

Implied terms - the return of the officious bystander



Salvador Dali once said "Have no fear of perfection - you'll never reach it."

While we doubt that he had in mind either sophisticated contracting parties or their busy lawyers they – like everyone – can sometimes fail to cover every contingency in their planning and drafting. When that happens disputes often arise and the courts will then need to construe the express words of the agreement, and if it is still not possible to ascertain the meaning, the court may then be willing to imply certain terms.

In practice the situations in which courts are prepared to imply a term into an agreement are limited. This briefing examines a case where the Hong Kong court considered and addressed an unusual position in relation to a trading contract and clarified the parties' legal position by implying a term.

This trading contract

In this case, *Ask Re Limited v Grain Mineral Resources Pte Limited* [2015] HKCFI 1232, the Hong Kong Court of First Instance allowed a term that both parties will rely only on documents known or believed to be genuine to be implied into a commercial contract which involves payment by a documentary credit system. The plaintiff was the buyer in the transaction and the defendant was the seller. They entered into an agreement for the sale and purchase of 10,000 metric tons of tapioca chips for delivery to a port in China. It was agreed that payment would be by letter of credit.

The seller submitted the required copied documents under the letter of credit to the bank and provided a DHL Air waybill showing the originals of same had been dispatched to the buyer. But in fact, those original documents and the DHL Air waybill were never couriered. Although the payment was ultimately stopped since the banks discovered some discrepancies between the documents submitted and as required under the letter of credit, the Court found that the seller fraudulently misled the bank in the preparation and submission of the documents. The Court held that "there can be no sensible doubt about the implication of a term that both parties to a transaction involving payment by a documentary credit system will rely only on documents known or believed to be genuine". Hence by submitting some false documents, the seller was found to be in breach of the implied term and thus was in repudiatory breach of the contract.

Although not expressly cited in the judgment, one can see from the above wording that the Court here did follow Lord Hoffman's approach on implied terms in *Attorney General & Ors v Belize Telecom Ltd & Anor* [2009] UKPC 10, where the test for implied terms was reduced down to one single question "is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?".

Six additional observations

Nonetheless, it may be worth-noting that Lord Hoffman's approach was clarified subsequently in the House of Lord's case of *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited* and another [2016] A.C. 742. There Lord Neuberger did affirm the general principles established in previous decisions on implied terms, and also made the following six additional observations:

1. The implication of a term is not dependent on proof of an actual intention of the parties when negotiating the contract.
2. A term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them.
3. The implied term must be reasonable and equitable.
4. Business necessity and obviousness are alternative requirements and only one of them need be satisfied.
5. If one approaches the issue by reference to the officious bystander, it is vital to formulate the question to be posed by him with the utmost care.

6. A term can only be implied if without the term, the contract would lack commercial or practical coherence.

After the Marks and Spencer case, it is important to note that the law has now moved closer to the pre-Belize Telecom case position. The Court has further made it clearer that the two traditional tests for implied terms - the business efficacy and officious bystander tests can be alternatives and only one of those tests need to be satisfied.

The Marks and Spencer case has been applied in the Hong Kong Court of First Instance case of Yifung Developments Limited v Liu Chi Keung Ricky and others [2016] HKCFI 678. This Hong Kong decision reinforces the application of the business efficacy and officious bystander tests when terms are implied into a contract, and that merely being reasonable and equitable do not justify the implication of such a term into the contract.

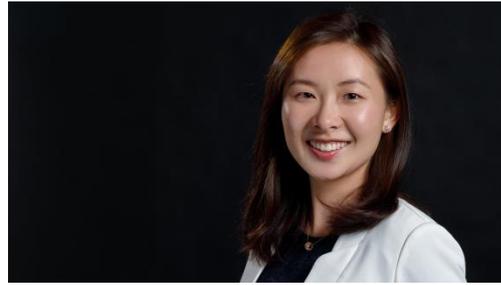
Readers who wish to examine this further may also be interested to know that the issues covered in this briefing are discussed and illuminated by two of our solicitors in the recently published podcast on “**Legal Listeners: terms implied into commercial contracts**”.

That podcast can be accessed on <https://www.shlegal.com/insights/greater-china-podcast> .

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