

**IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION**

CIVIL APPEAL No.179 of 2017

NABHA POWER LIMITED (NPL)

....Appellants

versus

**PUNJAB STATE POWER
CORPORATION LIMITED (PSPCL) & ANR.Respondents**

J U D G M E N T

SANJAY KISHAN KAUL, J.

Facts:

1. The Punjab State Electricity Board ('PSEB') in the year 2009 conducted an international competitive bidding for selection of developer through tariff based bidding process for procurement of power on long term basis from a power station to be set up at Village Nalash, Rajpura, District Patiala, Punjab. This power station was envisaged as a Case-2 bid project (Case-2,

Scenario-4) criteria by PSEB in terms of the competitive bidding guidelines issued by the Government of India as per Section 63 of the Electricity Act, 2003 (hereinafter referred to as the 'EA').

2. The significance of the aforesaid is that Part-7 of the EA, which contains the provisions for tariff, provides for tariff regulations to be determined by the appropriate commission as per guiding principles set out in the Section of the EA. The tariff is determined under Section 62 of the EA. However in a scenario such as the present case, the determination is as per

the provisions of Section 63 of the EA, which reads as under:

“Section 63. Determination of tariff by bidding process. – Notwithstanding anything contained in section 62, the Appropriate Commission shall adopt the tariff if such tariff has been determined through transparent process of bidding in accordance with the guidelines issued by the Central Government.”

3. In order to facilitate the implementation of the project the PSEB incorporated Nabha Power Limited ('NPL/Appellant') on 9.4.2007 as a special purpose vehicle ('SPV') for implementation of the project and the successful bidder was to acquire 100 per cent shareholding of the NPL and enter into a

25 year Power Purchase Agreement ('PPA') with PSEB.

4. It may be noticed for the purpose of completion of facts that the first respondent, Punjab State Power Corporation Limited, ('PSPCL') is the successor entity of the erstwhile PSEB subsequent to the unbundling of PSEB in accordance with the Punjab Power Sector Reforms Transfer Scheme, 2010, while the second respondent is the Punjab State Electricity Regulatory Commission ('PSERC').
5. On 10.6.2009, a Request for Qualification ('RFQ') and a Request for Proposal ('RFP') inviting proposals to supply 1200 MW of power from the Rajpura Thermal Power Project was issued. The RFQ specified that the following tasks had already been completed:
 - i. 1078 acres of land had been acquired.
 - ii. Environmental clearance had been obtained.
 - iii. Fuel arrangements had been tied up in the form of LoA dated 11/18.12.2008.
 - iv. Water arrangement had been tied up."

While the RFP specifically provided that:

“i. The source of primary fuel (coal) would be coal from SECL since SECL had already issued the LoA.

ii. The Railways had given assurance for transportation of coal from SECL over a distance of 1600 km.”

6. On the bidding document being issued on 16.9.2009, certain queries and clarifications were raised by the prospective bidders in terms of the bidding documents for which clarifications were issued. The significant clarifications qua the matter at hand, noticed even in the impugned order, are as under:

“i. SECL would supply Grade ‘F’ coal from Korba/Raigarh field, with GCV of 3900 Kcal/kg to 4260 Kcal/kg, Ash Content of 35% to 40%, total inherent moisture of 5% to 6%, Volatile matter of 24% to 32%, fixed carbon of 32% to 37% and Sulphur content of 0.05%.

ii. On a specific query of whether the coal to be supplied would be washed coal or unwashed coal, it was clarified that washing of coal was to be arranged by the successful bidder.

iii. In response to the queries raised by the bidders, clarifications on the model PPA were also issued on 17.09.2009. On the question of the costs associated with fuel supply, transportation and unloading being pass through, it was clarified that tariff payment will be in accordance with Schedule VII of the PPA.”

7. On the bidding process being completed, M/s. L&T Power

Development Limited ('L&T PDL') was declared as the successful bidder and a Letter of Intent was issued on 19.11.2009. Thereafter on 18.1.2010, a Share Purchase Agreement ('SPA') was entered into between PSEB and L&T PDL, transferring 100 per cent of the shares of NPL to L&T PDL. Simultaneously the PPA was entered into between PSEB and NPL. The contractual obligation began of the respective parties.

