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IMPLICATION IN FACT AS AN INSTANCE OF CONTRACTUAL INTERPRETATION

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THIS article proposes an account of the legal doctrine of implication of terms in fact. The first proposition presented herein is that implication in fact is an example of the more general process of interpretation of contractual documents. This proposition has been accepted by some[1] and discussed by a few.[2] I am happy to add my voice to these. To further the debate, this article seeks to dissect the particular part of the interpretative technique of which the implication of terms is an example: the part of interpretation dealing with supplementation. This dissection proceeds upon the assumption that interpretation is a pragmatic process of inference, a view supported by a large body of work in the field of linguistics.[3]

The second proposition made in this article is more specific. It is argued that the information implied into agreements varies in how "primary"—independent of the expressed information—it is. The more primary the information is, the less likely it will be intended to go without saying, and so the stricter a test of supplementation should be. Since full contractual terms are more primary than details implied into existing terms, one can see why the tests of implication in fact (the officious bystander and business efficacy tests) are stricter than the test for supplementing with details through ordinary interpretation (the objective test and the common sense principles outlined in the *Investors Compensation Scheme* case[4]).

Nevertheless, the second proposition does not justify the existence of a separate category for the implication of new terms,

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[1] See for example the quotations of Lords Steyn and Hoffmann, and K. Lewison, at text to notes 36–39, below; Oliver L.J. in *Harvela Investments* v. *Royal Trust Company of Canada* [1985] ch. 103 (C.A.), 138; A.L. Corbin, *Corbin On Contracts: One Volume Edition* (St. Paul, Minn. 1952), at [561 ff.], with a chapter called "Interpretation—The Process Called Implication"; S. Smith, *Contract Theory* (Oxford 2004), ch. 8.

[2] See particularly E. Peden, *Good Faith in the Performance of Contracts* (London 2003), especially 141 ff and E. Peden's PhD thesis, *A Rationalisation of Implied Terms in Contract Law*, University of Cambridge, 1998, copy supplied by author. See also J.P. Vorster's PhD thesis, *Implied Terms in the Law of Contract in England and South Africa*, University of Cambridge, 1987.

[3] See further A. Kramer, "Common Sense Principles of Contract Interpretation—And How We've been Using Them All Along" (2003) 23 O.J.L.S. 173 [hereinafter "Common Sense Principles"].

[4] *Investors Compensation Scheme* v. *West Bromwich Building Society* [1998] 1 W.L.R. 896 at 912.

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since primariness is a continuous and not binary variable: information is not merely primary or secondary, it is primary to a certain degree. As the primariness of information sits on a spectrum, the strictness of the test for supplementation should be a question of degree. Thus the separate category of implied in fact terms should be abolished, and all supplementation should take place through the basic test of interpretation that asks what it was reasonable to understand as going without saying. This test should take account of the primariness of the information to be implied, maybe using the officious bystander and business efficacy tests as rules of thumb when the supplementation is by way of very primary information (*i.e.* new terms).

In answer to the common criticism that any reference to intention or the will of the parties in discussions of implication in fact is merely fictional,[5] two things must be said. The first is that this is no more true of implication in fact than it is true of interpretation, since the former is an instance of the latter, as this paper seeks to show. The second is that reference to intention is not fictional in either case, since (as philosophers and practitioners of linguistics have long since realised) communication is based upon a process of pragmatic inference. Under this process, one can intend what goes without saying and what does not cross one's mind. A communicator intends the background of social norms and his goals and principles within which he (non-consciously) formulated his utterance. These norms and goals and principles are thus intended to be used to determine issues that are undetermined by the express utterance. This is not a fiction, or a diluted form of intention, it is the way communication and the mind works.[6] This is discussed elsewhere.[7]

[5] Rakoff, for example, refers to the reference to intention as an "ideological justification" and "a ceremonial bow to complete private autonomy": T.D. Rakoff, "The Implied Terms of Contracts: Of 'Default Rules' and 'Situation-Sense'" in J. Beatson and D. Friedmann, *Good Faith and Fault in Contract Law* (Oxford 1995), p. 191.

[6] For example, we "know" the conventional, dictionary, meaning of words but that meaning does not cross our mind when we use the word, indeed we can only formulate the meaning of words by testing our intuitive "knowledge". When we use the word "bachelor" we do not think about whether, according to our intended meaning of bachelor, all bachelors must be human or over the age of twelve. This does not mean that we have no intentions as to these issues, it is just that they do not cross our mind when we use the word. Interestingly, one test that linguistics experimenters use to test their intuitive knowledge as to the definition of a word is the "That's impossible test": If you say "'My tadpole is a bachelor' ... you would be likely to get the response: 'That's impossible ... bachelors have to be human'" (J. Aitchison, *Words in the Mind,* 2nd ed. (Oxford 1994), 44). Ignoring the limitations of the semantic model presupposed by this test (word meaning is much more complicated than a simple list of necessary definitional propositions), the reader may have noted the similarity between the linguistics experimenter's counterfactual and the officious bystander counterfactual test of implied terms, to which the analogous response is a testy "Of course". It is submitted that the similarity arises because both govern intentions dependant upon intuited norms that did not cross the communicator's mind and were not expressed but were nevertheless intended.

[7] See A. Kramer, "Common Sense Principles" and the works cited therein. See also B. Langille and A. Ripstein, "Strictly Speaking, It Went Without Saying" (1996) 2 Legal Theory 62.

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The Common Sense Principles of Interpretation

This article follows on from an earlier investigation of the welcome trend in the law of interpretation of contractual documents away from specialist rules of interpretation and towards the common sense principles by which communications are interpreted in everyday life.[8] The common sense principles of interpretation are, in brief, as follows:

1) A communicator is held responsible for what she reasonably appears (subjectively) to intend to mean. This is the objective principle of interpretation.
2) The first place a communicatee must look in finding the apparently intended meaning is to the linguistic meaning of the utterance in question—the meaning that has been codified using the shared rules of language.
3) The linguistic meaning, however, is only one element in the apparently intended meaning. The process of interpretation is, above all, governed by a process of pragmatic inference. Under this process, a communicatee infers (guesses) the communicator's purpose and hence what the communicator intended to mean. The communicatee's principal tools in this task are the information that appears to be mutually known (the "mutual context" or "matrix of fact"), and an assumption that the communicator intends what, and behaves as, a normal person would (the "assumption of normality"). One important element of the mutual context is the mutually known norms of the society, also known as the "reasonable expectations". Another is the personal mutual context that makes up the parties' previous discussions, negotiations and dealings (although there are legal rules restricting the admissibility of evidence of such mutual context).
4) The linguistic meaning is only *prima facie* the apparently intended meaning, as in some situations the communicatee must pragmatically infer that the communicator intended the communicatee to replace the linguistic meaning in some respects. The most common cases in which such replacement appears to be intended are when there is a dialectual meaning, such as a technical or customary meaning, that is more likely to have been intended than the linguistic meaning, or when the communicator appears to have made a mistake in formulating the utterance.

[8] Kramer, *ibid.*

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5) In addition, the linguistic meaning will often appear to be an incomplete communication of the communicator's intended meaning. Often it will reasonably appear (using the process of pragmatic inference) that the communicator's intended meaning goes beyond the linguistic meaning in some particular respects—most clearly where the linguistic meaning is ambiguous or vague in a way that it appears the communicator did not intend the communication to be, but also in many other cases in which it would be normal to leave things to inference. In such cases there is an apparently intended "licence to supplement by inference". In such cases the communicatee must pragmatically infer what was intended but was unsaid (by "unsaid" I mean not codified in the linguistic meaning of the utterance).
6) The interpretation will fail to resolve an issue where (a) the communication does not appear to be intended to extend to the issue in question (in other words, there is no licence to infer with regard to that particular issue and the linguistic meaning does not cover it) and so the utterance is incomplete, or (b) the communication does appear to be intended to extend to the issue in question, yet the utterance is uncertain such that it is not possible to pragmatically infer what was intended on that issue.

