

THE IMPLICATION OF CONTRACTUAL TERMS IN THE NEW MILLENNIUM

Brandon Kain*

As courts become increasingly sure of themselves, interpretation more and more involves an imaginative projection of the expressed purpose upon situations arising later, for which the parties did not provide and which they did not have in mind.

– *L.N. Jackson & Co. v. Royal Norwegian Government*,
177 F.2d 694 (2nd Cir. 1949), at p. 702,
per Learned Hand J. (dissenting)

I. INTRODUCTION

The implication of terms on the basis of “fact” is one of the most ubiquitous devices in the law of contract.¹ It is also one of the most naked exercises of judicial power in an area ostensibly driven by the principle of private ordering.² Nevertheless, the doctrinal underpinnings of implication in fact are rarely explored by Canadian courts. In the great majority of cases, the judge’s foray into the law of implied terms begins and ends with the totemistic invocation of the “business efficacy” or “officious bystander” tests. The nature of these tests, and of the judicial function in applying them, are simply ignored.³

Against this backdrop, the recent decision by the Judicial Committee of the Privy Council in *Attorney General of Belize v. Belize Telecom Ltd.*⁴ represents a welcome development. In many respects, the case involves the most significant rethinking of implied terms since the introduction of the “business efficacy” test in *The Moorcock*.⁵ It has also been received favourably by the

* Brandon Kain is partner in the litigation department of McCarthy Tétrault LLP, where his practice focuses on legal research.

1. The expression “fact” is used here to differentiate such terms from those that are implied on the basis of “law” or “custom”: see *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619, 170 D.L.R. (4th) 577, at para. 27.
2. See *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12 at pp. 29-30, 99 D.L.R. (4th) 577.
3. The ruling in *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711, 40 D.L.R. (4th) 385, is a notable exception to this trend.
4. [2009] 1 W.L.R. 1988, [2009] 2 All E.R. 1127 (P.C.).
5. (1889), 14 P.D. 64, 5 T.L.R. 316 (C.A.). In *Mediterranean Salvage & Towage Ltd. v. Seannar Trading & Commerce Inc.*, [2009] 2 Lloyd’s Rep. 639, [2009] EWCA Civ. 531 (C.A.), at para. 8, Lord Clarke M.R. predicted that Lord Hoffmann’s

English Court of Appeal⁶ and the Supreme Court of New Zealand,⁷ and it is only a matter of time before the case is considered by the Supreme Court of Canada.⁸ When that time comes, it is hoped the Court pays greater attention to the policy rationales behind the implication of terms than it has in the past. For, although *Belize* simplifies the law of implied terms, and places it on a clearer doctrinal plane, the new approach it advocates raises several questions of its own.

II. THE RULING IN *BELIZE*

The facts in *Belize*, though interesting, are relatively unimportant, and shall not be treated in detail here.⁹ What is most important about the case is the general approach that the Privy Council took to the implication of contractual terms in

analysis in *Belize* “will soon be as much referred to as his approach to the construction of contracts in *Investors Compensation Scheme v. West Bromwich Building Society*, [1998] 1 W.L.R. 896.”

6. *Crema v. Cenkos Securities Plc*, [2010] EWCA Civ. 1444, at para. 36. *Cf. Mediterranean Salvage & Towage Ltd. v. Seamar Trading & Commerce Inc.*, *supra*, footnote 5.
7. *Nielsen v. Dysart Timbers Ltd.*, [2009] NZSC 43, at para. 25 and note 12.
8. Commentators have also reacted favourably to *Belize*: see, e.g., Chris Peters, “The Implication of Terms In Fact” (2009), 68 C.L.J. 513; and Kevin F.K. Low and Kelly C.F. Loi, “The Many ‘Tests’ For Terms Implied in Fact: Welcome Clarity” (2009), 125 L.Q.R. 561 (although *cf.* Paul S. Davies, “Recent Developments in the Law of Implied Terms,” [2010] L.M.C.L.Q. 140).
9. The case involved a dispute over the articles of association of a company that had been formed to privatize the state telecommunications regime in Belize. At issue was whether two of the company’s eight directors, who had been appointed by the holder of a single special share, automatically ceased to hold office when the special shareholder lost most of its class C shares in the company. Pursuant to the articles, the special shareholder’s right to appoint and remove the two directors was conditional upon it holding both the special share, and at least 37.5% of the class C shares. The articles were silent upon what would happen to the directors if the special shareholder lost its class C shares after their appointment, although they did provide that the directors’ office was “subject only” to an article that contemplated their removal in certain non-applicable situations (e.g., bankruptcy or conflict of interest). The Privy Council ultimately reversed the Court of Appeal of Belize below, and held that a term should be implied into the articles which required the directors to vacate their office once the special shareholder failed to hold more than 37.5% of the class C shares. It did so notwithstanding the potential conflict between this implied term and the express “subject only” clause, which it resolved through a contextual interpretation of the latter. The Board found that the implied term was:

... required to avoid defeating what appears to have been the overriding purpose of the machinery of appointment and removal of directors, namely to ensure that the board reflects the appropriate shareholder interests in accordance with the scheme laid out in the articles.

