

## THE TERMS OF THE CONTRACT

### CENTRAL ISSUES

1. The answer to the question whether a statement made by one contracting party to another, prior to the conclusion of the contract, has been incorporated into the contract as a term or is merely a representation that has induced that party to enter into the contract depends upon the intention of the parties, objectively ascertained. In seeking to discern the intention of the parties the courts have regard to a variety of factors that are considered in this chapter.
2. While the distinction between a term and a representation remains one of some importance today it is not as important as it was prior to changes to the law of misrepresentation made by the judiciary in 1963 and by Parliament in 1967. Before these changes were made damages could be recovered for a fraudulent misrepresentation but not for an innocent or for a negligent misrepresentation. Thus a plaintiff who wished to recover damages in respect of an innocent or a negligent misstatement had to prove that the statement had been incorporated into the contract as a term in order to recover damages. Now that damages for misrepresentation are more widely available the distinction between a term and a representation tends to be of importance not to the *existence* of the jurisdiction to award damages but to the *measure* of damages recoverable.
3. In the case where the parties have reduced their contract to writing an issue can arise as to whether or not one of the parties is entitled to lead evidence of the existence of a term not to be found in that written document. The 'parol evidence' rule was thought to exclude such evidence where its effect was to add to, vary, or contradict the written document. But the status of this rule is the subject of some controversy. On one view the rule is a 'circular statement' on the basis that it only applies where the written document is intended by the parties to contain all the terms of the contract. The other view is that the rule is not circular because it applies where the document *looks* like a complete contract (even if it was not so intended by both parties) and, in such a case, the court will presume that the written document contains the whole contract in the absence of evidence to the contrary.

## 1. INTRODUCTION

A contract is composed of a number of terms. The number of terms will obviously depend upon the importance of the transaction. Large-scale transactions often produce contracts of considerable length and complexity and some of the standard form clauses, such as exclusion and limitation clauses, are likely to have been the subject of protracted negotiation between the parties (or at least between their lawyers). The terms of the contract are obviously of great significance to the parties because they define their rights and liabilities. English law gives the parties considerable freedom to define for themselves the terms of their contract: freedom of contract remains a fundamental part of English law. Many commercial parties have their own standard terms of business which they seek to incorporate into the contracts they conclude (hence the so-called 'battle of the forms' discussed at pp. 82–98, Chapter 3, Section 3(a)). However the freedom of the parties is not unlimited. Parliament has in recent years intervened to regulate the use of certain types of contract terms. Initially the regulation was confined principally to exclusion and limitation clauses but it was extended in 1994, in the case of contracts that have not been individually negotiated between a seller or a supplier and a consumer, to a much wider range of terms (see further pp. 462–479, Chapter 14, Sections 2 and 3). Not all terms are, however, agreed expressly by the parties. Some are implied into the contract either by the courts or by Parliament. Implied terms form an important part of many contracts, particularly contracts for the sale of goods.

This Part of the book is divided up in the following way. This chapter is devoted to two issues. The first relates to the identification of the express terms of the contract and the second concerns written contracts and the extent to which it is permissible to lead evidence of the existence of terms not found in the written contract. Chapter 9 deals with the subject of the incorporation of terms into a contract. This is an important issue in practice. Many companies spend substantial sums of money on legal advice in relation to the drafting of their standard terms of business but then fail to take adequate steps to ensure that these terms are incorporated into the contracts which they conclude. The subject matter of Chapter 10 is implied terms. Here the principal difficulty relates to the legal basis upon which courts imply terms into contracts. Chapter 11 deals with the principles applied by the courts when interpreting contracts. Many cases that come before the courts raise issues of interpretation or construction. Indeed, the most cited contract case in recent years is the decision of the House of Lords in *Investors Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 WLR 896 where Lord Hoffmann (at pp. 912–913) restated the principles by which contract documents are to be interpreted. Chapter 12 moves on to consider some standard clauses that are to be found in commercial contracts today (often known as 'boilerplate clauses'). The subject matter of Chapter 13 is one particular type of boilerplate clause, namely the exclusion or limitation clause. These clauses have been the subject of a considerable amount of judicial analysis and the Unfair Contract Terms Act 1977 was passed in order to regulate their use. Much of Chapter 13 is concerned with the statutory control of contract terms and this theme is developed in Chapter 14 which is devoted to the Unfair Terms in Consumer Contracts Regulations 1999. The Regulations give to the courts much broader powers to regulate terms in contracts which have not been individually negotiated and which have been concluded between sellers or suppliers, on the one hand, and consumers on the other hand. Chapter 15 draws this Part of the book to a close with a discussion of the role of good faith in contract law. The

location of any discussion of good faith is a matter of real difficulty in English law. The courts have so far refused to recognize the existence of a general principle of good faith and fair dealing in contract law (see *Walford v. Miles* [1992] 2 AC 128) yet, on the other hand, it may be said that notions of good faith and fair dealing permeate all parts of the law of contract (see, for example, *First Energy (UK) Ltd v. Hungarian International Bank Ltd* [1993] 2 Lloyd's Rep 194, 196). The principle of good faith and fair dealing is a fundamental part of the law of contract in most civilian legal systems and it is declared to be a mandatory principle by both the Unidroit Principles of International Commercial Contracts and the Principles of European Contract Law. Given that English law presently refuses to recognize the existence of a doctrine of good faith and fair dealing, it may seem odd to give it its own chapter. But the reality is that it is an issue that does require analysis and, a notion of good faith having been introduced into English law via the Unfair Terms in Consumer Contracts Regulations 1999, this provides helpful context for the discussion. The question which English law has to answer can be shortly stated, even if it cannot be answered easily. It is: is the role of good faith in English law confined to those cases that fall within the scope of the 1999 Regulations or will its influence extend beyond these cases and into transactions, particularly commercial transactions, that do not fall within the scope of the Regulations?

## 2. TWO PRELIMINARY ISSUES

The purpose of this chapter is not to consider the substantive content of the express terms of a contract. The content of the most important standard clauses found in commercial contracts is considered later in Chapter 12. Here we are concerned with two preliminary issues. The first relates to the identification of the terms of the contract. How do the courts decide what is and what is not a term of the contract? In the case where the parties reduce their agreement to the form of a written contract, the answer is fairly obvious, namely that the content is to be found in the terms set out in the document. But what about oral statements made prior to the conclusion of the contract? Are they also terms or are they merely representations which, while they may have induced one party to enter into the contract, are not part of the contract itself? The second issue concerns the entitlement of the parties to lead evidence of terms not to be found in their written contract. Where the parties take the time, trouble, and expense of reducing their agreement to writing, are they still entitled to adduce evidence of terms other than those found in the written document or is the written document the sole source of the terms of their contract? We shall explore each issue in turn.

## 3. TERMS AND REPRESENTATIONS

The question whether or not a statement made by one party to the other prior to the conclusion of the contract has been incorporated into the contract as a term is one of some importance. If the statement has been incorporated into the contract as a term then a failure to comply with it will amount to a breach of contract. On the other hand, if the statement has not been so incorporated then any liability cannot be for breach of contract but must be for misrepresentation. The distinction between a term and a representation

is an important one but it is not as significant as it used to be. The primary significance of the distinction lies in the different remedial responses to a breach of contract and a misrepresentation. We shall deal with the different remedial responses in more detail in the chapter on misrepresentation (see Chapter 17). Here it suffices to use one remedial difference for illustrative purposes. Every breach of contract gives rise to a claim for damages (in the case where the claimant suffers no loss as a result of the breach, she will still be entitled to recover damages but they will be nominal). But not every misrepresentation gives rise to a claim for damages. Indeed, prior to the decision of the House of Lords in *Hedley Byrne & Co Ltd v. Heller & Partners Ltd* [1964] AC 465 and the subsequent enactment of the Misrepresentation Act 1967, damages could only be recovered for fraudulent misrepresentations.<sup>1</sup> Fraud is not, however, an easy matter to prove (*Derry v. Peek* (1889) 14 App Cas 337). The fact that damages could not be recovered in respect of negligent or innocent misrepresentations prior to *Hedley Byrne* and the enactment of the 1967 Act had a significant impact on cases decided prior to these developments. In these cases a plaintiff who wished to recover damages had either to prove fraud (in order to recover damages for fraudulent misrepresentation) or prove that the statement had been incorporated into the contract as a term (in order to recover damages for breach of contract). In cases where the defendant had clearly not been fraudulent the only hope for a plaintiff who wished to recover damages was therefore to prove that the statement had been incorporated into the contract as a term. Cases can be found in which the courts adopted what appears to be a rather benevolent approach to the identification of a term in order to give a deserving plaintiff a remedy in damages (see, for example, *De Lassalle v. Guildford* [1901] 2 KB 215). But cases can also be found in which the courts took a stricter view. Thus in *Heilbut, Symons & Co v. Buckleton* [1913] AC 30, 51 Lord Moulton stated that ‘it is . . . of the greatest importance, in my opinion, that this House should maintain in its full integrity the principle that a person is not liable in damages for an innocent misrepresentation, no matter in what way or under what form the attack is made.’

How then do the courts decide whether or not a statement has been incorporated into a contract as a term? The answer is that the distinction turns upon the intention of the parties, objectively ascertained. As John Cartwright has pointed out (*Misrepresentation, Mistake and Non-Disclosure* (Sweet & Maxwell, 2007), para 8.05):

The question, in general terms, is whether the parties intended the statement to be incorporated into the contract as one of its terms; whether, therefore, the defendant intended to make a contractually binding promise about the accuracy of his statement.

When seeking to ascertain whether the defendant intended to make a contractually binding promise about the accuracy of his statement, no one factor predominates. As Lord Moulton stated in *Heilbut, Symons* (at p. 51), ‘the intention of the parties can only be deduced from the totality of the evidence, and no secondary principles . . . can be universally true’. It is therefore necessary to examine the cases in order to identify the range of issues to which the courts have regard when seeking to ascertain the intention of the parties. The approach that will be adopted here is to examine three illustrative cases and then seek to draw the threads together by setting out the range of factors taken into account by the courts in their decision-making.

<sup>1</sup> Here leaving to one side the decision of the House of Lords in *Nocton v. Lord Ashburton* [1914] AC 932.

**(a) THREE ILLUSTRATIVE CASES****Oscar Chess Ltd v. Williams**  
[1957] 1 WLR 370, Court of Appeal

The plaintiff car dealers bought a car from the defendant in a part-exchange deal under which the defendant bought a new car from the plaintiffs' garage (the defendant in fact purchased the car from a finance company to which the plaintiffs had sold the car, but nothing turns on this for present purposes). The events that led up to the purchase of the car by the plaintiffs were as follows. The defendant had told one of the plaintiffs' salesmen that he wished to buy a new car. The salesman was a neighbour of the defendant and he had been given a lift in the car on a number of occasions. He thought that the car was a 1948 Morris and indeed the defendant described the car to him as a 1948 10 h.p. Morris and produced the registration book for it. The salesman checked the registration book and it showed that 1948 was the date of first registration. He then consulted a book (known as 'Glass's Guide'), which gave him the current prices for second-hand cars according to the year of their manufacture. On this basis he offered the defendant an allowance of £290 against the purchase of a new car. The defendant agreed and the transactions were completed. Eight months later the plaintiffs discovered that the car was not in fact a 1948 Morris but a 1939 model. If the plaintiffs had known that it was a 1939 model they would have offered the defendant only £175 for the car. The defendant honestly believed that the car was a 1948 model. The car had previously been bought by his mother and she had bought it on the basis that it was a 1948 model. The car's registration book showed that it had been first registered in 1948 and that it had changed hands five times between 1948 and 1954.

The plaintiffs sought to recover from the defendant damages of £115, based on the difference in value between £290 and £175. The trial judge held that the defendant was liable in damages but the Court of Appeal allowed the defendant's appeal by a majority (Morris LJ dissenting) on the basis that the statement by the defendant as to the age of the car was not a term of the contract but an innocent misrepresentation that had induced the plaintiffs to enter into the contract.

**Denning LJ**

I entirely agree with the judge that both parties assumed that the Morris car was a 1948 model and that this assumption was fundamental to the contract. This does not prove, -however, that the representation was a term of the contract. The assumption was based by both of them on the date given in the registration book as the date of first registration. They both believed that the car was a 1948 model, whereas it was only a 1939 one. They were both mistaken and their mistake was of fundamental importance.

The effect of such a mistake is this: It does not make the contract a nullity from the beginning, but it does in some circumstances enable the contract to be set aside in equity. If the buyer had come promptly, he might have succeeded in getting the whole transaction set aside in equity on the ground of this mistake: see *Solle v. Butcher* [1950] 1 KB 671; but he did not do so and it is now too late for him to do it: see *Leaf v. International Galleries* [1950] 2 KB 86. His only remedy is in damages, and to recover these he must prove a warranty.

In saying that he must prove a warranty, I use the word 'warranty' in its ordinary English meaning to denote a binding promise. Everyone knows what a man means when he says, 'I guarantee it', or 'I warrant it', or 'I give you my word on it'. He means that he binds himself to it. That is the meaning which it has borne in English law for 300 years from the leading case

of *Chandelor v. Lopus* (1603), Cro Jac 4 onwards. During the last hundred years, however, the lawyers have come to use the word 'warranty' in another sense. They use it to denote a subsidiary term in a contract as distinct from a vital term which they call a 'condition'. In so doing they depart from the ordinary meaning, not only of the word 'warranty', but also of the word 'condition'. There is no harm in their doing this, so long as they confine this technical use to its proper sphere, namely, to distinguish between a vital term, the breach of which gives the right to treat the contract as at an end, and a subsidiary term which does not. The trouble comes, however, when one person uses the word 'warranty' in its ordinary meaning and another uses it in its technical meaning. . . . These different uses of the word seem to have been the source of confusion in the present case. The judge did not ask himself, 'Was the representation (that the car was a 1948 Morris car) intended to be a warranty?' He asked himself, 'Was it fundamental to the contract?' He answered it by saying that it was fundamental, and, therefore, it was a condition and not a warranty. By concentrating on whether it was fundamental, he seems to me to have missed the crucial point in the case which is whether it was a term of the contract at all. The crucial question is: Was it a binding promise or only an innocent misrepresentation? The technical distinction between a 'condition' and a 'warranty' is quite immaterial in this case, because it is far too late for the buyer to reject the car. He can, at best, only claim damages. The material distinction here is between a statement which is a term of the contract and a statement which is only an innocent misrepresentation. This distinction is best expressed by the ruling of Lord Holt: Was it intended as a warranty or not?, using the word warranty there in its ordinary English meaning: because it gives the exact shade of meaning that is required. It is something to which a man must be taken to bind himself.

In applying Lord Holt's test, however, some misunderstanding has arisen by the use of the word 'intended'. It is sometimes supposed that the tribunal must look into the minds of the parties to see what they themselves intended. That is a mistake. Lord Moulton made it quite clear, in *Heilbut, Symons & Co v. Buckleton* [1913] AC at p. 51, that 'The intention of the parties can only be deduced from the totality of the evidence'. The question whether a warranty was intended depends on the conduct of the parties, on their words and behaviour, rather than on their thoughts. If an intelligent bystander would reasonably infer that a warranty was intended, that will suffice. And this, when the facts are not in dispute, is a question of law. That is shown by *Heilbut, Symons & Co v. Buckleton* itself, where the House of Lords upset the jury's finding of a warranty.

It is instructive to take some recent instances to show how the courts have approached this question. When the seller states a fact which is or should be within his own knowledge and of which the buyer is ignorant, intending that the buyer should act on it, and he does so, it is easy to infer a warranty; see *Couchman v. Hill* [1947] KB 554, where the farmer stated that the heifer was unserved, and *Harling v. Eddy* [1951] 2 KB 739, where he stated that there was nothing wrong with her. So also if the seller makes a promise about something which is or should be within his own control; see *Birch v. Paramount Estates Ltd* (1956) 16 Estates Gazette 396, decided on October 2, 1956, in this court, where the seller stated that the house would be as good as the show house. But if the seller, when he states a fact, makes it clear that he has no knowledge of his own but has got his information elsewhere, and is merely passing it on, it is not so easy to imply a warranty. Such a case was *Routledge v. McKay* [1954] 1 All ER 855, where the seller 'stated that it was a 1942 model, and pointed to the corroboration found in the book', and it was held that there was no warranty.

Turning now to the present case, much depends on the precise words that were used. If the seller says: 'I believe the car is a 1948 Morris. Here is the registration book to prove it', there is clearly no warranty. It is a statement of belief, not a contractual promise. If, however, the seller says: 'I guarantee that it is a 1948 Morris. This is borne out by the registration book,

but you need not rely solely on that. I give you my own guarantee that it is', there is clearly a warranty. The seller is making himself contractually responsible, even though the registration book is wrong.

In this case much reliance was placed by the judge on the fact that the buyer looked up 'Glass's Guide' and paid £290 on the footing that the car was a 1948 model: but that fact seems to me to be neutral. Both sides believed the car to have been made in 1948 and in that belief the buyer paid £290. That belief can be just as firmly based on the buyer's own inspection of the log-book as on a contractual warranty by the seller.

Once that fact is put on one side, I ask myself: What is the proper inference from the known facts? It must have been obvious to both that the seller had himself no personal knowledge of the year when the car was made. He only became owner after a great number of changes. He must have been relying on the registration book. It is unlikely that such a person would warrant the year of manufacture. The most that he would do would be to state his belief, and then produce the registration book in verification of it. In these circumstances the intelligent bystander would, I suggest, say that the seller did not intend to bind himself so as to warrant that the car was a 1948 model. If the seller was asked to pledge himself to it, he would at once have said 'I cannot do that. I have only the log-book to go by, the same as you'.

The judge seems to have thought that there was a difference between written contracts and oral contracts. He thought that the reason why the buyer failed in *Heilbut, Symons & Co v. Buckleton* and *Routledge v. McKay* was because the sales were afterwards recorded in writing, and the written contracts contained no reference to the representation. I agree that that was an important factor in those cases. If an oral representation is afterwards recorded in writing, it is good evidence that it was intended as a warranty. If it is not put into writing, it is evidence against a warranty being intended; but it is by no means decisive. There have been many cases where the courts have found an oral warranty collateral to a written contract such as *Birch v. Paramount Estates Ltd*. But when the purchase is not recorded in writing at all it must not be supposed that every representation made in the course of the dealing is to be treated as a warranty. The question then is still: Was it intended as a warranty? In the leading case of *Chandelor v. Lopus* in 1603 a man by word of mouth sold a precious stone for £100 affirming it to be a bezar stone whereas it was not. The declaration averred that the seller affirmed it to be a bezar stone, but did not aver that he warranted it to be so. The declaration was held to be ill because (Cro Jac at p. 4): '... the bare affirmation that it was a bezar stone, without warranting it to be so, is no cause of action...' That has been the law from that day to this and it was emphatically re-affirmed by the House of Lords in *Heilbut, Symons & Co v. Buckleton* [1913] AC at pp. 38, 50.

One final word: It seems to me clear that the motor dealers who bought the car relied on the year stated in the log-book. If they had wished to make sure of it, they could have checked it then and there, by taking the engine number and chassis number and writing to the makers. They did not do so at the time, but only eight months later. They are experts, and, as they did not make that check at the time, I do not think that they should now be allowed to recover against the innocent seller who produced to them all the evidence which he had, namely, the registration book. I agree that it is hard on the plaintiffs to have paid more than the car is worth, but it would be equally hard on the seller to make him pay the difference. He would never have bought the Hillman car unless he had received the allowance of £290 for the Morris. The best course in all these cases would be to 'shunt' the difference down the train of innocent sellers until one reached the rogue who perpetrated the fraud; but he can rarely be traced, or if he can, he rarely has the money to pay the damages. Therefore, one is left to decide between a number of innocent people who is to bear the loss. That can only be done by applying the law about representations and warranties as we know it: and that is what I have tried to do. If the rogue can be traced, he can be sued by whosoever has suffered

the loss: but, if he cannot be traced, the loss must lie where it falls. It should not be inflicted on innocent sellers, who sold the car many months, perhaps many years before, and have forgotten all about it and have conducted their affairs on the basis that the transaction was concluded. Such a seller would not be able to recollect after all this length of time the exact words which he used, such as whether he said 'I believe it is a 1948 model', or 'I warrant it is a 1948 model'. The right course is to let the buyer set aside the transaction if he finds out the mistake quickly and comes promptly before other interests have irretrievably intervened, otherwise the loss must lie where it falls: and that is, I think, the course prescribed by law. I would allow this appeal accordingly.

### **Hodson LJ**

I am of opinion that there was no evidence to support the conclusion that the statement that the Morris car was a 1948 car was a term of the contract. The registration book, showing that the car was first registered in 1948, was produced by the defendant to the plaintiffs' representative, a motor salesman, who was familiar with the car, having often had lifts in it, thought it looked like a 1948 car, and checked up on the registration book.

The defendant was stating an opinion on a matter of which he had no special knowledge or on which the buyer might be expected also to have an opinion and to exercise his judgment.

This is not a decisive test, as was pointed out by Lord Moulton (in *Heilbut, Symons & Co v. Buckleton* [1913] AC at p. 50), but it is a feature which he said may be a criterion of value in guiding a jury in coming to a decision whether or not a warranty was intended.

There is, in my opinion, nothing in this case to set against the criterion to which I have referred. That is to say, there is nothing to indicate that the statement as to the date of the car amounted to a promise or guarantee that the information given was accurate.

### **Morris LJ** [dissenting]

In the present case, on a consideration of the evidence that he heard, the judge came to the conclusion that the statement which he held to have been made by the defendant at the time of the making of the contract was a statement made contractually. It seems to me that the totality of the evidence points to that view. The statement related to a vitally important matter: it described the subject matter of the contract then being made and the statement directed the parties to, and was the basis of, their agreement as to the price to be paid or credited to the defendant. In the language of Scott LJ [in *Couchman v. Hill* [1947] KB 554, 559], it seems to me that the statement made by the defendant was 'an item in the description' of what was being sold and that it constituted a substantial ingredient in the identity of the thing sold.

It is with diffidence that I arrive at a conclusion differing from that of my Lords, but I cannot see that the learned judge in any way misdirected himself or misapplied any principle of law, and I see no reason for disturbing his conclusion.

## Commentary

In order to be able to recover damages the plaintiffs had to show that the defendant's statement that the car was a 1948 model was a term of the contract. The word that is used in the judgments is generally not 'term' but 'warranty'. The difficulty with the latter word is, as Denning LJ points out, that it also has a technical meaning in that it can refer to a lesser, subsidiary term of the contract, the breach of which gives to the innocent party the right to claim damages but does not give him the right to terminate further performance of the contract (the technical meaning of 'warranty' is discussed in more detail at p. 773, Chapter 22,

Section 3(b)). In this chapter the word ‘term’ will be used in preference to ‘warranty’ for the reason that it describes more clearly the issue that is at stake in the cases. We are not here concerned with the status of a term of the contract (that is, whether it is important or not) but with the prior question of whether the statement made has been incorporated into the contract as a term or not. The central question may be formulated as follows: has the statement been incorporated into the contract as a term or is it simply a statement that has induced the other party to enter into the contract but does not form part of the contract itself?

The Court of Appeal concluded, by a majority, that the defendant’s statement was not a term but only an innocent misrepresentation. This conclusion was fatal to the plaintiffs’ claim for damages. But it is important to note that the plaintiffs’ claim for damages would not necessarily fail today. As has been noted, the law has moved on since *Oscar Chess* was decided in November 1956. In 1963 the House of Lords in *Hedley Byrne & Co Ltd v. Heller & Partners Ltd* [1964] AC 465 held that there is a tort of negligent misrepresentation which gives rise to a liability in damages (see further p. 616, Chapter 17, Section 5(b)). Section 2 of the Misrepresentation Act 1967 takes matters further. Section 2(1) imposes a liability in damages on a misrepresenter whose misrepresentation induces the claimant to enter into a contract with him unless the misrepresenter can show that he had reasonable grounds to believe and did believe in the truth of his statement up to the time that the contract was made (see further p. 607, Chapter 17, Section 5(a)). Section 2(2) goes still further and gives to the court a discretionary power to award damages in lieu of rescission in cases of entirely innocent misrepresentations (see further p. 604, Chapter 17, Section 5(d)). In the light of these developments it cannot be assumed that *Oscar Chess* would be decided the same way today. But, equally, it does not follow that all differences between terms and representations have been eliminated. In the days of *Oscar Chess* the difference between a term and a representation was relevant to the *existence* of the jurisdiction to award damages, whereas today it is relevant to the *measure* of damages recoverable. As we shall see, the amount recoverable in a misrepresentation claim is generally less than the sum recoverable in a breach of contract claim. The amount recoverable in a misrepresentation claim is the claimant’s reliance loss, that is to say the aim of the award of damages is to compensate the claimant for the loss that he has suffered as a result of relying to his detriment upon the truth of the statement made. In a breach of contract claim, on the other hand, the aim of the award of damages is to protect the claimant’s expectation interest, that is to say the aim is to put the claimant in the position which he would have been in had the contract been carried out according to its terms (the difference between the reliance measure and the expectation measure is discussed in more detail at pp. 814–823, Chapter 23, Section 2).

Denning LJ applied an objective test (on which see further Chapter 2) in order to distinguish between a term and a representation. The distinction therefore depends on the words used by the parties and their behaviour; it does not depend upon their innermost thoughts. What factors persuaded the majority in the present case to conclude that the statement was a representation and not a term? The crucial factor would appear to have been the knowledge, or rather the lack of it, of the defendant. Both Denning and Hodson LJ concluded that it was unlikely that the defendant, given the state of his knowledge, would have guaranteed that the car was in fact a 1948 model. Denning LJ also placed emphasis on the fact that the plaintiffs were experts and that they failed to take appropriate steps to check the vintage of the car. Morris LJ, in his dissenting judgment, emphasized the importance to the parties of the age of the car (in the sense that it had a considerable impact on the value of the car) and he also expressed his unwillingness to interfere with the finding of the trial judge. Denning LJ acknowledged the significance of the age of the car when he stated that both parties had

made a mistake of ‘fundamental importance’ in relation to the age of the car, but he held that this was not enough of itself to turn the defendant’s statement into a term of the contract. In his view, the significance of the importance of the statement was outweighed by the fact that the defendant lacked specialist knowledge and the fact that the plaintiffs were experts. The combination of these factors persuaded him to conclude that the statement was a representation and not a term. The significance of the knowledge of the parties becomes even more apparent when *Oscar Chess* is contrasted with the following case:

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**Dick Bentley Productions Ltd v. Harold Smith (Motors) Ltd**  
[1965] 1 WLR 623, Court of Appeal

The plaintiff, Dick Bentley, told the defendant, Harold Smith, that he was on the look-out for a ‘well vetted Bentley car’. Mr Smith found one and bought it for £1,500. He then informed Mr Bentley of his acquisition. Mr Bentley then went to see the car. Mr Smith told him that the car had been fitted with a replacement engine and gearbox and that it had done only 20,000 miles since the work had been carried out. The speedometer on the car showed only 20,000 miles. Mr Bentley agreed to buy the car for £1,850 but the car proved to be a ‘considerable disappointment to him’. He brought an action for damages for breach of warranty. Mr Smith admitted that he had made a statement that, to the best of his belief, the car had done only 20,000 miles since the replacement of the engine and the gear box but he denied that these statements amounted to warranties or representations and averred that the statements were made honestly in the belief that they were true. The trial judge found that certain representations, including the statement as to mileage, were untrue and amounted to warranties. He accordingly awarded Mr Bentley damages of £400. Mr Smith appealed to the Court of Appeal who dismissed his appeal.