Supplementation of the Linguistic Meaning

One part of this process of pragmatic inference deserves elaboration beyond that given above[9] and elsewhere,[10] and that is the process of supplementation of the linguistic meaning. This is the part of pragmatic inference that can, it is submitted, account for the process of implication in fact.

To convey all the intended meaning by encoding it, *i.e.* by including it all in the linguistic meaning of the words used, is unnecessarily (and probably impossibly) time consuming. The process of pragmatic inference allows information to be conveyed impliedly without encoding within the linguistic meaning of an utterance. By assuming normality on the part of the communicator, and assuming optimal design (that the communicator designed the utterance correctly in the light of the surrounding circumstances, his apparent purpose and the usual process of pragmatic inference), the communicator can convey information without needing to encode it all.

[9] Mentioned at point 5 in the previous section.
[10] See Kramer, "Common Sense Principles", note 7 above.

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Whilst the advantage of communicating through the process of pragmatic inference is a saving in time (and, more generally, drafting costs), the disadvantage is unreliability. Encoding meaning in language is a more reliable means of communicating than leaving meaning to pragmatic inference, since mutual knowledge of language (a large body of linguistic norms) can be easily inferred and its norms are fairly clear to apply. The process of pragmatic inference, however, involves both parties in modelling the norms of the surrounding society ("reasonable expectations", the normal practices of communication, and normal goals and means of arriving at them) and then estimating which of these norms, and which facts about the context, are mutually known. In such a process, the chances of error are much greater; parties are much less likely to have different opinions about the normal linguistic meaning of a sentence than they are to have different opinions about what is normally intended to go without saying.

Deciding whether to leave a part of her meaning to inference, then, involves a communicator in a rough cost-benefit analysis. Such an analysis requires the weighing of the probability that the information will be successfully inferred by the communicatee against the importance to the communicator that the particular piece of information is successfully communicated, and thus the calculation of whether it is worth making something explicit just to be surer of getting it across.

To understand this better, we need to see how a communicatee successfully infers that something goes without saying. The process can be loosely divided into two stages: identification of a gap in the linguistic meaning that is not present in the intended meaning, and filling the gap by pragmatic inference.

Stage One: Please Mind the Gap

The first stage of the process of supplementation by pragmatic inference involves identifying a gap in the linguistically encoded meaning, and finding a licence to supplement that meaning by way of pragmatic inference so as to fill the gap.[11]

[11] A gap in the linguistic meaning merely means that the linguistically encoded meaning does not cover the issue at hand. There are three possible conclusions a communicatee may reach at this point. The first possibility is that nothing was intended on the issue, and so the contract is silent, the contractual agreement is incomplete, and the gap in encoded meaning is also a "true contractual gap" (after A.J. Morris, "Practical Reasoning and Contract as Promise: Extending Contract-Based Criteria to Decide Excuse Cases" [1997] C.L.J. 147, 162). The second possibility is that the intended meaning does stretch to the issue in question, but the gap in encoded meaning cannot be filled by pragmatic inference because the document or utterance was badly drafted so the interpreter cannot identify a single salient meaning. This we might call a "design gap". The final possibility is that the intended meaning does stretch to the issue in question and the gap in encoded meaning can be filled by pragmatic inference.

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Where the linguistically encoded meaning is silent as to a particular issue, the communicatee must ask (a) whether it would be normal to intend a determination of that particular issue and (b) whether the silence can be taken to show that no determination of that issue was intended.

Would it be normal (in the circumstances) to intend a determination of the particular issue or type of issue that has not been determined within the linguistically encoded meaning?

Using the apparent purposes of the communicator, and other mutual context such as norms of behaviour, the communicatee must ask whether it would be normal for the communicator to intend to cover the particular issue. If I agree to buy goods travelling on The Peerless, it is apparent that I intend to refer to a particular ship and so the specific identity of the ship, which is not part of the linguistically encoded meaning (given that there are at least two ships called The Peerless), is part of my intended meaning.[12] Similarly, if I agree a charterparty with an option to redeliver "after 12 months' trading", it is apparent that I am not ambivalent as to whether the option is exercisable at any time after 12 months' trading or only at the specific point of time marked by passage of 12 months' trading.[13] These two phenomena, deictic reference and ambiguity, are easy examples of an apparent licence to supplement by inference since they provide linguistic markers as to an issue that was almost certainly determined by the intended meaning even though it is not determined in the linguistically encoded meaning. However even with such clear linguistic markers of the need to supplement, there may exceptionally be no apparent intention for supplementation (*i.e.* intention that a reference be saturated or that a linguistic ambiguity be disambiguated). For example, in some cases of ambiguity so little will turn on the choice between possible linguistic meanings that it will not be apparent that the communicator's intended meaning was any less ambiguous than the linguistically encoded meaning. If I say "they gave us much valued advice", is it likely that I care whether I am saying that they gave much advice that was valued rather than that they gave an unquantified amount of advice that was much valued?[14]

[12] The facts are taken from *Raffles* v. *Wichelhaus* (1864) 2 H. and C. 906. The utterances in this case did not yield a single salient intended meaning so the design gap rendered the contract uncertain.

[13] The facts are taken from *"The Karen Oltmann": Partenreederei M.S. Karen Oltmann* v. *Wscarsdale Shipping Co. Ltd.* [1976] 2 Lloyd's Rep. 708.

[14] The example is taken from D. Sperber and D. Wilson, "Reply to Clark" in N.V. Smith (ed.), *Mutual Knowledge* (London 1982), p. 130.

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Occasionally there will be a clear substantive marker as to an issue that is intended to be determined but is not explicitly determined, for example if there is an agreement to sell goods with no agreement as to price. Usually, however, there is no linguistic or explicit substantive marker; most cases concern linguistic vagueness or mere silence on a particular issue. Vagueness is a feature of most, if not all, words (*i.e.* of the semantic rules tied to words), but imprecision is a feature also of intention. The degree of precision with which issues are intended to be determined depends upon the apparent purpose of the utterance. The intended meaning of the author of a sign stating "no dogs allowed" almost certainly determines some issues of vagueness that the linguistic meaning does not determine, otherwise the sign would not be able to fulfil its purpose (*i.e.* the author probably does care whether wolves, or toy dogs, are included in the prohibition). Beyond even vagueness, there may simply be silence on an issue in the linguistic meaning with no indication as to an absence. Still, the communicatee must investigate whether the communicator is likely to have intended something upon a particular issue. If I book a hotel room I have said nothing about wanting a bed to be in it, and yet the hotel clerk can infer from my apparent purpose that my intended reservation includes more detail than my linguistically encoded reservation.

Would it be normal (in the circumstances) to intend the determination of such an issue or type of issue to go without saying, rather than to actually include it within the linguistically encoded meaning?

In other words, even though it would be normal to intend a determination of the issue, does the fact that it has not been determined within the linguistically encoded meaning indicate that the issue was not intended to be determined in this instance? Before the communicatee can set about using the assumption of normality, the reasonable expectations, and all the other tools of pragmatic inference, the communicatee must ask himself why the communicator did not linguistically encode her determination of the particular issue if she had intended to communicate such a determination. The fact that the communicator did not linguistically encode such a determination, and hence did not put its inclusion beyond doubt and beyond the risk of miscommunication, provides some evidence against an intention to communicate such a determination. Quite how much, depends upon the nature of the issue and the circumstances of the communication (something that we will return to later). The communicatee must

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ask himself whether it would be normal to leave communication of determination of a particular issue to pragmatic inference. Answering this question requires application of the cost-benefit analysis described above in order to assess the options that were available to the communicator (the cost being the time and effort of linguistic encoding, the benefit being the avoidance of the risk of failure to successfully communicate).