Belize, *supra*, footnote 4, at para. 32.

fact.¹⁰ Lord Hoffmann, in a characteristically lucid judgment, sought to resolve several contentious issues that have frequently shadowed this area of the law. His reasoning (which “repays detailed study”)¹¹ may be summarized as follows:

- (1) The court has no power to improve upon an instrument it is asked to construe, whether that instrument is a contract, a statute or a company’s articles of association. The court thus cannot introduce terms to make the instrument fairer or more reasonable. Instead, it concerned only to discover what the instrument means.
- (2) That meaning is not necessarily what the actual parties to the instrument would have intended. Rather, it is the objective meaning which the instrument would convey to a reasonable person having all of the background knowledge which would reasonably be available to the audience to whom the instrument is addressed. This objective meaning is conventionally called the intention of the parties or of Parliament.
- (3) The question of implication arises where an instrument does not expressly provide for what is to happen when an event occurs. In most cases, the usual inference is that nothing is to happen, and the express provisions of the instrument continue to operate undisturbed. If the event causes loss to one of the parties, the loss lies where it falls.
- (4) Occasionally, the reasonable addressee of the instrument will conclude that the *only* meaning which the instrument can have is that something is to happen in response to the relevant event. In that case, the court is said to imply a term as to the response.
- (5) However, the implication of the term is not an addition to the instrument, but only spells out what the instrument means. In other words, the implication of a term is an exercise in the construction of the instrument as a whole. This is supported by both logic (since a court has no power to alter what an instrument means) and authority.

10. At no point in *Belize* does the Board expressly limit its reasons to implication in fact. However, it is clear from the authorities cited by the Board and the tests it considers that implication by law or custom are not part of its analysis.

11. *Mediterranean Salvage & Towage Ltd. v. Seamar Trading & Commerce Inc.*, *supra*, footnote 5, at para. 9. See also *Stena Line Ltd. v. Merchant Navy Ratings Pension Fund Trustees Ltd & Anor*, [2011] EWCA Civ. 543, at para. 36.

- (6) It follows that in every case of implication, the *single question* is whether the implied provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean.
- (7) This single question has been expressed through various formulations in the past, including whether the implied term is: (1) necessary “to give . . . business efficacy to the [contract]” (as per *The Moorcock*);¹² (2) “so obvious that it goes without saying” (as per the “officious bystander” test from *Shirlaw v. Southern Foundries (1926) Ltd.*);¹³ or (3) together with these two tests, “reasonable and equitable,” “capable of clear expression” and does “not contradict any express term of the contract” (as per *B.P. Refinery (Westernport) Pty Ltd. v. Shire of Hastings*).¹⁴ However, these formulations should not be regarded as separate tests, but simply a collection of different ways for expressing the single question framed above.¹⁵

12. *Supra*, footnote 5, at p. 68 (P.D.):

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; and I believe if one were to take all the cases, and they are many, of implied warranties or covenants in law, it will be found that in all of them the 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. In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men . . .

13. [1939] 2 K.B. 206 (C.A.) at p. 227, affd [1940] A.C. 701, [1940] 2 All E.R. 445 (H.L.):

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

As has been frequently observed, the genesis of the “officious bystander” test was likely not *Shirlaw*, but Scrutton L.J.’s judgment in *Reigate v. Union Manufacturing Co. (Ramsbottom) Ltd.*, [1918] 1 K.B. 592 (C.A.), at p. 605.

14. (1977), 180 C.L.R. 266 (P.C. (Aus.)), at p. 347:

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

15. *Belize*, *supra*, footnote 4, at paras. 16-27. For a judicial summary of Lord Hoffmann’s ruling in *Belize*, see *Crema v. Cenkos Securities Plc*, *supra*, footnote 6, at para. 38.

In elaboration on point (7), Lord Hoffmann suggested that there are dangers to treating the alternative formulations of the single question as if they had a life of their own. This was illustrated through the “necessary to give business efficacy to the contract” test. According to Lord Hoffmann, this test was meant to convey only two points: (1) that the reasonable addressee of the instrument should take into account the practical “business” consequences of implying the term; and (2) that the court cannot imply a term simply because it expresses what the court considers it would have been *reasonable* for the parties to agree to, if it is not satisfied that the term is what the contract *actually* (or “necessarily”) means.¹⁶ To make more of this test risks undermining the meaning of the contract:

The danger lies, however, in detaching the phrase “necessary to give business efficacy” from the basic process of construction of the instrument. It is frequently the case that a contract may work perfectly well in the sense that both parties can perform their express obligations, but the consequences would contradict what a reasonable person would understand the contract to mean. Lord Steyn made this point in the *Equitable Life* case, at p 459, when he said that in that case an implication was necessary “to give effect to the reasonable expectations of the parties.”¹⁷

Similarly, Lord Hoffmann warned against the dangers of treating the “officious bystander” test as something more than an alternative way asking what a reasonable person would understand the instrument to mean. In his view:

Any attempt to make more of this requirement runs the risk of diverting attention from the objectivity which informs the whole process of construction into speculation about what the actual parties to the contract or authors (or supposed authors) of the instrument would have thought about the proposed implication. The imaginary conversation with an officious bystander in *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 206, 227 is celebrated throughout the common law world. . . . But it carries the danger of barren argument over how the actual parties would have reacted to the proposed amendment. That, in the Board’s opinion, is irrelevant.¹⁸

Thus, the effect of *Belize* is to replace all prior tests for the implication of contractual¹⁹ terms with a single question: does the

16. *Belize*, *ibid.*, at para. 22.

17. *Ibid.*, at para. 23.

18. *Ibid.*, at para. 25.

19. Lord Hoffmann’s analysis was not restricted to contract, but purported to extend to implication in relation to other classes of instruments, *e.g.*, statutes. However, the viability of his analysis in relation to non-contractual instruments is not addressed in this paper.

implied provision spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean?