- 8.** In the course of the contractual obligations, various issues arose, some of which were resolved. However, in respect of the amounts payable to the appellant, the controversy commenced, and remained right from the first invoice. It is the case of the appellant, that the first respondent made deductions from the amount due and payable under the invoices, on the following accounts:
- i. Component of the cost of purchasing coal comprising washing related costs including washery charges and cost of coal towards loss of quantity on account of washing (yield loss);
 - ii. Consideration of mid-point of GCV of ROM coal on equilibrated GCV basis ('EGCV') to calculate energy charges;

iii. Denial of road transportation cost – at the plant-end and at the mine-end.

iv. Denial of Liaising charges, denial of Transit and handling losses and denial of Third party coal testing charges; and

v. Non-payment of Capacity Charges for the period from 20.02.2014 to 03.03.2014 when the availability was declared on non-linkage (alternate) coal.”

- 9.** The aforesaid gave rise to a cause for the appellant to file Petition No.52 of 2014 under Section 86(1)(b) & (f) of the EA before the State Commission seeking relief on account of wrongful deduction of certain components of monthly tariff by the first respondent. The State Commission, post admission, dismissed this petition vide order dated 1.2.2016. The appellant, thus, filed Appeal No.64 of 2016 before the Appellate Tribunal (‘AT’). The appeal was, however, rejected vide order dated 14.12.2016 on most grounds except the non-payment of capacity charges allowed in favour of the appellant. It may be noticed that in the course of the appeal various questions of law were framed but ultimately the same were restricted only to five issues.

10. The dispute really is about the interpretation of the provisions of the PPA dated 18.1.2010 and is, thus, one of pure interpretation of the terms of the contract.

The plea of the Appellant:

11. Mr. Mukul Rohatgi, learned Senior Advocate, argued on behalf of the appellant. Mr. Rohatgi contended that the significant aspect is that the bidding process for the power project was in terms of the “Guidelines for Determination of Tariff by Bidding Process for Procurement of Power by Distribution Licensees, 2005” (hereinafter referred to as the ‘Guidelines’), which have a statutory flavor under Section 63 of the EA. Para 2.2 read with para 3.2(i) of the Guidelines envisages two routes of competitive bidding, Case-1 and Case-2. The said paras read as under:

“2.2. The guidelines shall apply for procurement of base-load, peak-load and seasonal power requirements through competitive bidding, through the following mechanisms:

- (i) Where the location, technology, or fuel is not specified by the procurer (Case 1);

(ii) For hydro power projects, load center projects or other location, specific projects with specific fuel allocation such as captive mines available, which the procurer intends to set up under tariff based bidding process (Case-2).

However separate RFP shall be used for procuring base load or peak load or seasonal load requirements as the case may be.”

.....

“3.2 (i) In order to ensure timely commencement of supply of electricity being procured and to convince the bidders about the irrevocable intention of the procurer, it is necessary that various project preparatory activities are completed in time. For long term procurement for projects for which pre-identified sites are to be utilized (Case-2), the following project preparatory activities should be completed by the procurer, or authorized representative of the procurer, simultaneously with bid process adhering to the milestones as indicated below:

(i) Site identification and land acquisition: If land is required to be acquired for the power station, the notification under section 4 of the Land Acquisition Act, 1894 should have been issued before the publication of RFQ. The notification under section 6 of the Land Acquisition Act, 1894 should have been issued before the issue of RFP. If the provisions of section 17 of the Land Acquisition Act, 1894 regarding emergency have not been applied, the Award under the Land Acquisition Act should have been declared before the PPA becomes effective.

(ii) Environmental clearance for the power station: Rapid Environmental Impact Assessment (EIA) report should be available before the publication of RFQ. Requisite proposal for the environmental clearance should have

been submitted before the concerned administrative authority responsible for according final approval in the Central/State Govt., as the case may be, before the issue of RFP. Environmental clearance should have been obtained before PPA becomes effective.

(iii) Forest Clearance (if applicable) for the land for the power station: Requisite proposal for the forest clearance should have been submitted before the concerned administrative authority responsible for according final approval in the Central/State Govt., as the case may be, before the issue of RFP.

(iv) Fuel Arrangements: If fuel linkage or captive coal mine(s) are to be provided, the same should be available before the publication of RFQ. In case, bidders are required to arrange fuel, the same should be clearly specified in the RFQ.

(v) Water linkage: It should be available before the publication of RFQ.

(vi) Requisite Hydrological, geological, meteorological and seismological data necessary for preparation of Detailed Project Report (DPR), where applicable. These should be available before the issue of RFP. The bidder shall be free to verify geological data through his own sources as the geological risk would lie with the project developer.