Concerning this analysis, a few things should be said about the benefit. The benefit of linguistic encoding is the multiple of the importance of successful communication on the one hand, and the probability of unsuccessful communication without linguistic encoding on the other. With regard to the former, the communicatee must look at whether (and to what extent) communication of the issue is important for the satisfaction of the communicator's goals, and this will relate to its place in the achievement of those goals, as well as the likelihood that circumstances will arise to make the issue a live one. In booking a hotel room I do not expect the fire safety of the hotel to be tested as fires are rare, so I am unlikely to make explicit my intended requirement that the hotel meets certain standards of fire safety in terms of materials and procedures. This is true even though I run the risk of failing to communicate the requirement as to fire safety, or particular aspects of it.

The second feature, the probability of unsuccessful communication without linguistic encoding, depends upon a variety of factors related to pragmatic inference, such as the amount of contextual information (as to circumstances, purposes, reasonable expectations, norms of individual practice) that is shared by the parties, since this is what is used by the communicatee to pragmatically infer. One crucial factor is the type of issue the determination of which is to be communicated, and we might call this the degree to which an issue is "primary", or independent.

A fully primary issue is one that is completely independent of other issues—an entirely new thread in an utterance. Such primary issues are the skeleton of the utterance, the bones of the communicator's preference, which fundamentally define the utterance or transaction. It is difficult to infer the determination of such issues because of their independence—they do not qualify or depend upon other issues for which a determination may be known, and so are more personal to the communicator. Consequently, norms of behaviour are of more use in predicting an intended determination of issues secondary to other issues for which the determination is known, than in predicting an intended determination of primary issues. This is the difference between

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inferring from a communicator's purpose what they want, and inferring the communicator's purpose itself. It is easier to infer the delivery arrangements for a sale agreement than to infer the identity of the goods or even that the transaction agreed upon is a sale rather than a loan or a gift (or a fight or a greeting). Even in cases in which norms exist as to the determination of primary issues, the assumption of normality is less reliable in the case of primary issues because primary issues are preferential, determinative of choices: thus norms are likely to be less clear, since the distribution of purposes is less likely to be normal than the distribution of means used to achieve a given purpose. The greater the primariness of an issue, the greater the probability of unsuccessful communication of a determination of the issue and the greater the importance of the issue, and so the greater the benefit of linguistic encoding of such a determination and the lesser the likelihood that such a determination was intended to go without saying.

A note on silence

Where an issue is specifically determined by the linguistically encoded meaning, in other words it is explicitly mentioned, it would not be normal to think that the communicator intended the issue to be determined by pragmatic inference, since the more secure and costly method of communication has been chosen. Consequently, as has been mentioned, the communicatee should only look to supplement by pragmatic inference when the linguistically encoded material is silent as to a particular issue.[15] It should be made clear, however, that the silence required for a licence to infer the determination of an issue means only that the linguistically encoded material does not specifically cover the issue. When a specific issue falls within a more general issue, and the general issue is determined in the linguistically encoded meaning, this does not mean that it is unlikely that the communicatee was intended infer a determination for the specific issue: indeed, as has been mentioned above, it is usual to specify a primary issue and leave secondary ones to implication. Determination of a specific issue as part of a more general issue, then, can also count as silence as to the specific issue for our purposes.

The secondary issues that are left to implication may be additive ("We haven't only agreed that I hire a hotel room, but also that it comes with a bed and a telephone *etc.*") or they may be

[15] Although note that even when there is no silence on an issue, everyday communication does allow the pragmatic inference of connotation of irony and other figurative meanings, and of course the fact that an issue is covered does not prevent the communicatee concluding that an error (typographical or otherwise) was made in drafting the utterance.

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qualificatory ("Of course, the agreement to let you a room is off if we find that you are using the room to conduct illegal activities").[16] In cases of inference of qualificatory issues, other examples of which are the granting of a discretion without specifying any restrictions upon its exercise, or any agreement that does not specify its common assumptions as to facts or supervening events, commentators and judges seem to be particularly strongly inclined to think that the contract does cover the particular issue.[17] Morris confuses the issue by saying of excuse cases (cases of common mistake or frustration), "[t]he problem is not that the contract does not provide a complete answer, but that the answer that the contract provides seems in some sense wrong".[18] In fact, a contract only provides a complete answer if we allow that silence on a secondary issue is an answer (that nothing beyond the linguistic meaning is intended as to the secondary issue). If this were to be accepted then the lack of a specified limit on the granting of a discretion would mean that the discretion is exercisable without limit, and the lack of a specified limit on the promise of action would mean that the action is to be performed whatever happens (so when an intervening event occurs the loss must fall where it lies). Of course, in some cases this will be the intended answer, but that does not mean that the answer comes from a full treatment of the specific issue (the additive or qualificatory detail) in the encoded meaning. Such undetermined specific issues are potential areas by which the linguistically encoded meaning may fall short of the intended meaning, and they need investigating.

If the answer to either question is negative then there is no licence to supplement: if it would not be normal to intend a determination of a particular issue or type of issue that has not been linguistically encoded, or it would not be normal to intend the determination of the undetermined issue to go without saying, then there is no licence to supplement. In this case it does not reasonably appear that the communicator intended the communicatee to supplement by inference the linguistically encoded meaning with regard to the particular undetermined issue. In such a situation there can be said to be a "true contractual

[16] Additive supplementations include the saturation of deictic references, disambiguation, the reduction of vagueness and implication in the cases of *The Moorcock* (1889) L.R. 14 P.D. 64 (C.A.) and *Malik* v. *B.C.C.I.* [1998] A.C. 20. Qualificatory supplementations include the cases of *B.C.C.I.* v. *Ali* [2001] UKHL 8, [2002] 1 A.C. 251 (H.L.), *Equitable Life Assurance Society* v. *Hyman* [2002] 1 A.C. 408 (H.L.), *British Movietonenews* v. *London and District Cinemas* [1952] A.C. 166 and mistake and frustration cases. Of course, supplementation by primary information will always be additive (since, being independent from other terms, it cannot qualify them) whereas supplementation by secondary information can be additive or qualificatory.

[17] But see Lord Denning, *The Discipline of Law* (London 1979), 41 ff.

[18] Morris, note 11 above, at p. 156.

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gap",[19] meaning that the contractual agreement, as apparently intended, does not extend to the issue in question (in other words, the contractual agreement is incomplete). What a court can and does do when faced with a true contractual gap is touched upon below.[20]

Stage Two: Filling the Gap in Linguistic Meaning: What Determination of the Particular Issue would it be Normal to Intend to go without Saying?

When the particular issue, of which there is no determination in the linguistically encoded material, is shown not to be a true contractual gap but rather to be an issue the determination of which was intended to be inferred (in other words (a) and (b) are both answered in the affirmative), the task remaining is to infer this determination. This means that the common sense principles must be applied to discover what it would be normal to intend on the particular issue, given the mutually known contextual circumstances. The answer to this inquiry can be said to have been "reasonably expected" or "what would have been intended if the parties had put their mind to it", although note that this does not mean that such a determination was not intended.[21] These principles have been discussed elsewhere.[22] Sometimes the norms (the community standards or past practice or reasonable expectations) will not determine an issue, and there can be said to be no single determination that appears to have been reasonably intended. In such cases the agreement does appear to cover a topic, but the utterance was not optimally designed and so is too uncertain for the identification of a single jointly salient meaning—the communicator's meaning has failed to get through. Such design gaps, resulting from uncertain utterances, are rare, except as to precise points of detail upon which there will be insufficient practical experience to develop a reliable norm. What the court can and does do when faced with a design gap will also be mentioned below.[23]

Supplementation in Contract Law

Discussion so far has been of supplementation as one aspect of interpretation, the pragmatic process of inference by which a communicatee understands what meaning a communicator intends.