III. ANALYSIS

The assimilation of contractual interpretation and implication did not begin with *Belize*.²⁰ As Learned Hand J. observed in the quotation cited at the beginning of this paper, the interpretive function is destined to grow, and come into conflict with the province of implication. However, *Belize* is important in that it marks the first time a Commonwealth court of final appeal has openly accepted the consequences of this development. Under *Belize*, implication in fact ceases to exist, at least in the sense of a discrete form of judicial power that is subject to its own unique principles and restrictions. What is left is merely a specialized branch of contractual interpretation.

It remains to be seen whether *Belize* will be adopted in Canada. At the very least, this would require a shift in direction from the Supreme Court. Like Lord Hoffmann, the Supreme Court of Canada has accepted that contractual interpretation should focus upon the intentions of the parties as objectively construed from the text and context of the agreement.²¹ However, in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*,²² Iacobucci J. took a different approach to implication in fact, one which seems at odds with Lord Hoffmann's view that the actual intentions of

20. See, e.g.: *Trollope & Colls Ltd. v. North West Metropolitan Regional Hospital Board*, [1973] 1 W.L.R. 601 at p. 606, [1973] 2 All E.R. 260 (H.L.), per Lord Pearson; *Codelfa Construction Proprietary Ltd. v. State Rail Authority of New South Wales* (1982), 149 C.L.R. 337 at pp. 345 and 353, [1982] HCA 24, per Mason J.; and Adam Kramer, "Implication in Fact as an Instance of Contractual Interpretation" (2004), 63 C.L.J. 384. See also Lord Hoffmann's own prior judgments in *South Australia Asset Management Corp. v. York Montague Ltd.*, [1997] A.C. 191 at p. 212, [1996] 3 All E.R. 365 (H.L.) sub nom. *Banque Bruxelles Lambert S.A. v. Eagle Star Insurance Co. Ltd.*; and *Transfield Shipping Inc. v. Mercator Shipping Inc. ("The Achilleas")*, [2009] 1 A.C. 61, [2008] UKHL 48, at paras. 11 and 26. For a contrary view, see: *Paddon-Hughes Development Co. v. Pancontinental Oil Ltd.*, [1999] 5 W.W.R. 726, 67 Alta. L.R. (3d) 104 (C.A.) at para. 41, leave to appeal to S.C.C. refused [1998] S.C.C.A. No. 600, 244 A.R. 400n; *Inforica Inc. v. CGI Information Systems and Management Consultants Inc.* (2009), 97 O.R. (3d) 161, 311 D.L.R. (4th) 728, 2009 ONCA 642, at paras. 36-37; and Davies, *supra*, footnote 8, at p. 140 and pp. 144-146.

21. *Eli Lilly and Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, 161 D.L.R. (4th) 1, at paras. 54-56. See also *Dumbrell v. Regional Group of Companies Inc.* (2007), 85 O.R. (3d) 616, 279 D.L.R. (4th) 201, 2007 ONCA 59, at paras. 47-56.

22. *Supra*, footnote 1.

the parties are as irrelevant to implication as they are to interpretation:

What is important in both [the business efficacy and officious bystander] formulations is a focus on the intentions of the *actual* parties. A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of *reasonable* parties.²³

It may be possible to read this remark consistently with *Belize* if Iacobucci J. was merely seeking to focus the court's attention upon the intentions of the actual parties as objectively construed, and not the intentions of the actual parties in a subjective sense. Nevertheless, after making this comment, Iacobucci J. proceeded to rely upon oral testimony about the parties' actual intentions when implying the term in *M.J.B.*²⁴ As a result, the Supreme Court seems to have taken broader view of the relevance of the parties' subjective intentions to implied terms than in *Belize*.

What is more problematic about *Belize*, however, is Lord Hoffmann's excessively reductionist focus upon "meaning" to the exclusion of all other concerns relevant to implication.²⁵ It is true

23. *Ibid.*, at para. 29 (emphasis in original).

24. *Ibid.*, at para. 51. Iacobucci J. stated that:

I note that my conclusion regarding the intention of the parties supporting an obligation to accept only a compliant bid is supported by the trial testimony of the respondent's own witnesses. . . . [A]t trial, the respondent's own witnesses revealed that it was always the respondent's intention to accept only compliant tenders.

Subsequent cases have cited *M.J.B.* for the proposition that "[w]hen implying a term, however, courts must be careful to do so based on actual evidence and not mere judicial discretion": *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325, 4 B.L.R. (4th) 324 (C.A.) at para. 31, leave to appeal to S.C.C. refused [2005] S.C.C.A. No. 334, [2005] 3 S.C.R. viii (and see also para. 32 of the same case: "[T]here is no evidence on the record to support the view that Yorkton and Venture intended that such a term be included in the agreement."). This aspect of *M.J.B.* is particularly interesting in that Iacobucci J. was the same judge who articulated the Supreme Court's objective approach to contractual interpretation in *Eli Lilly and Co. v. Novopharm Ltd.*, *supra*, footnote 21.