The project site shall be transferred to the successful bidder at a price to be intimated at least 15 days before the due date for submission of RFP bids.”

12. The essential difference between Case-1 and Case-2 procurement route is stated to be that a Case-2 is a ‘fuel

specific procurement' having a 'pre-identified site' as in the present case. It is in these circumstances that the first respondent, being the procurer is stated to have arranged the fuel linkage from SECL, Chhattisgarh and specified the site location for the project near Village Nalash, Tehsil Rajpura, Punjab. The bidder's responsibility included design, engineering, procurement, construction, testing, commissioning, financing, operation and maintenance of the power station. Even under the Case-2 model, there are stated to be five scenarios, and the bid parameters of each scenario is stated to be different – the present one being scenario 4. This is stated to be significant inasmuch as an all-inclusive fixed/capped energy charge was not a bidding parameter, and the energy charges were designed to vary in accordance with the actual cost of coal, and the actual quality of coal. The appellant, as bidder, is thus stated to have taken the risk only of one component of the energy charge formula, being the efficiency of the project, and not with respect to other two components, i.e., cost of coal and Gross Calorific Value

(‘GCV’) of coal, including its constituents. This is the reason stated for the relevant formula under Article 1.2.3 of Schedule 7 of the PPA, which will be discussed hereafter.

- 13.** It is the case of the appellant that on 16.9.2009, prior to the bid date, PSPCL disclosed the coal quality in its pre-bid clarification. The project was located at a distance of more than 1,000 kilometers from the SECL mine and the coal arranged by the respondent contained more than 34 per cent ash. The project, thus, came under the ambit of Ministry of Environment and Forest (for short ‘MoEF’) Notification of 1997, making it mandatory for the coal to be washed for the use of generation of electricity energy. PSPCL, also mandated that washing of coal was to be arranged by the successful bidder (pre-bid clarification). The query raised by the appellant was as to whether the coal to be supplied for the project, was washed coal or unwashed coal (query No.6). It is the plea of the appellant that, thus, the reference to coal and fuel in the PPA, including the energy charges formula, could only refer to washed coal and thus the actual cost of

purchasing, transporting and unloading coal referred to in Article 1.2.3 of Schedule 7 of the PPA, must refer to such actual cost of washed coal. The PSPCL, however, took a contrary stand that the term 'washing' is not part of the energy charges formula, while the appellant sought to include – (A) the actual cost of unwashed coal procured by NPL from SECL, including the cost of coal lost in washing (around 20 per cent); and (B) washing charges paid for getting the coal washed. The appellant's stand, thus, is that the clarification that the successful bidder would have to arrange for washing of coal, would not imply that the washing cost has to be fastened on to the appellant, as in terms of the PPA, the energy charge formula expressly provided for actual cost incurred, to be reimbursed.

- 14.** The significant contention of the appellant is that the operation cost mentioned in clause 2.7.1.4(3) of the RFP only referred to the cost towards operating and maintenance of power plant, and cannot refer to any cost associated with the cost of coal, which is a part of the energy charges.

- 15.** The appellant also invoked the principle of ‘business efficacy’ and the maxim ‘*Reddendo Singula Singulis*’ for interpreting the terms of the PPA and the Energy Charges Formula, as set out at Article 1.2.3 of Schedule 7 of the PPA.
- 16.** The aforesaid is really the major and the first dispute *inter se* the parties.
- 17.** The second dispute relates to the GCV of the coal, and is in a sense, linked to the first dispute. This is so as the PSPCL takes into account the theoretical/Equilibrated GCV² (‘EGCV’) of unwashed coal at the mine-end rather than GCV of washed coal on an As Received Basis (‘ARB’) at the project-end as part of PCV_n in the Energy Charges formula. The GCV of the coal is stated to change significantly due to transportation by rail over a period of 4 to 5 days, as coal contains moisture. The critical stage is stated to be the measure of GCV when the project coal reached the site (from the mine-end in Chhattisgarh to the project-site at Rajpura) when it is stated to be jointly sampled, tested and recorded by NPL and PSPCL. This is stated to be obvious from the definition of PCV_n. The

joint sampling done at the mines of SECL is only of unwashed coal.

