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Update on Contractual Interpretation: Implied Terms

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Introduction

We recently set out the principles that are applied by the English Court when it is required to interpret a contract that contains a provision that is ambiguous or that proposes more than one meaning, and when the Court is asked to imply a term into a contract to correct a mistake arising from an omission[1]. The issue of implied terms has been revisited by the Court of Appeal in the recent decision in *McKillen v Misland (Cyprus) Investments Ltd and others [2013]* EWCA Civ 781. The Court reiterated the conservative approach to be adopted when construing commercial contracts: the Court is reluctant to imply a term into a contract where the existing wording is unambiguous and produces a certain result, even if that result is unfavourable to one of the parties.

Summary of the current law on implied terms

The approach taken by the Court when determining whether to imply a term to correct (what at least one party considers to be) a mistake arising from an omission was set out in the judgment of Lord Hoffman in the Privy Council in *Attorney-General of Belize v Belize Telecom* [2009] UKPC 10:

> *"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."*

However, it should be emphasised that, when considering whether to imply a term into a contract, the Court is constrained by the same principles that govern the wider process of contractual interpretation: it will adhere to the two-part test set out in *Chartbrook Ltd v Persimmon Homes Ltd and Ors* [2009] UKHL 38 for ascertaining whether the Court can interpret a provision to remedy a clear mistake in the drafting. Before interpreting a term in a particular way, the *Chartbrook* test requires that (i) it must be clear that something has gone wrong with the language; and (ii) it should be clear what a reasonable person would have understood the parties to have meant. The Court will, therefore, only imply a term into a contract where it is necessary to make that contract workable. The overall reluctance of the Court to imply a term into a contract was highlighted by Lord Hoffman in *Belize:*

> *"[t]he 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."*

The Court of Appeal decision in *McKillen v Misland (Cyprus) Investments Ltd and others*

In *McKillen*, the Court was asked, *inter alia*, to consider the pre-emption provisions contained in a shareholders' agreement relating to Coroin Limited, a holding company that owns Claridge's, The Connaught and The Berkeley hotels in London. The shareholders' agreement contained, at clause 6, a pre-emption provision requiring that shares be offered for sale to existing shareholders before being transferred to a third party and, further, provided at clause 6.6 that if any security granted over shares held by a shareholder became enforceable, a transfer notice could be deemed to have been served if the directors made a determination to that effect within one month after that security became enforceable. The service of the transfer notice would set in motion the process by which other shareholders could purchase those shares.

One of the shareholders in Coroin, Mr Quinlan, had granted security over his shares and Mr McKillen (being both the Appellant and one of the other shareholders) argued that the security over Mr Quinlan's shares had become enforceable, with the effect that the directors were now required to determine whether to deem that a transfer notice should be given in respect of Mr Quinlan's shares.

The Respondents, who included Mr Quinlan, as well as certain entities associated with Sir David Barclay and Sir Frederick Barclay (which held the security over Mr Quinlan's shares), contested Mr McKillen's view that the security had become enforceable. Amongst other matters, the Respondents' case was also that, even if the security had become enforceable, the provisions in the shareholders' agreement were clear that the period of one month within which the directors could make their determination (if they were so minded) ran from the date that the shareholder security became enforceable, irrespective of whether Mr Quinlan had informed the company of the enforceability and therefore the directors may not have been aware of it.

Mr McKillen argued that it was necessary to imply an obligation on a shareholder to notify the company of the occurrence of any of the events which might trigger enforceability (and therefore the directors' power to exercise their discretion), as otherwise the result would be that security could become enforceable and the one month period could expire without the company or its directors knowing about it. According to Mr McKillen, this outcome would effectively mean that it would be a matter of chance whether the directors had the opportunity of making a determination under clause 6.6, which could not have been the intention of the parties.