**Lord Denning MR**

The first point is whether this representation, namely, that [the car] had done 20,000 miles only since it had been fitted with a replacement engine and gearbox, was an innocent misrepresentation (which does not give rise to damages), or whether it was a warranty. It was said by Holt CJ and repeated in *Heilbut, Symons & Co v. Buckleton* [1913] AC 30 at p. 49, that: ‘An affirmation at the time of the sale is a warranty, provided it appear on evidence to be so intended’. But that word ‘intended’ has given rise to difficulties. I endeavoured to explain in *Oscar Chess, Ltd v. Williams* [1957] 1 WLR 370 that the question whether a warranty was intended depends on the conduct of the parties, on their words and behaviour, rather than on their thoughts. If an intelligent bystander would reasonably infer that a warranty was intended, that will suffice. What conduct, then? What words and behaviour, lead to the inference of a warranty?

Looking at the cases once more, as we have done so often, it seems to me that if a representation is made in the course of dealings for a contract for the very purpose of inducing the other party to act on it, and actually inducing him to act upon it, by entering into the contract, that is prima facie ground for inferring that it was intended as a warranty. It is not necessary to speak of it as being collateral. Suffice it that it was intended to be acted upon and was in fact acted on. But the maker of the representation can rebut this inference if he can show that it really was an innocent misrepresentation, in that he was in fact innocent of fault in making it, and that it would not be reasonable in the circumstances for him to be bound by it. In the *Oscar Chess* case the inference was rebutted. There a man had bought a second-hand car and received with it a log-book, which stated the year of the car, 1948. He afterwards resold the car. When he resold it he simply repeated what was in the log-book and passed it on to

the buyer. He honestly believed on reasonable grounds that it was true. He was completely innocent of any fault. There was no warranty by him but only an innocent misrepresentation. Whereas in the present case it is very different. The inference is not rebutted. Here we have a dealer, Smith, who was in a position to know, or at least to find out, the history of the car. He could get it by writing to the makers. He did not do so. Indeed it was done later. When the history of this car was examined, his statement turned out to be quite wrong. He ought to have known better. There was no reasonable foundation for it.

[he summarized the history of the car, and continued]

The judge found that the representations were not dishonest. Smith was not guilty of fraud. But he made the statement as to 20,000 miles without any foundation. And the judge was well justified in finding that there was a warranty. He said: 'I have no hesitation [in saying] that as a matter of law the statement was a warranty. Smith stated a fact that should be within his own knowledge. He had jumped to a conclusion and stated it as a fact. A fact that a buyer would act on'. That is ample foundation for the inference of a warranty. So much for the first point...

[he then dealt with an issue on the counterclaim and on the county court judge's award of damages and concluded]

I hold that the appeal fails and should be dismissed.

### **Danckwerts LJ**

I agree with the judgment of Lord Denning MR.

### **Salmon LJ**

I agree. I have no doubt at all that the learned county court judge reached a correct conclusion when he decided that Smith gave a warranty to the plaintiff and that that warranty was broken. Was what Smith said intended and understood as a legally binding promise? If so, it was a warranty and as such may be part of the contract of sale or collateral to it. In effect, Smith said: 'If you will enter into a contract to buy this motor car from me for £1,850, I undertake that you will be getting a motor car which has done no more than 20,000 since it was fitted with a new engine and a new gearbox'. I have no doubt at all that what was said by Smith was so understood and was intended to be so understood by Bentley...

I accordingly agree that the appeal should be dismissed.

## **Commentary**

Lord Denning expressly distinguished *Oscar Chess* on the ground that the defendant in that case had no knowledge of the age of the car and had made his statement in all innocence. On the present facts Lord Denning had no hesitation in concluding that Mr Smith was a dealer who was in a position to know, or at least to find out, the history of the car. Given his knowledge, he was not entitled to turn round and assert that his statement in relation to the mileage done by the car since the repairs had been carried out was a mere representation on his part. It was a warranty, for the breach of which he was liable in damages. It would seem to follow from this case that a statement made by a dealer in relation to the goods sold will generally be held to be a term of the contract. Indeed, it may be possible to go further. It has been stated that *Dick Bentley* illustrates the point that the courts tend to place the responsibility on the person who they think reasonably ought to bear the responsibility, rather than

on the person who has agreed to bear it, for the simple reason that it is often not apparent whether anybody has agreed to bear it' (Atiyah's *An Introduction to the Law of Contract* (6th edn, Oxford University Press, 2005), p. 146).

Lord Denning in both *Oscar Chess* and *Dick Bentley* used the language of fault, in that he concluded that Mr Smith in *Dick Bentley* 'ought to have known better' while the plaintiffs in *Oscar Chess* could have checked the vintage of the car by 'taking the engine number and chassis number and writing to the makers'. But, while fault may be a relevant consideration when deciding whether a statement is a term or representation, liability for breach of contract does not generally depend upon fault so that, even if Mr Smith had taken all reasonable care to discover whether the car had done more than 20,000 miles since the repair work had been carried out, he would still have been liable to Mr Bentley in damages when it transpired that the car had, in fact, done more than 20,000 miles.

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### **Esso Petroleum Co Ltd v. Mardon** [1976] QB 801, Court of Appeal

In 1961 Esso found a site for a filling station on a busy main road. One of Esso's employees, Mr Leith, who had forty years' experience in the petrol trade, estimated that the throughput of petrol at the station would be 200,000 gallons per year by the third year of operation. After Esso had bought the site and started to build the station the local planning authority refused permission for the pumps to front onto the road, so that the station had to be built back to front. Nonetheless when in 1963 Esso interviewed Mr Mardon, a prospective tenant of the station, Mr Leith stated that the estimated throughput of the station was 200,000 gallons per year. On that basis Mr Mardon entered into a tenancy agreement with Esso for three years at a rent of £2,500 for the first two years and £3,000 for the third year. Despite Mr Mardon's best efforts, which included raising an overdraft with his bank and putting all his available capital into the business, in the first fifteen months the throughput of petrol was only 78,000 gallons. The trial judge found that the lack of throughput was due to the inability of passing traffic to see the pumps. In June 1964 Mr Mardon terminated the tenancy agreement by notice. However Esso offered him a new tenancy agreement for one year at a rent of £1,000 plus a surcharge on petrol sold. Mr Mardon entered into the agreement on these terms in September 1964. But the losses continued. When Mr Mardon failed to pay for petrol supplied, Esso cut off his supplies and brought an action for moneys owed. Mr Mardon counterclaimed for damages for breach of warranty as to the throughput of petrol and for negligent misrepresentation. The trial judge held that Mr Leith's statement as to the throughput was not a warranty such as to give Mr Mardon a cause of action for breach of warranty but that Esso was liable for negligent misrepresentation. The Court of Appeal held that Mr Leith's statement was a warranty which Esso had breached. In addition the statement was a negligent misrepresentation, for which they were also liable.

### **Lord Denning MR**

#### **Collateral warranty**

Ever since *Heilbut, Symons & Co v. Buckleton* [1913] AC 30, we have had to contend with the law as laid down by the House of Lords that an innocent misrepresentation gives no right to damages. In order to escape from that rule, the pleader used to allege—I often did it myself—that the misrepresentation was fraudulent, or alternatively a collateral warranty. At the trial we nearly always succeeded on collateral warranty. We had to reckon, of course, with the dictum of Lord Moulton, at p. 47, that 'such collateral contracts must from their very nature be rare'. But more often than not the court elevated the innocent misrepresentation

into a collateral warranty: and thereby did justice—in advance of the Misrepresentation Act 1967. I remember scores of cases of that kind, especially on the sale of a business. A representation as to the profits that had been made in the past was invariably held to be a warranty. Besides that experience, there have been many cases since I have sat in this court where we have readily held a representation—which induces a person to enter into a contract—to be a warranty sounding in damages. I summarised them in *Dick Bentley Productions Ltd v. Harold Smith (Motors) Ltd* [1965] 1 WLR 623, 627, when I said:

‘Looking at the cases once more, as we have done so often, it seems to me that if a representation is made in the course of dealings for a contract for the very purpose of inducing the other party to act upon it, and actually inducing him to act upon it, by entering into the contract, that is prima facie ground for inferring that it was intended as a warranty. It is not necessary to speak of it as being collateral. Suffice it that it was intended to be acted upon and was in fact acted on.’

Mr. Ross-Munro [counsel for Esso], retaliated, however, by citing *Bisset v. Wilkinson* [1927] AC 177, where the Privy Council said that a statement by a New Zealand farmer that an area of land ‘would carry 2,000 sheep’ was only an expression of opinion. He submitted that the forecast here of 200,000 gallons was an expression of opinion and not a statement of fact: and that it could not be interpreted as a warranty or promise.

Now I would quite agree with Mr Ross-Munro that it was not a warranty—in this sense—that it did not *guarantee* that the throughput *would* be 200,000 gallons. But, nevertheless, it was a forecast made by a party—Esso—who had special knowledge and skill. It was the yardstick (the estimated annual consumption) by which they measured the worth of a filling station. They knew the facts. They knew the traffic in the town. They knew the throughput of comparable stations. They had much experience and expertise at their disposal. They were in a much better position than Mr Mardon to make a forecast. It seems to me that if such a person makes a forecast, intending that the other should act upon it—and he does act upon it, it can well be interpreted as a warranty that the forecast is sound and reliable in the sense that they made it with reasonable care and skill. It is just as if Esso said to Mr Mardon: ‘Our forecast of throughput is 200,000 gallons. You can rely upon it as being a sound forecast of what the service station should do. The rent is calculated on that footing’. If the forecast turned out to be an unsound forecast such as no person of skill or experience should have made, there is a breach of warranty. Just as there is a breach of warranty when a forecast is made—‘expected to load’ by a certain date—if the maker has no reasonable grounds for it: see *Samuel Sanday and Co v. Keighley, Maxted and Co* (1922) 27 Com Cas 296; or bunkers ‘expected 600/700 tons’: see *Efploia Shipping Corporation Ltd v. Canadian Transport Co Ltd (The Pantanassa)* [1958] 2 Lloyd’s Rep 449, 455–457 by Diplock J. It is very different from the New Zealand case where the land had never been used as a sheep farm and both parties were equally able to form an opinion as to its carrying capacity: see particularly *Bisset v. Wilkinson* [1927] AC 177, 183–184.

In the present case it seems to me that there was a warranty that the forecast was sound, that is, Esso made it with reasonable care and skill. That warranty was broken. Most negligently Esso made a ‘fatal error’ in the forecast they stated to Mr Mardon, and on which he took the tenancy. For this they are liable in damages. The judge, however, declined to find a warranty. So I must go further.

### Negligent misrepresentation

Assuming that there was no warranty, the question arises whether Esso are liable for negligent misstatement under the doctrine of *Hedley Byrne & Co Ltd v. Heller & Partners Ltd* [1964] AC 465...

It seems to me that *Hedley Byrne & Co Ltd v. Heller & Partners Ltd* [1964] AC 465, properly understood, covers this particular proposition: if a man, who has or professes to have special knowledge or skill, makes a representation by virtue thereof to another—be it advice, information or opinion—with the intention of inducing him to enter into a contract with him, he is under a duty to use reasonable care to see that the representation is correct, and that the advice, information or opinion is reliable. If he negligently gives unsound advice or misleading information or expresses an erroneous opinion, and thereby induces the other side to enter into a contract with him, he is liable in damages. . . .

Applying this principle, it is plain that Esso professed to have—and did in fact have—special knowledge or skill in estimating the throughput of a filling station. They made the representation—they forecast a throughput of 200,000 gallons—intending to induce Mr Mardon to enter into a tenancy on the faith of it. They made it negligently. It was a ‘fatal error’. And thereby induced Mr Mardon to enter into a contract of tenancy that was disastrous to him. For this misrepresentation they are liable in damages.

### The measure of damages

Mr Mardon is not to be compensated here for ‘loss of a bargain’. He was given no bargain that the throughput *would* amount to 200,000 gallons a year. He is only to be compensated for having been induced to enter into a contract which turned out to be disastrous for him. Whether it be called breach of warranty or negligent misrepresentation, its effect was *not* to warrant the throughput, but only to induce him to enter the contract. So the damages in either case are to be measured by the loss he suffered. Just as in *Doyle v. Olby (Ironmongers) Ltd* [1969] 2 QB 158, 167 he can say: ‘. . . I would not have entered into this contract at all but for your representation. Owing to it, I have lost all the capital I put into it. I also incurred a large overdraft. I have spent four years of my life in wasted endeavour without reward: and it will take me some time to re-establish myself’.

For all such loss he is entitled to recover damages. It is to be measured in a similar way as the loss due to a personal injury. You should look into the future so as to forecast what would have been likely to happen if he had never entered into this contract: and contrast it with his position as it is now as a result of entering into it. The future is necessarily problematical and can only be a rough-and-ready estimate. But it must be done in assessing the loss.

### Shaw LJ

Mr Mardon complained that ‘he had been sold a pup’. I think he had; but it was a warranted pup, so that Esso are in breach of warranty and liable in damages accordingly. . . . Mr Mardon is entitled in my view to damages for breach of warranty or for negligent misrepresentation.

**Ormrod LJ** delivered a concurring judgment.

## Commentary

Esso were found liable to Mr Mardon on two grounds, namely breach of warranty and negligent misrepresentation. We can see that the law of misrepresentation has moved since *Oscar Chess* was decided because Lord Denning in his judgment here draws upon the decision of the House of Lords in *Hedley Byrne*. Thus the distinction between a term and a misrepresentation was not, as it was in *Oscar Chess*, significant in terms of the *existence* of the right to recover damages. Nor does it appear to have been significant for the *measure* of recovery. The same sum was recoverable by Mr Mardon whether his claim was one for breach of a term of the contract or for negligent misrepresentation. The reason for this was that the warranty found on the facts by the Court of Appeal was a promise that Esso had

used reasonable care and skill in making their forecast as to the likely throughput of petrol. It was not a case in which Esso had actually guaranteed that the throughput would reach a given level. Therefore the appropriate measure of recovery for breach of the term was not the profit Mr Mardon would have made had the projected throughput been reached, but the losses he had suffered as a result of relying to his detriment on the exercise by Esso of reasonable care and skill in making the projection. This formulation of the warranty given by Esso has been criticized. Thus Professor Taylor argues ('Expectation, Reliance and Misrepresentation' (1982) 45 *MLR* 139, 142) that:

*Esso v. Mardon* provides a good illustration of the court limiting the plaintiff to reliance damages precisely because the gist of his claim is that he has relied on a representation rather than that his expectations have been disappointed. Of course Mr Mardon's expectations were *in fact* disappointed but the Court of Appeal clearly did not think that his was a case where his expectations ought to be legally protected in damages but rather felt that compensation for reliance incurred because of expectations aroused by the forecast was more appropriate. It would have been better to express this by denying that the forecast made by Esso was a warranty, rather than by finding a warranty and then denying that expectation damages were available for it.

## (b) DRAWING THE THREADS TOGETHER

We can see from the decisions in *Oscar Chess*, *Dick Bentley*, and *Esso v. Mardon* that the knowledge of the parties is an important factor when seeking to decide whether or not a statement has been incorporated into a contract as a term. We can also see from the dissenting judgment of Morris LJ in *Oscar Chess* that the importance of the statement is also a relevant factor (in the sense that the more important the statement, the more likely it is that it will be incorporated into the contract as a term). Morris LJ cited as authority for this proposition the decision of the Court of Appeal in *Couchman v. Hill* [1947] KB 554. There the plaintiff purchased at an auction a heifer which was described in the sale catalogue as 'unserved'. At the auction the plaintiff asked the defendant vendor and the auctioneer whether the heifer was in fact unserved and was informed by both that she was. The plaintiff then bought the heifer. He later discovered that the heifer was in calf and she died as a result of the strain of carrying a calf at too young an age. The plaintiff brought an action against the defendant claiming damages for breach of warranty. One of the issues in the case was whether the defendant's oral representation at the auction was a warranty or not. The Court of Appeal concluded that it was and, in doing so, had regard to the importance to the plaintiff of the assurance given to him by the defendant that the heifer was unserved.

The range of factors taken into account by the courts extends beyond those we have already identified. The authorities have been helpfully summarized in the following terms in *Anson's Law of Contract* (29th edn, Oxford University Press, 2010, edited by J Beatson, A Burrows, and J Cartwright), p. 135):

First, [the courts] may have regard to the time which elapsed between the time of making the statement and the final manifestation of agreement; if the interval is a long one, this points to a representation. Secondly, they may consider the importance of the statement in

the minds of the parties; a statement which is important is likely to be classed as a term of the contract. Thirdly, if the statement was followed by the execution of a formal contract in writing, it is more likely to be regarded as a representation where it is not incorporated in the written document. Finally, where the maker of the statement is, *vis-à-vis* the other party, in a better position to ascertain the accuracy of the statement or has the primary responsibility for doing this, the Courts will tend to regard it as a contractual term.

But even this list is not complete. A further factor taken into account by the courts is whether or not the maker of the statement asks the other party to verify the truth of his statement. Where he does ask the other party to verify its truth it is unlikely that the statement will amount to a term (*Ecay v. Godfrey* (1947) 80 Ll LR 286). Conversely, where he states expressly that there is no need to verify its truth, it is more likely that the statement will amount to a term (*Schawel v. Reade* [1913] IR 64). It is not possible to define exhaustively the list of factors to which the courts will have regard. But we have been able to identify the principal factors taken into account by the courts. Whether or not a statement is incorporated into a contract as a term depends ultimately upon the facts of the individual case and, as *Oscar Chess* demonstrates, judges can and do differ in the conclusions which they reach in individual cases.

#### 4. THE PAROL EVIDENCE RULE

The second issue that arises for consideration concerns the situation where the parties have reduced their contract to writing. In such a case is it possible for them to lead evidence of terms other than those contained in their written contract or does the written contract constitute the sole repository of the terms of their contract? This is not an easy question to answer. The answer depends upon the scope of what is generally referred to as the 'parol evidence rule'. The scope of this rule is a matter of some controversy. One view is that the rule amounts to no more than this: that in the case where the parties intend that the written document shall contain all the terms of their contract it is not possible to lead evidence for the purpose of adding to, varying, subtracting from, or contradicting the terms contained in that document. An alternative view is that the rule does not rest on the intention of both parties but consists of a presumption made by the court that a document that looks like the whole contract is in fact the whole contract so that it is not possible to lead evidence for the purpose of adding to, varying, subtracting from, or contradicting the terms contained in the written document. Two contrasting views of the rule are set out in the following passages:

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#### **Law Commission No 154, *Law of Contract: The Parol Evidence Rule* (1986)**

##### **Nature of the parol evidence rule**

2.6. So far as we are aware, no English or Commonwealth court has ever found it necessary to analyse the parol evidence rule in detail as to its applicability, width and effect. In the cases in which the rule has been mentioned, it has generally been in terms which seem to indicate that the judge thought it was both obvious and well known. For the purpose of deciding whether the parol evidence rule should be abolished or amended by statute, it has

been necessary to analyse the rule in detail. We had to be clear as to what the rule was which might be abolished, amended or declared.

2.7. We have now concluded that although a proposition of law can be stated which can be described as the 'parol evidence rule' it is not a rule of law which, correctly applied, could lead to evidence being unjustly excluded. Rather, it is a proposition of law which is no more than a circular statement: *when it is proved or admitted that the parties to a contract intended that all the express terms of their agreement should be as recorded in a particular document or documents, evidence will be inadmissible (because irrelevant) if it is tendered only for the purpose of adding to, varying, subtracting from or contradicting the express terms of that contract.* We have considerable doubts whether such a proposition should properly be characterised as a 'rule' at all, but several leading textbook writers and judges have referred to it as a 'rule' and we are content to adopt their terminology for the purposes of this report.

2.8. Our conclusion as to the nature of the parol evidence rule is no new theory. The opinions of some leading textbook writers, who reached a similar conclusion long before we approached the subject, confirm us in our view that the parol evidence rule is no more than as we have stated above...

2.9. The two principal reasons which have led us to our conclusion on the nature of the parol evidence rule are, in substance, two aspects of the same process of reasoning.

2.10. The first relates to the circumstances in which the rule is to be applied. In our view, some statements of the rule may have given rise to misunderstandings because they have concentrated on the *effect* of the rule rather than *when it is to be applied*. The effect of the rule is to exclude evidence or to cause the judge to ignore the evidence if given. As to the application of the rule, Lord Morris' statement in *Bank of Australasia v. Palmer* refers to the inadmissibility of parol evidence to 'contradict, vary, add to or subtract from the terms of a *written contract*' (emphasis added). Thus, the rule can only be applied where the parties have entered into a written contract when 'the writing is intended by the parties as a contractual document which is to contain all the terms of their agreement'. When the parties have set down *all* the terms of their contract in writing, extrinsic evidence of other terms must be ignored. If the contract is not entirely in writing, it is not a written contract... If it is proved or admitted that all the terms of the contract have been set out in a particular document or documents, then evidence of other terms must be irrelevant and therefore inadmissible, because inconsistent with the finding that the parties have entered into a written contract.

2.11. The second reason for our conclusion as to the nature of the parol evidence rule is exemplified by the concept of the contract which is made partly orally and partly in writing...

2.12. Because a contract can be made partly orally and partly in writing, the mere production of a contractual document, however complete it may look, cannot as a matter of law exclude evidence of oral terms if the other party asserts that such terms were agreed. If that assertion is proved, evidence of the oral terms cannot be excluded because the court will, by definition, have found that the contractual terms are partly to be found in what was agreed orally as well as in the document in question. No parol evidence rule could apply. On the other hand, if that assertion is not proved, there can be no place for a parol evidence rule because the court will have found that all the terms of the contract were set out in the document in question and, by implication, will thereby have excluded evidence of terms being found elsewhere...

2.13. Of course, the more the parties have done to create what appears to be a written contract, the greater are the probabilities that the court will conclude that they did indeed

make such a contract. In this connection, in considering the parol evidence rule in 1959, Professor Lord Wedderburn concluded that,

‘What the parol evidence rule has bequeathed to the modern law is a presumption—namely that a document which *looks* like a contract is to be treated as the *whole* contract.’

While we have no doubt that this statement accurately reflects the practical effect of the parol evidence rule as we now believe it to be, the presumption (which can be displaced by evidence) is not a rule of law laying down whether a particular type of evidence should be admitted or, if it is admitted, whether the court should give effect to it. Moreover, we do not think that in this context it is strictly correct to refer to a ‘presumption’. In reaching a conclusion as to whether a document which looks like a complete contract was the whole contract, the court does not apply any presumption of law. Rather, it will reach its conclusion on the evidence tendered, applying to its judgment the *prima facie* probability derived from its experience of how people normally behave in a given situation. For example, if the plaintiff proves that the parties signed a document, such as a complicated lease of a commercial chattel, which document appears to be a complete contract and which is in a form generally adopted for setting out all the contractual terms, it may be difficult in practice for the defendant to prove, on the balance of probabilities, that terms were orally agreed in addition to those set out in the document.

**2.14.** The issue whether parties intended that the whole of their agreement should be as recorded in a particular document or documents is to be judged objectively. The court is not concerned with whether both parties, in their minds, intended the writing to contain the whole of the agreement between them but whether, having regard to what was said or done, and to what documents were signed and exchanged, and when, a reasonable person would have understood the writing to contain the whole of the agreement. A party is not permitted to give evidence of his private but uncommunicated intention as to what was to be agreed, or as to what the written agreement was to mean.

**2.15.** Sometimes parties may include in their contracts a clause to the effect that the whole contract is contained in the document and that nothing was agreed outside it (sometimes called a ‘merger’ or ‘integration’ clause). In particular, it may be provided that nothing said during negotiations is intended to be of any contractual effect unless recorded in the document. Without legislative provision such a clause cannot, we think, have conclusive effect. It may have a very strong persuasive effect but if it were proved that, notwithstanding the clause, the parties actually intended some additional term to be of contractual effect, the court would give effect to that term because such was the intention of the parties. If the parties intended that the additional term should have been recorded in the document, the contract could be rectified. If it had been their intention that the term should be of contractual effect but not be included in the document, the analysis likely to be adopted by the court is that the parties agreed a collateral contract alongside the written one. But if it were proved that the intention of the parties was to make one contract partly in writing and partly orally, the court would give effect to that contract. The parties might have been aware of the integration clause when they agreed the additional terms but have agreed to ignore it, or they might have forgotten about the clause or never read it. Whatever the reason for there being an integration clause and additional terms, the court will give effect to the intention of the parties as it is proved or admitted to have been. . . .

**2.17.** The conclusion which emerges from the discussion above is that there is no *rule of law* that evidence is rendered inadmissible or is to be ignored solely because a document exists which looks like a complete contract. Whether it is a complete contract depends upon the intention of the parties, objectively judged, and not on any rule of law.

Treitel states by way of reply:

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**GH Treitel, *The Law of Contract***

(13th edn, Sweet & Maxwell, 2011, edited by Edwin Peel), para 6–014

It has been argued [by the Law Commission] that the right of a party to rely on extrinsic evidence... turns the parol evidence rule (as applied to contracts) into 'no more than a circular statement'. For if the rule applies only where the written document is intended to contain *all* the terms of the contract, evidence of other terms would be useless even if admitted (since they would not form part of the contract); while the rule never prevents a party from relying on evidence of terms which *were* intended to be part of the contract. Accordingly, on this view, no injustice is caused by the operation of the rule. There is much force in this view in cases in which, at the time of contracting, both parties actually shared a common intention with regard to the term in question. But in most cases in which the rule is invoked this is not the position: the dispute arises precisely because the parties had different intentions, and one alleges, while the other denies, that terms not set out in the document were intended to form part of the contract. In such cases, the court will attach importance to the appearance of the document: if it *looks* like a complete contract to one of the parties taking a reasonable view of it, then the rule will prevent the other party from relying on extrinsic evidence to show that the contract also contained other terms.