- 18.** The formula, it is pleaded, of F^{COAL}_n is stated to refer to the actual cost of transporting the coal to the project and the actual cost of unloading at the project. The mere transfer of title of unwashed coal, which cannot be used in generation of electricity charges is, thus, pleaded not to imply delivery of coal to the project.
- 19.** On the same principle, there is a third aspect of the claim of transportation cost of coal with respect to the first mile and the last mile. The first mile is on account of the unwashed coal from the mine to the washery, while the last mile is stated to have been incurred for carriage of coal from the nearest railway station to the project, on account of incomplete land acquisition by the Government of Punjab on behalf of the PSPCL. The transportation has to be reimbursed irrespective of mode. In a Case-2 project, the risk towards land is not assigned to the bidder but is of the PSPCL.
- 20.** There are also certain other linked charges qua coal in the

context of transit and handling charges, third party testing charges and liaising charges.

21. In the synopsis filed, the appellant has claimed even interest on the disputed energy charges in view of Article 11.3.4 read with Article 11.6.8 requiring payment of interest/late payment surcharge on the disputed component of the monthly bill from the date on which such payment was originally due against whom the dispute is settled/decided. The absence of a separate prayer for the payment of interest, it has been pleaded, cannot deny the appellant such benefit which must enure in case of the appellant succeeding in the adjudication. Also the appellant having been deprived of the use of money, this deprivation cost should be compensated with interest/damages. We may note at the end of such submissions of the appellant, that along with certain synopsis, some documents have been filed showing joint sampling in the presence of NPL and PSPCL representatives for the coal received at the project-site including coal received after washing, to deny the plea of respondent No.1 that such

verification was being done only at the mine-site.

Plea of the First Respondent:

22. The first respondent through Mr. V. Giri, learned Senior Advocate canvassed that any claim of the appellant relating to coal has to be considered in terms of Clause 1.2.3 of Schedule 7 of the PPA. In terms thereof, there are stated to be only three distinct identifiable components of coal recognized for tariff: (a) Purchase; (b) Transportation and (c) Unloading. Thus, until and unless the claims squarely fall under one of these three heads, the same cannot be included in the monthly energy charges. It is not as if all costs relating to coal handling from the stage of procurement from SECL at the coal mine-site, up to stage of firing in the boiler to generate electricity is to be included. Had that been the intention, the stipulation would have been of actual cost of coal used for generation of power.

23. The plea raised is that the cost of coal is payable to SECL, which is provided on actual basis. It was abundantly clear that the coal supplied would not be washed coal and the obligation

of washing was on the appellant. Such washing could have been undertaken either by establishing a washery, or by outsourcing the washing activity to a third party. Not only washing, there were certain other essential activities to be undertaken in relation to coal after the purchase of coal, including sizing of coal, crushing of coal, sprinkling and moisturisation of coal for stacking and storage, sorting of coal, ash removal, removal of stones and other undesired contents, demojurisation of coal, pulverization of coal, etc. The calculation formula, for monthly energy charges, is claimed to provide for only the purchase price paid to SECL and not any other expenditure incurred by the appellant.

24. The first respondent contends that the definition of the term ‘fuel supply agreement’ refers to the agreement between the appellant and the fuel supplier, i.e., SECL, and thus, the transaction of purchase referred to in Clause 1.2.3 of Schedule 7 of the PPA is identifiable to the purchase in the definition of the fuel supply agreement.

25. The attention of the Court was also invited to “Project

Documents”, which reads as under:

““Project Documents” mean

- a) Construction Contracts;
- b) Fuel Supply Agreements including the Fuel Transportation Agreement;
- c) O&M contracts;
- d) RfP and RfP Project Documents; and
- e) any other agreements designated in writing as such, from time to time, jointly by the Procurer and the Seller;”

26. It is, thus, pleaded that there is no separate agreement for ‘washing’ included in this list of what constituted “Project Documents.” The delivery point under the fuel supply agreement is the loading end of the colliery whereafter the title and risk of the coal is that of the appellant. Thus, the purchase is complete.

27. The burden to obtain any clarification being on the appellant, it was submitted that the clarification which they actually sought was as to whether the coal to be supplied would be washed or unwashed, to which a categorical answer was given. Had the appellant any doubt about bearing the cost

for the washed coal, they could easily have raised a specific query in that behalf. This is sought to be read along with Clause 2.7.1.4 providing for the quoted tariff to be an ‘all inclusive tariff’ with no exclusion allowed. Thus, the washing of coal and other activities in relation thereto, are to be included in the quoted tariff, which is as per unit tariff. The

relevant clause, in this regard, reads as under:

“2.7.1.4 The Bidder shall *inter alia* take into account the following while preparing and submitting the financial Bid:

....

