

# Commentary on ‘The Challenge of Principled Gap-filling’\*

*J W Carter*

Professor of Commercial Law, University of Sydney  
General Editor, *Journal of Contract Law*  
Consultant, Herbert Smith Freehills  
Fellow of the Australian Academy of Law

## Introduction

A central feature of Justice Phang’s paper is a consideration of the views expressed by Lord Hoffmann, delivering the advice of the Privy Council in *Attorney General of Belize v Belize Telecom Ltd.*<sup>1</sup> Even at a basic level, the judgment of Lord Hoffmann has three quite striking features.

First, Lord Hoffmann’s conclusion that construction is the basis for the implication of contractual terms makes no allowance for the various categories of implied term to which Justice Phang refers in his paper. Lord Hoffmann spoke<sup>2</sup> in terms of ‘every case in which it is said that some provision ought to be implied in an instrument’. The subsequent cases appear to have assumed that he was speaking only of what are conventionally described as ‘terms implied in fact’. Perhaps that is because Lord Hoffmann cited only cases which deal with that category of implication. But I can think of no other reason for the assumption. For example, if anything, terms implied in law are more easily justified on a construction basis than terms implied in fact. Equally, the evidence which may be used to support (or rebut) the implication of a term does not always conform to the exclusionary rule,<sup>3</sup> for example, in relation to course of dealing.

---

\* A commentary on Justice Andrew Phang’s paper, ‘The Challenge of Principled Gap-filling – A Study of Implied Terms in Comparative Context’, delivered at the Current Legal Issues Seminar Series organised by The University of Queensland’s TC Beirne School of Law, the Queensland University of Technology Faculty of Law and the Bar Association of Queensland on 12 September 2013 in the Banco Court, Supreme Court of Queensland.

1 [2009] 1 WLR 1988; [2009] UKPC 10.

2 [2009] 1 WLR 1988 at 1994; [2009] UKPC 10 at [21].

3 See J W Carter, *The Construction of Commercial Contracts*, Hart Publishing, Oxford, 2013, §4-23 (extrinsic evidence is not admissible as a direct aid to the construction of a document).

The second point relates to the authorities relied on. Of course, Lord Hoffmann could not cite any authority to support the propositions that we should kill off the officious bystander,<sup>4</sup> or bury business efficacy beneath the mud at the bottom of the River Thames on which the *The Moorcock*<sup>5</sup> settled in 1887. He referred to only three modern cases:<sup>6</sup> two decisions of the House of Lords (*Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board*<sup>7</sup> and *Equitable Life Assurance Society v Hyman*);<sup>8</sup> and the (majority) advice of the Privy Council in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*.<sup>9</sup> Lord Hoffmann seemed to take some comfort from the House of Lords cases. However, it goes without saying that nobody perceived the *Trollope* decision (in 1973) as dispensing with the rule-based approach which, as Justice Phang explains in his paper, has typified analysis of terms implied in fact. And in relation to *Hyman*, the quotation in *Belize* from Lord Steyn's speech<sup>10</sup> omits not only the fact that Lord Steyn referred<sup>11</sup> to a 'legal test' for implied terms, namely, 'a standard of strict necessity', but also that he thought it 'necessary to distinguish between the processes of interpretation and implication'. (In his speech in that case, Lord Hoffmann said<sup>12</sup> he agreed with Lord Steyn.) It does seem remarkable that what has stood as the law for the best part of 150 years should be cast aside without a full analysis of the function of the rules.

Third, and perhaps most striking of all, in *Belize* Lord Hoffmann seems to have defined<sup>13</sup> an implied term as

---

<sup>4</sup> *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 206 at 227 per Mackinnon LJ (affirmed *sub nom Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701).

<sup>5</sup> (1889) 14 PD 64.

<sup>6</sup> There is reference ([2009] 1 WLR 1988 at 1997; [2009] UKPC 10 at [35]) to *Bratton Seymour Service Co Ltd v Oxborough* [1992] BCLC 693, as a case cited in the Court of Appeal of Belize.

