

courts to interpret and develop customary law in accordance with the “spirit, purport and objects of the Bill of Rights” (s 39(2) Constitution; see also *Bhe v Magistrate, Khayelitsha* (Commission for Gender Equality as amicus curiae); *Shibi v Sithole*; *South African Human Rights Commission v President of the Republic of South Africa* 2005 1 SA 580 (CC) 656-657 parrr 215-219).

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Baker Tilly (a firm) v Makar **[2010] EWCA Civ 1411**

Tacit terms and the common unexpressed intention of the parties to a contract

1 Introduction

When parties conclude a contract, there is a glimmer of consensus and when that contract is reduced to writing, at least in the English tradition, elaborate terms are crafted with much care and precision from established precedents and the skilled use of language to reflect the agreement reached by the parties. But the glimmer of consensus obscures the fact that there can hardly ever be complete agreement on every minute detail of the contract and no matter how carefully or with how much elaboration a contract is drafted, the ideal of a perfect contract remains eternally beyond the reach of the drafter. No matter how clearly the parties express themselves and no matter how well drafted a contract may be, it is never beyond the realm of possibility that the contract may yet contain some omission. There are various reasons why an omission may occur: Unforeseen circumstances may arise; circumstances change; parties change; needs change; conflicts of interest are ever present. Whatever the reason, omissions arise with sufficient frequency to warrant the existence of legal rules which explain in which circumstances a court may supply an omission. This is often done by the implication of certain unexpressed terms in a contract. The aim with this analysis is to consider the various kinds of unexpressed terms that can be implied in a contract from a comparative perspective against the backdrop of the judgment of the England and Wales Court of Appeals (Civil Division) in *Baker Tilly (a firm) v Makar* ([2010] EWCA Civ 1411).

2 Facts

The defendant was the chief executive officer, executive deputy chairperson and finance director of Triad Group PLC and held almost 30 per cent of the shares in Triad. In 2005, a major boardroom dispute arose

because the defendant believed that there had been serious financial irregularities in the company and breaches of fiduciary duties by officers of the company. This eventually led to her removal from the positions she had held in the company. As a result, she instituted action in the Employment Tribunal against Triad, claiming unfair dismissal and victimisation. Triad eventually accepted that the defendant had reasonable grounds for her concerns and that the circumstances of her dismissal were unfortunate. As a result, the claim in the Employment Tribunal was settled shortly before proceedings were to commence (par 2).

The defendant had engaged the services of the claimant, a firm of accountants, to provide forensic accounting services in support of her claim in the Employment Tribunal. The claimant agreed to conduct a forensic investigation, prepare an independent expert report and, if necessary, present expert evidence before the Employment Tribunal. The contract was formed by two letters, the formal instruction sent by the defendant's solicitors to the claimant and the letter of acceptance returned by the claimant on the same day. The fee payable was, however, not specified in the letters, but negotiated directly between the defendant herself and the claimant (par 3 *et seq*).

The claimant claimed payment for services rendered on the grounds that the contract came to an end as soon as it was informed of the settlement, since the occasion for providing a report to the Employment Tribunal had disappeared. The defendant, however, resisted the claim on the basis that this was not a contract merely to provide an expert report for the Employment Tribunal, but a contract to provide a report in accordance with the solicitors' instructions. In other words, the defendant's case was that the claimant was still contractually bound to provide the independent expert report and that it had not fulfilled this duty yet (parr 4-5).

3 Judgment

The Queen's Bench, per Seymour J, held that the contract contained an implied term to the effect that the contract would be terminated if the claim was settled and that the defendant would be liable for reasonable fees incurred up to that time. In the Court of Appeal, Hughes LJ upheld the judgment of Seymour J and explained (parr 15-16) that

[h]is critical holding ... is his conclusion that the contract contained the implied term, representing the common unexpressed understanding of the parties, that the client commissioning the report could terminate the engagement at any time, on the basis that she would be liable for reasonable fees incurred up to that point. ... [T]his critical holding of the judge cannot stand with the existence of an entire contract. This, I am quite satisfied, was not an entire contract.

4 Discussion

The judgment in *Baker Tilly* is significant in a South African context, since the South African law relating to the unexpressed terms of a contract is based on English law (*Minister van Landbou-Tegniese Dienste v Scholtz* 1971 3 SA 188 (A); *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 506 (A)). The way in which the English courts deal with the implication of terms can therefore also provide some insight into our own law regarding implied terms in South Africa.

