Disputes 2018: Implied terms and implied representations

In January 2018 the Court of Appeal is scheduled to hear the appeal in *Property Alliance Group v RBS*, an important case in the context of implied terms and implied representations.

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In brief

- Court of Appeal to hear key case arising out of the sale of interest rate derivative products.
- The Court may re-examine alleged implied terms and implied representations based, in this case, on the bank's alleged involvement in the manipulation of the London Interbank Offered Rate (LIBOR). It may also consider issues of implied contractual good faith.
- The hearing is listed for 29 January 2018.

When relations between commercial contracting parties break down, English courts examine carefully the exact, and express, terms of the bargain that the parties have struck. From time to time, a party seeking to escape from the contract will argue that the written contract that it negotiated and freely entered into did not define the entire relationship. Instead, it is said that the other contracting party made implied representations to it and/or that the contract contained implied terms that allow the aggrieved party to tear up the contract (rescission for misrepresentation) and/or claim damages (financial compensation for misrepresentation/breach of an implied term).

The claimant property investment company brought various claims arising out of the defendant bank's sale to it of interest rate swaps, all of which failed at first instance. The case is of general interest because it forms part of the ongoing debate surrounding the implication of terms into contract (including those relating to good faith) and the ability to rely on implied representations, especially those regarding the underlying subject matter of the contract. It is of specific interest to financial institutions because a number of the alleged implied terms and representations arise out of the manipulation of a reference rate. Indeed, it is the first major LIBOR case to get to trial. Other similar cases are waiting in the wings so, depending on what it covers, the Court of Appeal's review could be of considerable importance.

Implied terms and implied representations: general principles

Terms not stated in the contract but which are implied into it fall broadly into two categories - (i) those implied by law ie, implied by default where parties enter into a particular type of contract; and, (ii) those implied by fact ie implied in order to give effect to the intention of the parties.

No term will be implied in a contract unless:

- it does not contradict an express term of the contract
- it is capable of clear expression
- it is reasonable
- it is necessary to give business efficacy to the contract, and/or
- it is so obvious that it goes without saying.

Implying terms into a contract is a different process from construing the express terms of a contract, governed by different rules.

The test to be applied in relation to implied representations was summarised succinctly in *IFE Fund v Goldman Sachs* by Toulson J: “In determining whether there has been an express representation, and to what effect, the court has to consider what a reasonable person would have understood from the words used in the context in which they were used. In determining what, if any, implied representation has been made, the court has to perform a similar task, except that it has to consider what a reasonable person would have inferred was being implicitly represented by the representor’s words and conduct in their context.” The existence and nature of any representation “... must be judged objectively according to the impact that whatever is said may be expected to have on a reasonable representee in the position and with the known characteristics of the actual representee”.

The PAG case: implied terms and representations relating to LIBOR

The claimant sought rescission of the swaps and/or damages for misrepresentation (including fraudulent misrepresentation) and/or breach of contract arising out of the bank’s alleged participation in and knowledge of the manipulation of LIBOR rates by both the defendant and other LIBOR panel banks.

The claim was put in two ways: (1) a claim for rescission on the grounds that the bank made a number of misrepresentations, including fraudulent misrepresentations, about LIBOR and the way the rate was set and (2) a claim for damages on the grounds that the bank had breached a number of implied terms in each of the swaps similar to the alleged representations.

The claimant asserted that, had it known of LIBOR's manipulation, it would not have entered into the swaps, which were LIBOR based.

The judge accepted as axiomatic that parties to contractual arrangements will behave honestly, so that a term would be implied into each of the swaps that the parties would conduct themselves honestly when performing their obligations under the contracts.

She also allowed a limited implied term that the floating rate payable by or to the bank would be calculated by reference to LIBOR as defined by the BBA. However, terms as to the quality and setting of LIBOR could be implied into the swaps if and only to the extent that they were restricted to the specific bank's conduct (here RBS). The conduct of unknown banks on the LIBOR-setting panel would not have been within the parties' contemplation.

Overall, the judge concluded that there had been no breach of the implied terms.

Applying the accepted principles to the alleged misrepresentations, the judge found that there was no relevant conduct from which an inference could be drawn. In particular, in the relevant factual context of the case, the bank's mere proffering of draft swaps referable to the LIBOR rate was insufficient conduct from which the alleged misrepresentations could reasonably be inferred.

Furthermore, the evidence did not support the claimant's contention that it had entered into the swaps in reliance on the LIBOR representations. The claimant's directors had not properly understood the reference rate and could not be said to have relied on any implied representation about it. This leads to an interesting and slightly counterintuitive conclusion namely that, in the context of such a misrepresentation argument, a more sophisticated contracting party could be in a better position than a less sophisticated one.

Good faith: a very particular implied term

Many legal systems have general principles of good faith in contract law in some form. However, in English contract law, except where required by EU law, eg consumer rights, there is at present no general doctrine of "good faith".

There are several exceptions including: (1) cases where the parties have made an obligation of good faith an express term of their contract; (2) cases where the law itself makes an obligation of good faith an implied term of the parties' contract (eg insurance; employment contracts), and (3) cases where, on the facts, the law recognises an obligation of good faith as an implied term of the contract eg where one party has a contractual discretion.

In two recent cases - *Yam Seng Pte Ltd v International Trade Corp Ltd* and *MSC Mediterranean Shipping Company SA v Cottonex Anstalt*, a shipping case, one particular judge, Leggatt J (as he then was), has made clear that he thinks that English law should adopt, as part of its law of contract, a general principle of good faith. In his view, "… A duty to act in good faith, where it exists, is a modest requirement. It does no more than reflect the expectation that contracting party will act honestly towards the other party and will not conduct itself in a way which is calculated to frustrate the purpose of the contract or which would be regarded as commercially unacceptable by reasonable and honest people."

The Court of Appeal in the *MSC* case commented briefly on this, saying that it would be a significant step in our law of contract, but that it was not necessary or desirable to resort to it in order to decide the outcome of that case. Lord Justice Moore-Bick said that he saw "real danger" that if a general duty of good faith were established, it would be used to undermine the terms on which the parties have reached agreement.

In the PAG case, the claimant ran two good faith arguments based on the transfer of the claimant's business within the bank from one team to another. It argued that the transfer and the subsequent management of the business amounted to a breach of an implied duty of good faith, based on the decision in *Yam Seng*. It was also alleged that, following the decision in *Socimer International Bank v Standard Bank London*, the bank would exercise its contractual discretion rationally, in good faith and for a proper purpose.

No duty of good faith was found. The *Yam Seng* duty was not implied because of the sophistication of the parties and that it would be inconsistent with the express terms of the contract excluding the existence of such duties. The alleged implication of the *Socimer* duty failed because the bank had not at any point exercised a discretion. Even if the terms had been implied, the Judge found, on the facts, that they had not been breached.

What it means for you

The case represents the first proper test of arguments based on the alleged manipulation of LIBOR. On the basis of the first instance judgment, the existence of some form of implied term argument is available, although its scope is uncertain. It is to be hoped that the Court of Appeal's judgment provides some clarity.

The case is also of some interest in the context of contractual good faith. Claimants continue to argue for the existence of an implied duty of good faith in contracts although these have been resisted in many cases by the courts. Here the claimant argued for the existence of such a duty in a variety of ways including for a duty based on the controversial decision in *Yam Seng*. The Court of Appeal will have a further opportunity to provide some clear, comprehensive and authoritative guidance in the area.

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