This result has been described as being simply an application of the objective test of agreement; but, even if it can be so regarded, it is such a common and frequently recurring application of this test as to amount to an independent rule. In cases of the present kind, moreover, the law goes beyond the normal objective test. That test normally requires the party relying on it to prove that he reasonably believed that the other party was contracting on the terms alleged. Where a document *looks* like a complete contract, the party relying on it does not have to prove that he had such a belief: he can rely on a presumption to that effect which it is up to the other party to rebut. As laymen are known to attach greater importance than the law does to writing in a contractual context, it will be hard for the party relying on extrinsic evidence to rebut the presumption that the written document was an exclusive record of the terms agreed. Moreover, the objective test normally prevents a party from relying on his 'private but uncommunicated intention as to what was to be agreed'. The presumption which applies in the case of an apparently complete contractual document goes beyond this: it prevents a party from relying on evidence of intention that was not 'private and uncommunicated' at all, but simply not recorded in the document.

For these reasons, it is submitted that the admissibility of extrinsic evidence, where it is proved that the document was not in fact intended to contain all the terms of the contract, does not turn the rule into a merely 'circular statement'. Whether it also supports the conclusion that the rule is not one that 'could lead to evidence being unjustly excluded' is perhaps more doubtful. The primary purpose of the rule, like that of the objective test of agreement, is to promote certainty, sometimes even at the expense of justice. Where the parties have brought into being an apparently complete contractual document, the rejection of evidence of extrinsic terms that were actually agreed may cause injustice to the party relying on those terms, while the reception of such evidence may cause injustice to the other party, if he reasonably believed that the document formed an exclusive record of the contract. The question is which, on balance, is the greater injustice. Where the evidence is rejected because the party relying on it cannot overcome the presumption arising from the fact that the document *looks* like a complete contract, the greater injustice would appear to lie in the exclusion of the evidence; for the presumption seems to be based on the nature and form of the document, rather than on any actual belief of the party relying on it, that it formed an exclusive record of the contract.

## Commentary

The difference between these two views is not as stark as might at first sight appear. The reason for this is that any presumption that a document that looks like the whole contract is the whole contract does not appear to be a particularly strong one. This brings Treitel's view much closer to that of the Law Commission in the sense that it seems unlikely that the presumption will preclude a party from leading evidence of terms which it is argued were intended to be part of the contract. The modern court is more likely to admit the evidence and evaluate its significance than declare it to be inadmissible.

In any event, it is clear that the parol evidence rule, whatever its true scope, is the subject of a number of exceptions. For example, evidence is admissible to prove a custom (*Hutton v. Warren* (1836) 1 M & W 466, p. 343, Chapter 10, Section 3), to show that the contract is invalid on a ground such as misrepresentation, to show that the document should be rectified, and to prove the existence of a collateral agreement (*City and Westminster Properties (1934) Ltd v. Mudd* [1959] Ch 129).

The final point to be made relates to the wisdom of this drift towards the admissibility of such evidence and the desirability of leaving it to the court to evaluate its significance. There has been a commercial reaction against this trend, largely because it is said to promote uncertainty. The Law Commission at paragraph 2.15 of their report (extracted earlier) refer to 'merger' or 'integration' clauses. These clauses are often referred to today as 'entire agreement clauses'. We shall encounter them in more detail later (see pp. 402–403, Chapter 12, Section 3(j)). Here it suffices to note that the purpose of these clauses is generally to shut out evidence that the parol evidence rule would probably have excluded in the past. So evidence that is now admissible as a matter of law is sought to be excluded from judicial consideration by contractual stipulation. The Law Commission state that such provisions cannot have 'conclusive effect'. As we shall see, the modern courts have taken a more benevolent approach towards the construction of entire agreement clauses so that they can have the effect of preventing a party from leading evidence of terms other than those contained in the written contract (see, in particular, *Watford Electronics Ltd v. Sanderson CFL Ltd* [2001] All ER (Comm) 696, discussed in more detail at pp. 402–403, Chapter 12, Section 3(j), and 434, Chapter 13, Section 3, and the development of the doctrine of contractual estoppel in cases such as *Springwell Navigation Corporation v. JP Morgan Chase Bank* [2010] EWCA Civ 1221, [2010] All ER (D) 08 (Nov)). But the drafting of entire agreement clauses is a matter of great difficulty and the time and expense that is devoted by commercial parties and their lawyers to the drafting of such clauses tends to suggest that the relaxation of the parol evidence rule that has taken place over the last 100 years or more might not necessarily have been a desirable development.

### FURTHER READING

CARTWRIGHT, J, *Misrepresentation, Mistake and Non-Disclosure* (Sweet & Maxwell, 2007), ch. 8.

LAW COMMISSION, Report No 154, *Law of Contract: The Parol Evidence Rule* (1986).

STEVENS, R, 'Objectivity, Mistake and the Parol Evidence Rule' in A Burrows and E Peel (eds), *Contract Terms* (Oxford University Press, 2007), pp. 101, 107–110.

# 9

## INCORPORATION OF TERMS

### CENTRAL ISSUES

1. In order to be effective a term must have been incorporated into the contract between the parties. Incorporation can be a surprisingly difficult issue in commercial practice. Many businesses spend significant sums of money on legal advice in relation to the drafting of their standard terms of business but then adopt what appears to be a surprisingly lax approach when it comes to ensuring that these standard terms are incorporated into the contracts they conclude. It is a noticeable feature of litigation concerning standard form clauses, such as exclusion clauses and retention of title clauses, that the defendant frequently takes the point that the term in issue between the parties has not been incorporated into the contract. Incorporation issues are not, however, confined to exclusion clauses or retention of title clauses. They can arise in relation to any contract term.
2. The simplest method of incorporation is signature. A party is generally bound by terms he has signed, whether or not he has read them. This rule can produce harsh results and it has been criticized on this basis. The justification that is usually offered in support of the rule is that it promotes certainty and protects the interests of third parties who may rely to their detriment upon the validity of the signature.
3. Terms can also be incorporated into a contract by notice. In order to be effective the notice must have been given at or before the time of contracting, in a document that was intended to have contractual effect and reasonable steps must have been taken to bring the terms to the notice of the other party. Where the term is 'onerous' or 'unusual' greater steps must be taken to bring it to the attention of the other party. This rule is firmly established in English law but it is open to criticism on the ground that it gives rise to uncertainty (in terms of defining a clause that is 'onerous' or 'unusual') and on the basis that no convincing justification has been offered for differentiating between different terms in relation to their incorporation. Attempts to regulate the fairness of the terms of a contract should be done directly and not by the back-door of the rules relating to the incorporation of terms.
4. Finally terms can be incorporated into a contract by virtue of a course of dealing or as a result of the custom of the trade. In order to constitute a 'course of dealing' there must have been a series of transactions between the parties that was both 'consistent' and 'regular'.

## 1. INTRODUCTION

The incorporation of terms into a contract can be a contentious issue in practice. A failure by a party to take adequate steps to ensure that its standard terms are incorporated into the contracts it concludes can be an expensive mistake. A simple illustration of this point is provided by the facts of *Poseidon Freight Forwarding Co Ltd v. Davies Turner Southern Ltd* [1996] 2 Lloyd's Rep 388. A fax was sent by the defendants to the plaintiff. At the bottom of the fax appeared the words 'NOTE: The only conditions on which we transact business are shown on the back'. Unfortunately, it would appear that no one had informed the employee of the defendants who was operating the fax machine that it was necessary to fax the back page as well as the front page. So the terms on the back were never sent to the plaintiff. The Court of Appeal held that, in these circumstances, the defendants' terms had not been incorporated into the contract so that the defendants were unable to rely on an exemption clause contained in their standard terms. Leggatt LJ stated (at p. 394):

[t]his is not a case where a party declares that the terms are available for inspection. It is a case where, on documents sent by fax, reference is made to terms stated on the back, which are, however, not stated or otherwise communicated. Since what was described as being on the back was not sent, it was a more cogent inference that the terms were not intended to apply.

How can a party take adequate steps to ensure that its terms are incorporated into the contracts it concludes? Three principal options are available. The first is to ensure that the other party to the contract signs the document that contains all the relevant terms. The general rule in English law is that a party is bound by his signature and this rule applies whether or not the party signing the document has read it. The second is to take reasonable steps to bring the terms to the notice of the other party. This is a less reliable method of incorporation than signature because of the need to persuade the court that 'reasonable steps' have been taken (and, as we shall see, it is not always an easy task to persuade a court that reasonable steps have been taken). The third option is incorporation by course of dealing or by custom. The last option is the least satisfactory option, largely because of the difficulties involved in establishing the existence of a course of dealing that is sufficiently consistent and regular for it to amount in law to a 'course of dealing'. Incorporation by custom is easier to establish where both parties transact in a particular market or trade: in such a case the court may be relatively willing to infer that the customary trade terms have been incorporated into the parties' contract. It is, however, the case that it is safer to take more active steps to ensure that terms are incorporated into a contract, whether these active steps take the form of obtaining the signature of the other party or taking reasonable steps to bring the terms to the notice of the other party.

## 2. INCORPORATION BY SIGNATURE

A party is, in general, bound by his signature. This being the case, a party who signs a contract will, in principle, be bound by its terms. This is so, whether the party signing the document has actually read it or not. A party who does not want to be bound by the terms contained in the document should not sign it. The law does not in general allow him to sign

the document and afterwards claim that he is not bound by its terms on the basis that he had not read or understood its terms. The general rule that a party is bound by his signature can lead to harsh results, as the following case demonstrates:

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**L'Estrange v. F. Graucob Ltd**  
[1934] 2 KB 394, Divisional Court

Two of the defendants' representatives visited the plaintiff and asked her to buy an automatic slot machine for cigarettes. The plaintiff was the owner of a café in Llandudno. She agreed to buy the machine and signed a 'Sales Agreement' produced by one of the defendants' representatives. The document, so far as relevant, provided:

'Sales Agreement. Date Feb. 7, 1933. To F. Graucob, Ltd, . . . Please forward me as soon as possible: One Six Column Junior Ilam Automatic Machine . . . which I agree to purchase from you on the terms stated below . . . and to pay for the same in the following manner: Instalments 8l. 15s. 0d. down. 18 payments of 3l. 19s. 11d.'

There then followed some clauses in small print which, so far as material, provided:

'I agree to take delivery of the machine upon receiving notice that it is ready for delivery, and to make the first monthly payment 30 days after the date following that of the posting of such notice and all subsequent payments on the corresponding date of each succeeding month. . . . If any payment shall not have been received by you within a fortnight after it has become due, all the remaining payments shall fall due for immediate payment, and I agree to pay interest on these remaining payments at the rate of ten per cent. per annum as from the date of their so falling due. In consideration of your undertaking to put in hand at once work on this machine I agree not to countermand this order. . . . This agreement contains all the terms and conditions under which I agree to purchase the machine specified above, and any express or implied condition, statement, or warranty, statutory or otherwise not stated herein is hereby excluded. . . . (sgd.) H. M. L'Estrange.'

The machine was delivered to the plaintiff some six weeks later but the machine did not work satisfactorily and after a few days became jammed and unworkable. The plaintiff brought an action against the defendants. One of the claims advanced by the plaintiff was that the machine was not fit for the purpose for which it had been sold. The defendants denied liability on the basis that the agreement expressly provided for the exclusion of this and all other implied warranties. The plaintiff in turn contended that she was induced to sign the contract by the misrepresentation that it was an order form and that at the time when she signed she knew nothing of the conditions. The county court judge held that the defendants were not entitled to rely upon the clause which excluded implied warranties from the contract on the ground that they had not done what was reasonably sufficient to give the plaintiff notice of the conditions. The defendants appealed to the Court of Appeal who allowed the appeal. It was held that the plaintiff had not been induced to sign the contract by any misrepresentation and that she was bound by her signature. She was therefore bound by the terms of the contract, including the exclusion clause, and judgment was entered for the defendants.

**Scrutton LJ** [set out the facts and continued]

As to the defence that no action would lie for breach of implied warranty, the defendants relied upon the following clause in the contract: 'This agreement contains all the terms and conditions under which I agree to purchase the machine specified above and any express or implied condition, statement, or warranty, statutory or otherwise not stated herein is hereby

excluded'. A clause of that sort has been before the Courts for some time. The first reported case in which it made its appearance seems to be *Wallis, Son & Wells v. Pratt & Haynes* [1911] AC 394, where the exclusion clause mentioned only 'warranty' and it was held that it did not exclude conditions. In the more recent case of *Andrews Brothers (Bournemouth), Ltd v. Singer & Co* [1934] 1 KB 17, where the draftsman had put into the contract of sale a clause which excluded only implied conditions, warranties and liabilities, it was held that the clause did not apply to an express term describing the article, and did not exempt the seller from liability where he delivered an article of a different description. The clause here in question would seem to have been intended to go further than any of the previous clauses and to include all terms denoting collateral stipulations, in order to avoid the result of these decisions.

The main question raised in the present case is whether that clause formed part of the contract. If it did, it clearly excluded any condition or warranty.

In the course of the argument in the county court reference was made to the railway passenger and cloak-room ticket cases. . . . These cases have no application when the document has been signed. When a document containing contractual terms is signed, then, in the absence of fraud, or, I will add, misrepresentation, the party signing it is bound, and it is wholly immaterial whether he has read the document or not.

The plaintiff contended at the trial that she was induced by misrepresentation to sign the contract without knowing its terms, and that on that ground they are not binding upon her. The learned judge in his judgment makes no mention of that contention of the plaintiff, and he pronounces no finding as to the alleged misrepresentation. There is a further difficulty. Fraud is not mentioned in the pleadings, and I strongly object to deal with allegations of fraud where fraud is not expressly pleaded. I have read the evidence with care, and it contains no material upon which fraud could be found. . . .

In this case the plaintiff has signed a document headed 'Sales Agreement', which she admits had to do with an intended purchase, and which contained a clause excluding all conditions and warranties. That being so, the plaintiff, having put her signature to the document and not having been induced to do so by any fraud or misrepresentation, cannot be heard to say that she is not bound by the terms of the document because she has not read them.

### **Maugham LJ**

I regret the decision to which I have come, but I am bound by legal rules and cannot decide the case on other considerations.

The material question is whether or not there was a contract in writing between the plaintiff and the defendants in the terms contained in the brown paper document. . . .

In the present case on February 7, 1933, an order form, for such I consider the brown paper document to be, was signed by the plaintiff. It was an elaborate form containing a number of clauses, and among them certain terms and conditions in regrettably small print but quite legible. The plaintiff having signed that document gave it to a canvasser of the defendants, who took it away. It had been filled up in ink by the canvasser before she signed it. Another document called an order confirmation dated February 9, 1933, was sent to her by the defendants. In my opinion the contract was concluded not when the brown order form was signed by the plaintiff but when the order confirmation was signed by the defendants. If the document signed by the plaintiff was a part of a contract in writing, it is impossible to pick out certain clauses from it and ignore them as not binding on the plaintiff. . . .

I deal with this case on the footing that when the order confirmation was signed by the defendants confirming the order form which had been signed by the plaintiff, there was then a signed contract in writing between the parties. If that is so, then, subject to certain

contingencies, there is no doubt that it was wholly immaterial whether the plaintiff read the small print or not...

There are, however, two possibilities to be kept in view. The first is that it might be proved that the document, though signed by the plaintiff, was signed in circumstances which made it not her act. That is known as the case of *Non est factum*... The written document admittedly related to the purchase of the machine by the plaintiff. Even if she was told that it was an order form, she could not be heard to say that it did not affect her because she did not know its contents.

Another possibility is that the plaintiff might have been induced to sign the document by misrepresentation. She contended that she was so induced to sign the document inasmuch as (i.) she was assured that it was an order form, (ii.) that at the time when she signed it she knew nothing of the conditions which it contained. The second of these contentions is unavailing by reason of the fact that the document was in writing signed by the plaintiff. As to the first contention it is true that the document was an order form. But further, if the statement that it was an order form could be treated as a representation that it contained no clause expressly excluding all conditions and warranties, the answer would be that there is no evidence to prove that that statement was made by or on behalf of the defendants.

In this case it is, in my view, an irrelevant circumstance that the plaintiff did not read, or hear of, the parts of the sales document which are in small print, and that document should have effect according to its terms. I may add, however, that I could wish that the contract had been in a simpler and more usual form. It is unfortunate that the important clause excluding conditions and warranties is in such small print. I also think that the order confirmation form should have contained an express statement to the effect that it was exclusive of all conditions and warranties.

I agree that the appeal should be allowed.

## Commentary

Three points should be noted about *L'Estrange*. The first is that the Court of Appeal recognized that the rule that a person is bound by his signature is not an absolute one. Two exceptions were acknowledged on the facts of the case and a third has been recognized subsequently. The first exception arises where the party signing the document can invoke the defence of *non est factum*. The scope of this defence is discussed in more detail in a subsequent chapter (see pp. 571–576, Chapter 16, Section 7). Here it suffices to note that it is a defence that operates within narrow confines. In essence it allows a party to deny that the document which he has signed is his deed on the basis that he was unable, through no fault of his own, to have any real understanding of a document, without being given an explanation of it. The causes of the lack of understanding can be ‘defective education, illness or innate incapacity’ (see *Saunders v. Anglia Building Society* [1971] AC 1004, 1016).

The second arises where the person is induced to sign the document as the result of a misrepresentation made to him. In *Curtis v. Chemical Cleaning and Dyeing Co Ltd* [1951] 1 KB 805 the plaintiff took a white satin wedding dress to the defendants for cleaning. She was asked to sign a document that contained a clause which stated that the dress was ‘accepted on condition that the company is not liable for any damage howsoever arising’. Prior to signing the document the plaintiff inquired why it was that she was being asked to sign the document. She was told that it was because the defendants did not accept liability for damage done to beads or sequins on the dress. The plaintiff then signed the document but did not take the time to read its terms. When the dress was returned to her there was a stain on

it. She brought a claim against the defendants who attempted to rely on the exclusion clause by way of defence. The Court of Appeal held that they could not do so in the light of the representation made by the defendant's employee prior to the plaintiff signing the document. Denning LJ stated (at pp. 808–809):

If the party affected signs a written document, knowing it to be a contract which governs the relations between him and the other party, his signature is irrefragable evidence of his assent to the whole contract, including the exempting clauses, unless the signature is shown to be obtained by fraud or misrepresentation: see *L'Estrange v. Graucob*... What is a sufficient misrepresentation for this purpose?...

In my opinion, any behaviour by words or conduct is sufficient to be a misrepresentation if it is such as to mislead the other party about the existence or extent of the exemption. If it conveys a false impression, that is enough. If the false impression is created knowingly, it is a fraudulent misrepresentation; if it is created unwittingly, it is an innocent misrepresentation. But either is sufficient to disentitle the creator of it to the benefit of the exemption. It was held in *R v. Kylsant (Lord)* [1932] 1 KB 442 that a misrepresentation might be literally true but practically false, not because of what is said, but because of what it left unsaid. In short, because of what it implied. This is as true of an innocent misrepresentation as it is of a fraudulent misrepresentation. When one party puts forward a printed form for signature, failure by him to draw attention to the existence or extent of the exemption clause may in some circumstances convey the impression that there is no exemption at all, or, any rate, not so wide an exemption as that which is in fact contained in the document. The present case is a good illustration. The customer said in evidence:

'When I was asked to sign the document I asked why. The assistant said I was to accept any responsibility for damage to beads and sequins. I did not read it all before I signed it.'

In those circumstances, by failing to draw attention to the width of the exemption clause, the assistant created the false impression that the exemption clause related to the beads and sequins only, and that it did not extend to the material of which the dress was made. It was done perfectly innocently, but, nevertheless, a false impression was created... [I]t was a sufficient misrepresentation to disentitle the cleaners from relying on the exemption, except in regard to the beads and sequins.

The third exception, acknowledged in *Grogan v. Robin Meredith Plant Hire* [1996] CLC 1127, is that the document which has been signed must have been a document which purports to have contractual effect and not an administrative document, such as a time-sheet. The latter does not purport to constitute the contract; rather, it records or gives effect to a part of the contract that has already been concluded (for example, by recording the number of hours for which a piece of machinery has been hired out, so that the price payable can be calculated). Whether a document amounts to a contractual document or not is a decision that must be reached in the light of all the facts and circumstances of the case.

The second point to note is that the Unfair Contract Terms Act 1977 (see pp. 421–445, Chapter 13, Section 3) would now regulate the validity of the exclusion clause found in the contract between the parties in *L'Estrange*. But at the time at which *L'Estrange* was decided the court did not have the power at common law to strike down exclusion clauses on the ground that they were unreasonable or unfair. In so far as the criticisms of *L'Estrange* are based on the unfairness of the result, it can be argued that any such unfairness is best addressed by giving to the courts the power to control unreasonable or unfair terms and not by modifying the rule that a party is bound by his own signature.

The third point relates to the criticisms that have been levelled against the decision in *L'Estrange*. Maugham LJ expressed his regret at the outcome but was of the view that he was bound by authority so to conclude. Others have challenged the view that the court was in fact bound and, in doing so, have invoked cases discussed in Chapter 2 (see pp. 32–43, Chapter 2, Section 3 and 4) concerned with the objective approach adopted by the courts when seeking to ascertain whether or not the parties have reached agreement. In his article ‘Signature, Consent, and the Rule in *L'Estrange v. Graucob*’ [1973] *CLJ* 104, JR Spencer has this to say of *L'Estrange* (at pp. 114–115):

When Miss L'Estrange signed the order form on which were written various terms, she gave the appearance of agreeing to everything that was written on the document. To borrow the words from *Smith v. Hughes* itself, she so conducted herself ‘that a reasonable man would believe that she was assenting to the terms proposed by the other party’. It would usually follow from this that she was bound by her apparent consent to all those terms. However, a person is not bound by apparent consent where the other party knew that his mind did not go with his apparent consent, or where the other party is responsible for the mistake which has been made. Didn't the facts of the case bring Miss L'Estrange within the scope of these exceptions to apparent consent?

The order form which Graucob Ltd provided seems to have been drawn up in a most confusing way. Maugham LJ said ‘...I could wish that the contract had been in a simpler and more usual form. It is unfortunate that the important clause excluding conditions and warranties is in such small print’. Not only was the clause printed in small print, but it was also printed on brown paper, which must have made the small print even harder to read. The general layout of the form also appears to have been confusing, too, the exemption clause being in a part of the document where it easily escaped notice. Then was this not one of those cases where although A apparently consented to B's terms, he did so because B had earlier confused him as to what those terms should be? In principle, the case is surely the same as *Scriven v. Hindley*, where A was allowed to deny his apparent consent to a contract to buy tow, because the auction catalogue had been confusing, and had contributed to form A's belief that he was offering to buy, not tow, but hemp.

Perhaps Miss L'Estrange could have gone even further than this, and also denied her apparent consent to the exemption clause on the ground that the company either knew or ought to have known that her mind did not go with her apparent consent. Why did Graucob Ltd use order forms printed on brown paper containing obscure exemption clauses in minute print in unexpected places? Was it because it knew that if it said what it meant more plainly, its customers would understand the document they were being asked to sign, and would refuse to do so? Who in their right mind would sign a document headed ‘I agree to pay for your goods even if they are useless, and not to sue you even if they injure me?’ Even if Graucob Ltd had used the words it did use—‘any express or implied condition, statement or warranty, statutory or otherwise, not stated herein is hereby excluded’—Miss L'Estrange might still have refused to sign if those words had been printed clearly where they could be seen. She would not have understood them, of course, but... she might have asked the salesman what the words meant. If the salesman had explained correctly, presumably she would not have signed. If he had explained incorrectly, then the company would have misrepresented the legal effect of the form, and... would have been unable to rely on the exemption clause.

The truth is that whatever may have been Graucob Ltd's intentions disreputable companies put harsh exemption clauses in minute print in order to ‘put one over’ people like Miss L'Estrange. Then why should people in her position not be allowed to deny their apparent consent to the clause because the company either *knew* or *ought to have known* that their mind did not go with their apparent consent?

Yet the Divisional Court, which felt sorry for Miss L'Estrange, did not allow her to deny her assent to the exemption clause by alleging either that Graucob Ltd were to blame for her mistake, as in *Scriven v. Hindley* [see p. 39, Chapter 2, Section 4], or that they had actual or constructive knowledge of the mistake she had made, as in *Hartog v. Colin and Shields* [see p. 32, Chapter 2, Section 3]. Why not? . . .

The reason why the [court in *L'Estrange v. Graucob*] . . . refused to admit the usual defences based on *Smith v. Hughes*, and restricted the range of available defences to fraud, misrepresentation and *non est factum*, appears to be that [the court] thought that there was something special about a signed document. Where there is a signed document, the courts thought that some kind of magic operated to take the contract out of the usual rules that govern the formation of contracts, and to bind the signatory almost absolutely.

An approach similar to that advocated in the penultimate paragraph of Professor Spencer's article was adopted by the Court of Appeal of Ontario in *Tilden Rent-A-Car Co v. Clendinning* (1978) 83 DLR (3d) 400. The defendant, Mr Clendinning, rented a car from Tilden Rent-A-Car at Vancouver airport. He was asked whether or not he wished to have additional insurance cover and he replied that he did. He was given a form to sign which he signed without reading, as would have been apparent to the clerk. The question for the court was whether or not the defendant was bound by an exemption clause in the policy which had the effect of imposing liability upon him for damage done to the car. The Court of Appeal concluded that he was not bound by the term. Dubin JA stated (at pp. 403–409):

It was urged that the rights of the parties were governed by what has come to be known as 'the rule in *L'Estrange v. F Graucob Ltd*' . . . *Consensus ad idem* is as much a part of the law of written contracts as it is of oral contracts. The signature to a contract is only one way of manifesting assent to contractual terms . . .

The justification for the rule in *L'Estrange v. F Graucob Ltd* appears to have been founded upon the objective theory of contracts, by which means parties are bound to a contract in writing by measuring their conduct by outward appearance rather than what the parties inwardly meant to decide . . .

Even accepting the objective theory to determine whether Mr Clendinning had entered into a contract which included all the terms of the written instrument, it is to be observed that an essential part of that test is whether the other party entered into the contract in the belief that Mr Clendinning was assenting to all such terms. In the instant case, it was apparent to the employee of Tilden-Rent-A-Car that Mr Clendinning had not in fact read the document in its entirety before he signed it. It follows under such circumstances that Tilden-Rent-A-Car cannot rely on provisions of the contract which it had no reason to believe were being assented to by the other contracting party.

As stated in Waddams, *The Law of Contracts*, p. 191:

'One who signs a written document cannot complain if the other party reasonably relies on the signature as a manifestation of assent to the contents, or ascribes to words he uses their reasonable meaning. But the other side of the same coin is that only a reasonable expectation will be protected. If the party seeking to enforce the document knew or had reason to know of the other's mistake the document should not be enforced.'

In ordinary commercial practice where there is frequently a sense of formality in the transaction, and where there is a full opportunity for the parties to consider the terms of the proposed contract submitted for signature, it might well be safe to assume that the party who attaches his signature to the contract intends by so doing to acknowledge his acquiescence

to its terms, and that the other party entered into the contract upon that belief. This can hardly be said, however, where the contract is entered into in circumstances such as were present in this case.