<sup>7</sup> [1973] 1 WLR 601 at 609; [1973] 2 All ER 260.

<sup>8</sup> [2002] 1 AC 408 at 459.

<sup>9</sup> (1977) 180 CLR 266 at 282-3; 16 ALR 363.

<sup>10</sup> [2002] 1 AC 408 at 459 ('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.').

<sup>11</sup> [2002] 1 AC 408 at 460.

<sup>12</sup> [2002] 1 AC 408 at 460. Lords Cooke and Hobhouse also agreed with Lord Steyn.

<sup>13</sup> [2009] 1 WLR 1988 at 1994; [2009] UKPC 10 at [21].

a provision [which] would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean.

Lord Hoffmann was not invoking the technical perspective on implied terms, namely, that they do not actually form part of the instrument.<sup>14</sup> Instead, he was making the point that an implied term merely spells out what the contract 'means'. Apparently, that is true whether or not the implied term serves to create an additional contractual obligation. Perhaps that does follow from his construction approach. But it also seems to beg the question of why it is felt necessary to conceptualise the process in terms of 'implied terms'.

### **Implication and Construction**

There are two obvious features of the relationship between construction and implication. One feature was explained by Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*.<sup>15</sup> He said that 'in making the inquiry whether a term is to be implied the court is no more confined than it is when it construes the contract'. Therefore, as is true in all issues of intention, context must be taken into account. However, that feature alone does not mean that all terms are implied by construction. Accordingly, Mason J also described<sup>16</sup> implication as illustrating a 'process of construction ... differing from the more orthodox ascertainment of the meaning of a contractual provision'. It was this view which Lord Steyn later expressed in *Hyman*.

The other obvious feature is that a term cannot be implied if it would be inconsistent with the express terms of the contract. That feature is applicable no matter what the basis for implication. Whether it is also a feature of Lord Hoffmann's analysis in *Belize* is, surprisingly, far from clear. The methodology which he adopted tends to gloss over the point.

Neither feature operates to prevent a term being implied by construction. Indeed, there are cases which appear to treat 'construction' as a distinct category of

---

<sup>14</sup> See *Mechanical Horse (Australasia) Pty Ltd v Council of the City of Broken Hill* (1941) 41 SR (NSW) 135 at 139.

<sup>15</sup> (1982) 149 CLR 337 at 353; 41 ALR 367. Stephen and Wilson JJ agreed.

<sup>16</sup> (1982) 149 CLR 337 at 353; 41 ALR 367.

implication. The decision of the High Court of Australia in *Hart v MacDonald*<sup>17</sup> is an illustration. The buyer of a dairy plant promised to pay for the plant out of the proceeds obtained from the sale of butter made from milk produced by her cows. A term was implied that the buyer would use the plant to produce butter. Griffith CJ described<sup>18</sup> the implication as arising 'upon a proper construction of the express words'. The term could also have been described as obvious, or necessary to give business efficacy to the contract. Underlying most such cases is a presumption of intention which is applied when construing the contract. The implied term is an inference from the express terms in the sense that construction establishes that the parties have not reached a contrary agreement. Because of the underlying presumption, the implied term is more or less redundant. There are many examples of cases where redundant terms have been implied, usually by 'construction'.<sup>19</sup>

Where a term is sought to be implied on a factual basis, the presumption is that the contract does not include *any* term in relation to the matter which is alleged to be dealt with by the implied term.<sup>20</sup> But in *Hart v MacDonald* it was presumed that the parties intended some provision in relation to working the butter factory.<sup>21</sup> To the extent that it needed to be identified, the process was one of construction, not implication. However, in relying solely on construction, *Belize* not only seems to gloss over this point, but also seems to be concerned with purely redundant implications. On that basis, the case did not actually require recourse to the implied term concept. Rather, if *Belize* was correctly decided, the methodology suggests that the decision illustrates 'paraphrastic construction'.<sup>22</sup>

---

17 (1910) 10 CLR 417.

