>39</sup> It is following the identification of such a gap that the 'officious bystander' test then applies to identify the *exact* term that is to be implied to plug the gap.<sup>40</sup> On the facts, the Equality Premise Clause was implied into the clauses dependent on clause 5.1 since, once a party lost the right to appoint directors under clause 5.1, it naturally followed that all these other clauses ceased to have any effect.<sup>41</sup> Although the Court said that the traditional tests are applied complementarily according to its approach, the truth is that the Court departed from the usual understanding of the complementarity set out in *Reigate v Union Manufacturing Co (Ramsbottom) Ltd*, where Scrutton LJ described the two tests as follows:

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 some one [sic] 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.'<sup>42</sup>

Properly understood, this statement of principle in *Reigate* posits that the 'business efficacy' test constitutes the underlying normative reason for a term to be implied, while the 'officious bystander' test takes on the more practical task of application. However, the *Sembcorp* approach would have the 'business efficacy' test fulfil a different function from the 'officious bystander' test. This is not necessarily wrong, but it should be considered that, at times, the 'business efficacy' test would alone be sufficient.

More broadly, it may be possible to conceive of an approach that straddles the positions taken in *Belize*, which stresses the overarching test of 'interpretation', and *Sembcorp*, which stresses the primacy of the traditional tests. It is submitted that there are a variety of terms implied in fact. Indeed, in certain instances, the courts are really 'interpreting' the contract even while implying terms. This is because they are simply extrapolating from the existing material what the parties had in their minds, but left unexpressed. Some support for this may be derived

<sup>38</sup> *ibid* [91].

<sup>39</sup> *ibid* [90], citing J P Vorster, 'The Bases for the Implication of Contractual Terms' [1988] *Journal of South African Law* 161, 171.

<sup>40</sup> *Sembcorp* (n 1) [91].

<sup>41</sup> *ibid* [126].

<sup>42</sup> [1918] 1 KB 592 (CA) 605.



from Lord Wilberforce's speech in *Liverpool City Council v Irwin*, where his Lordship suggested that implication consists of 'shade[s] on a continuous spectrum'.<sup>43</sup> The relevant passage<sup>44</sup> supports the existence of three types<sup>45</sup> of terms implied in fact: first, terms implied as a matter of interpretation or, more precisely, extrapolation from the express terms as a matter of logic or obviousness; second, terms implied as a consequence of specific (albeit limited) creation, in order to achieve 'business efficacy'; and third, terms implied as a matter of general (again limited) creation, in pursuance of a broader notion of reasonableness.<sup>46</sup> It suffices to note that McLauchlan, who divides terms implied in fact into several distinct subcategories, alludes to the idea that there are distinct types of terms implied in fact, which, while not corresponding to Lord Wilberforce's categories, lend support to the more general notion that there are different types of terms implied in fact. He identifies three such subcategories: terms that are implied to give business efficacy to a contract; terms that are implied to fill gaps in an agreement intended to be binding that would otherwise be void for incompleteness; and terms that are implied as a matter of necessity.<sup>47</sup> Where terms are implied as a matter of necessity, or as an extrapolation from the express terms of the contract, it may be argued that there is a case for equating this exercise with interpreting the contract, but only in these situations. However, it may equally be true that this does not occur all the time, particularly when courts imply individualised terms as to a reasonable price or time.

In the end, perhaps the contribution that *Sembcorp* makes to the existing jurisprudence on implied terms in fact is to show the difficulty of rationalising this area of law through any overarching principle of interpretation. Perhaps a practically applicable test is what is required to guide both practitioners and judges in deciding whether a term should be implied. The Singaporean courts' preference for the traditional tests may therefore echo the view that the generality of the *Belize* approach entails reference to those tests rather than a 'direct resort to the meaning of the contract'.<sup>48</sup>

<sup>43</sup> [1977] AC 239 (HL) 254.

<sup>44</sup> *ibid* 253–54.

<sup>45</sup> cf Gerard McMeel, *The Construction of Contracts: Interpretation, Implication, and Rectification* (2nd edn, OUP 2011) [10.06]–[10.44].

<sup>46</sup> While Lord Wilberforce refers to a fourth category, that concerns the implication of terms by law and is not relevant for present purposes.

<sup>47</sup> D W McLauchlan, 'Interpretation and Necessary Implication' (2004) 21 *New Zealand Universities Law Review* 331.

<sup>48</sup> H G Beale, *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012) vol 1 [13-005].