A transaction, such as this one, is invariably carried out in a hurried, informal manner. The speed with which the transaction is completed is said to be one of the attractive features of the services provided.

The clauses relied on in this case... are inconsistent with the over-all purpose for which the contract is entered into by the hirer. Under such circumstances, something more should be done by the party submitting the contract for signature than merely handing it over to be signed...

In modern commercial practice, many standard form printed documents are signed without being read or understood. In many cases the parties seeking to rely on the terms of the contract know or ought to know that the signature of a party to the contract does not represent the true intention of the signer, and that the party signing is unaware of the stringent and onerous provisions which the standard form contains. Under such circumstances, I am of the opinion that the party seeking to rely on such terms should not be able to do so in the absence of first having taken reasonable measures to draw such terms to the attention of the other party, and, in the absence of such reasonable measures, it is not necessary for the party denying knowledge of such terms to prove either fraud, misrepresentation or *non est factum*.

In the case at bar, Tilden Rent-A-Car took no steps to alert Mr Clendinning to the onerous provisions in the standard form contract presented by it. The clerk could not help but have known that Mr Clendinning had not in fact read the contract before signing it. Indeed the form of the contract itself with the important provisions on the reverse side and in very small type would discourage even the most cautious customer from endeavouring to read and understand it. Under such circumstances, it was not open to Tilden Rent-A-Car to rely on those clauses, and it was not incumbent on Mr Clendinning to establish fraud, misrepresentation or *non est factum*. Having paid the premium, he was not liable for any damage to the vehicle while being driven by him.

The English courts have not embraced such a broad exception to the general rule (see *Peninsula Business Services Ltd v. Sweeney* [2004] IRLR 49 at [22]). The exceptions currently recognized are much narrower in scope. Why is this? The answer lies in the significance that is attached to a signature. Why do we generally treat a signature as conclusive? Professor Atiyah has stated ('Form and Substance in Contract Law' in *Essays on Contract* (Oxford University Press, 1986), p. 109) that:

A signature is, and is widely recognized even by the general public as, a formal device, and its value would be greatly reduced if it could not be treated as a conclusive ground of contractual liability at least in all ordinary circumstances.

A signature provides a measure of certainty and it is frequently relied upon by third parties. As Moore-Bick LJ observed in *Peekay Intermark Ltd v. Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386, [2006] 2 Lloyd's Rep 511 (at [43]) the rule in *L'Estrange* is 'an important principle of English law which underpins the whole of commercial life; any erosion of it would have serious repercussions' (see also *Coys of Kensington Automobiles Ltd v. Pugliese* [2011] EWHC 655 (QB), [2011] 2 All ER (Comm) 664, [40]).

New forms of technology may, however, challenge this perspective of the value of a signature. Will an electronic signature count as a signature for the purposes of the rule in *L'Estrange*? If it does, will the courts continue to follow *L'Estrange* or will they adopt the approach taken



in *Clendinning*? In time the English courts may well go down the road taken by the Canadian courts. But it is suggested that a preferable approach would be to adhere to the rule (as was done by the High Court of Australia in *Toll (FGCT) Pty Ltd v. Alphapharm Pty Ltd* (2004) 219 CLR 165, discussed in greater detail on the Online Resource Centre which supports this book), subject to its existing exceptions, and, if necessary, to give to the courts greater power to deal with unreasonable terms contained in contracts. In this way the value of a signature as a formal device would be retained but the courts would be given the power to deal with what seems to be the real evil in these cases, namely the presence of unfair terms in contracts (but contrast the approach taken by the courts in cases concerned with the incorporation by notice of terms, where the courts take a stricter approach in the case of terms that are ‘onerous’ or ‘unusual’, p. 328, Section 3).

### 3. INCORPORATION BY NOTICE

A party who wishes to incorporate terms into a contract by giving his contracting party notice of them must satisfy three requirements. First, notice must have been given at or before the time of contracting. This may require the courts to apply the rules of offer and acceptance in order to ascertain the moment in time at which the contract was concluded. Two cases illustrate this point. The first is *Olley v. Marlborough Court Ltd* [1949] 1 KB 532. Here the notice was located in a hotel bedroom. It was held that it was ineffective to exclude liability towards a guest of the hotel on the basis that the contract between the hotel and the guest had been concluded before she set foot in the hotel bedroom. It was therefore too late to be effective. A second example is provided by the case of *Thornton v. Shoe Lane Parking* [1971] 2 QB 163. There the exemption clause was to be found inside a car park. The Court of Appeal held that the defendants had not taken reasonable steps to bring the clause to the attention of the customer (this aspect of the case is analysed by Bingham LJ in his judgment in *Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd* [1989] QB 433, p. 326, later in this section). But Lord Denning also held that the clause was too late to be incorporated into the contract. The car park was described as a ‘multi-storey automatic car park’ and a ticket was issued to a customer when he drove up to the machine at the entrance to the car park. Lord Denning held that the contract was concluded at the moment of entry into the car park so that the notice contained inside the car park and the terms printed on the ticket were too late to be included. He analysed the nature of the transaction between the parties in the following terms (at p. 169):

The customer pays his money and gets a ticket. He cannot refuse it. He cannot get his money back. He may protest to the machine, even swear at it. But it will remain unmoved. He is committed beyond recall. He was committed at the very moment when he put his money into the machine. The contract was concluded at that time. It can be translated into offer and acceptance in this way: the offer is made when the proprietor of the machine holds it out as being ready to receive the money. The acceptance takes place when the customer puts his money into the slot. The terms of the offer are contained in the notice placed on or near the machine stating what is offered for the money. The customer is bound by those terms as long as they are sufficiently brought to his notice before-hand, but not otherwise. He is not bound by the terms printed on the ticket if they differ from the notice, because the ticket comes too late. The contract has already been made.

The second requirement is that the terms must have been contained or referred to in a document that was intended to have contractual effect. So, for example, where the terms are contained in a document that is a receipt rather than a contractual document, the receipt will not

be effective to incorporate the terms into the contract (see, for example, *Chapelton v. Barry UDC* [1940] 1 KB 532 where a ticket given to someone who hired a deckchair was held not to be a contractual document and so was not effective to give the hirer notice of the terms).

The third requirement is that reasonable steps must have been taken to bring the terms to the attention of the other party. This requirement has generated a considerable amount of case-law which dates back to the decision of the Court of Appeal in *Parker v. South Eastern Railway* (1877) 2 CPD 416. This case-law was helpfully reviewed by the Court of Appeal in the following case:

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### **Interfoto Picture Library Ltd v. Stiletto visual Programmes Ltd**

[1989] QB 433, Court of Appeal

The defendant advertising agency wanted some photographs for a presentation for a client. On 5 March 1984 Mr Beeching, a director of the agency, telephoned the plaintiffs who ran a library of photographic transparencies and inquired whether they had any photographs of the 1950s which would be suitable for the defendants' purpose. The plaintiffs responded that they would look into the matter and, later the same day, they sent forty-seven transparencies to the defendants in a jiffy bag together with a delivery note which contained a number of terms. The delivery note stated that the date for the return of the transparencies was 19 March 1984. At the bottom of the delivery note, under the heading 'Conditions' which was 'fairly prominently printed in capitals', there were nine conditions, printed in four columns. Condition 2 provided:

'All transparencies must be returned to us within 14 days from the date of posting/delivery/ collection. A holding fee of £5 plus VAT per day will be charged for each transparency which is retained by you longer than the said period of 14 days save where a copyright licence is granted or we agree a longer period in writing with you.'

On receipt of the transparencies Mr Beeching telephoned the plaintiffs to say that the defendants were very impressed with the speed of the service, that one or two of the transparencies could be of interest and that they would get back to the plaintiffs on the matter. The defendants did not, however, use the transparencies for the presentation. Instead they put them to one side and forgot about them. The plaintiffs attempted to contact Mr Beeching on 20 and 23 March but were only able to speak to his secretary. In the event, the transparencies were not returned until 2 April. The plaintiffs then sent an invoice to the defendants for £3,783.50, which represented the holding charge in respect of their retention of the transparencies. The defendants refused to pay. The plaintiffs brought an action to recover the £3,783.50. The trial judge gave judgment for the plaintiffs. The defendants appealed to the Court of Appeal where it was held that condition 2 had not been incorporated into the contract. The defendants' appeal was therefore allowed and the defendants were ordered to pay £3.50 per transparency per week on a quantum meruit basis for the retention of the transparencies beyond a reasonable period, which was fixed at fourteen days from the date of their receipt by the defendants.

**Dillon LJ** [set out the facts and continued]

Condition 2 of these plaintiffs' conditions is in my judgment a very onerous clause. The defendants could not conceivably have known, if their attention was not drawn to the clause, that the plaintiffs were proposing to charge a 'holding fee' for the retention of the transparencies at such a very high and exorbitant rate.

At the time of the ticket cases in the last century it was notorious that people hardly ever troubled to read printed conditions on a ticket or delivery note or similar document. That remains the case now. In the intervening years the printed conditions have tended to become more and more complicated and more and more one-sided in favour of the party who is imposing them, but the other parties, if they notice that there are printed conditions at all, generally still tend to assume that such conditions are only concerned with ancillary matters of form and are not of importance. In the ticket cases the courts held that the common law required that reasonable steps be taken to draw the other parties' attention to the printed conditions or they would not be part of the contract. It is, in my judgment, a logical development of the common law into modern conditions that it should be held, as it was in *Thornton v. Shoe Lane Parking Ltd* [1971] 2 QB 163, that, if one condition in a set of printed conditions is particularly onerous or unusual, the party seeking to enforce it must show that that particular condition was fairly brought to the attention of the other party.

In the present case, nothing whatever was done by the plaintiffs to draw the defendants' attention particularly to condition 2; it was merely one of four columns' width of conditions printed across the foot of the delivery note. Consequently condition 2 never, in my judgment, became part of the contract between the parties.

I would therefore allow this appeal and reduce the amount of the judgment which the judge awarded against the defendants to the amount which he would have awarded on a quantum meruit on his alternative findings, i.e. the reasonable charge of £3.50 per transparency per week for the retention of the transparencies beyond a reasonable period, which he fixed at 14 days from the date of their receipt by the defendants.

### **Bingham LJ**

In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as 'playing fair', 'coming clean' or 'putting one's cards face upwards on the table'. It is in essence a principle of fair and open dealing. In such a forum it might, I think, be held on the facts of this case that the plaintiffs were under a duty in all fairness to draw the defendants' attention specifically to the high price payable if the transparencies were not returned in time and, when the 14 days had expired, to point out to the defendants the high cost of continued failure to return them.

English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness. Many examples could be given. Thus equity has intervened to strike down unconscionable bargains. Parliament has stepped in to regulate the imposition of exemption clauses and the form of certain hire-purchase agreements. The common law also has made its contribution, by holding that certain classes of contract require the utmost good faith, by treating as irrecoverable what purport to be agreed estimates of damage but are in truth a disguised penalty for breach, and in many other ways.

The well-known cases on sufficiency of notice are in my view properly to be read in this context. At one level they are concerned with a question of pure contractual analysis, whether one party has done enough to give the other notice of the incorporation of a term in the contract. At another level they are concerned with a somewhat different question, whether it would in all the circumstances be fair (or reasonable) to hold a party bound by any conditions or by a particular condition of an unusual and stringent nature.

In the leading case of *Parker v. South Eastern Railway Co* (1877) 2 CPD 416, Baggallay LJ plainly thought on the facts that the plaintiffs were right, Bramwell LJ that they were wrong;

Mellish LJ thought that there had been a misdirection and there should be a re-trial, a view in which the other members of the court concurred. The judgments deserve to be re-read. Mellish LJ said, at pp. 422–423:

‘Now, I am of opinion that we cannot lay down, as a matter of law, either that the plaintiff was bound or that he was not bound by the conditions printed on the ticket, from the mere fact that he knew there was writing on the ticket, but did not know that the writing contained conditions. I think there may be cases in which a paper containing writing is delivered by one party to another in the course of a business transaction, where it would be quite reasonable that the party receiving it should assume that the writing contained in it no condition, and should put it in his pocket unread. . . . The railway company, as it seems to me, must be entitled to make some assumptions respecting the person who deposits luggage with them: I think they are entitled to assume that he can read, and that he understands the English language, and that he pays such attention to what he is about as may be reasonably expected from a person in such a transaction as that of depositing luggage in a cloak-room. The railway company must, however, take mankind as they find them, and if what they do is sufficient to inform people in general that the ticket contains conditions, I think that a particular plaintiff ought not to be in a better position than other persons on account of his exceptional ignorance or stupidity or carelessness. But if what the railway company do is not sufficient to convey to the minds of people in general that the ticket contains conditions, then they have received goods on deposit without obtaining the consent of the persons depositing them to the conditions limiting their liability.’

Baggallay LJ’s analytical approach was somewhat similar. He said, at pp. 425–426:

‘Now as regards each of the plaintiffs, if at the time when he accepted the ticket, he, either by actual examination of it, or by reason of previous experience, or from any other cause, was aware of the terms or purport or effect of the endorsed conditions, it can hardly be doubted that he became bound by them. I think also that he would be equally bound if he was aware or had good reason to believe that there were upon the ticket statements intended to affect the relative rights of himself and the company, but intentionally or negligently abstained from ascertaining whether there were any such, or from making himself acquainted with their purport. But I do not think that in the absence of any such knowledge or information, or good reason for belief, he was under any obligation to examine the ticket with the view of ascertaining whether there were any such statements or conditions upon it.’

Both Mellish LJ and Baggallay LJ were, as it seems to me distinguishing the case in which it would be fair to hold a party bound from the case in which it would not. But this approach is made more explicit in the strongly worded judgment of Bramwell LJ, at p. 427:

‘The plaintiffs have sworn that they did not know that the printing was the contract, and we must act as though that was true and we believed it, at least as far as entering the verdict for the defendants is concerned. Does this make any difference? The plaintiffs knew of the printed matter. Both admit they knew it concerned them in some way, though they said they did not know what it was; yet neither pretends that he knew or believed it was not the contract. Neither pretends he thought it had nothing to do with the business in hand; that he thought it was an advertisement or other matter unconnected with his deposit of a parcel at the defendants’ cloak-room. They admit that, for anything they knew or believed, it might be, only they did not know or believe it was, the contract. Their evidence is very much that they did not think, or, thinking, did not care about it. Now they claim to charge the company, and to have the benefit of their own indifference. Is this just? Is it reasonable? Is it the way in which any other business is allowed to be conducted? Is it even allowed to a man to ‘think’, ‘judge’, ‘guess’, ‘chance’ a matter, without informing himself when he can, and then when his ‘thought’, ‘judgment’, ‘guess’, or ‘chance’ turns out wrong or unsuccessful, claim to impose a burthen or duty on another which he could not have done had he informed himself as he might?’

He continued in the same vein, at p. 428:

'Has not the giver of the paper a right to suppose that the receiver is content to deal on the terms in the paper? What more can be done? Must he say, 'Read that?' As I have said, he does so in effect when he puts it into the other's hands. The truth is, people are content to take these things on trust. They know that there is a form which is always used—they are satisfied it is not unreasonable, because people do not usually put unreasonable terms into their contracts. If they did, then dealing would soon be stopped. Besides, unreasonable practices would be known. The very fact of not looking at the paper shews that this confidence exists. It is asked: What if there was some unreasonable condition, as for instance to forfeit £1,000 if the goods were not removed in 48 hours? Would the depositor be bound? I might content myself by asking: Would he be, if he were told 'our conditions are on this ticket', and he did not read them. In my judgment, he would not be bound in either case. I think there is an implied understanding that there is no condition unreasonable to the knowledge of the party tendering the document and not insisting on its being read—no condition not relevant to the matter in hand. I am of opinion, therefore, that the plaintiffs, having notice of the printing, were in the same situation as though the porter had said, 'Read that, it concerns the matter in hand'; that if the plaintiffs did not read it, they were as much bound as if they had read it and had not objected.'

This is not a simple contractual analysis whether an offer has been made and accepted...

*J Spurling Ltd v. Bradshaw* [1956] 1 WLR 461 concerned an exemption clause in a warehousing contract. The case is now remembered for the observations of Denning LJ, at p. 466:

'This brings me to the question whether this clause was part of the contract. Mr Sofer urged us to hold that the warehousemen did not do what was reasonably sufficient to give notice of the conditions within *Parker v. South Eastern Railway Co* 2 CPD 416. I quite agree that the more unreasonable a clause is, the greater the notice which must be given of it. Some clauses which I have seen would need to be printed in red ink on the face of the document with a red hand pointing to it before the notice could be held to be sufficient.'

Here, therefore, is made explicit what Bramwell LJ had perhaps foreshadowed, that what would be good notice of one condition would not be notice of another. The reason is that the more outlandish the clause the greater the notice which the other party, if he is to be bound must in all fairness be given...

Lastly I would mention *Thornton v. Shoe Lane Parking Ltd.* [1971] 2 QB 163. Lord Denning MR said, at pp. 169–170:

'Assuming, however, that an automatic machine is a booking clerk in disguise—so that the old fashioned ticket cases still apply to it. We then have to go back to the three questions put by Mellish LJ in *Parker v. South Eastern Railway Co*, 2 CPD 416, 423, subject to this qualification: Mellish LJ used the word "conditions" in the plural, whereas it would be more apt to use the word "condition" in the singular, as indeed the Lord Justice himself did on the next page. After all, the only condition that matters for this purpose is the exempting condition. It is no use telling the customer that the ticket is issued subject to some "conditions" or other, without more: for he may reasonably regard "conditions" in general as merely regulatory, and not as taking away his rights, unless the exempting condition is drawn specifically to his attention. (Alternatively, if the plural "conditions" is used, it would be better prefaced with the word "exempting", because the exempting conditions are the only conditions that matter for this purpose.) Telescoping the three questions, they come to this: the customer is bound by the exempting condition if he knows that the ticket is issued subject to it; or, if the company did what was reasonably sufficient to give him notice of it.

Mr Machin admitted here that the company did not do what was reasonably sufficient to give Mr Thornton notice of the exempting condition. That admission was properly made. I do not pause to inquire whether the exempting condition is void for unreasonableness. All I say is that it is so wide and so destructive of rights that the court should not hold any man bound by it unless it is drawn to his attention in the most explicit way. It is an instance of what I had in mind in *J Spurling Ltd v. Bradshaw* [1956] 1 WLR 461, 466. In order to give sufficient notice, it would need to be printed in red ink with a red hand pointing to it—or something equally startling.’

The judgment of Megaw LJ was to similar effect . . .

The tendency of the English authorities has, I think, been to look at the nature of the transaction in question and the character of the parties to it; to consider what notice the party alleged to be bound was given of the particular condition said to bind him; and to resolve whether in all the circumstances it is fair to hold him bound by the condition in question. This may yield a result not very different from the civil law principle of good faith, at any rate so far as the formation of the contract is concerned.

Turning to the present case, I am satisfied . . . that no contract was made on the telephone when the defendants made their initial request. I am equally satisfied that no contract was made on delivery of the transparencies to the defendants before the opening of the jiffy bag in which they were contained. Once the jiffy bag was opened and the transparencies taken out with the delivery note, it is in my judgment an inescapable inference that the defendants would have recognised the delivery note as a document of a kind likely to contain contractual terms and would have seen that there were conditions printed in small but visible lettering on the face of the document. To the extent that the conditions so displayed were common form or usual terms regularly encountered in this business, I do not think the defendants could successfully contend that they were not incorporated into the contract.

The crucial question in the case is whether the plaintiffs can be said fairly and reasonably to have brought condition 2 to the notice of the defendants. The judge made no finding on the point, but I think that it is open to this court to draw an inference from the primary findings which he did make. In my opinion the plaintiffs did not do so. They delivered 47 transparencies, which was a number the defendants had not specifically asked for. Condition 2 contained a daily rate per transparency after the initial period of 14 days many times greater than was usual or (so far as the evidence shows) heard of. For these 47 transparencies there was to be a charge for each day of delay of £235 plus value added tax. The result would be that a venial period of delay, as here, would lead to an inordinate liability. The defendants are not to be relieved of that liability because they did not read the condition, although doubtless they did not; but in my judgment they are to be relieved because the plaintiffs did not do what was necessary to draw this unreasonable and extortionate clause fairly to their attention. I would accordingly allow the defendants’ appeal and substitute for the judge’s award the sum which he assessed upon the alternative basis of quantum meruit.

In reaching the conclusion I have expressed I would not wish to be taken as deciding that condition 2 was not challengeable as a disguised penalty clause. This point was not argued before the judge nor raised in the notice of appeal. It was accordingly not argued before us. I have accordingly felt bound to assume, somewhat reluctantly, that condition 2 would be enforceable if fully and fairly brought to the defendants’ attention.

## Commentary

It is important to get the focus of attention right. The focus is not upon the recipient of the notice. The test applied by the court is not whether the recipient has read the terms or taken reasonable steps to discover their existence (although where the recipient has actual

knowledge of the existence of the terms it would appear that, in principle, he is bound by them: *Parker v. South Eastern Railway* (1877) 2 CPD 416, 421). Instead, the courts focus attention upon the party relying upon the terms and ask themselves whether that party has taken reasonable steps to bring notice of the term or terms to the attention of the other party. The case-law can be traced back to the old ‘ticket cases’, of which *Parker v. South Eastern Railway* (1877) 2 CPD 416 is a leading example, where the issue between the parties was generally whether or not a sweeping exclusion clause had been incorporated into the contract with the passenger.

In determining whether or not reasonable steps have been taken in order to draw the term to the attention of the other party, the courts have regard to obvious factors such as the location of the notice and its prominence. A notice which is located on the back of a document is unlikely to be incorporated in the absence of a reference on the front of the document alerting the reader to the presence of terms, or a reference to terms, on the back (see *Henderson v. Stevenson* (1875) LR 2 HL (Sc) 470). Similarly, a notice that has been obliterated by a stamp is unlikely to be incorporated (*Sugar v. London, Midland and Scottish Railway Co* [1941] 1 All ER 172). On the other hand, where the term, or the reference to the terms, is located prominently on the front of the document then the likelihood is that the term will be incorporated (*Thompson v. London, Midland and Scottish Railway Co Ltd* [1930] 1 KB 41).

However, as the judgment of Bingham LJ in *Interfoto* makes clear, the inquiry undertaken by the courts in this connection is no mere mechanical exercise. It requires the court to evaluate the nature of the term that one party is seeking to incorporate into the contract. The more onerous or unusual the term, the greater the steps that must be taken in order to draw its existence to the other party’s attention. This principle is applicable both to consumer and to commercial contracts (*Kaye v. Nu Skin UK Ltd* [2009] EWHC 3509 (Ch), [2011] 1 Lloyd’s Rep 40, [37]). Bingham LJ in his judgment endeavours to demonstrate that this approach has a sure foundation in the authorities. Its foundation in terms of principle is perhaps more debatable. Why seek to differentiate between different terms in relation to their incorporation into a contract? If the law’s concern is with the unfairness of the term itself, would this not be better expressed by conferring on the court a direct power to regulate unfair terms? One answer to this question is that the law does not presently confer upon the courts such a broad power and, in its absence, the courts have to make use of what might be said to be the ‘second-best alternative’ of regulating the incorporation of terms into contracts. While the Unfair Contract Terms Act 1977 does confer a limited power upon courts to regulate certain clauses which seek to exclude or restrict liability (on which see pp. 421–445, Chapter 13, Section 3), the Act does not extend to the type of clause in issue in *Interfoto*. In the absence of a power directly to control the substantive content of the clause, the court chose to regulate it by concluding that it had not been incorporated into the contract.

Post-*Interfoto* the courts have had some difficulty in identifying which terms are ‘onerous’ or ‘unusual’ and which are not. It should be noted that the term need not be ‘onerous’ in order to attract this more rigorous scrutiny. It suffices that it is ‘unusual’. Presumably, therefore, a party who changes his terms in significant respects may be under an obligation to take greater steps to draw these changes to the attention of the other party. Two cases illustrate the difficulties that the courts are currently experiencing.

The first is the decision of the Court of Appeal in *AEG (UK) Ltd v. Logic Resource Ltd* [1996] CLC 265. The plaintiffs sold goods to the defendants and the defendants in turn sub-sold them to their customers in Iran. The goods proved to be defective when they were inspected by the sub-buyers in Iran. Arrangements were made to air freight the goods back to the plaintiffs’ factory in the UK at a cost of some £4,230 so that the necessary modifications

could be carried out. The defendants refused to pay the £4,230. The plaintiffs sued to recover the sum on the basis of clause 7.5 of the contract which stated: 'the purchaser shall return the defective parts at his own expense to the supplier immediately upon request by the latter'. One of the issues before the court was whether or not this term had been incorporated into the contract between the parties and this depended upon whether or not the term was 'particularly onerous or unusual'. The majority, Hirst and Waite LJ, concluded that it was both 'extremely onerous... and also unusual in the absence of any evidence that it is a standard or common term'. The basis for their conclusion was that the only right available to the purchasers under the contract in the event of the goods proving to be defective was to exercise their right to return the goods to the plaintiffs. To append to this right the requirement that the purchaser pay for the cost of returning the goods was held to be both onerous and unusual. The position would probably have been different had the purchasers had available to them a range of rights in the event of the goods being defective. In such a case a seller might legitimately attach to the exercise of the right to return the goods for repair a condition that the purchaser meet the cost of returning the goods. Hobhouse LJ dissented and he did so in forthright terms. He stated:

The problem in the present case arises from the fact that these clauses have been unreasonably drafted. As is almost inevitable in printed standard terms, they are not related to the particular circumstances of the case and, furthermore, they stipulate for a greater protection of the seller than is reasonable, or anyway is reasonable without some special justification. In my judgment, and this is where I part company from Hirst and Waite LJ, it is necessary before excluding the incorporation of a clause *in limine* to consider the type of clause it is. Is it a clause of the type which you would expect to find in the printed conditions? If it is, then it is only in the most exceptional circumstances that a party will be able to say that it was not adequately brought to his notice by standard words of incorporation. If a party wishes to find out precisely how a clause of a normal sort has been worded, he should ask for the actual text of the clause. This case is not analogous to either of the two cases upon which the appellant founds. The *Interfoto* case involved an extortionate clause which did not relate directly to the expected rights and obligations of the parties. In the *Shoe Lane Parking* case, it related to personal injuries and the state of the premises and not to the subject matter of the car parking contract, which would, in the view of the Court of Appeal, have been concerned with damage to property.

Therefore, in my judgment, it is necessary to consider the type of clause, and only if it is a type of clause which it is not to be expected will be found in the printed conditions referred to then to go on to question its incorporation. These conditions do include clauses which, in my judgment, do fall foul of the *Interfoto* principle, but I do not consider that clause 7 comes into that category. In my judgment, it is desirable as a matter of principle to keep what was said in the *Interfoto* case within its proper bounds. A wide range of clauses are commonly incorporated into contracts by general words. If it is to be the policy of English law that in every case those clauses are to be gone through with, in effect, a toothcomb to see whether they were entirely usual and entirely desirable in the particular contract, then one is completely distorting the contractual relationship between the parties and the ordinary mechanisms of making contracts. It will introduce uncertainty into the law of contract.