[19] Note 11 above.
[20] See below "Failure for incompleteness or uncertainty".
[21] See the Introduction, above.
[22] See Kramer, "Common Sense Principles", note 7 above, *passim*.
[23] See below "Failure for incompleteness or uncertainty".

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The following are examples of some contract cases in which the apparently intended meaning goes further than the linguistically encoded meaning, and so pragmatic inference has been used to supplement the linguistically encoded meaning:

(i) In *The Karen Oltmann* a charterparty states, ambiguously, that the charterers have an option to redeliver the vessel "after 12 months' trading".[24] The court found, after looking at the pre-contractual negotiations and the norms of communication, that the option was intended to be exercisable at the specific point of time defined by the passage of 12 months' trading, rather than at any time after 12 months' trading had been completed.

(ii) In *B.C.C.I.* v. *Ali* an employee's release of "any or all claims" against his employer was intended to be qualified such that it did not apply to those claims that were unforeseeable at the time of contracting (claims for stigma damages).[25]

(iii) In *Equitable Life Assurance Society* v. *Hyman*[26] a pension company's general discretion was held to be intended to include an implied restriction preventing its exercise so as to deprive the guarantees of annual rate of any value. In *Paragon Finance* v. *Nash*,[27] a mortgage lender's variable interest clause was held to include an implied restriction preventing its exercise dishonestly, for an improper purpose, capriciously, arbitrarily or in a *Wednesbury* unreasonable manner.

(iv) In *The Moorcock*[28] an agreement to unload a vessel at a wharf was intended to include an implied warranty that the wharfingers had taken reasonable care to see that the river bottom was not in a dangerous condition.

(v) In *Malik* v. *B.C.C.I.*[29] an employment contract was held to be intended to include a promise by the employer not to engage in conduct likely to undermine the trust and confidence required if the employment relationship is to continue in the manner the employment contract implicitly envisages. Consequently, an employer is held to intend to promise to take reasonable care when writing an employee's reference (*Spring* v. *Guardian Assurance*[30]).

[24] *Partenreederei M.S. Karen Oltmann* v. *Wscarsdale Shipping Co. Ltd.* [1976] 2 Lloyd's Rep. 708 (Kerr J.).
[25] [2001] UKHL 8, [2002] 1 A.C. 251 (H.L.).
[26] [2002] 1 A.C. 408 (H.L.).
[27] [2001] EWCA Civ 1466, [2002] 1 W.L.R. 685 (C.A.).
[28] (1889) L.R. 14 P.D. 64 (C.A.).
[29] [1998] A.C. 20.
[30] [1995] 2 A.C. 296.

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(vi) In *Hutton* v. *Warren*[31] a lease was held to include a landlord's duty to compensate the tenant for seed and labour since the tenant had sown the land before quitting (upon notice to quit served by the landlord), such a duty being customary.

(vii) In *Liverpool CC* v. *Irwin*[32] a lease was held to include an implied obligation on the landlord to take reasonable care to keep in reasonable repair and usability the staircase, lifts and rubbish chutes, as well as implied rights in the tenants to use such facilities.

All of the above are cases of supplementation of the linguistic meaning by a process of pragmatic inference. In such cases there is an apparently intended licence to supplement because it would be normal to intend more than the linguistic meaning. However the interesting thing about law's treatment of these cases, all cases of the same linguistic process, is that they are divided by our principles of contract law into two categories. The cases outlined in headings (i) and (ii) are characterised by courts as cases of interpretation, and hence governed by the rules set down by Lord Hoffmann in the *Investors Compensation Scheme* v. *West Bromwich Building Society* case.[33] The cases under headings (iii) to (vii) are characterised by the courts as cases of implication of terms, and hence governed by the officious bystander test of *Shirlaw* v. *Southern Foundries (1926) Ltd.*[34] and/or the business efficacy test of *The Moorcock,* and/or the test for implying from custom, and/or the principles of implication in law.

It is, at least at first sight, puzzling that we should have two sets of rules to govern what is as a single task, that of supplementation by inference. Lord Steyn has said, extra-judicially, "The implication of terms is also part of the process of interpretation of written contracts".[35] Lord Hoffmann has said that "As in the case of any implied term, the process is one of construction of the agreement as a while in its commercial setting",[36] and extra-judicially, "the implication of terms into a contract is in essence a question of construction like any other".[37] Kim Lewison has observed that the

[31] (1836) 1 M. & W. 466 (Exchequer).
[32] [1977] A.C. 239 (H.L.).
[33] [1998] 1 W.L.R. 896, at 912.
[34] [1939] 2 K.B. 206, aff'd [1940] A.C. 701.
[35] "Interpretation: Legal Texts and their Landscape" in B. Markesinis (ed.) *The Coming Together of the Common Law and the Civil Law: The Clifford Chance Millenium Lectures* (Oxford 2000), p. 84, and, more recently, J. Steyn, "The Intractable Problem of The Interpretation of Legal Texts" (2003) 25 Sydney L. Rev. 5, 11.
[36] *South Australia Asset Management Corporation* v. *York Montague Ltd.* [1997] A.C. 191, 212.
[37] "Anthropomorphic Justice: Reasonable Man and His Friends" (1995) 29 Law Teacher 127, p. 139 (a paper delivered as the 24th Lord Upjohn Lecture at the Inns of Court School of Law on 12 May 1995).

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implication of terms is "part of the province of the interpretation of contracts", but rightly observes that "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".[38] Certainly, it is difficult to explain why the situation in (ii) is on a different side of the point of radical change to the situations in (iii), why this point of radical change exists and how it can be identified.

An attempt will be made in the following section to answer these questions by using the analysis of supplementation by pragmatic inference given above. Ultimately it will be shown to what degree the rules of implied terms are merely a special instance of interpretation of express terms, and whether a "bright line" separating the two tests and two categories can be justified.

A further source of confusion is the relationship between the implication of terms at law and the implication of terms in fact. Does the implication of terms in law fit onto the continuum that begins with the interpretation of express terms,[39] or is it something else altogether? This is a question that will remain largely unanswered by this article since the implication of terms in law does not seem to be an instance of interpretation, at least in principle.[40]

Using the Analysis of Supplementation by Pragmatic Inference to Explain the Law of Implied in Fact Terms

The Implication of Terms under the Officious Bystander and Business Efficacy Tests

As is well known, there are two common tests (or two formulations of one test) for the implication of terms in fact. The first is the "business efficacy test" of Bowen L.J. in *The Moorcock*, whereby a term will be implied if it is necessary to give "such business efficacy to the transaction as must have been intended at all events by both parties who are business men".[41] The second is the officious bystander test of MacKinnon L.J. in *Shirlaw* v. *Southern Foundries (1926) Ltd.*, whereby a term will be implied if it is ...

> ... so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander [or

[38] Lewison, *The Interpretation of Contracts*, 3rd edn. (London 2004) p. 156. The phrase "continuous spectrum" is Lord Wilberforce's, *Liverpool City Council* v. *Irwin* [1977] A.C. 239, 254. See also S.C. Smith, "Making Sense of Contracts" (1999) Scots Law Times 307, p. 311.
[39] As, *inter alia*, Lewison and Lord Wilberforce believe.
[40] Although see below "The implication of terms in law".
[41] (1889) L.R. 14 P.D. 64, 68 (C.A.).