The issues were argued before Mr Justice Richards in the High Court, *McKillen v Misland (Cyprus) Investments Ltd and Ors* [2012] EWHC 2343 (Ch). It was held that the shareholder security had not become enforceable but that it was appropriate to imply a term of the type Mr McKillen had argued for. In giving his judgment, Richards J relied on the Court of Appeal's judgment in *Tett v Phoenix Property and Investment Co Ltd* [1986] BCLC 149 (CA):

> *"Viewed objectively, it cannot sensibly have been the intention of the parties to the shareholders agreement that cl 6.6 should work as haphazardly as the Respondents suggest. There is no difficulty, in order to give commercial sense to the provision, in implying an obligation to give notice to the company of the occurrence of any of the triggering events within the knowledge of the shareholder: see Tett v Phoenix Property and Investment Co Ltd [1986] BCLC 149 (CA)."*

Mr McKillen subsequently appealed various other points determined by Richards J and, in the appeal, the Respondents' case remained that it was not necessary to imply such a term into clause 6.6. The Court of Appeal, having regard to Lord Hoffman's judgment in *Belize*, held that it was not necessary to imply a term in clause 6.6 and instead agreed with the Respondents' submissions that: (i) it was clear from the fact that the period of one month ran from the occurrence of the relevant event that the parties' primary concern was certainty of time; and (ii) if a security holder attempted to enforce its security by way of a sale, there would (under other provisions in the shareholders' agreement) still be the requirement for a transfer notice to be served to provide existing shareholders with first refusal over the shares. Consequently, the meaning of the language contained in the Shareholders' agreement was clear and workable; no such implied term was necessary.

Lady Justice Arden, giving the leading judgment, held that there was no obligation to inform Coroin of the

events which brought clause 6.6 into play and, although the one month period could elapse before the directors knew the relevant event had occurred, it did not follow that that would necessarily be the case, given that the shareholders intended to work closely with each other in the hotel business.

Arden LJ held that the decision of the court in Tett was distinguishable from this case. *Tett* also concerned the drafting of a pre-emption clause contained within a company's articles of association. The articles contained a general prohibition on the transfer of shares where a member or the wife, husband, parent or child of a member (a family member) was willing to purchase the shares to be sold. However, the articles did not contain any procedure for the disposal of the shares where a member (or their family member) was willing to purchase them. The Court of Appeal in *Tett* held that *"the parties to the articles clearly contemplated that, before a member was to be at liberty to transfer his shares to an outsider, some opportunity would first have to be given to the other members and their specified relatives to make an offer for the shares in question"*. It was, therefore, clear that the parties intended there to be a pre-emption right, but without implying a term to provide for some mechanic (by way of notification) to operate that pre-emption right, the right itself could not be realised, and so it was appropriate for the Court to imply a term to give effect to the intention of the parties.

This was not the case in *McKillen*. In *Tett*, the pre-emption provisions were unworkable without implying some language to facilitate the intended outcome; in the case of the shareholders' agreement of Coroin in *McKillen, "clause 6.6 [was] not rendered ineffectual without the implied term."* Rimer LJ said:

> *"In my view, the words mean what they say. First, as a matter of language, there is no scope for reading them as meaning anything else; and no basis for an inference that something has gone wrong with the drafting. It may perhaps not be a very clever piece of drafting, but it is not the court's function, by a process of purported interpretation, to improve the scheme that Coroin has chosen to adopt."*

The Court highlighted another clause of the Coroin shareholders' agreement that permitted transfers of shares to the family trust of a shareholder but required the trustees of such trust to notify the directors if the shares ceased to be held on trust. The Court held that, the presence of the notification requirement in that situation, and its absence from clause 6.6, suggested that it had been purposefully omitted from clause 6.6.

Conclusion

The decision in *McKillen* reiterates that the Court is reluctant to interfere with unambiguous, precisely drafted terms that produce a certain result and essentially will not imply a term unless the relevant provision renders the contract unworkable in that regard without it.

By Hannah Field-Lowes and James Harvey of Weil, Gotshal & Manges (who represented Sir David Barclay and Sir Frederick Barclay and their associated entities in the various above referenced proceedings of *Patrick McKillen v Misland (Cyprus) Investments Limited & Ors).*

[1] The Evolving Landscape of Contractual Interpretation by Hannah Field-Lowes and Victoria Burton, legalweeklaw.com, published 19 February 2013.

If you would like more information about the topics raised in this briefing, please speak to your regular contact at Weil or to any member of the Dispute Resolution group:

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