In the past there may have been a tendency to introduce more strict criteria but this is no longer necessary in view of the Unfair Contract Terms Act. The reasonableness of clauses is the subject matter of the Unfair Contract Terms Act and it is under the provisions of that Act that problems of unreasonable clauses should be addressed and the solution found. In the present case, it is my opinion that the Act provides the answer to the question which has been raised.

The second case is *O'Brien v. MGN Ltd* [2002] CLC 33. The claimant thought that he had won a prize in a scratchcard game in the defendants' newspaper. Unfortunately for him, a mistake had been made by the defendants in that they had failed to notice that a number of cards had been issued with the winning numbers on them. Instead of there being two winners of the £50,000 prize some 1,472 people rang up to claim the prize. In these circumstances the defendants refused to pay out to all the 'winners'. They relied upon rule 5 of the competition rules which provided that, if more prizes were claimed than were available in any prize category for any reason, a separate draw would then take place for the prize. The question for the court was whether or not rule 5 had been incorporated into the contract between the parties. The trial judge found that a contract was concluded between the parties on 3 July 1995, the day on which the claimant bought the paper. The offer was contained in the paper that day and the claimant accepted the offer when he telephoned the hotline in order to claim his prize. Alongside the instructions relating to the telephone hotline were the words: 'Normal Mirror Group rules apply'. Was this reference to the rules sufficient to incorporate them into the contract? The Court of Appeal held that it was.

This time the Court of Appeal held that the clause was neither 'onerous' nor 'unusual'. It was not onerous because it did not seek to impose a burden on the claimant, nor did it attempt to exclude liability for negligently caused personal injury. It simply deprived 'the claimant of a windfall for which he has done very little in return'. Nor could it be said that the clause was 'unusual' given that other games and competitions had similar rules.

Hale LJ concluded (at [23]):

the words 'onerous or unusual' are not terms of art. They are simply one way of putting the general proposition that reasonable steps must be taken to draw the particular term in question to the notice of those who are bound by it and that more is required in relation to certain terms than to others depending on their effect. In the particular context of this particular game, I consider that the defendants did just enough to bring the rules to the claimant's attention. There was a clear reference to rules on the face of the card he used. There was a clear reference to rules in the paper containing the offer of a telephone prize. There was evidence that those rules could be discovered either from the newspaper offices or from back issues of the paper. The claimant had been able to discover them when the problem arose.

Sir Anthony Evans was much more hesitant. He held that the rule had been incorporated but only because he was not prepared to interfere with the finding of fact by the trial judge that the rule had been incorporated. In his view 'the promise of significant riches' deserved more and he stated that a rule which gave the 'winner' no more than a further chance to obtain the prize was sufficiently onerous, if not unusual, to require greater prominence than was given to this one. While the result in the case was ultimately unanimous, the judgments nevertheless display a degree of unease about the meaning of the words 'onerous or unusual' and about the application of this test to any given fact situation.

Where a term is held to be 'onerous' or 'unusual', what steps are required in order to incorporate it into the contract? In *Interfoto* it does not appear that the plaintiffs attempted to hide their conditions on the delivery note and the defendants were presumably capable of reading them. Yet condition 2 was not incorporated. What should they have done to ensure that it was incorporated? In *J Spurling Ltd v. Bradshaw* [1956] 1 WLR 461 (referred to in the judgment of Bingham LJ in *Interfoto* at p. 326, extracted earlier) Denning LJ famously referred to the need for a 'red hand' pointing to the clause. While his comment may have made its mark on the judicial memory and on textbook writers, it has not been translated into commercial practice. Little red hands are not to be found in commercial contracts in the UK. A more

realistic step to take is to put the clause in bold print or specifically to draw the other party's attention to the existence of the clause in a letter. A court may be more likely to conclude that reasonable steps have been taken where there has been 'an express acknowledgement in the contractual documents that the terms and conditions in question were incorporated' (*Ocean Chemical Transport Inc v. Exnor Craggs Ltd* [2000] 1 Lloyd's Rep 446, 454). This was confirmed by Edwards-Stuart J in *William McIlroy Swindon Ltd v. Quinn Insurance Ltd* [2010] EWHC 2448 (TCC), [2011] BLR 136, when he questioned whether the result in *Interfoto* would have been the same if Interfoto's secretary had typed on to the delivery note words to the following effect: 'The printed terms set out below affect your rights. Before accepting deliveries of the transparencies you are strongly advised to read them to ensure that they are acceptable.' It is not entirely clear that a clause of this type would have been effective to incorporate the clause into the contract. But, without a clause of this type or similar, it is clear that the clause will not be incorporated.

#### 4. INCORPORATION BY COURSE OF DEALING AND BY CUSTOM

Finally, a term may be incorporated into a contract as a result of a course of dealing between the parties or as a result of the custom of the trade in which the parties work. The leading case on incorporation by course of dealing is the following decision of the House of Lords:

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##### **McCutcheon v. David MacBrayne Ltd** [1964] 1 WLR 430, House of Lords

Mr McCutcheon, the appellant, asked his brother-in-law, Mr McSporrán, to arrange for his car to be shipped from Islay to the mainland. Mr McSporrán took the car to the respondents' office in Port Askaig where he was quoted a price for a return journey for the car. He paid the fare and was given a receipt. He delivered the car into the possession of the respondents. The vessel sank on the journey as a result of the negligence of the respondents' employees and the car was a total loss. The appellant brought an action in negligence against the respondents, who sought to rely on the terms of an exclusion clause contained in their conditions of carriage.

The usual practice of the respondents was to ask the person sending the goods to sign a risk note by which the person sending the goods agreed to be bound by the respondents' terms and conditions. But on this occasion Mr McSporrán was not asked to sign the risk note and so did not sign one. He gave evidence to the effect that he had shipped goods before with the respondents and had sometimes been asked to sign a risk note but had never read it. The appellant himself had consigned goods with the respondents on four occasions. On three of them he had been acting on behalf of his employer and on the other occasion he had shipped his own car. On all four occasions he had signed a risk note. He admitted that he knew of the existence of the conditions but stated that he was not aware of their content. The House of Lords held that the respondents' terms had not been incorporated into the contract with the consequence that the respondents had not excluded their liability in negligence.

##### **Lord Reid**

The only other ground on which it would seem possible to import these conditions is that based on a course of dealing. If two parties have made a series of similar contracts each containing certain conditions, and then they make another without expressly referring to those

conditions it may be that those conditions ought to be implied. If the officious bystander had asked them whether they had intended to leave out the conditions this time, both must, as honest men, have said 'of course not'. But again the facts here will not support that ground. According to Mr McSporrán, there had been no consistent course of dealing; sometimes he was asked to sign and sometimes not. And, moreover, he did not know what the conditions were. This time he was offered an oral contract without any reference to conditions, and he accepted the offer in good faith.

The respondents also rely on the appellant's previous knowledge. I doubt whether it is possible to spell out a course of dealing in his case. In all but one of the previous cases he had been acting on behalf of his employer in sending a different kind of goods and he did not know that the respondents always sought to insist on excluding liability for their own negligence. So it cannot be said that when he asked his agent to make a contract for him he knew that this or, indeed, any other special term would be included in it. He left his agent a free hand to contract, and I see nothing to prevent him from taking advantage of the contract which his agent in fact made.

'The judicial task is not to discover the actual intentions of each party; it is to decide what each was reasonably entitled to conclude from the attitude of the other.' [*W.M. Gloag on Contract* (2nd edn, W Green, 1929), p. 7.]

In this case I do not think that either party was reasonably bound or entitled to conclude from the attitude of the other as known to him that these conditions were intended by the other party to be part of this contract. I would, therefore, allow the appeal and restore the interlocutor of the Lord Ordinary.

### **Lord Guest**

All that the previous dealings in the present case can show is that the appellant and his agent knew that the previous practice of the respondents was to impose special conditions. But knowledge on their part did not and could not by itself import acceptance by them of these conditions, the exact terms of which they were unaware, into a contract which was different in character from those in the previous course of dealing. The practice of the respondents was to insist on a written contract incorporated in the risk note. On the occasion in question a verbal contract was made without reference to the conditions.

### **Lord Devlin**

In my opinion, the bare fact that there have been previous dealings between the parties does not assist the respondents at all. The fact that a man has made a contract in the same form 99 times (let alone three or four times which are here alleged) will not of itself affect the 100th contract in which the form is not used. Previous dealings are relevant only if they prove knowledge of the terms, actual and not constructive, and assent to them. If a term is not expressed in a contract, there is only one other way in which it can come into it and that is by implication. No implication can be made against a party of a term which was unknown to him. If previous dealings show that a man knew of and agreed to a term on 99 occasions, there is a basis for saying that it can be imported into the 100th contract without an express statement. It may or may not be sufficient to justify the importation—that depends on the circumstances; but at least by proving knowledge the essential beginning is made. Without knowledge there is nothing. . .

If a man is given a blank ticket without conditions or any reference to them, even if he knows in detail what the conditions usually exacted are, he is not, in the absence of any allegation of fraud or of that sort of mistake for which the law gives relief, bound by such conditions. It may seem a narrow and artificial line that divides a ticket that is blank on the back

from one that says 'For conditions see time-tables', or something of that sort, that has been held to be enough notice. I agree that it is an artificial line and one that has little relevance to everyday conditions. It may be beyond your Lordships' power to make the artificial line more natural: but at least you can see that it is drawn fairly for both sides and that there is not one law for individuals and another for organizations that can issue printed documents. If the respondents had remembered to issue a risk note in this case, they would have invited your Lordships to give a curt answer to any complaint by the appellant. He might say that the terms were unfair and unreasonable, that he had never voluntarily agreed to them, that it was impossible to read or understand them and that anyway if he had tried to negotiate any change the respondents would not have listened to him. The respondents would expect him to be told that he had made his contract and must abide by it. Now the boot is on the other foot. It is just as legitimate, but also just as vain, for the respondents to say that it was only a slip on their part, that it is unfair and unreasonable of the appellant to take advantage of it and that he knew perfectly well that they never carried goods except on conditions. The law must give the same answer: they must abide by the contract they made. What is sauce for the goose is sauce for the gander. It will remain unpalatable sauce for both animals until the Legislature, if the Courts cannot do it, intervenes to secure that when contracts are made in circumstances in which there is no scope for free negotiation of the terms, they are made upon terms that are clear, fair and reasonable and settled independently as such. That is what Parliament has done in the case of carriage of goods by rail and on the high seas.

### **Lord Pearce**

The defenders rely on the course of dealing. But they are seeking to establish an oral contract by a course of dealing which always insisted on a written contract. It is the consistency of a course of conduct which gives rise to the implication that in similar circumstances a similar contractual result will follow. When the conduct is *not* consistent, there is no reason why it should still produce an invariable contractual result. The defenders having previously offered a written contract, on this occasion offered an oral one. The pursuer's agent duly paid the freight for which he was asked and accepted the oral contract thus offered. This raises no implication that the conditions of the oral contract must be the same as the conditions of the written contract would have been had the defenders preferred one.

Recourse is then sought to knowledge and intention. This is not a case where there was any bad faith on the part of the pursuer or his agent. Had the pursuer's agent snatched at an offer that he knew was not intended, or deliberately taken advantage of the defenders' omission to proffer their usual printed form for his signature, the situation would be different and other considerations would apply. But neither the pursuer nor his agent gave any thought to conditions. Nor had they any knowledge that Clause 11 would contain, wrapped in 30 lines of small print and in language intelligible only to a lawyer or a person of education and perspicacity, a total exclusion of liability for almost every conceivable act of the defenders that might damage the pursuer's goods.

The defenders never intended to offer or make any oral contract on the terms of the printed conditions. They intended to offer a written contract and by mistake they offered an oral one. The pursuer was unaware of the mistake. He accepted an oral contract but he never intended to accept an oral contract on the printed conditions. He knew that he usually had to sign a form which he supposed contained some conditions. When he was offered an oral contract without conditions he accepted with no thought about its terms. Why should such intentions or knowledge on the part of the contracting parties lead the Court to create a contract which neither intended? The furthest to which this argument of the defenders could lead is to the conclusion that the parties were never *ad idem*; in which case there was no special contract and the common-law contract prevails.

Some reliance was placed on the fact that the pursuer and his agent were in no wise misled nor suffered from the absence of the written form since they would not have read it or paid any attention to it in any event. This argument has a cynical flavour. It really amounts to saying that because the pursuer would have been bound by a harsh condition, of which he did not know, if the defenders had taken the proper legal steps, he should be likewise bound when they neglected to take those steps. The law inflicts some hardship on ignorant or careless plaintiffs who accept a ticket or sign a printed form in that it holds them bound by printed conditions which they have not read and of which they know nothing. The reasons for this are given in *Parker v. South Eastern Railway Company* (1877) 2 CPD 416. If the defenders are to have the benefit of the reasoning in *Parker's Case*, they must take the necessary steps. To decide in the defenders' favour on the facts of this case would be a further extension of the protection afforded to defendants by the ticket cases. Such an extension seems to me very undesirable.

**Lord Hodson** delivered a concurring judgment.

## Commentary

In order to establish the existence of a course of dealing there must be both a regularity and a consistency of dealing between the parties. The downfall of the respondents in *McCutcheon* was the lack of consistency in their previous dealings with the appellant and Mr McSporrان. But the consistency point should not be taken too far. Both Lord Guest and Lord Pearce emphasized the fact that the respondents were attempting to establish an oral contract by reference to a course of dealing which always required a written contract. This should not have been a decisive factor. A party will generally only rely on a 'course of dealing' argument where he has, for some reason, failed to comply with his standard practice and, if this failure also had the effect of negating the consistency of dealing, incorporation by course of dealing would be almost an impossibility. So the mere fact that the contract in the present case was an oral contract should not, of itself, have prevented the respondents from establishing a course of dealing on the basis of written contracts. The better reason for the failure of the respondents to incorporate their terms into the contract was given by Lord Reid, namely that past practice was itself inconsistent. As Mr McSporrان stated in evidence 'sometimes he was asked to sign [a risk note] and sometimes not'. The extent of the consistency required must ultimately depend upon the facts of the case. In essence the courts are looking for a consistency of dealing which is such as to lead both parties reasonably to believe that the standard terms have been incorporated into their contract.

It can also be difficult to prove a sufficient regularity of dealing, especially where the contract is concluded between a consumer and a business. In *Hollier v. Rambler Motors (AMC) Ltd* [1972] 2 QB 71 the plaintiff brought an action for damages against the defendant garage after his car had been badly damaged in a fire at the defendants' garage. The car had been left with the defendants so that repair work could be undertaken. The defendants sought to rely on an exclusion clause contained in an invoice which stated that 'The Company is not responsible for damage caused by fire to customers' cars on the premises'. The plaintiff had signed this invoice on at least two previous occasions when the defendants repaired his car but he was not asked to sign it on this occasion. The plaintiff had had his car repaired by the defendants on three or four occasions over a five-year period. The defendants submitted that the exclusion clause contained in the invoice had been incorporated into the contract as a result of the course of dealing between the parties. The Court of Appeal rejected this submission. It was held that 'not quite one dealing a year' was insufficient to constitute a course of

dealing. A greater degree of regularity is required (see, for example, *Henry Kendall & Sons (A Firm) v. William Lillico & Sons Ltd* [1969] 2 AC 31, where there were three or four transactions between the parties per month over a three-year period).

The position may, however, be different where the parties to the transaction are in the same trade or industry. In such a case the court may be able to incorporate the term into the contract either on the basis of a course of dealing between the parties or on the basis of the ‘common understanding’ of the parties derived from the practice of the trade. This point is demonstrated by the following case:

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**British Crane Hire Corporation v. Ipswich Plant Hire Ltd**  
[1975] QB 303, Court of Appeal

The defendants being in urgent need of a dragline crane agreed to hire one from the plaintiffs. Both parties were in the business of hiring out heavy earth-moving equipment. Given the urgency of the situation, the agreement was reached over the telephone. Agreement was reached on the price but nothing was said about the general conditions of hire. The plaintiffs did send their conditions of hire to the defendants but before the defendants signed it the crane sank into the marshy ground on which the defendants were working (although the accident occurred without negligence on the part of the defendants). The plaintiffs sought to recover from the defendants the cost of recovering the crane from the marshy ground. The defendants denied that they were liable to meet this cost. The Court of Appeal held that the defendants were liable to meet this cost on the basis that the plaintiffs’ terms contained a clause which required the defendants to indemnify them against such losses and such a term was, as the defendants knew, in standard use in the trade.

**Lord Denning MR**

In support of the course of dealing, the plaintiffs relied on two previous transactions in which the defendants had hired cranes from the plaintiffs. One was February 20, 1969; and the other October 6, 1969. Each was on a printed form which set out the hiring of a crane, the price, the site, and so forth; and also setting out the conditions the same as those here. There were thus only two transactions many months before and they were not known to the defendants’ manager who ordered this crane. In the circumstances I doubt whether those two would be sufficient to show a course of dealing.

In *Hollier v. Rambler Motors (AMC) Ltd* [1972] 2 QB 71, 76 Salmon LJ said he knew of no case

‘in which it has been decided or even argued that a term could be implied into an oral contract on the strength of a course of dealing (if it can be so called) which consisted at the most of three or four transactions over a period of five years.’

That was a case of a private individual who had had his car repaired by the defendants and had signed forms with conditions on three or four occasions. The plaintiff there was not of equal bargaining power with the garage company which repaired the car. The conditions were not incorporated.

But here the parties were both in the trade and were of equal bargaining power. Each was a firm of plant hirers who hired out plant. The defendants themselves knew that firms in the plant-hiring trade always imposed conditions in regard to the hiring of plant: and that their conditions were on much the same lines...

[he considered the evidence and continued]

From that evidence it is clear that both parties knew quite well that conditions were habitually imposed by the supplier of these machines: and both parties knew the substance of those conditions. In particular that if the crane sank in soft ground it was the hirer's job to recover it: and that there was an indemnity clause. In these circumstances, I think the conditions on the form should be regarded as incorporated into the contract. I would not put it so much on the course of dealing, but rather on the common understanding which is to be derived from the conduct of the parties, namely, that the hiring was to be on the terms of the plaintiffs' usual conditions.

As Lord Reid said in *McCutcheon v. David MacBrayne Ltd* [1964] 1 WLR 125, 128 quoting from the Scottish textbook, *Gloag on Contract*, 2nd edn (1929), p. 7:

'The judicial task is not to discover the actual intentions of each party; it is to decide what each was reasonably entitled to conclude from the attitude of the other.'

It seems to me that, in view of the relationship of the parties, when the defendants requested this crane urgently and it was supplied at once—before the usual form was received—the plaintiffs were entitled to conclude that the defendants were accepting it on the terms of the plaintiffs' own printed conditions—which would follow in a day or two. It is just as if the plaintiffs had said: 'We will supply it on our usual conditions', and the defendants said 'Of course, that is quite understood'.

Applying the conditions, it is quite clear that nos. 6 and 8 cover the second mishap. The defendants are liable for the cost of recovering the crane from the soft ground.

**Megaw LJ** concurred and **Sir Eric Sachs** delivered a concurring judgment.

#### FURTHER READING

CLARKE, M, 'Notice of Contractual Terms' [1976] *CLJ* 51.

MACDONALD, E, 'Incorporation of Contract Terms by a "Consistent Course of Dealing"' (1988) 8 *Legal Studies* 48.

—, 'The Duty to Give Notice of Unusual Contract Terms' [1988] *JBL* 375.

SPENCER, JR, 'Signature, Consent, and the Rule in *L'Estrange v. Graucob*' [1973] *CLJ* 104.

## IMPLIED TERMS

### CENTRAL ISSUES

1. Terms may be implied into contracts from three principal sources, namely statute, custom, and the courts.
2. Terms are frequently implied into contracts by Parliament. These terms can be very important in practice. For example, terms are implied into contracts for the sale of goods which give buyers important rights against sellers. These terms were first enacted in the Sale of Goods Act 1893 and are now to be found in the Sale of Goods Act 1979.
3. Terms can also be implied into contracts by custom where the custom is certain, reasonable, and notorious. Customs and usages are an important source of obligations in commercial contracts.
4. Courts also imply terms into contracts. The jurisdiction of the court to imply terms into a contract is a source of considerable controversy. The difficulty which the courts have experienced lies in locating both the basis and the extent of their jurisdiction to imply terms into a contract. The traditional justification for the implication of terms is that the court is giving effect to the presumed intention of the parties. Terms were therefore implied on the basis that it was necessary to do so. However it is difficult, if not impossible, to justify the implication of all terms on the basis of necessity. In some cases the courts take account of a wider range of considerations than the presumed intention of the parties and apply a test that is less stringent than necessity. On the other hand, the courts have rejected the proposition that they can imply a term into a contract simply on the basis that it is reasonable to do so.
5. Implied terms are customarily divided into two categories, namely terms implied in law and terms implied in fact. In the case of terms implied in fact it is possible to ascribe the implied term to the intention of the parties, but it is much more difficult to do this where the term is implied in law. In the latter case a term is implied as an incident of every contract of that kind and the courts take account of a wide range of considerations when deciding whether or not to imply such a term into the contract.

## 1. INTRODUCTION

Implied terms are important both in practice and in theory. They are important in practice because a number of important terms in contracts today are there as a result of implication rather than express agreement. The implied terms contained in sections 12–15 of the Sale of Goods Act 1979 impose important obligations upon sellers of goods. The word ‘impose’ is important. These terms can no longer be attributed to the intention of the parties because Parliament has intervened to establish very strict limits within which these terms can be excluded (in the case of consumer contracts they cannot be excluded at all). One of the important terms to be found in contracts of employment is a term to the effect that the parties must not conduct themselves in such a way as to undermine the relationship of ‘trust and confidence’ that exists between an employer and an employee. Again, this implied term does not owe its origin to the express agreement of the parties. Its source is to be found in the willingness of the courts to imply such a term into contracts of employment (*Mahmud v. Bank of Credit and Commercial International SA* [1998] AC 20, see further pp. 364–365, Section 4(b)).

Two issues of particular significance arise in relation to implied terms. The first relates to the justification for implying terms into contracts. On what basis do the courts and Parliament imply terms into a contract? Is it to give effect to the presumed intention of the parties or is the search for an implied term based on wider considerations of policy? The second issue relates to the test to be applied by the courts when deciding whether or not to imply a term into a contract. This issue is related to the first one. If the justification for implying a term into a contract is to give effect to the presumed intention of the parties then the likelihood is that the test will be based on necessity. A term will only be implied where it is necessary to give effect to the presumed intention of the parties. On the other hand, if the justification for implying a term is to be located in broader issues of policy, then one would expect the test applied by the court to reflect these broader policy issues: in short, one would expect a test based upon criteria such as the reasonableness of the implication on the facts of the case.

## 2. TERMS IMPLIED BY STATUTE

Parliament has, on a number of occasions, implied terms into contracts. The precise reason for the implication of the term obviously depends upon the particular statute. It may be to give effect to the presumed intention of the parties; it may be to reduce uncertainty by enacting a default rule out of which the parties can contract if they do not like the term that Parliament has seen fit to imply; or it may be to protect one party to the transaction from the superior bargaining power of the other party. Terms have been implied by Parliament into a wide range of transactions: for example, contracts for the sale of goods, hire-purchase contracts, other contracts for the supply of goods, contracts for the supply of services, and contracts for the construction of a dwelling. We shall use contracts for the sale of goods as our example. Sections 12–15 of the Sale of Goods Act 1979 imply a number of terms into contracts for the sale of goods. These terms are as follows:

### **Implied terms about title, etc.**

- 12.—(1) In a contract of sale, other than one to which subsection (3) below applies, there is an implied term on the part of the seller that in the case of a sale he has a right to sell the goods, and in the case of an agreement to sell he will have such a right at the time when the property is to pass.

- (2) In a contract of sale, other than one to which subsection (3) below applies, there is also an implied term that—
  - (a) the goods are free, and will remain free until the time when the property is to pass, from any charge or encumbrance not disclosed or known to the buyer before the contract is made, and
  - (b) the buyer will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known.
- (1) This subsection applies to a contract of sale in the case of which there appears from the contract or is to be inferred from its circumstances an intention that the seller should transfer only such title as he or a third person may have.
- (2) In a contract to which subsection (3) above applies there is an implied term that all charges or encumbrances known to the seller and not known to the buyer have been disclosed to the buyer before the contract is made.
- (3) In a contract to which subsection (3) above applies there is also an implied term that none of the following will disturb the buyer's quiet possession of the goods, namely—
  - (a) the seller;
  - (b) in a case where the parties to the contract intend that the seller should transfer only such title as a third person may have, that person;
  - (c) anyone claiming through or under the seller or that third person otherwise than under a charge or encumbrance disclosed or known to the buyer before the contract is made.
- (5A) As regards England and Wales and Northern Ireland, the term implied by subsection (1) above is a condition and the terms implied by subsections (2), (4) and (5) above are warranties.

### **Sale by description**

- 13.—(1) Where there is a contract for the sale of goods by description, there is an implied term that the goods will correspond with the description.
- (1A) As regards England and Wales and Northern Ireland, the term implied by subsection (1) above is a condition.
  - (2) If the sale is by sample as well as by description it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.
  - (3) A sale of goods is not prevented from being a sale by description by reason only that, being exposed for sale or hire, they are selected by the buyer.

### **Implied terms about quality or fitness**

- 14.—(1) Except as provided by this section and section 15 below and subject to any other enactment, there is no implied term about the quality or fitness for any particular purpose of goods supplied under a contract of sale.
- (2) Where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality.
  - (2A) For the purposes of this Act, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account

of any description of the goods, the price (if relevant) and all the other relevant circumstances.

- (2B) For the purposes of this Act, the quality of goods includes their state and condition and the following (among others) are in appropriate cases aspects of the quality of goods—
- (a) fitness for all the purposes for which goods of the kind in question are commonly supplied,
  - (b) appearance and finish,
  - (c) freedom from minor defects,
  - (d) safety, and
  - (e) durability.
- (2C) The term implied by subsection (2) above does not extend to any matter making the quality of goods unsatisfactory—
- (a) which is specifically drawn to the buyer's attention before the contract is made,
  - (b) where the buyer examines the goods before the contract is made, which that examination ought to reveal, or
  - (c) in the case of a contract for sale by sample, which would have been apparent on a reasonable examination of the sample.
- (2D) If the buyer deals as consumer or, in Scotland, if a contract of sale is a consumer contract, the relevant circumstances mentioned in subsection (2A) above include any public statements on the specific characteristics of the goods made about them by the seller, the producer or his representative, particularly in advertising or on labelling.
- (2E) A public statement is not by virtue of subsection (2D) above a relevant circumstance for the purposes of subsection (2A) above in the case of a contract of sale, if the seller shows that—
- (a) at the time the contract was made, he was not, and could not reasonably have been, aware of the statement,
  - (b) before the contract was made, the statement had been withdrawn in public or, to the extent that it contained anything which was incorrect or misleading, it had been corrected in public, or
  - (c) the decision to buy the goods could not have been influenced by the statement.
- (2F) Subsections (2D) and (2E) above do not prevent any public statement from being a relevant circumstance for the purposes of subsection (2A) above (whether or not the buyer deals as consumer or, in Scotland, whether or not the contract of sale is a consumer contract) if the statement would have been such a circumstance apart from those subsections.
- (3) Where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known—
- (a) to the seller, or
  - (b) where the purchase price or part of it is payable by instalments and the goods were previously sold by a credit-broker to the seller, to that credit-broker,
- any particular purpose for which the goods are being bought, there is an implied term that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the seller or credit-broker.