25. Another question arises with respect to the status of rectification after *Belize*. If terms implied in fact do not involve an "addition" to the agreement, but simply reflect the agreement as it existed between the parties all along, the recognition of the implied term should logically have a retroactive effect. This would create a result similar to rectification, but without the court being forced to observe the stringent requirements that are necessary for that form of relief: *Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd.*, [2002] 1 S.C.R. 678, 209 D.L.R. (4th) 318, 2002 scc 19, at para. 35; *Swiss Reinsurance Co. v. Camarín Ltd.* (2007), 52 C.C.L.I. (4th) 94, 2007 bcsc 1202, at para. 82 (*cf. CivicLife.com Inc. v. Canada (Attorney General)* (2006), 215 O.A.C. 43, 149 A.C.W.S. (3d) 417 (C.A.), at para. 52). Traditionally, courts have distinguished between rectification and implication in fact: *Codelfa Construction Proprietary Ltd.*, *supra*, footnote 20, at p. 346 (C.L.R.), *per* Mason J.

that the congruity between a proposed term and the meaning of the contract is one of the most important factors that courts rely upon in deciding whether implication is appropriate.²⁶ This is reflected in their traditional focus upon the parties' "presumed intentions," together with the hydra-like *B.P.* requirements, some of which are, as Lord Hoffmann rightly observed, duplicative of this point. However, not every test for implication is concerned solely, or even primarily, with meaning. Running alongside this concern is another equally important issue. This is the appropriate institutional role of courts in resolving contractual disputes.

Judges have frequently remarked that the implication of contractual terms should be approached with caution.²⁷ As Lord Hoffmann himself observes in *Belize*, the court has no official power to improve upon a contract by introducing terms that make it more fair or reasonable (though sceptics may question whether courts exercise such a power in any event).²⁸ This cautionary approach reflects at least three important ideas. The first is that it is inconsistent with the idea of freedom of contract for courts to

26. See, e.g., *Pacific National Investments Ltd. v. Victoria (City)*, [2000] 2 S.C.R. 919, 193 D.L.R. (4th) 385, 2000 scc 64, at para. 30: "It would also have to demonstrate that such an implied term has indeed been agreed to by the parties and should thus be read into their contract."

27. *Hamlyn & Co. v. Wood & Co.*, [1891] 2 Q.B. 488 at p. 494, 7 T.L.R. 731 (C.A.), per Kay L.J.; *Codelfa Construction Proprietary Ltd.*, *supra*, footnote 20, at p. 346 (C.L.R.), per Mason J.; *ter Neuzen v. Korn*, [1995] 3 S.C.R. 674, 127 D.L.R. (4th) 577, at paras. 80 and 82.

28. See *Bell v. Lever Brothers Ltd.*, [1932] A.C. 161 at p. 226, 48 T.L.R. 133 (H.L.), per Lord Atkin; *Jedfro Investments (U.S.A.) Ltd. v. Jacyk*, [2007] 3 S.C.R. 679, 289 D.L.R. (4th) 385, 2007 scc 55, at para. 34; and *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, [2010] 1 S.C.R. 69, 315 D.L.R. (4th) 385, 2010 scc 4, at para. 114, per Binnie J. (dissenting on other grounds). It may be objected that the existence of the category of terms implied in "law" demonstrates that courts do, in fact, have such a power. However, a term that is implied in law is implied on a class-wide basis, and is one which the parties can be deemed to have known in advance and thus agreed to by not expressly excluding it. A term implied in fact, on the other hand, is implied on an *ad hoc* basis, and it would be entirely fictional to assert that it was agreed to by the parties (except, perhaps, insofar as it is found to reflect the meaning of the contract via the test for implication in fact). It may also be objected that the court does have the power to relieve parties from the consequences of unfair bargains given doctrines such as unconscionability, duress or public policy. However, in invoking these doctrines, the court does not add to the parties' agreement itself, but focuses instead upon the legal consequences of their agreement. Finally, it should be noted that in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, *supra*, footnote 1, at paras. 30 and 41, the Supreme Court did appear to imply a term based on whether it was "reasonable," without regard to whether it was also necessary. However, subsequent cases have interpreted *M.J.B.* as turning upon a finding of necessity: *Tercon Contractors*, at para. 23.

rewrite the parties' bargains based upon their own notions of what is fair and reasonable.²⁹ The second is that it would undermine the certainty that is essential to commercial relationships if courts were to engage too frequently in the *ad hoc* implication of contractual terms.³⁰ The third is that a court's view of what implied terms a "reasonable" person would conclude the parties have agreed upon is itself open to attack on the ground of subjectivity.³¹

For these reasons, the Anglo-Canadian courts have traditionally applied a test of *necessity* to implication in fact.³² This is reflected most clearly in the *Moorcock* test, which requires that a term be "necessary to give business efficacy to the contract" before it may be implied.³³ In *Belize*, Lord Hoffmann asserted that the "necessity" element of this test was only intended to ensure that courts be satisfied the implied term is what the contract actually means.³⁴ In other words, the test is a way of asking whether the

29. Though freedom of contract no longer holds the same prominence it once did, the Supreme Court of Canada has frequently affirmed its importance as a guiding legal principle: see, e.g., *Tercon Contractors, ibid.*, at paras. 82, 85-86 and 117-120, *per* Binnie J. (dissenting on other grounds).

30. A similar concept has been recognized in relation to rectification (which, as noted at footnote 25 above, creates a result that is similar to the implication of terms in *Belize*). As stated in *Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd.*, *supra*, footnote 25, at para. 31:

[A] relaxed approach to rectification as a substitute for due diligence at the time a document is signed would undermine the confidence of the commercial world in written contracts.

31. See O.W. Holmes, "The Path of the Law" (1897), 10 Harv. L. Rev. 457, at p. 466: You can always imply a condition in a contract. But why do you imply it? It is because of some belief as to the practice of the community or of a class, or because of some opinion as to policy, or, in short, because of some attitude of yours upon a matter not capable of bounding exact logical conclusions. Such matters really are battle grounds where the means do not exist for determinations that shall be good for all time, and where the decision can do no more than embody the preference of a given body in a given time and place.