The law with regard to the implication of terms in English law has been restated by the courts repeatedly. In *Equitable Life Assurance Society v Hyman* ([2000] 3 All ER 961 (HL) 970) Steyn LJ explained that

a term can be implied by law in the sense of incidents annexed to particular forms of contracts. Such standardised implied terms operate as general default rules; ... If a term is to be implied it could ... [also] be a term implied from the language ... in its particular commercial setting. Such implied terms operate as *ad hoc* gap fillers. ... Such a term may imputed to the parties: It is not critically dependent on proof of an actual intention of the parties. The process 'is one of construction of the agreement as a whole in its commercial setting': ... This principle is sparingly and cautiously used and may never be employed to imply a term in conflict with the express terms of the text. The legal test for the implication of such a term is a standard of strict necessity.

The consensus among English judges seems to be that a term can be implied in a contract in one of two instances only: Firstly, a term can be implied *ex lege* as a general default rule which applies to all contracts of a particular form. Secondly, a term can be implied on an *ad hoc* basis in a contract between particular parties if it is strictly necessary to fill a gap in order to arrive at the objective meaning of the contract. (See also *McCarthy v McCarthy & Stone Plc* [2006] 4 All ER 1127 (Ch); *Hilton v Barker Booth and Eastwood (a firm)* [2005] 1 All ER 651 (HL); *Crest Nicholson Residential (South) Ltd v McAllister* [2003] 1 All ER 46 (Ch); *Ashworth Frazer Ltd v Gloucester City Council* [2002] 1 All ER 377 (HL).)

This also seems to be the predominant view amongst the authors of textbooks on the interpretation of contracts in English law. Lewison (*The Interpretation of Contracts* (2011) 269) explains that

[t]he implication of terms into a contract depends on the presumed intention of the parties. In some cases that intention is collected merely from the express words of the contract or from a combination of the express words of the contract and the surrounding circumstances; in others it is collected from the nature of the legal relationship into which the parties have entered.

(For a comprehensive discussion of English law relating to the implication of terms, see Austen-Baker *Implied Terms in English Contract Law* (2011). See also McMeel *The Construction of Contracts – Interpretation, Implication, and Rectification* (2007) 113 *et seq.*, 225 *et seq.*)

This distinction between a term implied *ex lege* as a general default rule which applies to all contracts of a particular form and a term implied

on an *ad hoc* basis in a contract between particular parties if it is strictly necessary to fill a gap in order to arrive at the objective meaning of the contract, has also apparently found favour in South Africa. In *Seven Eleven Corporation of SA (Pty) Ltd v Cancun Trading No 150 CC* ([2005] 2 All SA 256 (SCA)), Lewis JA explained (265) that

[t]he distinction between implied and tacit terms is now trite. The former is a term implied by the law, the latter a term implied by the facts. ... The principle applied over many years is that the term to be incorporated in the contract must be necessary, not merely desirable. The classic tests used to give effect to this principle do not, however, take into account the actual intentions of the respective parties. They require the court to consider whether the term contended for would give 'business efficacy' to the contract or to ask what the 'officious bystander' – a person who is not a party to the contract but asked whether the term is necessary – would say. These are objective tests. On either test, when one asks whether it was necessary to incorporate a term in the franchise contract ... the answer must be that such a term was not necessary [in this case]. ... Whether one looks at the matter on a subjective basis – what the parties actually thought at the time of entering into the contract – or on the objective tests applied over many decades, the answer is clear. There was no tacit term that the respondent was entitled to the benefit of early settlement discounts or of rebates.

But the clause implied in *Baker Tilly* does not fit into either of these categories. Neither the Queen's Bench, nor the Court of Appeals seem to have based the implication of the term concerned on the principle that the term can be implied *ex lege* as a general default rule which applies to all contracts for the commissioning of forensic reports. It is not a term which one would necessarily read into every contract for the rendering or commissioning of forensic reports. Not all reports are commissioned when the dispute is already heading to court. Often, a forensic report is commissioned to uncover any impropriety and determine whether any legal action is in fact warranted. Furthermore, the term implied was not strictly necessary to fill a gap in order to arrive at the objective meaning of the contract – the contract would have been perfectly operational and executable in the absence of such a term. Instead, both the Queen's Bench and the Court of Appeals based the implication of the term on the common unexpressed understanding of the parties, and this seems to fly in the face of common wisdom as explained above.