- (4) An implied term about quality or fitness for a particular purpose may be annexed to a contract of sale by usage.
- (5) The preceding provisions of this section apply to a sale by a person who in the course of a business is acting as agent for another as they apply to a sale by a principal in the course of a business, except where that other is not selling in the course of a business and either the buyer knows that fact or reasonable steps are taken to bring it to the notice of the buyer before the contract is made.
- (6) As regards England and Wales and Northern Ireland, the terms implied by subsections (2) and (3) above are conditions.
- ...

### Sale by sample

#### Sale by sample

- 15.—(1) A contract of sale is a contract for sale by sample where there is an express or implied term to that effect in the contract.
- (2) In the case of a contract for sale by sample there is an implied term—
    - (a) that the bulk will correspond with the sample in quality;
    - ...
    - (b) that the goods will be free from any defect, making their quality unsatisfactory, which would not be apparent on reasonable examination of the sample.
  - (3) As regards England and Wales and Northern Ireland, the term implied by subsection (2) above is a condition.

## Commentary

These implied terms are of considerable significance for buyers of goods because they give them a number of important rights against sellers of goods. The rule at common law was generally believed to be ‘*caveat emptor*’ (let the buyer beware). Under such a rule the onus was put upon the buyer to seek a specific undertaking from the seller in relation to the quality of the goods. Now that the implied terms have been enacted the need for buyers to seek express undertakings from sellers has been significantly reduced. The implied terms contained in sections 12–15 of the Sale of Goods Act 1979 provide buyers with a minimum floor of rights and, as we shall see, the law has placed considerable limits on the ability of sellers to contract out of these implied terms.

The aim of section 12 is to give a buyer a remedy against a seller in the event that the seller does not have title to sell the goods that he has contracted to sell to the buyer. In such a case the buyer will generally be entitled to recover from the seller the price which he has paid for the goods. This is so even in the case where the buyer has been able to make use of the goods over a period of time prior to discovery of the fact that the seller did not have title to the goods that have been sold to the buyer (see, for example, *Rowland v. Divall* [1923] 2 KB 500). Section 12(2) also implies two warranties into contracts for the sale of goods. The function of the warranties of freedom from encumbrances and quiet possession is, essentially, to enable the buyer to enjoy the use of the goods without interference by third parties. The implied term as to title is a condition, whereas the implied terms relating to freedom from encumbrances and quiet possession are warranties. The difference between a condition and a warranty will be explained in more detail in a later chapter (see pp. 758–774, Chapter 22, Section 3(a)). Here it suffices to note that breach of a condition entitles a buyer to reject the goods and terminate the contract, whereas breach of a warranty does not. The only remedy for breach of a warranty is damages.

Section 13 provides protection for the buyer who receives goods that do not correspond with the description. The section is, however, more difficult than it looks at first sight and it has generated a considerable amount of case-law. The section only comes into play where there has been a contract for sale 'by' description. In order for the contract to be by description the buyer must have entered into the contract in reliance upon the description provided by the seller (*Harlingdon and Leinster Enterprises Ltd v. Christopher Hull Fine Art Ltd* [1991] 1 QB 564). In order to amount to a 'description' the words used must identify the subject matter of the contract (*Reardon Smith Line Ltd v. Yngvar Hansen-Tangen* [1976] 1 WLR 989).

Section 14 implies two very important conditions into contracts for the sale of goods. The first, contained in section 14(2), (2A), and (2B), is that the goods must be of 'satisfactory quality' (formerly 'merchantable quality'). The definition of 'satisfactory quality' was inserted into the 1979 Act by the Sale and Supply of Goods Act 1994 and was further amended by the Sale and Supply of Goods to Consumers Regulations 2002 (SI No 2002/3045). It provides a checklist of factors to be taken into account when deciding whether or not goods are of satisfactory quality. The list is applicable to all contracts of sale but it seems to have been drafted with consumer sales particularly in mind. The second condition, to be found in section 14(3), is that the goods must be reasonably fit for their purpose. A buyer who wishes to make some unusual use of the goods must disclose that use to the seller prior to entry into the contract of sale if he wishes to be able to invoke the fitness for purpose implied term. The seller does not provide a guarantee that the goods will be fit for all purposes. The goods need only be 'reasonably fit' for their purpose. So, where the goods cannot be used for their intended purpose because of some idiosyncrasy, not made known to the seller, of the buyer or in the circumstances of the use of the goods by the buyer, the seller will not be liable to the buyer under section 14(3) (*Slater v. Finning Ltd* [1997] AC 473). These two conditions only come into play where the 'seller sells goods in the course of a business'. The test applied by the court when deciding whether or not the seller sold in the course of a business does not depend upon the regularity of the sale or whether it was integral to the seller's business. In *Stevenson v. Rogers* [1999] QB 1028 the Court of Appeal held that, unless the sale was 'a purely private sale of goods outside the confines of the business (if any) carried on by the seller' it is within the course of the seller's business so as to attract the implied terms relating to satisfactory quality and fitness for purpose.

Section 15 implies two conditions in the case of a sale of goods by sample. The first is that the bulk will correspond with the sample in quality and the second is that the goods will be free from any defect making their quality unsatisfactory, which would not be apparent on reasonable examination of the sample (see *Godley v. Perry* [1960] 1 WLR 9).

The importance of these implied terms is demonstrated by the fact that Parliament has intervened to place restrictions upon the ability of sellers to exclude their operation. In the case of consumer sales, the implied terms cannot be excluded as against the consumer. In commercial sales the implied terms can be excluded provided that it is reasonable to do so (except in the case of section 12 where it is not possible to exclude liability for breach of this term, even in the case of a commercial sales contract). Statutory controls on exclusion and limitation of liability are discussed in more detail later (see pp. 421–445, Chapter 13, Section 3).

What is the basis of these implied terms? Are they based on the presumed intention of the parties? There is some support for this proposition in the authorities. In *Philips Electronics Grand Publique SA v. British Sky Broadcasting Ltd* [1995] EMLR 472 Lord Bingham MR stated (at p. 481) that:

quite apart from statute, the courts would not ordinarily hesitate to imply into a contract for the sale of unseen goods that they should be of merchantable quality and answer to their

description and conform with sample. It is hard to imagine trade conducted, in the absence of express agreement, on any other terms.

While it may be ‘hard to imagine’ trade being conducted on any other terms, it is not impossible. There is still in English law no general implied term that a house is fit for any particular purpose or even for human habitation. Further, as a general rule a landlord does not give an implied undertaking that leased premises will be fit for habitation or for any particular purpose, although in the case of a lease of furnished premises there is an implied condition that the premises are fit for human habitation at the beginning of the tenancy. If contracts for the sale of real property can be concluded without the benefit of extensive implied terms for the benefit of the purchaser, can the same not be said of contracts for the sale of personal property, such as goods? Support for the proposition that contracts for the sale of goods can be concluded without the benefit of such implied terms can be derived from the law of sale in the nineteenth century, where *caveat emptor* played a much more dominant role than it does today. This being the case, the claim that the implied terms are based on the presumed intention of the parties seems very doubtful. It is much more likely that the function of the implied terms is to protect what are perceived to be the legitimate or reasonable expectations of buyers when they enter into contracts for the sale of goods. That this is so is evidenced by the fact that Parliament has intervened to limit the ability of sellers to contract out of these terms. The fact that it is impossible to contract out of some of these implied terms demonstrates that they are not based on the presumed intention of the parties. They are part of a legislative policy to protect the expectations of buyers, especially consumer buyers.

### 3. TERMS IMPLIED FROM USAGE OR CUSTOM

Terms may be implied into a contract from the usage or custom of the industry or market in which the parties transact. In *Hutton v. Warren* (1836) 1 M & W 466, Parke B stated (at p. 475) that:

It has long been settled, that, in commercial transactions, extrinsic evidence of custom and usage is admissible to annex incidents to written contracts, in matters with respect to which they are silent. The same rule has also been applied to contracts in other transactions of life, in which known usages have been established and prevailed; and this has been done upon the principle of presumption that, in such transactions, the parties did not mean to express in writing the whole of the contract by which they intended to be bound, but a contract with reference to those known usages. Whether such a relaxation of the strictness of the common law was wisely applied, where formal instruments have been entered into, and particularly leases under seal, may well be doubted; but the contrary has been established by such authority, and the relations between landlord and tenant have been so long regulated upon the supposition that all customary obligations, not altered by the contract, are to remain in force, that it is too late to pursue a contrary course; and it would be productive of much inconvenience if this practice were now to be disturbed.

Two points emerge from this statement. The first is that the usage must be a ‘known’ usage. This does not mean that the parties must actually have been aware of its existence. It suffices that it was so well known that ‘an outsider who makes reasonable enquiries could

not fail to be made aware of it' (*Kum v. Wah Tat Bank Ltd* [1971] 1 Lloyd's Rep 439, 444). The requirement that the custom be 'known' is often expressed in the formula that the custom or usage must be 'notorious, certain and reasonable'. In *Cunliffe-Owen v. Teather & Greenwood* [1967] 1 WLR 1421 Ungood-Thomas J stated (at pp. 1438–1439) that:

For the practice to amount to such a recognised usage, it must be certain, in the sense that the practice is clearly established; it must be notorious, in the sense that it is so well known in the market in which it is alleged to exist that those who conduct business in that market contract with the usage as an implied term, and it must be reasonable. The burden lies on those alleging usage to establish it. . . . The practice that has to be established consists of a continuity of acts, and those acts have to be established by persons familiar with them, although, as is accepted before me, they may be sufficiently established by such persons without a detailed recital of instances. Practice is not a matter of opinion of even the most highly qualified expert as to what it is desirable that the practice should be. However, evidence of those versed in a market, so it seems to me, may be admissible and valuable in identifying those features of any transaction that attract usage and in discounting other features which for such purpose are merely incidental and if there is conflict of evidence about this it is subject to being resolved like other conflicts of evidence. Arrangements or compromises to the same effect as the alleged usage do not establish usage; they contradict it. They may be the precursors of usage, but usage presupposes that arrangements and compromises are no longer required. It is, in my view, clearly not necessary that a practice should be challenged and enforced before it can become a usage as, otherwise, a practice so obviously universally accepted and acted on as not to be challenged could never be a usage. However, enforcement would be valuable and might be conclusive in establishing usage. What is necessary is that for a practice to be a recognised usage it should be established as a practice having binding effect.

The last sentence is important because it demonstrates that repetitive behaviour in the market is not sufficient, of itself, to establish a custom: 'it must also be shown that this pattern of behaviour is observed from a sense of legally binding obligation, not from mere courtesy, convenience or expediency' (R Goode, 'Usage and its Reception in Transnational Commercial Law' (1997) 46 ICLQ 1, 8). In *General Reinsurance Corp v. Forsakringsaktiebolaget Fennia Patria* [1983] QB 856, 874 Slade LJ stated:

There is, however, the world of difference between a course of conduct that is frequently, or even habitually, followed in a particular commercial community as a matter of grace and a course which is habitually followed because it is considered that the parties concerned have a legally binding right to demand it.

The distinction between courtesy and obligation, while easy to state in theory, can be difficult to draw in practice (see, for example, *Libyan Arab Foreign Bank v. Bankers Trust Co* [1989] QB 728). It is nevertheless a distinction of considerable importance.

The second point that can be derived from the judgment of Parke B in *Warren* is that the custom must not have been 'altered by the contract'. A term will therefore not be implied into a contract by custom where the custom is inconsistent with the express terms of the contract (*Palgrave, Brown & Son Ltd v. SS Turid (Owners)* [1922] 1 AC 397).

Custom and usage play an important role in commercial law generally as the following extract demonstrates:

**Ewan McKendrick (ed), *Goode on Commercial Law***  
 (4th edn, Penguin, 2010), pp. 13–14

Of great importance as a source of obligation in commercial contracts are the unwritten customs and usages of merchants. The impact of these on the content and interpretation of contract terms cannot be overstated. It is, perhaps, this feature above all which distinguishes commercial from other contracts, a distinction not formally adopted by the law. The fertility of the business mind and the fact that a practice which begins life by having no legal force acquires over time the sanctity of law are key factors to which the commercial lawyer must continually be responsive. Is a particular document a document of title? The House of Lords may have said no, possibly more than once. But how long ago was the ruling given? Cannot it now be said, in another time, that the acceptance of this document as a document of title in mercantile usage is so entrenched as to justify according it legal recognition as such? . . .

What is it that gives binding force to unwritten mercantile usage? Is it the express or implied adoption of the usage by the parties in their contract? Or does mercantile usage have independent normative force? The question has been much debated in the context of international commercial arbitration and the controversy as to the existence of an international *lex mercatoria*. In some legal systems the binding force of mercantile usage does not depend on adoption by contract, but in the theory of English law usage takes effect as an express or implied term of the contract between the parties and is dependent for its validity on satisfying certain legal criteria, namely certainty and consistency of practice, reasonableness, notoriety, and conformity with mandatory law . . .

It is in the nature of unwritten custom or usage that its meaning and content may be understood differently by different people; indeed, the very existence of an alleged usage may be challenged. In areas of business or finance with a highly developed and widely used body of custom or usage it is particularly important to avoid disputes of this kind. To that end, national and international trade associations and clearing houses may find it convenient to formulate the relevant usages in a published code or set of rules. These will rarely reflect existing usage in every particular, since the opportunity will usually be taken to make improvements to established practice and procedures, but the intended effect of the code or rules is to state or restate best practice. They may be given effect either by making adherence to them a condition of membership of the relevant association or clearing house or by incorporation into individual contracts. At the international level the prime mover in the codification of international trade usage is the International Chamber of Commerce (ICC), an international non-governmental organization serving world business. Working through its specialist Commissions, the ICC has produced numerous uniform rules which are adopted by incorporation into contracts. These fall broadly into three groups: banking and insurance, international trade and international transport. The most long-standing and successful of the various ICC formulations is the Uniform Customs and Practice for Documentary Credits (UCP), first promulgated by the ICC in 1933. Bankers throughout the world have adopted the UCP, which is now used almost universally in documentary credit transactions.<sup>1</sup> . . .

In English law codified customs and usages, like those which are uncodified, depend for their operation on express or implied adoption in the contract.

As the last sentence of the extract makes clear, customs, at least in English law, depend for their operation on ‘express or implied’ incorporation into the contract. Very often that incorporation will be express (and so might properly be said to fall within the scope

<sup>1</sup> Letters of credit are discussed in more detail at p. 247, Chapter 5, Section 4, where their essential nature is described.

of Chapter 9). Thus banks will generally incorporate the UCP expressly into their contracts with their customers. The reason for this is that the matter is too important to be left to implication by a court. However, should a bank fail, for some reason, to incorporate the UCP into a contract with one of its customers, it is likely that a court would conclude that it was incorporated into the contract either on the basis of custom or on the basis of a course of dealing between the parties (on which see pp. 331–336, Chapter 9, Section 4).

#### 4. TERMS IMPLIED BY THE COURTS

It is customary to divide terms implied by the courts into two groups, namely terms implied in fact and terms implied in law. A term is implied in fact when it is implied into the contract in order to give effect to what is deemed by the court to be the unexpressed intention of the parties. It is generally, but not always, a term that is specific to the particular transaction between the parties. Terms implied in law ‘are those terms that are consistently implied into all contracts of a particular type because of the nature of the contract, rather than the supposed intentions of the parties’ (E Peden, ‘Policy Concerns Behind Implication of Terms in Law’ (2001) 117 *LQR* 459). For example, the courts have held that there is an implied term of ‘trust and confidence’ in contracts of employment (see pp. 364–365, Section (b)). The existence of this term is not dependent upon it being representative of the unexpressed intention of the parties to the particular employment contract. It is a term that is implied into all contracts of employment unless it has been expressly excluded by the parties.

The importance of the distinction between a term implied in fact and a term implied in law is that the test for the implication of a term as a matter of law appears to be less stringent than that applicable to terms implied in fact. Traditionally, the courts have insisted that they will only imply a term into a contract as a matter of fact where it is ‘necessary’ to do so. In the case of terms implied in law, however, it would appear that the test is not one of necessity, although the precise nature of the test remains unclear. It appears to be somewhere in between ‘reasonableness’ and ‘necessity’. Thus it might be said that it must be ‘reasonably necessary’ to imply the term into the contract.

While the distinction between terms implied in fact and terms implied in law is not always an easy one to draw, the cases do seem to draw this distinction and so we shall make use of it in this chapter (while bearing in mind the difficulty that can arise in terms of drawing the distinction). We shall start with terms implied in fact before moving on to the more difficult issue of terms implied in law.

##### (a) TERMS IMPLIED IN FACT

We shall start with the first leading case on the implication of terms into a contract, namely the decision of the Court of Appeal in *The Moorcock* (1889) 14 PD 64. It articulated a test based on ‘necessity’ rather than ‘reasonableness’. We shall then make the leap to the leading modern decision on terms implied in fact, namely the decision of the Privy Council in *Attorney-General of Belize v. Belize Telecom Ltd* [2009] UKPC 10, [2009] 2 All ER 1127.

***The Moorcock*****(1889) 14 PD 64, Court of Appeal**

The defendants agreed to allow the plaintiff to discharge his vessel at their wharf so that the vessel could discharge and load her cargo. In order for the vessel to be able to discharge her cargo it was necessary for the vessel to be moored alongside the jetty (which was also owned by the defendants). The jetty extended in to the River Thames and the bed of the river adjoining the jetty was vested in the Conservators of the River Thames. While the vessel was moored at the end of the jetty, the tide ebbed so that the vessel was no longer waterborne and she suffered damage as a result of the uneven condition of the river bed. The plaintiff brought an action for damages against the defendants. The defendants admitted that they had not taken any steps to ascertain whether or not the ground was level and suitable for the vessel. The trial judge, Butt J, held that the defendants were liable in damages to the plaintiff on the ground that they were in breach of an implied undertaking to take 'reasonable care to ascertain that the bottom of the river at the jetty was in such a condition as not to endanger the vessel using their premises in the ordinary way'. The defendants appealed to the Court of Appeal but the appeal was dismissed.

**Bowen LJ**

The question which arises here is whether when a contract is made to let the use of this jetty to a ship which can only use it, as is known by both parties, by taking the ground, there is any implied warranty on the part of the owners of the jetty, and if so, what is the extent of the warranty. Now, an implied warranty, or, as it is called, a covenant in law, as distinguished from an express contract or express warranty, really is in all cases founded on the presumed intention of the parties, and upon reason. 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; not to impose on one side all the perils of the transaction, or to emancipate one side from all the chances of failure, but to make each party promise in law as much, at all events, as it must have been in the contemplation of both parties that he should be responsible for in respect of those perils or chances.

Now what did each party in a case like this know? For if we are examining into their presumed intention we must examine into their minds as to what the transaction was. Both parties knew that this jetty was let out for hire, and knew that it could only be used under the contract by the ship taking the ground. They must have known that it was by grounding that she used the jetty; in fact, except so far as the transport to the jetty of the cargo in the ship was concerned, they must have known, both of them, that unless the ground was safe the ship would be simply buying an opportunity of danger, and that all consideration would fail unless some care had been taken to see that the ground was safe. In fact the business of the jetty could not be carried on except upon such a basis. The parties also knew that with regard to the safety of the ground outside the jetty the shipowner could know nothing at all, and the jetty owner might with reasonable care know everything. The owners of the jetty, or their servants, were there at high and low tide, and with little trouble they could satisfy

themselves, in case of doubt, as to whether the berth was reasonably safe. The ship's owner, on the other hand, had not the means of verifying the state of the jetty, because the berth itself opposite the jetty might be occupied by another ship at any moment.

Now the question is how much of the peril of the safety of this berth is it necessary to assume that the shipowner and the jetty owner intended respectively to bear—in order that such a minimum of efficacy should be secured for the transaction, as both parties must have intended it to bear? Assume that the berth outside had been absolutely under the control of the owners of the jetty, that they could have repaired it and made it fit for the purpose of the unloading and the loading. If this had been the case, then the case of *The Mersey Docks Trustees v. Gibbs* Law Rep 1 HL 93 shews that those who owned the jetty, who took money for the use of the jetty, and who had under their control the locus in quo, would have been bound to take all reasonable care to prevent danger to those who were using the jetty—either to make the berth outside good, or else not to invite ships to go there—either to make the berth safe, or to advise persons not to go there. But there is a distinction in the present instance. The berth outside the jetty was not under the actual control of the jetty owners. It is in the bed of the river, and it may be said that those who owned the jetty had no duty cast upon them by statute or common law to repair the bed of the river, and that they had no power to interfere with the bed of the river unless under the licence of the Conservators. Now it does make a difference, it seems to me, where the entire control of the locus in quo—be it canal, or be it dock, or be it river berth—is not under the control of the persons who are taking toll for accommodation which involves its user, and, to a certain extent, the view must be modified of the necessary implication which the law would make about the duties of the parties receiving the remuneration. This must be done exactly for the reason laid down by Lord Holt in his judgment in *Coggs v. Bernard* Ld Raym 909, where he says 'it would be unreasonable to charge persons with a trust further than the nature of the thing puts it in their power to perform'. Applying that modification, which is one of reason, to this case, it may well be said that the law will not imply that the persons who have not the control of the place have taken reasonable care to make it good, but it does not follow that they are relieved from all responsibility. They are on the spot. They must know that the jetty cannot be used unless reasonable care is taken, if not to make it safe, at all events to see whether it is safe. No one can tell whether reasonable safety has been secured except themselves, and I think if they let out their jetty for use they at all events imply that they have taken reasonable care to see whether the berth, which is the essential part of the use of the jetty, is safe, and if it is not safe, and if they have not taken such reasonable care, it is their duty to warn persons with whom they have dealings that they have not done so. This is a business transaction as to which at any moment the parties may make any bargain they please, and either side may by the contract throw upon the other the burden of the unseen and existing danger. The question is what inference is to be drawn where the parties are dealing with each other on the assumption that the negotiations are to have some fruit, and where they say nothing about the burden of this kind of unseen peril, leaving the law to raise such inferences as are reasonable from the very nature of the transaction. So far as I am concerned I do not wish it to be understood that I at all consider this is a case of any duty on the part of the owners of the jetty to see to the access to the jetty being kept clear. The difference between access to the jetty and the actual use of the jetty seems to me, as Mr Finlay [counsel for the defendants] says it is, only a question of degree, but when you are dealing with implications which the law directs, you cannot afford to neglect questions of degree, and it is just that difference of degree which brings one case on the line and prevents the other from approaching it. I confess that on the broad view of the case I think that business could not be carried on unless there was an implication to the extent I have laid down, at all events in the case where a jetty like the present is so to be used, and, although the case is a novel one, and the cases which

have been cited do not assist us, I feel no difficulty in drawing the inference that this case comes within the line.

**Lord Esher MR** and **Fry LJ** delivered concurring judgments.

## Commentary

*The Moorcock* is an important case for two reasons. The first relates to the source of the implied term. Bowen LJ attributed it to the ‘presumed intention of the parties’. In this way he avoided the conclusion that the court was making the contract for the parties. Instead, the court stated that it was giving effect to the intention of the parties, albeit that the intention was presumed rather than express. However it should be noted that Bowen LJ does not rest the implication of terms solely upon the ‘presumed intention of the parties’. He adds that it is also based ‘upon reason’. This appears to suggest a wider basis for the implication of terms, a point to which we shall return. The second point relates to the test put forward by Bowen LJ. It is one based on the need to give ‘business efficacy’ to the transaction. This has been interpreted subsequently as a test that is based on necessity rather than reasonableness. In other words, the court does not imply a term into the contract on the basis that it is, in the opinion of the court, reasonable to do so. The court implies a term into the contract on the basis that it is necessary to do so in order to make the contract work. That said, was the term implied in *The Moorcock* one that was necessary to give efficacy to the contract? Could the contract not have worked without such a term? The issue before the court was, in essence, who was to take the risk of the bed of the river being unsuitable for the vessel. Business efficacy does not seem to require that the risk be allocated to one party or the other. Nevertheless, the court took the view that business efficacy supported the implication of a term to the effect that the defendants had undertaken to exercise reasonable care to ascertain that the river bed adjoining the jetty was in such a condition as not to cause injury to the vessel.

In the years following *The Moorcock* the necessity test established itself in the case-law. Two famous judicial statements demonstrate this. The first is taken from the judgment of Scrutton LJ in *Reigate v. Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592 when he stated (at p. 605):

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 to the parties, ‘What will happen in such a case’, they would both have replied, ‘Of course, so and so will happen; we did not trouble to say that; it is too clear’. Unless the Court comes to some such conclusion as that, it ought not to imply a term which the parties themselves have not expressed.

The second example is a passage from the judgment of MacKinnon LJ in *Shirlaw v. Southern Foundries (1926) Ltd* [1939] 2 KB 206 when he said (at p. 227):

I recognize that the right or duty of a Court to find the existence of an implied term or implied terms in a written contract is a matter to be exercised with care; and a Court is too often invited to do so upon vague and uncertain grounds. Too often also such an invitation is backed by the citation of a sentence or two from the judgment of Bowen LJ in *The Moorcock* (1889) 14 PD 64. They are sentences from an extempore judgment as sound and sensible as all the utterances of that great judge; but I fancy that he would have been rather surprised if he could have foreseen that these general remarks of his would come to be a favourite citation

of a supposed principle of law, and I even think that he might sympathize with the occasional impatience of his successors when *The Moorcock* is so often flushed for them in that guise.

For my part, I think that there is a test that may be at least as useful as such generalities. 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!"'

This test has become known as the 'officious bystander' test and it emphasizes the fact that the test to be applied by the court is one of necessity, not reasonableness. The significance of these various formulations of the test to be applied when deciding whether or not to imply a term into a contract was considered by the Privy Council in the following case:

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**Attorney-General of Belize v. Belize Telecom Ltd**  
[2009] UKPC 10, [2009] 2 All ER 1127, Privy Council

The issue before the Privy Council was whether a term should be implied into the articles of association of a company, making provision for the removal of directors in certain circumstances. The interest of the case lies in Lord Hoffmann's wide-ranging consideration of the basis on which courts decide whether or not to imply a term into a contract.