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> imaginative friend[42]] were to suggest some express provision for it in their agreement, they would testily suppress him with a common "Oh, of course!"[43]

The relationship between these two tests is not entirely clear. MacKinnon L.J. thought that his test "may be at least as useful" as Bowen L.J.'s test in *The Moorcock*, suggesting that both tests were formulations of the same principle. It has been convincingly shown[44] that MacKinnon L.J.'s test actually derives from Scrutton L.J.'s judgment in *Reigate* v. *Union Manufacturing Co. (Ramsbottom) Ltd.*:[45]

> 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 had said of 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".

It is clear that Scrutton L.J. also believed that the business efficacy test and the officious bystander test were formulations of the same principle. Phang has argued that the latter test is practical application of the former, which is the basic theoretical guideline and is based upon fairness.[46] The generally held view is probably the opposite: although Steyn L.J. emphasised that both tests were based upon "strict necessity", he explained that the officious bystander test was wider than the business efficacy test and to that extent should be preferred. In other words, he sees the business efficacy test as a rule of thumb that will often but not always satisfy the true, officious bystander, test.[47] Treitel seems to agree,[48] although the Privy Council in *BP Refinery (Westernport) Pty Ltd.* v. *Shire of Hastings* seemed to view the tests as cumulative requirements to implication,[49] and Phang's latest view is that the tests are complementary.[50]

It is not necessary to take sides in this debate as it seems fairly clear that the test is at least based upon presumed intention of

[42] *Broome* v. *Pardess Co-operative Society of Orange Growers (est. 1900) Ltd.* [1940] 1 All E.R. 603, at 612–613, cited by A. Phang, "Implied Terms, Business Efficacy and the Officious Bystander—A Modern History" [1998] J.B.L. 1 [hereinafter "A Modern History"], 17 ff.
[43] [1939] 2 K.B. 206, 227.
[44] Phang, "A Modern History", note 42 above, at 17 ff.
[45] [1918] 1 K.B. 592 (C.A.), at 605.
[46] "Implied Terms Revisited" [1990] J.B.L. 394, p. 397.
[47] *Watts* v. *Aldington*, LEXIS Transcript, December 15 1993, also *Society of Lloyd's* v. *John Stewart Clementson* [1995] I.R.L.R. 307, 330, both cited by Phang, "A Modern History", note 42 above, at pp. 26 and 34.
[48] *The Law of Contract*, 10th edn. (London 1999), p. 185.
[49] (1977) 180 C.L.R. 266, 283.
[50] Phang, "A Modern History", note 42 above.

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some sort. If this is so, then we must ask (after Glanville Williams) whether this is this an intention that was presumed to be actually held, or a hypothetical intention that the parties would have held if they had foreseen and considered the matter?[51] Even if the implication of terms is not founded upon principles of interpretation, it is sufficiently similar a project that it must be governed by the objective principle to avoid confusion and incoherence in the law. If this is so, then Williams' distinction should be reformulated as that between, on the one hand, implying terms that reasonably appear to have been in fact intended, and, on the other hand, implying terms that reasonably appear to be what the parties would have intended if they had put their mind to the matter. This nice distinction fades away when we realise that one can intend something without it crossing one's mind—applying intended principles to interpolate or extrapolate from what is expressed *is* to find out what was intended even if it was not consciously considered.[52]

If this is correct, then at their hearts the tests of implication in fact require that the term to be implied be one that reasonably appears to have been intended—the same test as that for interpretation of express terms by supplementation. This is consistent with the raft of rules surrounding the implication of terms, for example that a term cannot be implied where it is inconsistent with the express terms (in other words, where it is inconsistent with linguistically encoded material and that which is implied in interpreting such material). This stands to reason—it cannot reasonably appear to have been intended if the linguistically encoded material, which clearly was intended, is inconsistent with it. The business efficacy test, as a neither necessary nor sufficient guide to what terms can be implied, fits with the basic common sense principles of interpretation: all students of contractual interpretation know that the court should be slow to construe a commercial agreement in a way that produces an uncommercial or absurd result because it is very unlikely to have been intended.[53] To say that any term that is necessary for business efficacy is likely to have been intended is merely an application of this principle.

Yet the officious bystander test appears to be stricter than the basic objective principle of interpretation ("does it reasonably appear that the term was intended by both parties") rather than merely a colourful recounting of it, and it is usually understood in

[51] "Language and the Law—IV" (1945) 61 L.Q.R. 384, 401.
[52] See Introduction, above.
[53] *Wickam Machine Tools Sales Ltd.* v. *Shuler AG* [1974] A.C. 235, at 251. Vorster also makes the point that the business efficacy test is an equivalent to the interpretative presumption against absurdity, note 2 above, at p. 87 and footnote 193 and accompanying text.

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that way. Should implied terms have a stricter test than the implication of supplementary material through interpretation, and if so why? This is perhaps the real mystery of implied terms, and the main obstacle to seeing implication in fact as part of the rules interpretation.

Explaining why the test for implication of terms is stricter than the basic objective test

First, it is a mistake to think that the basic test for supplementation through the ordinary process of interpretation is not strict. When, as is often the case, we are dealing with commercial written contractual documents, a special type of utterance, the interpreter can reasonably assume less licence to supplement by inference than in other cases. Such utterances are likely to have left less to inference than an ordinary utterance because certainty and successful communication are particularly important to those making commercial agreements, and inference is less reliable than linguistic encoding. In addition, being written, commercial and legal, they will be carefully drafted, so not much that is important is likely to have been missed by the drafters, and so that which is not expressed is probably not intended. Finally, certainty is doubly important in the case of contracts (rather than other utterances) because there is no opportunity for subsequent clarification, as contracts are binding as to their meaning at the time of contracting. For these reasons, in practice the basic objective principle itself justifies a strict test for inferential supplementation. Indeed, the test should be stricter the more complete the linguistically encoded (usually written) record of the contract appears to be, and there is some evidence that judges see things this way too.[54] Nevertheless, this does not explain the difference between the test for implication of terms in fact and the test of interpretation, since the strictness justified here should apply equally to both tests for supplementation.

Crucially for an understanding of why the implication of terms tests are stricter than the basic interpretation tests, there is a principled difference between the implication of terms and the interpretation of express terms, although the distinction cannot be drawn with a bright line. Earlier, when discussing when it is

[54] In Australia, at least, the test for the implication of terms is less strict where it is apparent that the parties have not attempted to spell out the full terms of their contract: *Byrne* v. *Australian Airlines Ltd.* (1995) 131 A.L.R. 422 approving the qualification made by Deane J. in *Hospital Products Ltd.* v. *United States Surgical Corp.* (1984) 156 C.L.R. 41, 121 and *Hawkins* v. *Clayton* (1988) 164 C.L.R. 539, 573 to the Privy Council's criteria for the implication of terms, laid down in *BP Refinery (Westernport) Pty Ltd.* v. *Shire of Hastings* (1977) 180 C.L.R. 266, 283.

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reasonable to infer that the determination of an undetermined issue was intended to go without saying,[55] the difference between primary and secondary information was identified. We may remember that primary information is that which is more independent, which forms the skeleton of the preferences or goals of the communicator, and which identifies new issues rather than relating to other issues in an utterance. Such information is important and the inference of such information is more unreliable than the inference of secondary information. For these reasons, the benefits of expressing such information are by far outweighed by the costs of doing so, and so primary information is less likely to be intended to go without saying than secondary information.

With this in mind, the stricter (implication of terms in fact) test of supplementation can be justified by reconceptualising it as an instance of the application of the basic interpretation principles (the objective test *etc.*) to the special situation of primary information. The test is strict because the information inferred is primary and so less likely to be intended to go without saying: information characterised as a new term to be implied is more primary than information characterised as detail to be inferred in interpretation of an existing linguistically encoded term.[56] As new terms are more primary than details supplementing existing terms, the licence to supplement by inference is much harder to infer in the case of the implication of terms than in the case of the interpretation of terms.