There is, though, according to *Chitty* (Beale *Chitty on Contracts Volume 1* (2012) 992) in the case of an incomplete contract

yet another situation where a term may be implied. This is where the court 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'.

The contract in *Baker Tilly* seems to fit squarely into this category of an incomplete contract and the term concerned was implied to complete the contract. This also seems to accord with the view of Salmond and

Williams (*Principles of the Law of Contracts* (1945)), expressed almost eighty years ago, when they explained (36) that

implied terms of a contract, meaning thereby the terms devised and implied by the law itself and imported into the contract as supplementary to the express terms which have their origin in the actual intention of the parties, must be distinguished from those terms inferred as a matter of fact to have been actually, though tacitly, declared or indicated by the party or parties whose declared will constitutes the contract. These latter terms may be described as tacit terms. It is regrettable that the word *implied* is ambiguous and is frequently applied not only to terms implied in law but also implied in fact, *i.e.*, tacit terms.

... Indeed, a complete contract may be made by such conduct, as when a purchaser takes a newspaper from a bookstall and thereby incurs an obligation to pay for it. In such cases the contractual intention or will is considered to be an actual fact inferable from the conduct of the persons concerned. Such cases, therefore, do not differ in essence from those where the intention or will is expressed in spoken or written words, for speaking and writing are themselves merely particular forms of human conduct. In both kinds of case, the essential thing is that there is considered to be in the minds of the parties an actual intention or will manifested or declared by the parties by their overt acts, whether those acts take the form of written or spoken words, or other conduct. Both tacit and express terms are considered to represent the actual intention of the parties. Implied terms, on the other hand, are introduced by the law in default of the manifestation by the parties of any such actual intention ...

Around the same time, the position in English law was summarised by Williams ("Language and the law" 1945 *LQR* 71 401), where he explained that there are three kinds of unexpressed terms that may be implied in a contract:

- (i) terms that the parties probably had in mind but did not trouble to express;
- (ii) terms that the parties, whether or not they actually had them in mind, would probably have expressed if the question had been brought to their attention; and
- (iii) terms that, whether or not the parties had them in mind or would have expressed them if they had foreseen the difficulty, are implied by the court because of the courts view of fairness or policy or in consequences of rules of law.

Lewison (271-272) seems to dismiss the distinction between the first and second kind of terms mentioned by Williams since

the actual intention of the parties is not what the court is trying to ascertain. What the court seeks to ascertain is the presumed intention of the parties (or more accurately the meaning that the contract would convey to a reasonable reader). It is, therefore, more accurate to describe case (i) as an effort to arrive at the presumed intention of the parties, rather than their actual intention; or what the reasonable reader would understand the contract to mean. Both case (i) and case (ii) involve a search for the presumed intention of the parties,

although case [(i)] requires the further assumption that the subsequent difficulty was foreseen at the date of the contract.

(There seems to be an error in the text which I have corrected above. Case (i) refers to terms which the parties probably had in mind, while case (ii) (as referred to in the original text) refers to terms which the parties would probably have expressed if the question had been brought to their attention.)

Although it is often said that the purpose of interpretation is to ascertain the intention of the parties, it is trite that it is the objective meaning of the contract, rather than the subjective intention, which is being determined. In *Attorney General of Belize v Belize Telecom Ltd* ([2009] 2 All ER 1127 (PC) 1132) the Privy Council, per Hoffmann LJ, explained that

[t]he 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 ... It is this objective meaning which is conventionally called the intention of the parties, or the intention of Parliament, or the intention of whatever person or body was or is deemed to have been the author of the instrument.

Lewison is therefore correct in stressing that case (i) involves a search for the presumed intention of the parties, rather than an attempt to arrive at their actual subjective intention. But there is an important difference between case (i) and case (ii). In case (ii), the contract completely reflects the consensus between the parties, but the contract fails to address an unforeseen eventuality. A term is then implied, if it is strictly necessary to give business efficacy to the contract, on the basis of what the parties, as reasonable people, would have agreed to if that eventuality had been brought to their attention at the time when the contract was concluded. In case (i), on the other hand, there is clearly an incomplete expression of consensus in the contract. The unexpressed consensus must then be gathered objectively from the conduct of the parties and the background knowledge which is reasonably available, and one or more terms are implied to complete the contract. In case (i), the reader looks at the various verbal and non-verbal expressions of consensus to ascertain the terms that have been omitted, whereas in case (ii), the reader looks beyond the expression of consensus to find a solution for an unforeseen eventuality.