32. See *Liverpool City Council v. Irwin*, [1977] A.C. 239 at p. 266, [1976] 2 All E.R. 39 (H.L.), *per* Lord Edmund-Davies ("[t]he touchstone is always *necessity* and not merely *reasonableness*"). See also: *Vancouver Milling & Grain Co. v. C.C. Ranch Co.*, [1924] S.C.R. 671 at p. 674, [1925] 1 D.L.R. 185; *Grover v. Stirling Bonding Co.*, [1935] 3 D.L.R. 481 (S.C.C.), at p. 490; *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, *supra*, footnote 3, at p. 776 (S.C.R.); and *Wotherspoon v. Canadian Pacific Ltd.*, [1987] 1 S.C.R. 952 at pp. 1040-1041, 39 D.L.R. (4th) 169.

33. The expression "necessary to give business efficacy to the contract" is how the *Moorcock* test has come to be framed: see, e.g., *Double N Earthmovers Ltd. v. Edmonton (City)*, [2007] 1 S.C.R. 116, 275 D.L.R. (4th) 577, 2007 scc 3, at para. 30. Interestingly, however, in the *Moorcock* itself, business efficacy was the object of the implication process rather than a requirement for implication: Kim Lewison, *The Interpretation of Contracts*, 4th ed. (London, Sweet & Maxwell, 2007), at p. 208.

34. *Supra*, footnote 4, at para. 22.

implied term is *necessary as a matter of meaning*, such that the term is the “only” interpretive conclusion open to a reasonable person (or a person seeking to give effect to the reasonable expectations of the parties).³⁵ According to Lord Hoffmann, the term need not be necessary in the further sense that the contract is *unworkable* without it.³⁶

It is submitted that this characterization of the business efficacy test is flawed. The reason behind the necessity element of the test is not only to ensure that courts ascertain the proper contractual meaning. It is also to ensure that courts refrain from exercising the extraordinary jurisdiction to imply a term on an *ad hoc* basis save in clearly delineated circumstances where the consequences of not doing so would be extreme (*i.e.*, the contract would be commercially ineffective). That this is one of the concerns at play in the necessity requirement can be seen from *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, where Le Dain J., in considering whether the test for implication should be one of reasonableness or necessity, stated that “[t]his is an important issue of judicial policy respecting the limits of judicial power to impose obligations or duties on the parties to a contract by implication.”³⁷ Similarly, in *Mediterranean Salvage & Towage Ltd. v. Seamar Trading & Commerce Inc.*, the English Court of Appeal, in finding that *Belize* did not eliminate the requirement that “the proposed implied term [be] necessary to make the contract work,” quoted Lord Bingham M.R.’s comment that “[i]t is because the implication of terms is potentially so intrusive that the law imposes strict constraints on the exercise of this extraordinary power.”³⁸

In the end, courts are not linguists, concerned only with contractual meaning. They are public organs whose decisions are made within an intricate network of constitutional and institutional constraints that sometimes preclude them from taking positions which may otherwise appear normatively

35. *Ibid.*, at paras. 23-24.

36. Cf. Chris Ward, “Unsafe Berths and Implied Terms Reborn,” [2010] L.M.C.L.Q. 489, at pp. 490-491, who argues that Lord Hoffmann did not abandon the business efficacy test in *Belize*.

37. *Supra*, footnote 3, at p. 776 (S.C.R.). Although Le Dain J. was here speaking with reference to the test for implication by law rather than implication by fact, he did so with reference to case law regarding the latter form of implication. Thus, his comments appear equally applicable to both.

38. *Supra*, footnote 5, at para§. 17-18, *per* Lord Clarke M.R., citing *Phelps Electronique Grand Public S.A. v. British Sky Broadcasting Ltd.*, [1995] E.M.L.R. 472 (C.A.), at p. 481.

correct. While it may be that case that a contract can “only” mean that the parties agreed to a given term, the court must still weigh the merits of recognizing that term against a host of other factors (e.g., the need to promote commercial certainty by encouraging parties to make their obligations express).³⁹

Lord Hoffmann, in reply, might argue that there is no justification for imposing a more stringent test of necessity in cases of implication than interpretation, since there is no real justification for distinguishing between the two processes at all. There is some force to this position, since courts increasingly engage in acts of “interpretation” that concern the meaning of contracts in circumstances where the answer is not express, but only inferentially available from context. However, in *Belize*, Lord Hoffmann himself appeared to recognize a continued distinction between interpretation and implication (at least insofar as the latter is a discrete sub-species of the former).⁴⁰ Further, the existence of some overlap is not a reason for abandoning the distinction between implication and interpretation (any more than it is for abandoning the distinction between other areas of overlap, e.g., mistake and misrepresentation, or contract and tort).⁴¹ As Lewison notes, the fact that courts have focused upon different issues in the areas of interpretation and implication (e.g., the reasonableness of a construction, versus the necessity of a term) suggests that somewhere along the spectrum a “radical change” occurs that justifies the use of a different set of principles.⁴²

While it is difficult to define precisely when that change occurs,⁴³ one possibility is that interpretation ends, and implication begins, when the effect of the court’s process is to

39. Similarly, a term which might otherwise meet the test for implication can be denied on the ground of public policy: *Pacific National Investments Ltd. v. Victoria (City)*, *supra*, footnote 26, at para. 74.