18 (1910) 10 CLR 417 at 421.

19 See J W Carter, *The Construction of Commercial Contracts*, Hart Publishing, Oxford, 2013, §3-32.

20 The onus of proof is therefore on the party who propounds the term. See *Heimann v The Commonwealth* (1938) 38 SR (NSW) 691 at 695; *Luxor (Eastbourne) Ltd v Cooper* [1941] AC 108 at 137.

21 It is arguable that *The Moorcock* was such a case.

22 See J W Carter, *The Construction of Commercial Contracts*, Hart Publishing, Oxford, 2013, §3-09.

## Functions of Construction

*Belize* says that we do not need any special rules for implied terms. Instead, the applicable rules are general principles of contract construction. The decision to adopt that approach was made without analysis of the two quite different functions of construction as a legal process.

One function of construction is to determine what a contract means, that is, its linguistic sense. Where the meaning of a contract is at issue, the applicable principles are construction principles. Those principles are legal principles, supported by precedent. Some, such as the exclusionary rule, are applied as substantive rules of law. However, if we put third party standard form contracts to one side, the conclusion, that is, the 'meaning' of the contract, is unique. In reaching that conclusion, no prior case in which another contract has been given a particular meaning is relevant as a precedent. Whether the focus of the dispute is the same word or words construed in a prior case is irrelevant. Therefore, in equating the implication of a term with what a contract 'means', *Belize* decides that no principles other than construction principles are relevant. Doctrine disappears, and it is not open to a court to apply any test for implication. Accordingly, prior cases become irrelevant and the only element of 'system' in the process is provided by construction principles. It would therefore seem to follow from *Belize* that implied term debates are no more than construction debates. Since construction debates are often resolved by choosing the more reasonable construction, *Belize* appears to dispense with the requirement of 'necessity'.<sup>23</sup>

However, the role of construction is not limited to determining what a contract means. Another function of construction is to *apply contract doctrine*. Example after example could be given where construction, although crucial, is simply the process by which legal rules are applied. These rules do not form part of the principles of contract construction. Rather, they give content to contract doctrine. Construction principles then operate at the level of process. Two obvious illustrations are the doctrine of frustration and the classification of promissory terms as conditions, warranties or intermediate terms. In relation to the former, ever since Lord Radcliffe's

---

<sup>23</sup> Cf John McCaughran, 'Implied Terms: The Journey of The Man on the Clapham Omnibus' [2011] *CLJ* 607.

speech in *Davis Contractors Ltd v Fareham Urban District Council*,<sup>24</sup> whether or not a contract is frustrated has been treated as a question of construction. An even longer line of authority supports the same approach to the classification of promissory terms.<sup>25</sup>

An essential characteristic of doctrine is, of course, that there exists some established legal test or principle, such as that stated for frustration by Lord Radcliffe in *Davis Contractors*. There may be more than one test, or a single test or principle may exist in any number of formulations. Accordingly, in relation to the classification of promissory terms, although Australian law has respected the criterion relied on by Jordan CJ in *Tramways Advertising Pty Ltd v Luna Park (NSW) Ltd*,<sup>26</sup> it is not the only test. For example, another frequently applied test for deciding whether a term is a condition was stated by Bowen LJ in *Bentsen v Taylor Sons & Co (No 2)*.<sup>27</sup> Whatever the test or criterion, it is applied by construction. But that does not deny that the concern is to apply doctrine. Therefore, by way of contrast with the position where the meaning of a contract is at issue, because there are legal criteria, precedent is important. Lines of authority develop, as do subsidiary rules. Some of these rules will also be applied by construction of the contract. Terms implied in fact conform to this analysis. There are tests, such as the business efficacy test, and essential elements, such as that the term must be necessary, and not contradict the express terms. These tests and elements then make up the doctrine of terms implied in fact which is *applied* by construction.