3. The Quoted Tariff in Format 1 of Annexure 4 shall be an all inclusive tariff and no exclusions shall be allowed. The Bidder shall take into account all costs including capital and operating costs, statutory taxes, duties, levies while quoting such tariff. Availability of the inputs necessary for generation of power should be ensured by the Seller at the Project Site and all costs involved in procuring the inputs (including statutory taxes, duties, levies thereof) at the Project Site must be reflected in the Quoted Tariff.”

....

“6. The Bidders should factor the cost of the secondary fuel into the Quoted Tariff and no separate reimbursement shall be allowed on this account.”

28. The first respondent seeks to draw a distinction between the purchase cost of fuel and the cost of usable fuel for the contention that it is only the first one which is to be included.

29. On the second issue of GCV, the plea raised is that it is the own case of the appellant itself that SECL is actually overstating the GCV of coal actually supplied. Since the coal is to be jointly analyzed and tested at the stage of delivery, it is not understood how SECL is supplying inferior coal but billing for superior coal. In any case, this is an issue to be raised with SECL. The formula of energy charges in relation to GCV, is using the expression the coal delivered “to the project.” This is in contradistinction to the expression “to and at the project” which is used in relation to the cost of coal. Thus, with these two different expressions used, they obviously mean two different things. In support of his proposition reliance is placed on *Life Corporation of India & Anr. vs. Dharam Vir*

*Anand*¹, wherein it was observed as under:

“6. In construing a particular Clause of the Contract it is only reasonable to construe that the word and the terms used therein must be given effect to. In other words one part of the Contract cannot be made otiose by giving a meaning to the policy of the contract. Then again when the same Clause of a contract uses two different expressions, ordinarily those different expressions conveying one and the same meaning.”

30. Qua the issue of road transportation charges, a reference

¹ (1998) 7 SCC 348

has been made to the RFP where under the heading of “Activities/Milestones to be completed before issue of RfP as per Bidding guidelines” at serial No.3 only transportation through Railways has been envisaged:

Sl. No.	Project Inputs/clearances	Parameters	Status of activities/milestones
3.	Fuel Transportation	For Coal approx. 1600 km	Railways have given assurance for transportation of Coal from SECL.

31. The land for the Railways siding was to be acquired by the bidder (appellant) as per the requirement, and the Government of Punjab was to facilitate the acquisition of land. 1078 acres of land was already acquired. The relevant extract of the RFP is as under:

B. Other Project Related Activities/Milestones			
Sl. No.	Project Inputs/clearances	Parameters	Status of activities/milestones
1.	Land		
	ii) Railway sidings and rail lines from nearby station to site		To be acquired by Selected Bidder as per requirement. Govt. of Punjab will facilitate acquisition of

			land as desired by the Selected Bidder.
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32. The endeavour to get any other linked claim arising from coal is also thus denied, as is the claim for interest, which was not even claimed. It is added by providing a copy of the order dated 7.6.2017 of the Commission dealing with the remand proceedings, that since the claim for interest there has been rejected now on the ground that there was no claim made earlier, the submission sought to be made in respect of the claim for interest is an attempt to get over the said defect. The question of payment of interest arises only qua bills, which are not in dispute, the relevant clause being, clause 11.3.4, as under:

“11.3.4 In the event of delay in payment of a Monthly Bill by the Procurer beyond its Due Date month billing, a Late Payment Surcharge shall be payable by the Procurer to the Seller at the rate of two (2) percent in excess of the applicable SBAR per annum, on the amount of outstanding payment, calculated on a day to day basis (and compounded with Monthly rest), for each day of the delay.”

Legal Principles for interpretation of a commercial contract:

33. The contours of the controversy show that we are really concerned with the interpretation of the commercial contract *inter se* the parties. Before analyzing the relevant clauses of the contract including the Definition clause and formulae, we consider it appropriate to set forth certain judicial pronouncements relevant for determination of the issue.