40. See *Belize*, *supra*, footnote 4, at para. 34, where in distinguishing an earlier ruling concerning the interpretation of company articles, Lord Hoffmann noted that:

In the case of an implied term, however, the question is not what any particular language in the instrument means but whether, without it having been expressly stated, that is the meaning of the instrument.

Cf. Thompson v. Goblin Hill Hotels Ltd. (Jamaica), [2011] UKPC 8, at para. 27.

41. There are numerous areas of contract law that overlap. The question of whether a given legal doctrine should continue to exist in the face of some overlap cannot, therefore, be resolved simply on account of the existence the overlap itself. Instead, it must be asked whether the doctrine contains a sufficiently discrete and unitary identity that its separate existence is justifiable as a matter of principle. See also Davies, *supra*, footnote 8, at p. 145.

42. Lewison, *supra*, footnote 33, at p. 197.

43. See *66 Checo International Ltd. v. British Columbia Hydro and Power Authority*, *supra*, footnote 2, at p. 31 (S.C.R.).

recognize a new *right* or *obligation* that is not express (and not, *e.g.*, a new way of applying a right or obligation that is express).⁴⁴ This line of demarcation creates at least a principled rationale for applying a more rigorous test of necessity in cases of implication than interpretation. When courts move to impose rights and obligations upon parties that are not clearly consensual, they risk exiting the perimeter of contractual liability and entering that of restitution or tort.

The question may still be asked, how should “necessity” in this context be understood?⁴⁵ The classical, *Moorcock* approach requires that an implied term be necessary to give “business efficacy” to the contract, *i.e.*, that the contract be pragmatically “unworkable” without it.⁴⁶ However, in other cases, courts have joined with *Belize* in requiring that the term only be “necessary” as a matter of meaning,⁴⁷ or “necessary” to effect the parties’

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44. It is not fruitful to draw the distinction between construction and implication along the lines of the “express” and “unexpress” language of the contract, as has often been done by the courts. The parties may include an express term (*e.g.*, a limitation period for claims) that is silent on how it is to apply in a given situation (*e.g.*, whether it runs from the date an event occurs or the date the event is discovered where these diverge). In determining how an express term applies in a situation for which no express provision has been made, the court could then be said to engage in both construction and implication. The better approach is to focus upon the *character* of the conclusion arrived at by the court, and ask whether it results in the addition of a new *term* (*i.e.*, a new right or obligation).
45. See H.K. Lücke, “Ad Hoc Implications in Written Contracts” (1973), 5 *Adel. L. Rev.* 32, at pp. 34-35.
46. See, *e.g.*, *Liverpool City Council v. Irwin*, *supra*, footnote 32, at p. 253 (A.C.) (“courts are willing to add a term on the ground that without it the contract will not work”); *Tai Hing Cotton Mill Ltd. v. Liu Chong Hing Bank Ltd.*, [1986] A.C. 80 at p. 105, [1985] 2 All E.R. 947 (P.C.) (the term must be one without which the contract would be “inefficacious, futile and absurd”); *Con-Stan Industries of Australia Proprietary Ltd. v. Norwich Winterthur Insurance (Australia) Ltd.* (1986), 160 C.L.R. 226 at p. 241, [1986] HCA 14 (“there is real difficulty in the proposition that either term is necessary [since] [t]he contract is capable of sensible operation in the absence of the implied terms”); *Wotherspoon v. Canadian Pacific Ltd.*, *supra*, footnote 32, at p. 1040 (S.C.R.) (“I cannot conclude that it is necessary to imply any such terms in order to give efficacy to the contract”); and *Marinangeli v. Marinangeli* (2003), 66 O.R. (3d) 40, 228 D.L.R. (4th) 376 (C.A.), at para. 64 (“The underlying rationale for implying a term of business efficacy is that it is necessary to make the transaction effective. In other words, if such a term was not implied, the very rationale for entering into the Minutes would be undermined.”).
47. See *Trollope & Colls Ltd. v. North West Metropolitan Regional Hospital Board*, *supra*, footnote 20, at p. 609 (W.L.R.), *per* Lord Pearson: “An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract.” Interestingly, at least two decisions of the English Court of Appeal after *Mediterranean* have also taken this position:

reasonable expectations.⁴⁸ This issue is further obfuscated by the fact that courts have yet to decide whether the “officious bystander” test from *Shirlaw* is the same as the “business efficacy” test from the *Moorcock*, and if not, in what sense the former test requires necessity (if at all).⁴⁹

In my view, the appropriate standard of necessity is one of business efficacy. For the reasons discussed above, a test that turns solely upon whether the term is necessary as a matter of “meaning” fails to account for the many supra-hermeneutical factors that also constrain the court’s role in the process of implication (e.g., the importance of promoting freedom of contract, or certainty in commercial affairs). It also fails to give sufficient guidance to lower courts. This is not to discount the importance of contractual meaning when implying a term. There is much value in Lord Hoffmann’s insight that some of the previous tests for implication (e.g., whether the term does not “contradict any express term of the contract”) were simply different ways of testing whether the proposed term could objectively be attributed to the parties (though it may be questioned whether Lord Hoffmann’s notion of meaning is truly equivalent to the earlier concept of the “presumed intention” of the parties).⁵⁰ Logically, any test for implication in