**Lord Hoffmann** (delivering the judgment of the Board)

16. The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed: see *Investors Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 WLR 896, 912–913. It is this objective meaning which is conventionally called the intention of the parties...

17. The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.

18. In some cases, however, the reasonable addressee would understand the instrument to mean something else. He would consider that the only meaning consistent with the other provisions of the instrument, read against the relevant background, is that something is to happen. The event in question is to affect the rights of the parties. The instrument may not have expressly said so, but this is what it must mean. In such a case, it is said that the court implies a term as to what will happen if the event in question occurs. But the implication of the term is not an addition to the instrument. It only spells out what the instrument means.

19. The proposition that the implication of a term is an exercise in the construction of the instrument as a whole is not only a matter of logic (since a court has no power to alter what

the instrument means) but also well supported by authority. In *Trollope & Colls Ltd v. North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601, 609 Lord Pearson, with whom Lord Guest and Lord Diplock agreed, said:

'[T]he court does not make a contract for the parties. The court will not even improve the contract which the parties have made for themselves, however desirable the improvement might be. The court's function is to interpret and apply the contract which the parties have made for themselves. If the express terms are perfectly clear and free from ambiguity, there is no choice to be made between different possible meanings: the clear terms must be applied even if the court thinks some other terms would have been more suitable. An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract: it is not enough for the court to find that such a term would have been adopted by the parties as reasonable men if it had been suggested to them: it must have been a term that went without saying, a term necessary to give business efficacy to the contract, a term which, though tacit, formed part of the contract which the parties made for themselves.'

20. More recently, in *Equitable Life Assurance Society v. Hyman* [2002] 1 AC 408, 459, Lord Steyn said:

'If a term is to be implied, it could only be a term implied from the language of [the instrument] read in its commercial setting.'

21. It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. It will be noticed from Lord Pearson's speech that this question can be reformulated in various ways which a court may find helpful in providing an answer—the implied term must 'go without saying', it must be 'necessary to give business efficacy to the contract' and so on—but these are not in the Board's opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?

22. There are dangers in treating these alternative formulations of the question as if they had a life of their own. Take, for example, the question of whether the implied term is 'necessary to give business efficacy' to the contract. That formulation serves to underline two important points. The first, conveyed by the use of the word 'business', is that in considering what the instrument would have meant to a reasonable person who had knowledge of the relevant background, one assumes the notional reader will take into account the practical consequences of deciding that it means one thing or the other. In the case of an instrument such as a commercial contract, he will consider whether a different construction would frustrate the apparent business purpose of the parties... The second, conveyed by the use of the word 'necessary', is that it is not enough for a court to consider that the implied term expresses what it would have been reasonable for the parties to agree to. It must be satisfied that it is what the contract actually means.

23. 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.'

24. The same point had been made many years earlier by Bowen LJ in his well-known formulation in *The Moorcock* (1889) 14 PD 64, 68:

'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.'

25. Likewise, the requirement that the implied term must 'go without saying' is no more than another way of saying that, although the instrument does not expressly say so, that is what a reasonable person would understand it to mean. 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. Like the phrase 'necessary to give business efficacy', it vividly emphasises the need for the court to be satisfied that the proposed implication spells out what the contract would reasonably be understood to mean. 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. Likewise, it is not necessary that the need for the implied term should be obvious in the sense of being immediately apparent, even upon a superficial consideration of the terms of the contract and the relevant background. The need for an implied term not infrequently arises when the draftsman of a complicated instrument has omitted to make express provision for some event because he has not fully thought through the contingencies which might arise, even though it is obvious after a careful consideration of the express terms and the background that only one answer would be consistent with the rest of the instrument. In such circumstances, the fact that the actual parties might have said to the officious bystander 'Could you please explain that again?' does not matter.

26. In *BP Refinery (Westernport) Pty Ltd v. Shire of Hastings* (1977) 180 CLR 266, 282–283 Lord Simon of Glaisdale, giving the advice of the majority of the Board, said that it was 'not . . . necessary to review exhaustively the authorities on the implication of a term in a contract' but that 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'.

27. The Board considers that this list is best regarded, not as a series of independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means, or in which they have explained why they did not think that it did so. The Board has already discussed the significance of 'necessary to give business efficacy' and 'goes without saying'. As for the other formulations, the fact that the proposed implied term would be inequitable or unreasonable, or contradict what the parties have expressly said, or is incapable of clear expression, are all good reasons for saying that a reasonable man would not have understood that to be what the instrument meant.

## Commentary

This is a striking judgment for a number of reasons. The first is the parallel drawn between the implication of a term into a contract and the interpretation of an express term of the contract (see [16]–[21]). The approach adopted by the courts to the interpretation of contracts is discussed in the next chapter (see in particular the discussion of *Investors Compensation*

*Scheme Ltd v. West Bromwich Building Society* at pp. 373–376, Chapter 11, Section 3). In Lord Hoffmann’s opinion, the essential question to be asked in the two cases is the same (see [21]). While the analogy between implication and interpretation is a helpful one, it is suggested that it can be pressed too far. When seeking to interpret an express term of the contract there is no difficulty in ascertaining the words that make up the term and the task of the court (which can be a difficult one) is to ascertain the meaning of these words and thereby the meaning of the term. But in the case of an implied term, the court has the additional difficulty of identifying the wording of the term that is to be implied into the contract. As Lord Bingham observed in *Philips Electronique Grand Publique SA v. British Sky Broadcasting Ltd* [1995] EMLR 472, 481, the implication of a term ‘involves a different and altogether more ambitious undertaking’ than that involved in the interpretation of a contract because it requires the ‘interpolation of terms to deal with matters for which, ex hypothesi, the parties themselves have made no provision.’

Secondly, the judgment is notable for its attempt to bring together the different formulations of the test which have been applied by the courts over the years and to emphasize their similarities rather than their differences (see [22]–[27]). Although the emphasis is ‘on the basic process of construction’ ([23]), Lord Hoffmann did not intend to liberalize the approach of the courts to the implication of terms into a contract (see in particular the opening section of [16]). As Lord Clarke of Stone-cum-Ebony MR observed in *Mediterranean Salvage & Towage Ltd v. Seamar Trading & Commerce Inc (The Reborn)* [2009] EWCA Civ 531, [2009] 2 Lloyd’s Rep 639, [15], Lord Hoffmann was ‘not in any way resiling from the often stated proposition that it must be necessary to imply the proposed term’. The status of the different tests that have been applied by the courts over the years is ‘not wholly clear’ (*Stena Line Ltd v. Merchant Navy Ratings Pension Fund Trustees Ltd* [2011] EWCA Civ 432, [2011] All ER (D) 121 (May), [44]). Lord Hoffmann acknowledges that they may still be ‘helpful’ but warns against their use as different or additional tests: in particular they are not to be regarded as ‘free-standing tests’ (*Crema v. Cenkos Securities plc* [2010] EWCA Civ 1444, [2010] All ER (D) 212 (Dec), [38]) each of which must be satisfied before a term can be implied.

Thirdly, it has been argued (J McCaughran, ‘Implied Terms: The Journey of the Man on the Clapham Omnibus’ [2011] *CLJ* 607) that Lord Hoffmann has effected some significant changes in this area of the law, most notably by replacing the officious bystander with the man on the Clapham omnibus. More particularly (at p. 614), it has been claimed that

Lord Hoffmann has altered the characteristics and role of the independent third party observer. In the test, as laid down by Scrutton LJ in *Reigate*, and by MacKinnon LJ in *Shirlaw*, the third party observer was officious, and he asked the relevant questions for the parties to answer. He was not an arbiter. In Lord Hoffmann’s formulation, the third party observer becomes the person to whom the relevant question is addressed; he has become reasonable; and it is for him to answer, not to ask, the relevant question.

On this basis, it is argued (at p. 617) that Lord Hoffmann has given ‘some additional latitude’ to a trial judge, particularly in the case where ‘it is clear that some term is missing from the express terms of the contract, but it cannot be said for sure what the parties would have agreed, if they had thought about it before making the contract.’ It remains to be seen whether the judges will accept this analysis and adopt an expansive interpretation of Lord Hoffmann’s judgment. Thus far the attitude of the courts has been a cautious one (see, for example, *The Reborn* (earlier in this section) and *Groveholt Ltd v. Alan Hughes* [2010] EWCA

Civ 538, [2010] All ER (D) 196 (May)) and they have tended to view Lord Hoffmann's judgment as a reformulation of the law rather than a revolution.

Finally, although he does not expressly say so, Lord Hoffmann's approach would appear to be confined to the case where it is sought to imply a term into the contract as a matter of fact. Cases in which it is sought to imply a term into a particular type of contract as a matter of law raise rather more difficult issues, to which we now turn.

## (b) TERMS IMPLIED IN LAW

The basis on which terms are implied into contracts as a matter of law has given rise to considerable difficulty. It would appear that the test applied by the courts in this context is less rigorous than in the context of terms implied in fact, but the difference would appear to be one of degree, not kind. The controversy that exists in this area of law can best be seen by examining one of the leading cases, *Liverpool City Council v. Irwin*, a case which is notable for the contrast between the reasoning of Lord Denning in the Court of Appeal and Lord Wilberforce in the House of Lords.

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### **Liverpool City Council v. Irwin**

[1976] QB 319, Court of Appeal; [1977] AC 239, House of Lords

The defendant tenants lived in Haigh Heights, a tower block in the district of Everton in Liverpool. The plaintiffs, Liverpool City Council, were their landlords. The defendants stopped paying rent for their maisonette on the ninth and tenth floors of the tower block. The plaintiffs brought an action for possession. The defendants counterclaimed for nominal damages of £10 for (i) breach of the landlord's duty to repair and maintain the common parts of the building retained by the plaintiffs, namely the lifts, staircases, passages, rubbish chutes, playground, etc. and in relation to the maisonette itself, (ii) breach of the covenant for quiet enjoyment, and (iii) breach of the implied covenant in section 32(1) of the Housing Act 1961, specifying defects in and disrepair of the water closet cisterns, damp, defective door frames, and related matters. The plaintiffs denied the existence of any implied obligation to keep the common parts of the building in repair and they also denied breaches of the covenant for quiet enjoyment and of the covenant implied under section 32(1). The trial judge held that the plaintiffs were in breach of all three duties and, while he granted the council an order for possession, he awarded the defendants nominal damages of £10.

The plaintiffs appealed to the Court of Appeal. The Court of Appeal allowed their appeal. It held by a majority (Lord Denning MR dissenting) that the plaintiffs were not under any contractual duty to keep the common parts in repair and, further, that they were not in breach of the implied covenant in section 32(1) of the Housing Act 1961. The majority refused to imply a term into the tenancy contract to the effect that the plaintiffs would keep the common parts in repair on the ground that it was not necessary to imply such an onerous obligation into the tenancy agreement in order to give it business efficacy. Lord Denning took a different approach. He held that the plaintiffs were subject to an implied duty to take reasonable care to keep the common parts reasonably fit for use by the tenants but that the tenants had failed to prove that the plaintiffs had not exercised reasonable care. He therefore concurred in the result, namely that the defendants were not entitled to recover damages from the plaintiffs.

The defendants appealed to the House of Lords. The House of Lords allowed their appeal in part. Their appeal was successful in relation to their claim pursuant to section 32(1) of the Housing Act 1961 and it was held that they were entitled to nominal damages of £5. In relation

to their claim that the plaintiffs were in breach of their duty to keep the common parts of the building in repair, the House of Lords held that the plaintiffs were subject to an obligation to take reasonable care to do so but that, on the facts, they had not breached that duty.

Two extracts from the case are set out here. The first is taken from the dissenting judgment of Lord Denning MR in the Court of Appeal and the second from the speech of Lord Wilberforce in the House of Lords. The extracts do not deal with the scope of section 32(1) of the Housing Act 1961. They deal only with the defendants' submission that the plaintiffs were in breach of their implied duty to keep the common parts of the building in repair.

### Lord Denning MR

It is often said that the courts only imply a term in a contract when it is reasonable and necessary to do so in order to give business efficacy to the transaction: see *The Moorcock* (1889) 14 PD 64, 68. (Emphasis is put on the word 'necessary': *Reigate v. Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592, 605.) Or when it is obvious that both parties must have intended it: so obvious indeed that if an officious bystander had asked them whether there was to be such a term, both would have suppressed it testily: 'Yes, of course': see *Shirlaw v. Southern Foundries (1926) Ltd* [1939] 2 KB 206, 227.

Those expressions have been repeated so often that it is with some trepidation that I venture to question them. I do so because they do not truly represent the way in which the courts act. Let me take some instances. There are stacks of them. Such as the terms implied by the courts into a contract for the sale of goods—*Jones v. Just* (1868) LR 3 QB 197: or the hire of goods—*Asley Industrial Trust Ltd v. Grimley* [1963] 1 WLR 584: into a contract for work and materials—*Young & Marten Ltd v. McManus Childs Ltd* [1969] 1 AC 454: or into a contract for letting an unfurnished house—*Hart v. Windsor* (1843) 12 M & W 68: or a furnished house—*Collins v. Hopkins* [1923] 2 KB 617: or into the carriage of a passenger by railway: see *Readhead v. Midland Railway Co* (1869) LR 4 QB 379: or to enter on premises: see *Francis v. Cockrell* (1870) LR 5 QB 501: or to buy a house in course of erection: see *Hancock v. B W Brazier (Anerley) Ltd* [1966] 1 WLR 1317.

If you read the discussion in those cases, you will see that in none of them did the court ask: what did both parties intend? If asked, each party would have said he never gave it a thought: or the one would have intended something different from the other. Nor did the court ask: Is it necessary to give business efficacy to the transaction? If asked, the answer would have been: 'It is reasonable, but it is not necessary'. The judgments in all those cases show that the courts implied a term according to whether or not it was reasonable in all the circumstances to do so. Very often it was conceded that there was some implied term. The only question was: 'What was the extent of it?' Such as, was it an absolute warranty of fitness, or only a promise to use reasonable care? That cannot be solved by inquiring what they both intended, or into what was necessary. But only into what was reasonable. This is to be decided as matter of law, not as matter of fact. Lord Wright pulled the blinkers off our eyes when he said in 1935 to the Holdsworth Club:

'The truth is that the court... decides this question in accordance with what seems to be just or reasonable in its eyes. The judge finds in himself the criterion of what is reasonable. The court is in this sense making a contract for the parties—though it is almost blasphemy to say so.' (Lord Wright of Durley, *Legal Essays and Addresses* (1939), p. 259.)

In 1956, Lord Radcliffe put it elegantly when he said of the parties to an implied term:

'their actual persons should be allowed to rest in peace. In their place there rises the figure of the fair and reasonable man. And the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself': see *Davis Contractors Ltd v. Fareham Urban District Council* [1956] AC 696, 728.

In 1969, Lord Reid put it simply when he said: ‘...no warranty ought to be implied in a contract unless it is in all the circumstances reasonable,’ see *Young & Marten Ltd v. McManus Childs Ltd* [1969] 1 AC 454, 465: and Lord Upjohn echoed it when he said, at p. 471, that the implied warranty was ‘imposed by law’.

Is there a term to be implied in this tenancy about the lifts and staircases and other common parts? ...

[he considered the case-law and other authorities and concluded]

It is clearly the duty of the landlord, not only to take care to keep the lifts and staircase safe, but also to take care to keep them reasonably fit for the use of the tenant and his visitors. If the lifts break down, the landlord ought to repair them. If the lights on the staircase fail, the landlord ought to replace them.

[he then considered whether or not there had been a breach of the duty and concluded that, on the facts, there had been no breach].

### Lord Wilberforce

We have then a contract which is partly, but not wholly, stated in writing. In order to complete it, in particular to give it a bilateral character, it is necessary to take account of the actions of the parties and the circumstances. As actions of the parties, we must note the granting of possession by the landlords and reservation by them of the ‘common parts’—stairs, lifts, chutes, etc. As circumstances we must include the nature of the premises, viz., a maisonette for family use on the ninth floor of a high block, one which is occupied by a large number of other tenants, all using the common parts and dependent upon them, none of them having any expressed obligation to maintain or repair them.

To say that the construction of a complete contract out of these elements involves a process of ‘implication’ may be correct; it would be so if implication means the supplying of what is not expressed. But there are varieties of implications which the courts think fit to make and they do not necessarily involve the same process. Where there is, on the face of it, a complete, bilateral contract, the courts are sometimes willing to add terms to it, as implied terms: this is very common in mercantile contracts where there is an established usage: in that case the courts are spelling out what both parties know and would, if asked, unhesitatingly agree to be part of the bargain. In other cases, where there is an apparently complete bargain, the courts are willing to add a term on the ground that without it the contract will not work—this is the case, if not of *The Moorcock* (1889) 14 PD 64 itself on its facts, at least of the doctrine of *The Moorcock* as usually applied. This is, as was pointed out by the majority in the Court of Appeal, a strict test—though the degree of strictness seems to vary with the current legal trend—and I think that they were right not to accept it as applicable here. There is a third variety of implication, that which I think Lord Denning MR favours, or at least did favour in this case, and that is the implication of reasonable terms. But though I agree with many of his instances, which in fact fall under one or other of the preceding heads, I cannot go so far as to endorse his principle; indeed, it seems to me, with respect, to extend a long, and undesirable, way beyond sound authority.

The present case, in my opinion, represents a fourth category, or I would rather say a fourth shade on a continuous spectrum. The court here is simply concerned to establish what the contract is, the parties not having themselves fully stated the terms. In this sense the court is searching for what must be implied.

What then should this contract be held to be? There must first be implied a letting, that is, a grant of the right of exclusive possession to the tenants. With this there must, I would suppose, be implied a covenant for quiet enjoyment, as a necessary incident of the letting. The difficulty begins when we consider the common parts. We start with the fact that the demise is useless unless access is obtained by the staircase; we can add that, having regard to the

height of the block, and the family nature of the dwellings, the demise would be useless without a lift service; we can continue that, there being rubbish chutes built into the structures and no other means of disposing of light rubbish, there must be a right to use the chutes. The question to be answered—and it is the only question in this case—is what is to be the legal relationship between landlord and tenant as regards these matters.

There can be no doubt that there must be implied (i) an easement for the tenants and their licensees to use the stairs, (ii) a right in the nature of an easement to use the lifts, (iii) an easement to use the rubbish chutes.

But are these easements to be accompanied by any obligation upon the landlord, and what obligation? There seem to be two alternatives. The first, for which the council contends, is for an easement coupled with no legal obligation, except such as may arise under the Occupiers' Liability Act 1957 as regards the safety of those using the facilities, and possibly such other liability as might exist under the ordinary law of tort. The alternative is for easements coupled with some obligation on the part of the landlords as regards the maintenance of the subject of them, so that they are available for use.

My Lords, in order to be able to choose between these, it is necessary to define what test is to be applied, and I do not find this difficult. In my opinion such obligation should be read into the contract as the nature of the contract itself implicitly requires, no more, no less: a test, in other words, of necessity. The relationship accepted by the corporation is that of landlord and tenant: the tenant accepts obligations accordingly, in relation inter alia to the stairs, the lifts and the chutes. All these are not just facilities, or conveniences provided at discretion: they are essentials of the tenancy without which life in the dwellings, as a tenant, is not possible. To leave the landlord free of contractual obligation as regards these matters, and subject only to administrative or political pressure, is, in my opinion, inconsistent totally with the nature of this relationship. The subject matter of the lease (high rise blocks) and the relationship created by the tenancy demand, of their nature, some contractual obligation on the landlord.

I do not think that this approach involves any innovation as regards the law of contract. The necessity to have regard to the inherent nature of a contract and of the relationship thereby established was stated in this House in *Lister v. Romford Ice and Cold Storage Co Ltd* [1957] AC 555. That was a case between master and servant and of a search for an 'implied term'. Viscount Simonds, at p. 579, makes a clear distinction between a search for an implied term such as might be necessary to give 'business efficacy' to the particular contract and a search, based on wider considerations, for such a term as the nature of the contract might call for, or as a legal incident of this kind of contract. If the search were for the former, he says, '... I should lose myself in the attempt to formulate it with the necessary precision'. (p. 576.) We see an echo of this in the present case, when the majority in the Court of Appeal, considering a 'business efficacy term'—i.e., a 'Moorcock' term (*The Moorcock*, 14 PD 64)—found themselves faced with five alternative terms and therefore rejected all of them. But that is not, in my opinion, the end, or indeed the object, of the search.

We have some guidance in authority for the kind of term which this typical relationship (of landlord and tenant in a multi-occupational dwelling) requires in *Miller v. Hancock* [1893] 2 QB 177. There Bowen LJ said, at pp. 180–181:

'The tenants could only use their flats by using the staircase. The defendant, therefore, when he let the flats, impliedly granted to the tenants an easement over the staircase, which he retained in his own occupation, for the purpose of the enjoyment of the flats so let. Under those circumstances, what is the law as to the repairs of the staircase? It was contended by the defendant's counsel that, according to the common law, the person in enjoyment of an easement is bound to do the necessary repairs himself. That may be true with regard to easements in general, but it is subject to the qualification that the grantor of the easement may undertake to do the repairs

either in express terms or by necessary implication. This is not the mere case of a grant of an easement without special circumstances. It appears to me obvious, when one considers what a flat of this kind is, and the only way in which it can be enjoyed, that the parties to the demise of it must have intended by necessary implication, as a basis without which the whole transaction would be futile, that the landlord should maintain the staircase, which is essential to the enjoyment of the premises demised, and should keep it reasonably safe for the use of the tenants, and also of those persons who would necessarily go up and down the stairs in the ordinary course of business with the tenants; because, of course, a landlord must know when he lets a flat that tradesmen and other persons having business with the tenant must have access to it. It seems to me that it would render the whole transaction inefficacious and absurd if an implied undertaking were not assumed on the part of the landlord to maintain the staircase so far as might be necessary for the reasonable enjoyment of the demised premises.'

Certainly that case, as a decision concerning a claim by a visitor, has been overruled: *Fairman v. Perpetual Investment Building Society* [1923] AC 74. But I cite the passage for its common sense as between landlord and tenant, and you cannot overrule common sense.

There are other passages in which the same thought has been expressed . . .

These are all reflections of what necessarily arises whenever a landlord lets portions of a building for multiple occupation, retaining essential means of access.

I accept, of course, the argument that a mere grant of an easement does not carry with it any obligation on the part of the servient owner to maintain the subject matter. The dominant owner must spend the necessary money, for example in repairing a drive leading to his house and the same principle may apply when a landlord lets an upper floor with access by a staircase: responsibility for maintenance may well rest on the tenant. But there is a difference between that case and the case where there is an essential means of access, retained in the landlord's occupation, to units in a building of multi-occupation, for unless the obligation to maintain is, in a defined manner, placed upon the tenants, individually or collectively, the nature of the contract, and the circumstances, require that it be placed on the landlord.

It remains to define the standard. My Lords, if, as I think, the test of the existence of the term is necessity the standard must surely not exceed what is necessary having regard to the circumstances. To imply an absolute obligation to repair would go beyond what is a necessary legal incident and would indeed be unreasonable. An obligation to take reasonable care to keep in reasonable repair and usability is what fits the requirements of the case. Such a definition involves—and I think rightly—recognition that the tenants themselves have their responsibilities. What it is reasonable to expect of a landlord has a clear relation to what a reasonable set of tenants should do for themselves.

I add one word as to lighting. In general I would accept that a grant of an easement of passage does not carry with it an obligation on the grantor to light the way. The grantee must take the way accompanied by the primeval separation of darkness from light and if he passes during the former must bring his own illumination. . . . But the case may be different when the means of passage are constructed, and when natural light is either absent or insufficient. In such a case, to the extent that the easement is useless without some artificial light being provided, the grant should carry with it an obligation to take reasonable care to maintain adequate lighting—comparable to the obligation as regards the lifts. To impose an absolute obligation would be unreasonable; to impose some might be necessary. We have not sufficient material before us to see whether the present case on its facts meets these conditions.

I would hold therefore that the landlords' obligation is as I have described and in agreement, I believe, with your Lordships I would hold that it has not been shown in this case that there was any breach of that obligation. On the main point therefore I would hold that the appeal fails.

My Lords, it will be seen that I have reached exactly the same conclusion as that of Lord Denning MR, with most of whose thinking I respectfully agree. I must only differ from the passage in which, more adventurously, he suggests that the courts have power to introduce into contracts any terms they think reasonable or to anticipate legislative recommendations of the Law Commission. A just result can be reached, if I am right, by a less dangerous route.

## Commentary

The term sought to be implied into the tenancy agreement was one which related to the obligation of the landlord to keep the common parts of the tower block in repair and properly lit. Two principal issues arose in relation to this term. The first was whether or not such an obligation should be implied into the tenancy agreement at all and the second was, if such a term was to be implied, what was its scope? Was it an obligation to take reasonable care to keep the tower block in repair or was it a stricter obligation? The House of Lords concluded that a term was to be implied, that it required the plaintiffs to exercise reasonable care, and that, on the facts, the plaintiffs had not breached their duty.

Two further points are worthy of note. The first relates to the test to be applied when deciding whether or not to imply a term into the contract. Lord Denning advocated a test based on reasonableness but the House of Lords rejected his analysis. Lord Wilberforce did so in a rather restrained fashion in the final extracted paragraph of his speech. Some of the other judges in the House of Lords were more robust. Thus Lord Salmon stated (at p. 262):

I cannot go so far as Lord Denning MR and hold that the courts have any power to imply a term into a contract merely because it seems reasonable to do so. Indeed, I think that such a proposition is contrary to all authority. To say, as Lord Reid said in *Young & Marten Ltd v. McManus Childs Ltd* [1969] 1 AC 454, 465, that '... no warranty ought to be implied in a contract unless it is in all the circumstances reasonable' is, in my view, quite different from saying that any warranty or term which is, in all the circumstances, reasonable ought to be implied in a contract. I am confident that Lord Reid meant no more than that unless a warranty or term is in all the circumstances reasonable there can be no question of implying it into a contract, but before it is implied much else besides is necessary, for example that without it the contract would be inefficacious, futile and absurd.

Lord Edmund-Davies stated (at p. 266) that the 'touchstone is always *necessity* and not merely *reasonableness*'. The difficulty with the 'necessity' analysis relates to its application to the facts. Was it really 'necessary' to imply such a term into the tenancy agreement? The reality would appear to be that the House of Lords was deciding a matter of social policy in relation to the extent of the obligations that are to be imposed upon landlords. Are they expected to keep the common parts in repair and to provide facilities to their tenants? If they are, what is the scope of their duty? Are they liable even in the case where the problems were caused by vandals who damaged the lifts and removed the light bulbs from the stairs? It is by no means clear that there is a 'necessary' answer to these questions. The point has been well made (Atiyah's *An Introduction to the Law of Contract* (6th edn, Oxford University Press, 2006), p. 161) in the following terms:

the difference between the judges on this point seems somewhat unreal... It is obviously not strictly or literally *necessary* to have lifts in blocks of flats ten storeys high, though it would no

doubt be exceedingly inconvenient not to have them. So 'necessary' really seems to mean 'reasonably necessary', and that must mean, 'reasonably necessary having regard to the context and the price'.