34. To begin with we refer to the judgment of the Court of Appeal in *The Moorcock*². Bowen, L.J., dealt with the implied warranty on the part of the owners of the jetty, in respect of a contract made for the use of the jetty to a ship, for discharge of its cargo. The name of the ship was ‘The Moorcock’. It was observed as under:

“**Bowen, L.J. :**Now, an implied warranty, or, as it is called, a covenant in law, as distinguished from an express contract or an express warranty, really is in all cases founded on the presumed intention of the parties, and upon reason. The implication which the law draws from what must obviously have been the intention of the parties, the law draws with the object of giving efficacy to the transaction and preventing such a failure of consideration as cannot have been within the contemplation of either side; and I believe that if one were to take all the cases, and they are many, of implied warranties or covenants in law, it will be found that in all of them the law is raising an implication from the presumed intention of the parties with the object of giving to the transaction such efficacy as both parties must have

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(1889) 14 PD 64

intended that at all events it should have. *In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men; not impose on one side all the perils of the transaction, or to emancipate one side from the all chances of failure, but to make each party promise in law as much, at all events, as it must have been in the contemplation of both parties that he should be responsible for in respect of those perils or chances.*” (Emphasis supplied)

35. The significant issue was the principle of ‘business efficacy to the transactions’ which are intended at all events by parties who are businessmen.

36. The aforesaid was, once again, relied upon in *Shirlaw v. Southern Foundries (1926) L.D.*³ wherein MacKinnon, L.J.,

observed as under:

“I recognize that the right or duty of a Court to find the existence of an implied term or implied terms in a written contract is a matter to be exercised with care; and a Court is too often invited to do so upon vague and uncertain grounds. Too often also such an invitation is backed by the citation of a sentence or two from the judgment of Bowen L.J. in *The Moorcock* (1939) 2 KB 206. They are sentences from an extempore judgment as sound and sensible as all the utterances of that great judge; but I fancy that he would have been rather surprised if he could have foreseen that these general remarks of his would come to be a favourite citation of a supposed principle of law, and I even think that he might sympathize with the occasional impatience of his successors when *The Moorcock* (1939) 2 KB 206 is so often flushed for them in that guise.

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(1939) 2 KB 206

For my part, I think that there is a test that may be at least as useful as such generalities. If I may quote from an essay which I wrote some years ago, I then said: “Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common ‘Oh, of course!’ ”

At least it is true, I think, that, if a term were never implied by a judge unless it could pass that test, he could not be held to be wrong.”

37. The aforesaid, thus, extended a word of caution while applying The Moorcock test, by bringing forth “The Officious Bystander Test” of ‘Oh, of course!’.

38. In *Reigate vs. Union Manufacturing Co. (Ramsbottom)*

*Ltd.*⁴, Scrutton L.J., discussed the developments in respect of

these principles and observed as under:

“These principles, however, have been clearly established: The first thing is to see what the parties have expressed in the contract; and then an implied term is not to be added because the Court thinks it would have been reasonable to have inserted it in the contract. A term can only be implied if it is necessary in the business sense to give efficacy to the contract; that is, if it is such a term that it can confidently be said that if at the time the contract was being negotiated some one 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.” Unless the Court comes to some such

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[1918] 1 K.B. 592

conclusion as that, it ought not to imply a term which the parties themselves have not expressed.”

.....

“Is that a necessary implication? If this matter had been mooted at the time when the contract was being negotiated, I expect that the parties would at once have disagreed as to what the position was. Unless we are satisfied that it is an implication which must necessarily have been in the minds of both parties, we cannot imply a term which they have not expressed, especially when I see that they have thought sufficiently about the matter to express two conditions on which the agreement is to be determined, first, the obvious one on the death of the agent; and, secondly, by six months' notice after the expiration of the seven years.”

39. In *Liverpool City Council vs. Irwin*⁵, Lord Denning M.R.,

observed as under:

“It is often said that the courts only imply a term in a contract when it is reasonable and necessary to do so in order to give business efficacy to the transaction: see *The Moorcock* (1889) 14 P.D. 64, 68. (Emphasis is put on the word “necessary”: *Reigate v. Union Manufacturing Co. (Ramsbottom) Ltd.* [1918] 1 K.B. 592, 605.) Or when it is obvious that both parties must have intended it: so obvious indeed that if an officious bystander had asked them whether there was to be such a term, both would have suppressed it testily: “Yes, of course”: see *Shirlaw v. Southern Foundries (1926) Ltd.* [1939] 2 K.B. 206, 227.