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- Chantry Estates v. Anderson* (2010), 130 Con. L.R. 11 (C.A.), at paras. 16-19; and *Crema v. Cenkos Securities Plc*, *supra*, footnote 6, at paras. 39 and 51.
48. *Equitable Life Assurance Society v. Hyman*, [2002] 1 A.C. 408 at p. 459, [2000] 3 All E.R. 961 (H.L.), *per* Lord Steyn.
49. The distinction between these two tests was left open in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, *supra*, footnote 1, at para. 29. See also *Double N Earthmovers Ltd. v. Edmonton (City)*, *supra*, footnote 33, at paras. 32 and 51, where the court applied a test of “obviousness” alone in implying a term. But compare *R. v. Marshall*, [1999] 3 S.C.R. 456, 177 D.L.R. (4th) 513 at para. 43 (motion for rehearing dismissed 179 D.L.R. (4th) 193, [1999] 3 S.C.R. 533), where the Supreme Court treated the officious bystander test as a manifestation of the business efficacy test.
50. As noted by some commentators, the concept of “presumed intent” may extend to both “presumed actual intentions” (i.e., what the parties likely actually held but did express) and “hypothetical intentions” (i.e., what the parties would have agreed to had they considered the matter in question): see Glanville Williams, “Language and the Law – IV” (1945), 61 L.Q.R. 384. The officious bystander test traditionally allowed for terms to be implied on the basis of hypothetical intent. However, this test was rejected in *Belize*. Further, Lord Hoffmann noted that there will be many situations in which no term can be implied, because a reasonable interpretation of the contract does not suggest that the parties intended anything to happen in that situation. These aspects of *Belize* suggest that Lord Hoffmann’s concept of meaning focuses solely upon “presumed actual intent.” Nevertheless, a better way of reading *Belize* (and of conceptualizing the concepts of meaning and intent in implication generally) is that Lord Hoffmann only required the implied term to be one which reasonably appears to have been

fact must ask whether the term reflects the meaning of the contract, for if the answer is no, then the court would be implying a term on the basis of law instead.⁵¹ However, that question should not exhaust the scope of the appropriate test.

Nor should the standard of necessity be such that the term is only required to give effect to the “reasonable expectations” of the parties. First, in the authority cited for this proposition by Lord Hoffmann, *Equitable Life Assurance Society v. Hyman*,⁵² Lord Steyn used that test when implying a term that the directors of a life assurance society not use their *discretion* in a way that would deprive the policyholders of the substantial value of their policies. While Lord Steyn admittedly approached the issue from the perspective of implication in fact, such a term would likely be categorized as a manifestation of the duty of good faith under Canadian law (which is clearly concerned with the reasonable expectations of the parties, and which, if it is an implied term at all, is more similar to a term implied in law than in fact).⁵³

intended (a suggestion earlier made by Adam Kramer, *supra*, footnote 20, at pp. 399 and 411). It is possible for a term to be one which reasonably appears to have been intended even though the parties did not actually turn their mind to the situation. This is demonstrated in the classic illustration by Wittgenstein, sometimes cited in the literature on implied terms:

Someone says to me: “Shew the children a game.” I teach them gaming with dice, and the other says “I didn’t mean that sort of game.” Must the exclusion of the game with dice have come before his mind when he gave me the order?

(Ludwig Wittgenstein, *Philosophical Investigations*, 3rd ed., (New York, MacMillan, 1968), at p. 33). Thus, Lord Hoffmann’s concept of meaning should be capable of embracing terms which a reasonable person would view the parties as intending even though they did not consciously consider the situation. That said, in using this concept, courts must be careful not to imply terms where the parties cannot be reasonably viewed as having consciously or unconsciously reached actual agreement on them, since attributing the term to their “presumed intention” or to the meaning of the contract would then be a legal fiction: see *Restatement (Second) of Contracts*, § 204, Comment c (1981).

51. It cannot be sufficient for implication that a term is necessary to make a contract workable in a given situation, if the term does not also reflect the necessary meaning of the contract in that situation. Otherwise, courts would never apply the doctrine of frustration, but would relieve parties from all supervening difficulties of performance through implied terms. It is the very fact that the parties *cannot* be reasonably understood to have made provision for a given situation which renders the contract unworkable that triggers the doctrine of frustration; see *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, [2001] 2 S.C.R. 943, 204 D.L.R. (4th) 513, at para. 53.
52. *Equitable Life Assurance Society v. Hyman*, *supra*, footnote 48, at p. 459 (A.C.): [T]he directors of the Society resolved upon a differential policy which was designed to deprive the relevant guarantees of any substantial value. In my judgment an implication precluding the use of the directors’ discretion in this way is strictly necessary. The implication is essential to give effect to the reasonable expectations of the parties.

Second, and leaving aside the debate over whether the protection of reasonable expectations is truly an organizing principle of contract law,⁵⁴ not every contractual doctrine is designed to protect every reasonable expectation notionally held by the parties. In this respect, there is an important analogy to be drawn between implication in fact and frustration.⁵⁵ Like implication in fact, the doctrine of frustration (which began its life as an implied term) is designed to respond to the situation where an event occurs for which no express provision is made in the contract. The effect of the doctrine is that the parties will be granted relief from their obligations if, but only if, the event would render performance of those obligations something “radically different” from that which was undertaken by the contract.⁵⁶ Courts will not relieve parties from their obligations simply because the supervening event would render performance of those obligations contrary to their “reasonable expectations” more generally.

This suggests that there exists a hierarchy of reasonable expectations, only some of which are protected by certain contractual doctrines (perhaps because the extension of those doctrines to all of the parties’ reasonable expectations would undermine other values important to the law of contract). Like frustration, implication in fact should be understood to focus upon a *basic* expectation, *i.e.*, the expectation that the contract will be commercially workable. The existence of this expectation can generally be inferred *a priori* from the fact of entry into the agreement itself. Accordingly, unlike more complex expectations, there is little risk that judicial intervention to protect this expectation will violate the parties’ intentions or otherwise detract from freedom of contract.