In South Africa, there is similarly authority for the view that there are three kinds of unexpressed terms that can be implied in a contract. Firstly, there are implied terms. These terms are inferred *ex lege* in a contract, despite the fact that the parties did not reach or would not have reached agreement on the matters involved. These terms, often referred

to as *naturalia*, are derived from the common law, statute, precedent, custom or trade usage and are not dependent on the actual or presumed intention of the parties (*AA Farm Sales (Pty) Ltd (t/a AA Farms) v Kirkaldy* 1980 1 SA 13 (A) 17C). They are duties imposed by law.

Implied terms must be distinguished from tacit terms. But not all tacit terms are alike. In *Wilkins NO v Voges* (1994 3 SA 130 (A)) Nienaber JA explained that

[a] tacit term, one so self-evident as to go without saying, can be actual or imputed. It is actual if both parties thought about a matter which is pertinent but did not bother to declare their assent. It is imputed if they would have assented about such a matter if only they had thought about it – which they did not do because they overlooked a present fact or failed to anticipate a future one.

Secondly, therefore, there are actual tacit terms. For reasons that will become apparent below, these terms can also be referred to as “consensual tacit terms”. These are terms relating to matters concerning which the parties had actually reached agreement or with regard to which the parties had some common expectation, but failed to express in writing or speech. According to McEwan J (*Cardoso v Tuckers Land and Development Corporation (Pty) Ltd* 1981 3 SA 54 (W) 61G) a consensual tacit term “is found, if at all, in the unexpressed common intention of the parties as determined from the surrounding circumstances or any other proper source”. Because consensual tacit terms are derived from the actual intention of the parties, the test to determine whether a consensual tacit term can be read into a contract is subjective. It is a question of fact decided by analysing the conduct of the parties and other indicators of their actual states of mind.

Thirdly, there are imputed tacit terms. These are terms concerning matters which the parties had not considered, but they would have agreed to the term concerned had their attention been drawn thereto at the time when they concluded the contract. Terms of this nature are based on the assumed intention of the parties. The officious bystander test is often applied to determine whether or not a term should be implied into a contract. The classic formulation of this test remains the dictum of Scrutton LJ in the English case of *Reigate v Union Manufacturing Co (Ramsbottom)* (1 KB 592) (cited in *Alfred McAlpine* (533B) and *Seven Eleven* (266A)):

[I]f at the time the contract was being negotiated someone 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’.

The test to determine whether an implied term can be inferred in a contract, is objective – what would the parties, as reasonable people have agreed to? (*Trollope & Colls v NWMR Hospital Board* [1973] 1 WLR 601 613C.) Inferring an implied term into a contract is based on a legal fiction and is consequently a question of law.

The distinction between consensual and imputed tacit terms was eloquently explained by Wunsh J in *Bezuidenhout v Otto* (1996 3 SA 339 (W) 344A-E).

What is not always appreciated in some of the books is the difference between the following:

1. A tacit term, which is sometimes called an implied term

In earlier cases also described as an implied term, which a court will find to exist when:

- (a) it is necessary to import it to give business efficacy to the contract; or
- (b) the parties did not, in fact, apply their minds to it, but if an officious bystander had asked them if it should have been in the contract, they would unhesitatingly have responded in the affirmative. ...

2. A tacit term proper

That is to say one which the parties actually agreed upon, but did not articulate; a term they did agree to, as distinguished from one they must have agreed to. The inquiry is whether on the basis of the proved facts and circumstances it was probable that a tacit agreement had been reached.

Consensual tacit terms, therefore, are based on fact – what the parties had actually intended with regard to a matter which they had considered, but failed to express. Imputed tacit terms are based on fiction – what the parties would have agreed to if they had considered the matter at the time when the contract was concluded.

This threefold approach is also generally followed in other jurisdictions with a Common law tradition. In *Byrne v Australian Airlines Ltd* (185 CLR 410) the High Court of Australia distinguished between different kinds of terms that can be implied in a contract. The court firstly referred to terms that can be implied into a contract in terms of the officious bystander test (440). Secondly, there are terms that can be implied if it is necessary to give business efficacy to a contract (441). However, the court questioned whether there is any real distinction between these two kinds of terms (447). Thirdly, the court referred to incidental terms which the law imports into contracts of a particular kind irrespective of the parties' intention (447). Lastly, an Australian court can imply into a contract a "tacit term" to identify the latent unexpressed intentions of the parties" (447). (See also *Shepherd v Felt & Textiles of Australia Ltd* 45 CLR 359 378).