The narrow formulation of the implication in fact tests seeks to point to the narrow range of situations in which it is credible to believe that such primary information went without saying—to wit, those situations in which a term is easy to identify (*i.e.* "so obvious that it goes without saying") and those situations in which it appears that the communicaters may have forgotten to express the term (hence their testy suppression of the officious bystander's reminder).

It is thus submitted that this difference between primary and secondary information explains the existence of a separate and strict test for the implication of terms in fact.[57] The test for the implication of terms is thus a special instance of contractual interpretation; a special application of the common sense principles (particularly the objective principle). Terms that are implied in fact

[55] Part (b) of "Stage One: Please mind the gap", above.

[56] Cf. the European distinction between *principal* and *collateral* terms: H. Kötz, *European Contract Law Volume 1: Formation, Validity, and Content of Contracts; Contract and Third Parties*, T. Weir trans., (Oxford 1997), 120 ff.

[57] Note that this use of the terms "primary" and "secondary" is very different to that of Lord Diplock in his famous discussions of primary obligations (to do) and secondary obligations (to compensate if you don't), *e.g.* in *Photo Production Ltd.* v. *Securicor Transport Ltd.* [1980] A.C. 827, 848 ff.

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are really terms that are tacitly intended, the process of implication being the same as the process by which information is imported through interpretation, but the type of information implied being different.[58] This explanation, however, does not completely fit with the orthodox understanding of the law. Under the proposed explanation there should be no bright line between the implication of terms and the interpretation of contracts, since primary and secondary information sit on opposite ends of a continuum of importance and independence of issue, rather than in two mutually exclusive categories.[59] As a result, the law should view the officious bystander test as, at most, a special version of the basic objective test of agreement that governs interpretation, to be applied in varying degrees. The more primary a piece of (proposed) implied information is, the more scepticism should be used in applying the basic test, up to the very sceptical officious bystander test when the implied information is very primary indeed.[60] A lot of information will be between the two extremes of primary and secondary, and in such cases judges will probably concentrate more on the general interpretation by supplementation approach and pay little heed to the special officious bystander version of the test.[61]

To determine whether a continuum approach is in fact that taken by the courts, despite their outward adherence to the binary categorisation, is a large task that will not be undertaken here. Existing surveys of cases do show that judges are inconsistent as to whether they classify what they are doing as interpretation (governed by a basic test) or implication (governed by a strict test), whether they apply the strict test of implication more or less strictly, and whether they classify their implication as implication in fact or implication in law.[62] However, a very brief investigation of our own should suffice to show that only a continuum approach makes any sense of the law. The list of examples of supplementation given above[63] has been loosely arranged in an order proceeding from most secondary to most primary (although

[58] On the other hand, terms that are implied in law are implied in a different way to both terms implied in fact and information implied through interpretation. Arguably, terms implied in law should be labelled "imposed", "constructed" or "constructive" terms.

[59] Concomitantly, "new term" and "detail to an existing term" are also at opposite ends of this continuum.

[60] Note the approach taken in Australian courts, mentioned above at note 54, and note Peden's sensible observation that contracts do not easily fall into the categories of "formal and complete" and "informal and incomplete", *A Rationalisation of Implied Terms in Contract Law*, note 2 above, at p. 127. Of course, this is correct—how formal and complete a contract reasonably appears to be is a matter of degree like many other matters, and should contribute to locating the correct point on the scale of scepticism, the scale ending in the model of the implied term.

[61] See *e.g.* the recent decision of *Cel Group* v. *Nedlloyd Lines UK Ltd.* [2003] EWCA Civ 1716.

[62] See Peden, *A Rationalisation of Implied Terms in Contract Law*, note 2 above.

[63] Above, "Supplementation in contract law".

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information supplemented can also be more secondary than the first example or more primary than the last). It makes more sense of these cases to see them, like this, as a continuum of secondary to primary information, whereby this feature of primariness, all other things being equal, increases the scepticism of the supplementing interpreter accordingly. The alternative is to understand these examples as cases falling into two categories, the demarcation for which must be identified and justified (a task which, to me, seems impossible[64]).

Recommendations for Changes to the Law of Implication in Fact

Four categorisation options spring to mind:

1) Abolish the implication of terms in fact and re-characterise all implication in fact cases within the unchanged rules of either interpretation or the implication of terms in law, ignoring the particularly primary nature of what we call "terms". This solution seems to be favoured by Peden and Vorster,[65] who agree with the writer that the maintenance of a separate implication in fact category is incoherent and unjustifiable.
2) Abolish the implication of terms in fact and re-characterise all implication in fact cases within the rules of either interpretation or the implication of terms in law, incorporating into the approach to interpretation the notion that the more primary a piece of information is, the harder it will be to convince oneself and a court that the information was intended even though it went unsaid (*i.e.* even though it was not encoded in the express words through their linguistic meaning).[66]
3) Retain the categories of interpretation, implication of terms in fact, and implication of terms in law, but reconceptualise them as being on a continuum, in particular viewing interpretation and implication in fact as two extreme applications of the same inquiry (an inquiry which asks

[64] By way of contrast, note that the Scottish Law Commission excludes the implication of terms from its *Report on Interpretation in Private Law* (Scot Law Com No. 160 (1999)) by way of a five line explanation that "the implication of terms is a different matter from the interpretation of terms" (p. 2).

[65] Peden, *Good Faith in the Performance of Contracts*, note 2 above, at 141 ff, Vorster, note 2 above, at chapters 5–6. Peden views implication in fact as "the odd card in the deck", an accident of history (at p. 142). Vorster's argument for the abolition of implication in fact is that in those cases of implication in fact that are not cases of interpretation or implication in law, the court is merely applying policy reasons to find the justice of an individual case unjustifiably.

[66] Peden is wrong to say that "[n]othing is lost" if implication in fact is seen as a part of construction (*Good Faith in the Performance of Contracts*, *ibid*, at p. 143), unless the different approach to more primary information is salvaged from the implication in fact tests.

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what reasonably appears to have been intended). This solution is substantially similar to the previous one, but with a slight difference of emphasis.

4) Maintain the system as it is (or appears to be), with a bright line between interpretation and the implication of terms in fact.

I would submit that the fourth option is unacceptable as the law is at present incoherent and unjustifiable: the distinction between implication in fact and interpretation is impossible to draw clearly because there is no justifiable principle upon which such a sharp distinction can be based. Therefore, it is dishonest (since it entails that the varying degrees of strictness in interpreting and implying are not made openly) and renders the law unpredictable (what test will be applied?) The first option is better because it removes the problem of two apparently distinct categories that are actually doing the same thing, but it ignores the problem that the separate category of implied in fact terms seems to be trying to answer. Of the second and third options, I would favour the third because it seems less drastic and so is likely to be more palatable to lawyers, the judiciary and jurists, as it permits the reconceptualisation of a body of rules rather than their excision. In truth, though, the second solution is probably the most honest and the easiest to understand, although both solutions make the important steps of recognising that implication in fact and interpretation are doing the same job, and recognising that the strictness of the test—the scepticism of the interpreter to possible supplementations—must vary with the degree to which the information to be implied is primary.

As Lord Hoffmann has written, extra-judicially, "the officious bystander test ... diverts attention from the fact that the implication of terms into a contract is in essence a question of construction like any other".[67] One consequence of accepting that implication in fact is an instance of interpretation is to recharacterise the business efficacy and officious bystander tests as useful pointers or rules of thumb.[68] When they are treated as more than that, one is liable to become confused and to ask things like "would the parties really agree if they were asked by an officious bystander?" In truth the answer may well be no, but the correct question to ask is "given that the parties were not asked and did not express a view on the matter, is it reasonable for each party to think that the agreement included the proposed term?" The answer

[67] Note 37 above, at p. 139.
[68] Peden, *Good Faith in the Performance of Contracts*, note 2 above, at 147 ff.