It is also possible to extend this approach to the officious bystander test. As noted by the courts, the officious bystander test

53. See *CivicLife.com Inc. v. Canada (Attorney General)*, *supra*, footnote 25, at para. 49; and Michael Furmston, *Cheshire, Fifoot & Furmston’s Law of Contract*, 15th ed. (Oxford, Oxford University Press, 2007), at p. 190.

54. See generally, Stephen A. Smith, “‘The Reasonable Expectations of the Parties’: An Unhelpful Concept” (2010), 48 C.B.L.J. 366.

55. Interestingly, when engaging in implication in fact, some courts have even applied a business efficacy test of necessity that requires the frustration of the contract in the absence of the implied term: *Zeitler v. Zeitler Estate* (2010), 319 D.L.R. (4th) 106, 2010 BCCA 216 at para. 36, *supp. reasons* 322 D.L.R. (4th) 382, 2010 BCCA 360.

56. *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, [2001] 2 S.C.R. 943, 204 D.L.R. (4th) 513, 2001 SCC 58, at paras. 53 and 55-56.

may call for the implication of a term on the ground of obviousness, even if it is not necessary to give business efficacy to the contract.⁵⁷ Accordingly, despite efforts to reconcile the tests (on the ground, *e.g.*, that the quality of obviousness itself demonstrates necessity),⁵⁸ it seems clear that the tests can be distinct as a matter of effect. Nevertheless, the tests are reconcilable if they are viewed as protecting business efficacy at *different stages* of the contractual process. In other words, the *Moorcock* test can be seen to focus upon ensuring business efficacy in the *performance* of the contract: if the contract is commercially unworkable, there is no justification for past or future performance. The officious bystander test, on the other hand, focuses upon ensuring business efficacy in the *formation* of the contract: if parties were forced to include every pedestrian assumption in their contract, the drafting process would quickly become unwieldy. Therefore, both tests may be seen to derive from the same concept of necessity.

Finally, it is possible to apply this conception in a way that preserves flexibility for the courts. Although some judges have cautioned against adopting a test of business efficacy for fear that this would make implication too difficult to establish,⁵⁹ others have acknowledged that the degree of strictness relative to this test “seems to vary with the current legal trend.”⁶⁰ Put differently, necessity is not a uniform proposition. Food is necessary for human life, although water is more necessary, and neither is as necessary as air. The same should be true of implied terms and business efficacy. It would be preferable if courts were to openly recognize that the necessity test involves a variegated approach, as some have hinted,⁶¹ with the required degree of necessity

57. *Watts v. Aldington*, [1999] L. & T.R. 578 (C.A.), at pp. 596-597, *per* Steyn L.J. See also Davies, *supra*, footnote 8, at p. 142. Conversely, it is possible that the business efficacy test may call for the implication of terms that would not meet the officious bystander test: Furmston, *supra*, footnote 53, at p. 189.

58. See *Reigate v. Union Manufacturing Co. (Ramsbottom) Ltd.*, *supra*, footnote 13, at p. 605; *Comptoir Commercial Anversois v. Power, Son and Co. (In re)*, [1920] 1 K.B. 868 (C.A.), at p. 899-900, *per* Scrutton L.J.; Andrew Phang, “Implied terms, Business Efficacy and the Officious Bystander – A Modern History,” [1998] J.B.L. 1, at pp. 28 and 33; and Richard Austen-Baker, “Implied Terms in English Contract Law: The Long Voyage of *The Moorcock*” (2009), 38 *Comm. L. World Rev.* 56, at p. 79.

59. See *Watts v. Aldington*, *supra*, footnote 57, at pp. 596-597, *per* Steyn L.J.

60. *Liverpool City Council v. Irwin*, *supra*, footnote 32, at p. 253, *per* Lord Wilberforce.

61. See, *e.g.*, *Codelfa Construction Proprietary Ltd.*, *supra*, footnote 20, at pp. 356 and 374 (C.L.R.); *Byrne v. Australian Airlines Ltd.* (1995), 185 C.L.R. 410 at p.

depending on factors such as the commercial sophistication of the parties, whether the contract is written or oral, whether the contract is one of adhesion, the level of detail it contains, and the proximity between the contract and the proposed term. Surely this is a better way of responding to considerations of individual justice than giving courts a roving discretion to imply terms on the basis of "meaning" alone.

IV. CONCLUSION

In the famous contract case of *Wood v. Lucy, Lady Duff-Gordon*, Justice Cardozo observed that "[t]he law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view to-day."⁶² The decision in *Belize* is a reflection of that trend. However, courts must be careful not to take too broad a view. The *ad hoc* implication of rights and obligations has the potential to seriously undermine commercial certainty and freedom of contract, particularly in the case of detailed agreements drafted by sophisticated legal advisers. The fact that an unexpressed term is necessary as a matter of meaning should not be a sufficient requirement for reading it into a contract. In addition, the term should be necessary as a matter of business efficacy, whether in the performance or the formation of the contract, with the required level of necessity depending upon the circumstances of the individual case. In the absence of that exigency, the parties should bear the consequences of their own failure to make the term express.

422, [1995] HCA 24; and *CSRS Ltd. v. Embley* (2008), 87 B.C.L.R. (4th) 251, 2008 BCCA 533, at paras. 22-23. See also Adam Kramer, *supra*, footnote 20.

62. 222 N.Y. 88 at p. 91, 118 N.E. 214 (1917).