Whether every category of implied terms conform to this analysis might perhaps be debated. However, it seems absolutely clear that ever since the nineteenth century — when the modern rules for implied terms started to emerge — the implication of a term has been regarded as a matter of contract doctrine. It is simply incorrect to say that, because the relevant legal rules are applied by construction, implication is solely concerned with what a contract means. Of course, the virtues of

---

24 [1956] AC 696.

25 See, eg *Behn v Burness* (1863) 3 B & S 751; 122 ER 281.

26 (1938) 38 SR (NSW) 632 at 642 per Jordan CJ (reversed on other grounds *sub nom Luna Park (NSW) Ltd v Tramways Advertising Pty Ltd* (1938) 61 CLR 286, but approved *Associated Newspapers Ltd v Bancks* (1951) 83 CLR 322).

27 [1893] 2 QB 274 at 281.

doctrine can be debated. The arguments in favour of doctrine are fully explained in Justice Phang's paper. Those arguments win out, both as a matter of law and because of the methodology adopted in *Belize*.

## Methodology

Whatever the failings of doctrine in relation to terms implied in fact, *Belize* is unacceptable because nothing is put in the place of doctrine.

It came as something of a surprise to hear from *Belize* that if there is a gap in a contract the task of the court is to fill it by construing the document which states or evidences the contract. Both lawyer and layperson could be forgiven for thinking that such an approach leads nowhere. As a matter of logic, in order to dispense with doctrine, the evidential inquiry must be broader than is normally the case in construction. Accordingly, a layperson might expect the answer to be found in the prior negotiations of the parties, or in their testimony in court. Because doctrine is applied by construction, extrinsic evidence is admissible only to the extent that it is permissible under the implied term rules themselves. But where it is alleged that a term should be implied in fact, there is no relevant exception to the exclusionary rule which permits reliance on the parties' prior negotiations or direct evidence of their intention.

Although it is pure speculation, it seems reasonable to say that the restrictive rules on extrinsic evidence were important in leading courts to take a doctrinal approach to term implication. Indeed, when the implied term theory of frustration held sway, the decision in *Krell v Henry*<sup>28</sup> was thought by Latham CJ in *Scanlan's New Neon Ltd v Tooheys Ltd*<sup>29</sup> to be a suspect authority because of the use made in *Krell* of the 'surrounding circumstances'. Latham CJ regarded the decision as based on an illegitimate use of 'extrinsic evidence'. Today, that is regarded as complete nonsense. Whichever function of construction is being applied, a court must have regard to context. No extrinsic evidence is permitted by the rules relating to terms implied in

---

<sup>28</sup> [1903] 2 KB 740.

<sup>29</sup> (1943) 67 CLR 169 at 191-4.

fact.<sup>30</sup> Accordingly, the evidence in *Belize* did not go beyond evidence of context — and there was precious little of that.

In all his pronouncements on construction in the House of Lords, including in his famous speech in *Investors Compensation Scheme Ltd v West Bromwich Building Society*<sup>31</sup> and his final pronouncement on construction in the House of Lords in *Chartbrook Ltd v Persimmon Homes Ltd*,<sup>32</sup> Lord Hoffmann steadfastly maintained the view that where a contract is stated in (or evidenced by) a document, the contract has only one meaning, namely, the meaning of the document when construed in light of context. Under this approach, it is wrong to consider what meaning a document has 'on its face', and then to consider whether it has a different meaning when construed in context.<sup>33</sup> For example, in *Charter Reinsurance Co Ltd v Fagan*<sup>34</sup> Lord Hoffmann explained:

It is artificial to start with an acontextual preconception about the meaning of the words and then see whether that meaning is somehow displaced.

That is clearly correct. But it is not easy to understand the methodology of *Belize* from that perspective.

In *Belize* the shareholders who had appointed certain directors, and had power to remove them, ceased to hold the requisite shareholding, on the basis of which the appointments had been made. Were the directors to remain in office? Clearly enough, when he construed the contract Lord Hoffmann detected a lacuna in relation to that matter. By construing the contract Lord Hoffmann was able to fill the lacuna. This seems a remarkably unsatisfying methodology. It is remarkable that a court would say, 'construing this contract there is a gap'; but then say 'construing this contract there is no gap'. Simply, why was it necessary to imply a term into the contract when, as a matter of construction, there was no gap?