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will often be in the negative if the term is strongly contrary to the interests of one of the parties, but all terms are against one party's interests and that is not conclusive. If a term is not strictly necessary for business efficacy—and, after all, how necessary is necessary?—then one has to look for another reason why it is reasonable to think that it went without saying. These tests are not carefully-drafted legislation, they are individual judges' ideas of how to apply the general test in a particular instance. The general test is the test of whether it is reasonable, all things considered, to understand the intended agreement as including the proposed term even though it was unexpressed. It is not possible to achieve a greater level of certainty than this without sacrificing fairness and justifiability.

An illustration of this type of approach is provided by the rules by which the grant of an easement[69] may be implied into a deed of conveyance of a piece of land when the vendor also owns land neighbouring that being sold. It is easiest to imply such a grant where it is a grant of a right of way (over the land retained by the vendor) and the conveyance (into which the grant is to be implied) is of some land that there would otherwise be no way of legally accessing. This type of implication is called an implication out of necessity.[70] Another type of implication is possible where there is evidence of a common intention that the easement be (impliedly) granted.[71] In addition, easements will be implied to permit any type of land-use that was enjoyed by the vendor before the sale "continuous[ly] and apparent[ly]" for the benefit of the land an estate in which is now being sold, or any easement that is "necessary for reasonable enjoyment" of the property in which an estate is now being sold.[72] Finally, if before the sale the buyer has been in occupation of the property in which the buyer is now buying an estate, and has been permitted by the vendor to use the neighbouring land (also owned by the vendor and now retained by him), an easement giving a proprietary right to such use over the neighbouring land will be implied into the conveyance.[73] Like the officious bystander and business efficacy tests for implied terms,

[69] A type of proprietary right, exercisable over the land of a neighbour, enabling the holder to use the neighbour's land in a particular way.

[70] For example, *Nickerson* v. *Barraclough* [1981] ch. 426 (C.A.).

[71] *Wong* v. *Beaumont Property Trust Ltd.* [1965] 1 Q.B. 173 (C.A.) is usually cited for this proposition.

[72] *Wheeldon* v. *Burrows* (1879) 12 ch. D. 31, 49, per Thesiger L.J. Interestingly, a similar discussion has taken place concerning the relationship between the two elements of "continuous and apparent" and "necessary for reasonable enjoyment" in the *Wheeldon* test as has taken place with regard to the business efficacy and officious bystander tests.

[73] *International Tea Stores Co.* v. *Hobbs* [1903] 2 ch. 165 (ch.), *Wright* v. *Macadam* [1949] 2 K.B. 744 (C.A.) and *Sovmots Investments Ltd.* v. *SSE* [1979] A.C. 144, putting s. 62 Law of Property Act 1925 to a rather unexpected use.

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these tests are all based upon presumed intention and as such are subject to expressed contrary intention.[74] To varying degrees they rely upon basic underlying norms such as that one would not intend an absurd result (land with no method of legal access), that a grantor must not derogate from his grant, that a buyer would expect the property to include the incidents with which it is usually enjoyed.[75] Nobody assumes that one test excludes all others, or that one norm is all important, or that the words of the tests are sacrosanct, or that all the tests will even all make sense in every situation. They are merely useful pointers towards what might reasonably have been expected to have been intended, couched in imprecise enough terms to enable them to be used to find whatever the intention reasonably appears to have been in a particular case.

A Note on How Terms are Implied in Fact: The Use of Norms

By the account proposed, terms are implied in fact through the general method of supplementation through pragmatic inference, discussed above. Part of this process is the use of norms governing society, particular communities, and particular relationships. It is difficult to generalise about the application of the process of inference beyond what has already been said, but it may be instructive to identify a few examples of norms or types of norm that seem to play an important part in supplementation, in other words norms that are often intended to be applied to specific (often unconsidered or even unforeseen) situations. The key point to remember here is that these norms are important only when and to the extent that they reasonably appear by both parties to have been intended (which in practice means that one party would assume that the norm would apply and the other would not have disabused them of this assumption). They are what the parties would have reasonably expected to apply.[76]

One example of a norm relevant to interpretation is the basic idea that people are generally out to serve themselves.[77] Thus, in

[74] *Birmingham Dudley & District Banking Co.* v. *Ross* (1888) 38 ch. D. 295 (C.A.), s. 62(4) Law of Property Act 1925, *Nickerson* v. *Barraclough* [1981] ch. 426 (C.A.).

[75] For the importance of general norms, see the discussion in the next section.

[76] J. Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 L.Q.R. 433, 440, emphasises that customary terms ("terms taken for granted and therefore not spelled out in writing") and other terms implied in fact give effect to the reasonable expectations of the parties.

Catherine Mitchell usefully identifies ambiguity in the term "reasonable expectations" in C. Mitchell, "Leading a Life of Its Own? The Roles of Reasonable Expectations in Contract Law" (2003) 23 O.J.L.S. 639. To use her terminology, we are largely concerned with empirical reasonable expectations, and with normative expectations but only if and to the extent that they are empirical.

[77] Cf. the sentiments of Lord Ackner in *Walford* v. *Miles* [1992] 1 All E.R. 453 (H.L.).

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general, one cannot reasonably expect another contracting party to serve one's interests beyond what they have promised to do—this leads to the principles of *caveat emptor* and that the loss lies where it falls. However not all contractual situations are so hostile. Usually at least some cooperation will be reasonably expected, and in such cases one applicable norm will be that a conferral of a benefit comes with a promise not to do something that substantially detracts from the conferral, which J.F. Burrows identifies as the source of the common principle that one must not derogate from one's grant (*e.g.* in contracts granting interests in land).[78] Similarly, the parties will often reasonably expect the agreement to include the norm by which a party has a duty not to obstruct the other party's performance of his obligations or even a duty to cooperate in it.[79]

In many situations the climate of negotiation is less hard-nosed still, and the parties may reasonably expect their consumer dealings (for example) to be governed less by the norm "what you see is what you get" and more by the norm "this product will do what you want it to do except where I say otherwise", which leads to implied warranties of fitness for purpose and the like, and the norm "this product will come with the accessories and incidents that one would normally expect or that it normally has", which leads to the inclusion of all fittings in sales of real property. Further, it may often be the case that a task or cost that remains unallocated is intended to be performed by the party best placed, in terms of control or cost or ability to insure, to perform it.[80]

When parties are engaged in a more cooperative venture such as a long-term employment contract or a partnership, their relationship may be positively friendly, or at least far less hostile. In such situations it will be easier to imply duties of cooperation since cooperation is a basic norm that applies to such relationships.[81]

[78] "Contractual Co-operation and the Implied Term" (1968) 31 M.L.R. 390. See also J.M. Paterson, "Terms Implied in Fact: the Basis for Implication" (1998) 13 J.C.L. 103, 118 ff, who formulates a "duty to cooperate" as "each party agrees ... to do all such things as are necessary on his part to enable the other party to have the benefit of the contract" (after Griffith C.J. in *Butt* v. *McDonald* (1896) 7 Q.L.J. 68, 70).

[79] See E. Peden, "'Construction' in English Contract Law—To Construe or Imply?" (2000) 16 J.C.L. 57, "Incorporating Terms of Good Faith in Contract Law in Australia" [2001] 23 Sydney L. Rev. 222.

[80] Paterson, note 78 above, at 111 ff.

[81] This is what Lord Cooke calls, in employment situations, the "portmanteau duty to take reasonable care to act consistently with the trust and confidence with should exist between employer and employee" ("The Right of Spring" in P. Cane and J. Stapleton, *The Law of Obligations: Essays in Celebration of John Fleming* (Oxford 1998), 56), as identified in *Malik* v. *B.C.C.I.* [1998] A.C. 20, that gives rise to specific duties such as that in *Spring* v. *Guardian Assurance* [1995] 2 A.C. 296. See also Paterson, note 52 above, at 119 ff. See, earlier, *Hivac Ltd.* v. *Park Royal Scientific Instruments Ltd.* [1946] ch. 169.