Those expressions have been repeated so often that it is with some trepidation that I venture to question them. I do so because they do not truly represent the way in which the courts act. Let me take some instances. There are stacks of them. Such as the terms implied by the courts into a contract for the sale of goods

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(1976) Q.B. 319

— Jones v. Just (1868) L.R. 3 Q.B. 197: or the hire of goods — Asley Industrial Trust Ltd. v. Grimley [1963] 1 W.L.R. 584: into a contract for work and materials — Young & Marten Ltd. v. McManus Childs Ltd. [1969] 1 A.C. 454: or into a contract for letting an unfurnished house — Hart v. Windsor (1843) 12 M. & W. 68: or a furnished house — Collins v. Hopkins [1923] 2 K.B. 617: or into the carriage of a passenger by railway: see Readhead v. Midland Railway Co. (1869) L.R. 4 Q.B. 379: or to enter on premises: see Francis v. Cockrell (1870) L.R. 5 Q.B. 501: or to buy a house in course of erection: see Hancock v. B. W. Brazier (Anerley) Ltd. [1966] 1 W.L.R. 1317.

If you read the discussion in those cases, you will see that in none of them did the court ask: what did both parties intend? If asked, each party would have said he never gave it a thought: or the one would have intended something different from the other. Nor did the court ask: Is it necessary to give business efficacy to the transaction? If asked, the answer would have been: “It is reasonable, but it is not necessary.” The judgments in all those cases show that the courts implied a term according to whether or not it was reasonable in all the circumstances to do so. Very often it was conceded that there was some implied term. The only question was: “What was the extent of it?” Such as, was it an absolute warranty of fitness, or only a promise to use reasonable care? That cannot be solved by inquiring what they both intended, or into what was necessary. But only into what was reasonable. This is to be decided as matter of law, not as matter of fact. Lord Wright pulled the blinkers off our eyes when he said in 1935 to the Holdsworth Club:

“The truth is that the court decides this question in accordance with what seems to be just or reasonable in its eyes. The judge finds in himself the criterion of what is reasonable. The court is in this sense making a contract for the parties — though it is almost blasphemy to say so.” (Lord Wright of Durley, *Legal Essays and Addresses* (1939), p. 259.)

In 1956, Lord Radcliffe put it elegantly when he said of the

parties to an implied term:

“their actual persons should be allowed to rest in peace. In their place there rises the figure of the fair and reasonable man. And the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself”: see *Davis Contractors Ltd. v. Fareham Urban District Council* [1956] A.C. 696, 728.

In 1969, Lord Reid put it simply when he said: “... no warranty ought to be implied in a contract unless it is in all the circumstances reasonable,” see *Young & Marten Ltd. v. McManus Childs Ltd.* [1969] 1 A.C. 454, 465: and Lord Upjohn echoed it when he said, at p. 471, that the implied warranty was “imposed by law.””

40. The aforesaid judgment was carried in appeal to the House of Lords in *Liverpool City Council vs. Irwin [H.L. (E.)]*⁶. However, it was clarified that the touchstone for interpreting commercial documents, cannot be ‘mere reasonableness’ as Lord Denning had observed, but ‘necessity’ :

Edmund–Davies, L.J.: “That set the Court of Appeal off on considering in what circumstances a contractual term could be implied, and that understandably but unfortunately led them to *The Moorcock* , 14 P.D. 64. It had not been cited in *Miller v. Hancock* but the Court of Appeal considered that it enshrined the only possible basis for implying such a term as that contended for by the tenants. It is right to say, furthermore, that such was the only basis advanced on behalf of the tenants themselves at

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(1976) 2 WLR 562

that time. The Court of Appeal accordingly proceeded to consider whether, in the light of *The Moorcock*, such a term could be implied in the tenancy agreement. Roskill L.J. (with whom Ormrod L.J. agreed) said [1975] 3 W.L.R. 663, 677:

“I cannot agree ... that it is open to us in the court at the present day to imply a term because subjectively or objectively we as individual judges think it would be reasonable so to do. It must be necessary in order to make the contract work as well as reasonable so to do, before the court can write into a contract as a matter of implication some term which the parties have themselves, assumedly deliberately, omitted to do.”

Lord Denning M.R., on the other hand, “with some trepidation” (p. 669) (which was understandable), took a different view and, after referring to some out of the “stacks” of relevant cases, said, at p. 670:

“...in none of them did the court ask: what did both parties intend? If asked, each party would have said he never gave it a thought: or the one would have intended something different from the other. Nor did the court ask: Is it necessary to give business efficacy to the transaction? If asked, the answer would have been: ‘It is reasonable, but it is not necessary.’ The judgments in all those cases show that the courts implied a term according to whether or not it was reasonable in all the circumstances to do so This is to be decided as matter of law, not as matter of fact.”