---

<sup>30</sup> But cf *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352-3; 41 ALR 367.

<sup>31</sup> [1998] 1 WLR 896.

<sup>32</sup> [2009] 1 AC 1101; [2009] UKHL 38.

<sup>33</sup> It is true that Australian law has some difficulty with this approach, but now is not the occasion for its discussion.

<sup>34</sup> [1997] AC 313 at 392.



## Australian Law

I have not mentioned the decision in *BP*. In that case the majority set out no less than five specific requirements which must be satisfied before a term can be implied on a factual basis. Those requirements were considered in *Belize*. However, Lord Hoffmann turned them on their head. He regarded them as mere factors to be considered. And even then, he treated them as 'good reasons'<sup>35</sup> why in particular circumstances a term ought *not* to be implied. Surprisingly, he made no exception for the requirement that the implied term 'must not contradict any express term of the contract'.

The *BP* requirements were approved by the High Court in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd*.<sup>36</sup> They were treated as applicable to all contracts. However, in *Byrne v Australian Airlines Ltd*<sup>37</sup> the High Court decided<sup>38</sup> that the *BP* requirements do not apply if it is apparent that the parties have not attempted to spell out the full terms of their contract. Supposedly, a less restrictive set of criteria applies in that context. Whether there is any difference might be debated. But it is absolutely clear that the approach of the High Court has been doctrinal. The decision in *Belize* is not applicable in Australia.

## Conclusion

Unless the term is a redundant implication, that a gap exists in a contract can only be decided by construing the contract in light of context. Implied term allegations must therefore assume that construction in light of context exposes a gap. In the vast majority of cases, implied term allegations fail because the ordinary construction process indicates that there is no gap.

If there is a gap, the conventional view is that the gap is filled by the application of contract doctrine. Assuming that the allegation is that a term should be implied in fact, the relevant doctrine is found in the cases which state the legal requirements, that is, the various tests, rules and criteria. An integral element of

---

<sup>35</sup> [2009] 1 WLR 1988 at 1995; [2009] UKPC 10 at [27].

<sup>36</sup> (1979) 144 CLR 596 at 605-6; 26 ALR 567.

<sup>37</sup> (1995) 185 CLR 410; 131 ALR 422.

<sup>38</sup> Approving *Hawkins v Clayton* (1988) 164 CLR 539 at 573; 78 ALR 69.

implication of a term on a factual basis is therefore proof that those requirements are satisfied. They are applied by construction. If, as *Belize* suggests, general principles of construction replace specific legal requirements, the process which is used to identify the gap must also be used to fill it. If that is correct, there is a single process at work and the implied term rationale is quite pointless. However, logic suggests that in order for the *Belize* approach to be viable in relation to a contract on negotiated terms, further raw material must be made available.

The approach of Lord Hoffmann in *Belize* would therefore be much more compelling if identification of a gap by the ordinary processes of construction activated an exception to the exclusionary rule. But the approach of Anglo-Australian law to evidence in construction is very conservative. The doctrine of terms implied in fact is a product of that conservatism. It is, indeed, designed to overcome the limitations on construction as a process. Therefore, rather than just inquire what a contract means, the court must apply doctrine by construction. It is therefore irrelevant whether the contract document was the product of a negotiation.

There is a clear contrast with the position in the United States. No reference can be found in the *Contracts Restatement 2d* (1979)<sup>39</sup> to officious bystanders. All the work which in Anglo-Australian law is done under the rubric of terms implied in fact is indeed done by construction. But that is because the prior negotiations — and a great deal more — are admissible in construction.

---

<sup>39</sup> American Law Institute, *Restatement of the Law Second, Contracts 2d*, as adopted and promulgated in May 1979, American Law Institute Publishers, St Paul, 1981.