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These types of norms, applicable where it is reasonable to think that they are intended to apply, are how the parties and courts determine what would have been intended in a particular situation. They exist in society, are part of the common background to the contracting, and are sufficiently precise to be useful. The general duty of good faith is, unless the law takes an interventionist stance for policy reasons and abandons the intention of the parties in this matter, merely a general norm of society that is intended to apply sometimes to some specific situations in some way, all depending upon what it is reasonable to expect. Where application of this general norm is intended, it will indicate the intended determination of many specific issues.[82] However countervailing norms that one must watch one's own back and do only what one has promised will usually, particularly in commercial situations, indicate that little of a concept of good faith is intended to apply.

Failure for Incompleteness or Uncertainty

There are two types of situation in which the interpreter will be unable to discover an intended meaning on a particular issue. The first is where the intended meaning is incomplete because it is not reasonable to think that the communicator intended anything on the particular issue—the case of true contractual gaps. Because of the norms that would be reasonably expected to apply, this type of incompleteness will be rare except with regard to small details (the incompleteness of which results from the incompleteness and uncertainty of the norms themselves). The second type of uncertainty is the design gap and occurs when the utterance has run out even though the intention may not have—in other words, the utterance was inadequately designed such that it is impossible to identify one salient meaning that reasonably appears to have been intended.

Providing that enough of the contract's skeleton exists, the contract will be held to subsist.[83] In such a case, the courts must go

[82] Peden sees cooperation (the requirement of honesty and due regard to the legitimate interests of the other party) as a principle of contract law or a rule of construction, indeed she views cooperation as underlying all interpretation (see particularly, Peden, *Good Faith in the Performance of Contracts*, note 2 above, at chapter 6). I prefer Brownsword's view that cooperation (good faith) is relevant when and to the extent that the norms of cooperation formed part of the background (factual matrix) in which the parties negotiated and entered their agreement, "'Good Faith in Contracts' Revisited" (1996) 49 C.L.P. 111, particularly at p. 127 and footnote 49. In other words, cooperation is not a principle of contract law, it is a principle of our community, and is relevant when and to the extent that it was intended (reasonably expected) to govern the agreement. The difference between Peden's view and that put forward in this article appears to be only a difference of degree.

[83] See the recent discussion by D.W. McLauchlan, "Intention, Incompleteness and Uncertainty in the New Zealand Court of Appeal" (2002) 18 J.C.L. 153, which considers the New Zealand

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outside the contract (the parties' intentions) to fill the gap, although the ways in which they do this are beyond the scope of this work.[84]

The Implication of Terms in Law

The implication of terms in law, *i.e.* on the basis of considerations other than the parties' intentions, is not an instance of interpretation, since the supplementation is not based (or not solely based) upon the inferred intention of the communicators. Implication in law, then, is largely omitted from the discussion in this article, although this is done in the knowledge that the distinction between implication in law and implication in fact is a "thin and slippery one" and is "notoriously unclear",[85] running as it does from default rules and rebuttable presumptions as to intention to judicial legislation on the basis of policy.[86] However, two things will be said.

First, when the process of supplementation is understood as the application of norms that might be reasonably expected to govern, rather than the discovery of precise details that would have been intended if they had been considered, not only does the criticism that the whole approach is a fiction disappear, but many of the cases that are currently characterised as implied in law can be seen to be implied in fact. Not only is it a "necessary incident" of the relationship of landlord and tenant that the landlord repair the common areas and keep them in good usable order[87] (ignoring the uncertainty of the term "necessary incident" for a moment), it is what would be reasonably expected because the common areas are in the control of the landlord, are bound to be used, *etc.* Also, many of the terms implied as normal incidents to a relationship are assumed to be part of the agreement because they are normal in such a relationship, in other words they are implied in fact through a trade or other custom.[88]

Second, there may be a category of hitherto unidentified cases in which the term is imposed by law but is imposed to fill a gap that is implied in fact. In other words, applying the test of pragmatic inference above, the court discovers that it is reasonable to assume that the parties intended something on a particular issue but, due to inadequate drafting or for another reason, it is impossible to

Court of Appeal case of *Fletcher Challenge Energy Ltd.* v. *Electricity Corporation of New Zealand Ltd.* [2002] 2 N.Z.L.R. 433.

[84] See the next section, and see Kramer, "Common Sense Principles", note 7 above, at 192 ff, and the works cited therein.

[85] Law Comm Rep. 242: "Privity of Contract: Contracts for the Benefit of Third Parties", at para. [7.8].

[86] But see Peden, *A Rationalisation of Implied Terms in Contract Law*, note 2 above, at p. 128.

[87] Cf. *Liverpool CC* v. *Irwin* [1977] A.C. 239.

[88] Cf. Peden, *Good Faith in the Performance of Contracts*, n. 2 above, at 102 ff.

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identify one salient answer to the issue that it would be normal to intend. In such cases, a gap in encoding has been identified but the courts must stipulate and impose to fill that gap, by an implication in law.[89]

Conclusion

In the first sections of this article, the part that supplementation of unexpressed but intended information plays in communication has been outlined. This outline goes into a level of technical detail that will convince many readers of its inability to contribute anything useful to a discussion of such a practical area of contract law as implied terms. However, that the proposed model of supplementation is complex does not prove that it is inaccurate; it is describing communication, one of the most complex processes there is. That the proposed model is unfamiliar also does not prove that it is inaccurate and does not mean that the process it is modelling is unfamiliar; communication is a process that we all apply intuitively/at a non-conscious level.

Still, the reader is entitled to ask how the discussion is useful and what reasons are behind such a technical discussion. The answer is that, at a general level, if an accurate model of supplementation can be provided—and the model proposed may or may not fit the bill—then lawyers and judges can be more rigorous and precise in their discussions about supplementation of contracts. Such a model can, for example, provide the tools necessary to engage in an argument about whether a particular thing would have been written down if it had been intended.

In addition, the technical discussion allows us to evaluate the argument, put forward in this article, that the process of implication in fact deals with substantially the same thing as a part of the process of interpretation. The discussion helps us with such an argument because it shows what is going on in both cases.

However, the most specific benefit resulting from the technical discussion in the first half of the article is that it allows us to see the difference between implication in fact and the relevant part of the process of interpretation, or, more accurately, it allows us to see the way in which implication in fact is a special instance of interpretation. Primary information will rarely be intended to go without saying, and so the more primary the information that the contract might be supplemented with, the more sceptical a communicatee should be as to claims that the information was intended to go without saying. The reasons for this are given in the

[89] Cf. Peden, *ibid.*, at p. 135.

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first half of the article, and the implications of it in the second half. These are that, although implication in fact should be seen as a type of interpretation, the strictness of the test for implication of terms in fact should be retained in a new form. Instead of having two tests, there should be one basic test (the objective test of what reasonably appears to have been intended), but with the application of such a test varying in its strictness according to the degree of primariness of the information with which the contract might be supplemented. This strictness reflects a scepticism that primary information would be intended to go without saying. Two options for change to the law were proposed for discussion. The first is to abolish the category of implication in fact, leaving us only with a single test that necessarily varies in strictness, perhaps retaining the officious bystander and business efficacy tests as rules of thumb for the strict end of the test. The second is to retain the category of implication in fact, but to reconceptualise its relationship with interpretation by supplementation as being one of a continuum of strictness, rather than a bright-line distinction. Which of these is preferred is to some extent a matter of taste, but it is argued that the law's existing approach to interpretation and implication is incoherent and cannot be justified.

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