In *Canadian Pacific Hotels Ltd v Bank of Montreal* (77 NR 161) the Supreme Court of Canada distinguished between terms that can be implied by law and are incidental to a particular kind of contract, as opposed to terms that are necessary to give business efficacy to a contract. A further distinction was made by the British Columbia Court of Appeal in *Petro-Canada v Disco Oil & Gas Ltd* (96 BCLR (2d) 174) where the court indicated that a term can firstly be implied where it is necessary to give business efficacy to the contract and secondly, where the term implied represents the obvious, but unexpressed, intention of the parties.

In the United States, the Supreme Court of Texas explained in *Danciger Oil & Refining Co of Texas v Powell* (154 SW 2d 632) that an implied term (635)

must appear that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it, and therefore omitted to do so, or it must appear that it is necessary to infer such a covenant in order to effectuate the full purpose of the contract as a whole as gathered from the written instrument. ... However, covenants will be implied in fact when necessary to give effect to the actual intention of the parties.

In *Grimes v Walsh & Watts Inc* (649 SW 2d 724) the Texas Court of Appeals refined the position somewhat when it explained that “a court can declare implied covenants to exist only where it appears such covenants were clearly contemplated by the parties or were necessary to effect the purpose of the contract”. (For terms actually contemplated by the parties, see also *Universal Health Services Inc v Renaissance Women's Group PA* 121 SW 3d 742; for terms necessary to effect the purpose of the contract, see also *WesternGeco LLC v Input/Output Inc* 246 SW 3d 776.)

A similar approach is followed in other US states (see eg *Percoff v Solomon* 67 So 2d 31 (Alabama); *Walgreen Arizona Drug Co v Plaza Center Corp* 647 P 2d 643 (Arizona); *Kroger Co v Bonny Corp* 216 SE 2d 341 (Georgia); *Bobenal Investment Inc v Giant Super Markets Inc* 260 NW 2d 915 (Michigan); *Tuttle v WT Grant Co* 171 NYS 2d 954 (New York); *Mercury Investment Co v FW Woolworth Co* 706 P 2d 523 (Oklahoma)).

A seminal aspect of the implication of terms which is emphasised in all Common law jurisdictions, is that courts only have a limited discretion to compliment the terms of a contract with implied terms. Courts cannot imply terms into a contract merely because it would be reasonable, fair or expedient. In addition, courts are generally reluctant to interfere with the terms of a contract which parties had entered into freely.

5 Conclusion

The significance of *Baker Tilly* lies in the apparent recognition of a kind of unexpressed term other than those mentioned by Steyn LJ in *Equitable Life Assurance* or Lewis JA in *Seven Eleven*. It is a kind of term which occurs seldom in the context of written contracts, because, as Hughes LJ stressed (par 16) it “cannot stand with the existence of an entire contract”. This is firstly because the parol evidence rule would exclude evidence to add to, vary or detract from the terms of a contract, but secondly, because most well-drafted written contracts contain “entire contract” clauses which would exclude the possibility of reading consensual tacit terms into the contract (for more in this regard, see my previous discussions in Cornelius “Background Circumstances, Surrounding Circumstances and the Interpretation of Contracts” 2009 TSAR 767; “Die toelaatbaarheid van ekstrinsieke getuienis by die uitleg van kontrakte” 2013 TSAR 805). As a result, this kind of unexpressed

term is also frequently ignored by courts and authors writing on the construction or interpretation of contracts. But not all written contracts are entire integrated contracts. The seminal aspect of the judgment in *Baker Tilly* (and, for that matter, in *Wilkins*) is that it is to a substantial extent based on inclusion of an implied (or tacit) term in the contract, representing the common unexpressed understanding of the parties. It is not a term which the law implies as general default rule in a particular kind of contract. Nor is it a term which is strictly necessary to give business efficacy to the contract. It is a term implied in the contract simply because it reflected the actual intention or common understanding of the parties which they had failed to express where the written contract did not constitute a complete integration of the agreement between the parties.

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