When the contract is silent

Sometimes the parties negotiating a contract omit to address an important issue. Only in certain circumstances can the courts imply a term in the contract to deal with the situation.

The legal test was established in an often-quoted 1977 English case, *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*. For a term to be implied in a contract:\

(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.

A recent example[1]

Pernod appointed Lion as its distributor of certain brands of wine from 1 November 2010. The distribution agreement ran only until settlement of the sale of those brands to Lion on 22 December 2010. Simultaneously Pernod sold wine production assets to Indevin, who would supply bulk wine to Lion after settlement.

Although the parties spent several months negotiating, the agreements were silent about the payment of excise duty. Pernod was legally liable to pay the excise duty to the government on finished goods such as the bottled wine supplied to Lion. The question for the High Court was whether Lion was required to reimburse Pernod for the excise duty. The total duty payable for bottled wine supplied under the distribution agreement was more than $10 million.

The prices for wine supplied under the distribution agreement were calculated in accordance with the sale and purchase agreement. The parties knew the prices for bottled wine were Pernod's book values, which reflected Pernod's costs of production and did not include excise duty. Lion's financial modelling, and hence forecast profit and valuation, included an expectation that Lion would incur excise duty on wine purchased from Pernod from the start of the distribution agreement. Lion was able to, and subsequently did, recover that from its customers when on-selling the finished goods. So the evidence indicated that Lion personnel expected to be paying Pernod for the excise duty on finished goods.

The principles revisited

The High Court accepted that the threshold for the implication of a term in a detailed commercial contract is high, particularly where the contract documents are complex. This is because of the need for commercial certainty.

Applying a 2009 Privy Council case *Attorney-General of Belize v Belize Telecom Ltd*, the High Court held that the modern approach is to objectively assess the overall intention of the parties. The degree of commercial absurdity that would result is relevant. The five-point list at the start of this article is not a series of independent tests which must each be surmounted. Rather it describes different ways of expressing the central idea that the proposed implied term must spell out what the contract actually means – or why it does not do so.

In this case there was, perhaps unusually, a body of evidence that before signing the contract both Pernod and Lion envisaged that Lion would be paying excise duty on finished goods. The High Court therefore found the contracts did include an implied term that the excise duty was payable by Lion to Pernod.

[1] *Pernod Ricard New Zealand Ltd v Lion – Beer, Spirits & Wine Ltd and Indevin Group Ltd* [2012] NZHC 2801

What this means for you

An implied term can be a useful way of dealing with commercial absurdities, but because the threshold is high (quite apart from the time and costs associated with a legal dispute) it is obviously preferable to make sure that all important issues are expressly addressed in a negotiated contract.

Contact Us

Lesley Brook, Partner
Phone: 03 467 7164
Mobile: 027 434 5295
E-mail: lesley.brook@andersonlloyd.co.nz