There is a second aspect to *Liverpool City Council v. Irwin* which merits further consideration and that relates to the question whether the term implied into the contract was a term implied in law or a term implied in fact. The case is generally regarded as an authority on terms implied in law, on the basis that the term that the landlord was under an obligation to take reasonable care to keep the common parts in repair was to be implied into all tenancy contracts between occupants of flats in tower blocks and their landlords. It was not a term that was peculiar to the relationship between this particular landlord and this particular tenant. However it would appear that counsel for the defendants put his case on two different bases. First, he argued that such a term ought to be implied into all contracts of this type (in other words, it was a term implied in law) but he also relied upon the 'officious bystander' test. Lord Cross of Chelsea rejected (at p. 258) the submission that the term satisfied the 'officious bystander' test but nevertheless agreed (at p. 259) that the term was to be implied as a general incident of all contracts of this type. Thus Lord Cross seems to have concluded that a term could not be implied as a matter of fact but that it was appropriate to imply a term as a matter of law. If this is correct, it demonstrates that there is a difference between the test to be applied for terms implied in fact and the test applicable to terms implied in law.

The difficulty is that not all of the judges were as clear as Lord Cross on the distinction between terms implied in law and terms implied in fact. This point can be made in relation to Lord Denning's advocacy of the reasonableness test. While he stated that 'stacks' of cases cannot be reconciled with the necessity test most, if not all of the cases that he cites in support of the proposition that reasonableness is the test applied by the courts, are cases concerned with terms implied in law (that is to say they are terms that are generally implied into all contracts of a particular type). Indeed, his failure to address the distinction between terms implied in law and terms implied in fact was criticized by Lord Cross of Chelsea (at pp. 257–258) in the following passage:

When it implies a term in a contract the court is sometimes laying down a general rule that in all contracts of a certain type—sale of goods, master and servant, landlord and tenant and so on—some provision is to be implied unless the parties have expressly excluded it. In deciding whether or not to lay down such a prima facie rule the court will naturally ask itself whether in the general run of such cases the term in question would be one which it would be reasonable to insert. Sometimes, however, there is no question of laying down any prima facie rule applicable to all cases of a defined type but what the court is being in effect asked to do is to rectify a particular—often a very detailed—contract by inserting in it a term which the parties have not expressed. Here it is not enough for the court to say that the suggested term is a reasonable one the presence of which would make the contract a better or fairer one; it must be able to say that the insertion of the term is necessary to give—as it is put—'business efficacy' to the contract and that if its absence had been pointed out at the time both parties—assuming them to have been reasonable men—would have agreed without hesitation to its insertion. The distinction between the two types of case was pointed out by Viscount Simonds and Lord Tucker in their speeches in *Listerv. Romford Ice and Cold Storage Co Ltd* [1957] AC 555, 579, 594, but I think that Lord Denning MR in proceeding—albeit with some trepidation—to 'kill off' MacKinnon LJ's 'officious bystander' (*Shirlaw v. Southern Foundries (1926) Ltd* [1939] 2 KB 206, 227) must have overlooked it.

Lord Denning returned to his theme in *Shell UK Ltd v. Lostock Garage Ltd* [1976] 1 WLR 1187 when he sought to divide the cases into the following two categories:

### Implied terms

The first category comprehends all those relationships which are of common occurrence, such as the relationship of seller and buyer, owner and hirer, master and servant, landlord and tenant, carrier by land or by sea, contractor for building works, and so forth. In all those relationships the courts have imposed obligations on one party or the other, saying they are implied terms. These obligations are not founded on the intention of the parties, actual or presumed, but on more general considerations... In such relationships the problem is not solved by asking: what did the parties intend? Or, would they have unhesitatingly agreed to it, if asked? It is to be solved by asking: has the law already defined the obligation or the extent of it? If so, let it be followed. If not, look to see what would be reasonable in the general run of such cases (see by Lord Cross of Chelsea at p. 570H): and then say what the obligation shall be. The House in *Liverpool City Council v. Irwin* [1976] 2 WLR 562 went through that very process. They examined the existing law of landlord and tenant, in particular that relating to easements, to see if it contained the solution to the problem; and, having found that it did not, they imposed an obligation on the landlord to use reasonable care. In these relationships the parties can exclude or modify the obligation by express words, but unless they do so, the obligation is a legal incident of the relationship which is attached by the law itself and not by reason of any implied term...

The second category comprehends those cases which are not within the first category. These are cases, not of common occurrence, in which from the particular circumstances a term is to be implied. In these cases the implication is based on an intention imputed to the parties from their actual circumstances: see *Luxor (Eastbourne) Ltd v. Cooper* [1941] AC 108, 137 per Lord Wright. Such an imputation is only to be made when it is necessary to imply a term to give efficacy to the contract and make it a workable agreement in such manner as the parties would clearly have done if they had applied their mind to the contingency which has arisen. These are the 'officious bystander' type of case: see *Lister v. Romford Ice & Cold Storage Co* [1957] AC 555, 594 per Lord Tucker. In such cases a term is not to be implied on the ground that it would be reasonable, but only when it is necessary and can be formulated with a sufficient degree of precision. This was the test applied by the majority of this court in *Liverpool City Council v. Irwin* [1976] QB 319, and they were emphatically upheld by the House on this point; see [1976] 2 WLR 562, 571D–H by Lord Cross of Chelsea; p. 578G–579A by Lord Edmund-Davies.

There is this point to be noted about *Liverpool City Council v. Irwin*. In this court the argument was only about an implication in the second category. In the House of Lords that argument was not pursued. It was only the first category.

In this passage Lord Denning affirms that the arguments advanced in *Irwin* encompassed both categories but he suggests that, in the House of Lords, the arguments were confined to the first category. Where then did the decision of the House of Lords in *Liverpool City Council v. Irwin* leave the law? In the first place it re-affirmed that the test to be applied when deciding whether or not to imply a term is based on necessity and not simply on reasonableness. But it left some uncertainty in relation to terms implied in law because the term implied into the tenancy contract did not seem to be a necessary ingredient of all contracts of this type. It might have been 'reasonably necessary' but not 'necessary'. That the test for the implication of terms as a matter of law might be slightly less stringent than that applicable to terms implied in fact is evidenced by the fact that Lord Cross concluded that a term was not to be implied on the basis of the officious bystander test but

that it was nevertheless appropriate to imply a term as a matter of law into all contracts of this type.

The basis on which the courts imply terms as a matter of law into contracts was further considered by the House of Lords in the following case:

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**Scally v. Southern Health and Social Services Board**  
[1992] 1 AC 294, House of Lords

The plaintiffs brought an action against the defendants, their employers, for damages for breach of contract, negligence, and breach of statutory duty in failing adequately to advise and inform them about their contractual and statutory rights in relation to the superannuation<sup>2</sup> scheme of which they were members. In order to qualify for a full pension under the original scheme it was necessary for an employee to complete forty years of contributory service. In 1975 a change was made to the scheme which entitled employees to purchase additional years of contributing service at advantageous rates. However this right was only exercisable within twelve months of the change coming into force. The Department of Health and Social Services were initially given a discretion to extend the twelve-month period but that discretion was taken away in 1983 and replaced by a right given to the employee to purchase added years at any time until two years before an employee's retirement on fixed and progressively less favourable terms.

The defendants failed to inform the plaintiffs of their right to purchase additional years of service at advantageous rates. The plaintiffs alleged that the defendants' failure to do so amounted to a breach of an implied term of the contract of employment, breach of a duty of care owed to the plaintiffs, and a breach of statutory duty. The House of Lords held that the defendants had not breached their statutory duty but that they were in breach of an implied term to take reasonable steps to inform the employees of the existence of their right to take steps to enhance their pension entitlement on advantageous terms. The defendants were therefore liable in damages to the plaintiffs and the case was remitted to the trial judge so that the losses suffered by the plaintiffs could be assessed.

**Lord Bridge of Harwich**

Leaving aside the claim based on breach of statutory duty... it seems to me that the plaintiffs' common law claims can only succeed if the duty allegedly owed to them by their employers arose out of the contract of employment. If a duty of the kind in question was not inherent in the contractual relationship, I do not see how it could possibly be derived from the tort of negligence....

In the instant case I believe that an attempt to analyse the issue in terms of the law of tort may be positively misleading.... The strong trend of recent authority has been to narrow the range of circumstances which the law of tort will recognise as sufficient to impose on one person a duty of care to protect another from damage which consists in purely economic loss...

But if the issue is analysed in contract, the starting point is quite different. Here the express terms of the contract of employment confer a valuable right on the employee which is, however, contingent upon his taking certain action. Where that situation is known to the employer but not to the employee, will the law imply a contractual obligation on the employer to take reasonable steps to bring the existence of the contingent right to the notice of the employee? It is true that

<sup>2</sup> A superannuation scheme is a form of pension scheme.

such an implication may have the consequence of sustaining a claim for purely economic loss. But this consideration would not furnish the essential reason for making the implication. If there is a basis for making the implication, it must lie rather in the consideration that the availability of the contingent right was intended by those who drew up the terms of the contract for the benefit of the employee; but if the existence of the contingent right never comes to his attention, he cannot profit by it and it might, so far as he is concerned, just as well not exist.

The problem is a novel one which could not arise in the classical contractual situation in which all the contractual terms, having been agreed between the parties, must, *ex hypothesi*, have been known to both parties. But in the modern world it is increasingly common for individuals to enter into contracts, particularly contracts of employment, on complex terms which have been settled in the course of negotiations between representative bodies or organisations and many details of which the individual employee cannot be expected to know unless they are drawn to his attention. The instant case presents an example of this phenomenon arising in the context of the statutory provisions which regulate the operation of the health services in Northern Ireland...

[he set out the terms of these statutory provisions, rejected a submission made by the defendants that the obligation to notify the plaintiffs lay with the Department of Health and Social Services and not themselves and continued]

Will the law then imply a term in the contract of employment imposing such an obligation on the employer? The implication cannot, of course, be justified as necessary to give business efficacy to the contract of employment as a whole. I think there is force in the submission that, since the employee's entitlement to enhance his pension rights by the purchase of added years is of no effect unless he is aware of it and since he cannot be expected to become aware of it unless it is drawn to his attention, it is necessary to imply an obligation on the employer to bring it to his attention to render efficacious the very benefit which the contractual right to purchase added years was intended to confer. But this may be stretching the doctrine of implication for the sake of business efficacy beyond its proper reach. A clear distinction is drawn in the speeches of Viscount Simonds in *Lister v. Romford Ice and Cold Storage Co Ltd* [1957] AC 555 and Lord Wilberforce in *Liverpool City Council v. Irwin* [1977] AC 239 between the search for an implied term necessary to give business efficacy to a particular contract and the search, based on wider considerations, for a term which the law will imply as a necessary incident of a definable category of contractual relationship. If any implication is appropriate here, it is, I think, of this latter type. Carswell J accepted the submission that any formulation of an implied term of this kind which would be effective to sustain the plaintiffs' claims in this case must necessarily be too wide in its ambit to be acceptable as of general application. I believe however that this difficulty is surmounted if the category of contractual relationship in which the implication will arise is defined with sufficient precision. I would define it as the relationship of employer and employee where the following circumstances obtain: (1) the terms of the contract of employment have not been negotiated with the individual employee but result from negotiation with a representative body or are otherwise incorporated by reference; (2) a particular term of the contract makes available to the employee a valuable right contingent upon action being taken by him to avail himself of its benefit; (3) the employee cannot, in all the circumstances, reasonably be expected to be aware of the term unless it is drawn to his attention. I fully appreciate that the criterion to justify an implication of this kind is necessity, not reasonableness. But I take the view that it is not merely reasonable, but necessary, in the circumstances postulated, to imply an obligation on the employer to take reasonable steps to bring the term of the contract in question to the employee's attention, so that he may be in a position to enjoy its benefit. Accordingly I

would hold that there was an implied term in each of the plaintiffs' contracts of employment of which the boards were in each case in breach.

**Lord Roskill, Lord Goff of Chieveley, Lord Jauncey of Tullichettle, and Lord Lowry** concurred.

## Commentary

The implied term, as set out in the last paragraph of the speech of Lord Bridge, is narrowly drawn. As Professor Freedland has pointed out ((1992) 21 *ILJ* 135, 139):

the implied term was confined to the case where a particular term of the contract makes available to the employee a valuable right contingent upon action being taken by him to avail himself of its benefit, and where the employee cannot reasonably be expected to be aware of the term unless it is drawn to his attention. There are few if any other situations where this would occur in an employment context, except when the employee is in the position of an investor, for example in relation to employee share purchase schemes.

While the implied term recognized is narrow in scope, Lord Bridge does acknowledge that it is based 'on wider considerations' than whether the term is 'necessary to give business efficacy to a particular contract'. This being the case, there must be a difference between a term implied in law, at least in the sense of a term that is implied as a 'necessary incident of a definable category of contractual relationship' and a term that is implied as a matter of fact into a particular contractual relationship. That this is so can be demonstrated by reference to the cases concerned with the obligation of 'trust and confidence' that is implied into contracts of employment. The existence of this implied term was approved by the House of Lords in *Mahmud v. Bank of Credit and Commerce International SA* [1998] AC 20 where Lord Steyn stated (at pp. 45–46):

### The implied term of mutual trust and confidence

The applicants do not rely on a term implied in fact. They do not therefore rely on an individualised term to be implied from the particular provisions of their employment contracts considered against their specific contextual setting. Instead they rely on a standardised term implied by law, that is, on a term which is said to be an incident of all contracts of employment: *Scally v. Southern Health and Social Services Board* [1992] 1 AC 294, 307B. Such implied terms operate as default rules. The parties are free to exclude or modify them. . . .

The employee's primary case is based on a formulation of the implied term that has been applied at first instance and in the Court of Appeal. It imposes reciprocal duties on the employer and employee. Given that this case is concerned with alleged obligations of an employer I will concentrate on its effect on the position of employers. For convenience I will set out the term again. It is expressed to impose an obligation that the employer shall not:

'without reasonable and proper cause, conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of confidence and trust between employer and employee.'

. . . A useful anthology of the cases applying this term, or something like it, is given in *Sweet & Maxwell's Encyclopedia of Employment Law* (looseleaf ed.), vol. 1, para 1.5107, pp. 1467–1470. The evolution of the term is a comparatively recent development. The obligation

probably has its origin in the general duty of co-operation between contracting parties: *Hepple & O'Higgins, Employment Law*, 4th ed. (1981), pp. 134–135, paras. 291–292. The reason for this development is part of the history of the development of employment law in this century. The notion of a 'master and servant' relationship became obsolete. Lord Slynn of Hadley recently noted 'the changes which have taken place in the employer–employee relationship, with far greater duties imposed on the employer than in the past, whether by statute or by judicial decision, to care for the physical, financial and even psychological welfare of the employee': *Spring v. Guardian Assurance plc* [1995] 2 AC 296, 335B. A striking illustration of this change is *Scally's* case [1992] 1 AC 294... where the House of Lords implied a term that all employees in a certain category had to be notified by an employer of their entitlement to certain benefits. It was the change in legal culture which made possible the evolution of the implied term of trust and confidence.

There was some debate at the hearing about the possible interaction of the implied obligation of confidence and trust with other more specific terms implied by law. It is true that the implied term adds little to the employee's implied obligations to serve his employer loyally and not to act contrary to his employer's interests. The major importance of the implied duty of trust and confidence lies in its impact on the obligations of the employer: Douglas Brodie, 'Recent Cases, Commentary, The Heart of the Matter: Mutual Trust and Confidence' (1996) 25 ILJ 121. And the implied obligation as formulated is apt to cover the great diversity of situations in which a balance has to be struck between an employer's interest in managing his business as he sees fit and the employee's interest in not being unfairly and improperly exploited.

The evolution of the implied term of trust and confidence is a fact. It has not yet been endorsed by your Lordships' House. It has proved a workable principle in practice. It has not been the subject of adverse criticism in any decided cases and it has been welcomed in academic writings. I regard the emergence of the implied obligation of mutual trust and confidence as a sound development.

In the light of *Scally* and *Mahmud* it seems appropriate to conclude that the test applied by the courts in cases of terms implied in law is not based on necessity alone. It seems to be based on a slightly lower standard which entitles the court to take account of 'wider considerations'. That this is so can be demonstrated by reference to the following two decisions.

The first is the decision of the Court of Appeal in *Paragon Finance plc v. Nash* [2001] EWCA Civ 1466, [2002] 1 WLR 685. The claimant made secured loans to the defendants in 1987 and 1990. Both agreements contained variable interest clauses. The claimant claimed possession from the defendants on the ground that the defendants were in arrears with their mortgage payments. The defendants defended the claim on a number of grounds. One of the issues before the Court of Appeal was whether or not the claimant's power to set the interest rates from time to time was completely unfettered. The Court of Appeal held that it was not. A term was to be implied into both agreements to the effect that the rates of interest would not be set dishonestly, for an improper purpose, capriciously or arbitrarily, or in a way in which no reasonable mortgagee, acting reasonably, would do. *Paragon Finance* is a fascinating case because it demonstrates the willingness of the courts in a private law claim to draw on the analogy of public law for the purpose of placing limits on the discretionary power of a contracting party. On what basis did the Court of Appeal see fit to imply this term into the contract? Was it on the basis of necessity? While some limit on the power of the creditor to vary interest rates is clearly highly desirable it is not clear that it can be said to be necessary. Dyson LJ, on the other hand, stated (at [36]) that the implied term was 'necessary to give

effect to the reasonable expectations of the parties'. However it would appear that the driving force behind the recognition of the implied term was the 'reasonable expectations of the parties' (on which see Section 5) rather than necessity.

The second case is the decision of the Court of Appeal in *Crossley v. Faithful & Gould Holdings Ltd* [2004] EWCA Civ 293, [2004] 4 All ER 447. The issue before the court was whether or not there was an 'implied term of any contract of employment that the employer will take reasonable care for the economic well-being of his employee'. In answering this question Dyson LJ stated (at [36]):

It seems to me that, rather than focus on the elusive concept of necessity, it is better to recognise that, to some extent at least, the existence and scope of standardised implied terms raise questions of reasonableness, fairness and the balancing of competing policy considerations: see Peden (2001) *LQR* 459, 467–475.

Dyson LJ concluded, after a review of the authorities, that the implied term proposed on behalf of the employee should be rejected. He relied on two principal considerations in reaching this conclusion. First, after referring to *Scally*, he stated that 'it is not for this court to take a big leap to introduce a major extension of the law in this area when only comparatively recently the House of Lords declined to do so.' As we have noted (p. 364, earlier in this section), the implied term recognized in *Scally* was drawn in very narrow terms and so it was thought to be inappropriate for the Court of Appeal now to imply a term cast in much broader terms. Secondly, he concluded that such an implied term 'would impose an unfair and unreasonable burden on employers'. He continued:

It is one thing to say that, if an employer assumes the responsibility for giving financial advice to his employee, he is under a duty to take reasonable care in giving that advice. . . . It is quite a different matter to impose on an employer the duty to give his employee financial advice in relation to benefits accruing from his employment, or generally to safeguard the employee's economic well-being.

Dyson LJ pointed out that the interests of employers and employees can and do conflict and, in such cases, he stated that it would be 'unreasonable' to require the employer 'to have regard to the employee's financial circumstances when he takes lawful business decisions which may affect the employee's economic welfare.' Further, it was held not be the function of an employer to 'act as his employee's financial adviser' on the ground that it 'is simply not part of the bargain that is comprised in the contract of employment'. This being the case, it was held that there were 'no obvious policy reasons to impose on an employer the general duty to protect his employee's economic well-being'. In this way the conclusion that no term should be implied into the contract of employment obliging the employer to take reasonable care for the economic well-being of an employee was based, not on the need for such a term, but on the appropriateness of the term having regard to the court's perception of the nature of the relationship that exists between an employer and an employee.

While the test applied by the courts in cases of terms implied in law may no longer be based solely on necessity it does not follow that the judges have a free hand to imply terms into contracts when they see fit. They do not. As Lord Bingham MR observed in *Philips Electronique Grand Publique SA v. British Sky Broadcasting Ltd* [1995] EMLR 472, 481, 'it is because the implication of terms is so potentially intrusive that the law imposes strict

constraints on the exercise of this extraordinary power.’ In the case of terms implied in fact the test is probably still based on necessity and the courts will in general be slow to imply a term into a contract, particularly where the parties have entered into a lengthy and carefully-drafted contract but have failed to make provision for a particular issue. And, while the courts take a less stringent approach in the case of a term implied in law, cases such as *Scally*, *Mahmud*, and *Paragon Finance* demonstrate that the threshold for the implication of a term remains a high one.

## 5. CONCLUSION

What is the justification for implying terms into a contract? This issue is considered in the following two extracts. In the first extract Professor Collins considers a range of possible justifications, while in the second extract Lord Steyn, writing extra-judicially, surveys the different categories of implied terms. Interestingly, they reach a similar conclusion, albeit by different routes, namely that the justification for implied terms is to be found in the court’s view of the reasonable expectations of the contracting parties.

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**H Collins, *The Law of Contract***  
(4th edn, Butterworths, 2003), pp. 245–246

How can we explain and justify the . . . use of implied terms to supplement contractual obligations? In some instances it is apparent that the reference to the joint intention of the parties, as evidenced by the need to give business efficacy to their transaction, supports the implication of terms on grounds which merely complement the traditional justification of contractual obligations based upon the will of the parties. It is true that the will of the parties was never expressed, but the evidence supporting the claim that the term represents a presupposition or necessary implication of the words used can be so overwhelming that few could doubt that the term represents their original intention. But it is clear that the use of implied terms extends beyond any sort of justification of the type that the term merely states expressly what was silently understood by the parties.

Economic analysis of law suggests a good reason why the courts should provide a set of default rules to govern contractual relations in the absence of express terms. Default rules save transaction costs by permitting the parties to avoid the costs of negotiating every detail of their arrangement every time they make a contract, because they know that the courts will fill in the gaps in the usual way. This makes good sense, but it is arguable whether or not participants in the market deliberately avail themselves of this opportunity to save transaction costs. On the contrary, the proliferation of the standard form contract suggests that any party with sufficient resources is likely to devise a standard set of express terms to suit his or her purposes exactly. Many cases we have discussed so far concerning implied terms, such as . . . *Liverpool City Council v. Irwin*, comprise instances where the claim that an implied term exists is used to combat the one-sided standard form contract of the other party.

Nor does the economic analysis suggest a satisfactory account of the grounds for the selection of terms by the courts. Under the efficiency analysis, the court should select those implied terms to which the parties would have agreed but for the presence of transaction costs. Although this criterion makes sense for terms which give a contract business efficacy, it is far from clear that it provides an intelligible guide in other cases. Consider the bargaining situation in *Liverpool City Council v. Irwin*. The council was presumably reluctant to agree to

an obligation to maintain the common premises, so it would have held out against such an obligation, and, depending upon the local forces of supply and demand for tower block local authority housing, it might or might not have been successful. But even if it had agreed to the obligation, it could have insisted upon an increased rent to cover those costs, so to imply a term requiring a maintenance obligation without adjusting the rent produces a contract to which the parties never would have agreed.

Further this economic analysis does not appear to correspond to the reasons ventured by the courts for the selection of implied terms. What seems to be at the heart of the model reasoning surrounding the implication of terms is the courts' endeavour to structure contracts so that they incorporate a fair and practical allocation of risks. The court imposed the duty to maintain the premises upon Liverpool City Council almost certainly because this was the most practical and efficient means of achieving the result. In the context of the employment relationship, the recent introduction of implied terms which impose obligations upon employers surely reflects changing views about the fair treatment of employees and the risk of losing a job. Similarly, the duty imposed upon professional sellers of goods to ensure that they are of satisfactory quality cannot be justified as the term which would have been agreed in the absence of transaction costs, for sellers would almost certainly seek to avoid such liability for latent defects. The reason for this allocation of risk is surely that it fits both the purpose of consumer protection and it places the risk of defects on the person in the better position to avoid the advent of such risks occurring.

The notion of a default rule is therefore a misleading description of the use of implied terms. Through the implication of terms the courts can achieve what they regard as a fair and practical allocation of risks between the contracting parties, a view which may alter over time as illustrated by the changing implied terms inserted into the contract of employment. In this process the courts can seek to equalise the obligations of the parties, even in the teeth of express terms of standard form contracts, and so pursue ideas of fairness. The justification for implied terms therefore rests ultimately not on the intentions of the parties but rather the court's view of the reasonable expectations of the parties to the transaction.

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### **Lord Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men'**

(1997) 113 *LQR* 433, 441–442

In systems of law where there is a general duty of good faith in the performance of contracts the need to supplement the written contract by implied terms is less than in the English system. In our system, however, the implication of terms fulfils an important function in promoting the reasonable expectations of parties. Three categories of implied terms can be identified. First, there are terms implied by virtue of the usages of trade and commerce. The assumption is that usages are taken for granted and therefore not spelled out in writing. The recognition of trade usages protects the reasonable expectations of the parties. Secondly, there are terms implied in fact, i.e. from the contextual scene of the particular contract. Such implied terms fulfil the role of ad hoc gap fillers. Often the expectations of the parties would be defeated if a term were not implied, e.g. sometimes a contract simply will not work unless a particular duty to co-operate is implied. The law has evolved practical tests for the permissibility of such an implication, such as the test of whether the term is necessary to give business efficacy to the contract or the less stringent test whether the conventional bystander,

when faced with the problem, would immediately say ‘yes, it is obvious that there is such an implied term’. The legal test for the implication of a term is the standard of strict necessity. And it is right that it should be so since courts ought not to supplement a contract by an implication unless it is perfectly obvious that it is necessary to give effect to the reasonable expectations of parties. It is, however, a myth to regard such an implied term as based on an inference of the actual intention of the parties. The reasonable expectations of the parties in an objective sense are controlling: they sometimes demand that such terms be imputed to the parties. The third category is terms implied by law. This occurs when incidents are impliedly annexed to particular forms of contracts, e.g. contracts for building work, contracts of sale, hire etc. Such implied terms operate as default rules. By and large such implied terms have crystallised in statute or case law. But there is scope for further development. In such new cases a broader approach than applied in the case of terms implied in fact must necessarily prevail. The proposed implication must fit the generality of cases. Indeed, despite some confusion in the authorities, it is tolerably clear that the court may take into account considerations of reasonableness in laying down the scope of terms to be implied in contracts of common occurrence. This function of the court is essential in providing a reasonable and fair framework for contracting. After all, there are many incidents of contracts of common occurrence which the parties cannot always be expected to reproduce in writing. This type of supplementation of contracts also fulfils an essential function in promoting the reasonable expectations of the parties.

#### FURTHER READING

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