I have respectfully to say that I prefer the views of the majority in the Court of Appeal. Bowen L.J. said in the well known passage in *The Moorcock*, 14 P.D. 64, 68:

“In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at

all events by both parties who are business men; ... to make each party promise in law as much, at all events, as it must have been in the contemplation of both parties that he should be responsible for ...”

That is not to say, of course, that consideration of what is reasonable plays no part in determining whether or not a term should be implied. Thus, in *Hamlyn & Co. v. Wood & Co.* [1891] 2 Q.B. 488, decided only two years after *The Moorcock* (to which he had been a party), Lord Esher M.R. said, at p. 491:

“... the court has no right to imply in a written contract any such stipulation, unless , on considering the terms of the contract in a reasonable and business manner , an implication necessarily arises that the parties must have intended that the suggested stipulation should exist. It is not enough to say that it would be a reasonable thing to make such an implication. It must be a necessary implication in the sense that I have mentioned.”

Bowen and Kay L.JJ., who had also been members of the *Moorcock* court, delivered similar judgments. *The touchstone is always necessity and not merely reasonableness* : see, for example, the judgment of Scrutton L.J. in *Reigate v. Union Manufacturing Co. (Ramsbottom) Ltd.* [1918] 1 K.B. 592, 605, and in the case cited below by Roskill L.J., *In re Comptoir Commercial Anversois v. Power, Son and Co.* [1920] 1 K.B. 868. 899.

But be the test that of necessity, (as I think, in common with Roskill and Ormrod L.JJ.) or reasonableness, (as Lord Denning M.R. thought), *the exercise involved is that of ascertaining the presumed intention of the parties.* Whichever of these two tests one applies to the facts of the instant case, in my judgment the outcome would be the same for, in the words of Roskill L.J. [1975] 3 W.L.R. 663, 677–678:

“... I find it absolutely impossible to believe that the

Liverpool City Council, if asked whether it was their intention as well as that of their tenants of these flats that any of the implied terms contended for by Mr. Godfrey should be written into the contract, would have given an affirmative answer. Their answers would clearly have been ‘No.’” (Emphasis supplied)

41. In a sense, this was a turning around to what was observed in *The Moorcock* (supra).

42. Lord Denning, M.R., in *Shell U.K. Ltd. vs. Lostock Garage Ltd.*⁷, once again, considered the law as to implied

terms and summarized it:

“This submission makes it necessary once again to consider the law as to implied terms. I ventured with some trepidation to suggest that terms implied by law could be brought within one comprehensive category — in which the courts could imply a term such as was just and reasonable in the circumstances: see *Greaves & Co. (Contractors) Ltd. v. Baynham Meikle & Partners* [1975] 1 W.L.R. 1095, 1099–1100; *Liverpool City Council v. Irwin* [1976] Q.B. 319, 331–332. But, as I feared, the House of Lords in *Liverpool City Council v. Irwin* [1976] 2 W.L.R. 562, have rejected it as quite unacceptable. As I read the speeches, there are two broad categories of implied terms.

(i) *The first category*

The first category comprehends all those relationships which are of common occurrence. Such as the relationship of seller and buyer, owner and hirer, master and servant, landlord and tenant, carrier by land or by sea, contractor for building works, and so forth. In all those relationships the courts have imposed

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(1976) 1 WLR 1187

obligations on one party or the other, saying they are “implied terms.” These obligations are not founded on the intention of the parties, actual or presumed, but on more general considerations: see *Luxor (Eastbourne) Ltd. v. Cooper* [1941] A.C. 108, 137 by Lord Wright; *Lister v. Romford Ice and Cold Storage Co. Ltd.* [1957] A.C. 555, 576 by Viscount Simonds, and at p. 594 by Lord Tucker (both of whom give interesting illustrations); and *Liverpool City Council v. Irwin* [1976] 2 W.L.R. 562, 571 by Lord Cross of Chelsea, and at p. 579 by Lord Edmund-Davies. In such relationships the problem is not to be solved by asking what did the parties intend? Or would they have unhesitatingly agreed to it, if asked? It is to be solved by asking: has the law already defined the obligation or the extent of it? If so, let it be followed. If not, look to see what would be reasonable in the general run of such cases: see by Lord Cross of Chelsea at p. 570H: and then say what the obligation shall be. The House in *Liverpool City Council v. Irwin* [1976] 2 W.L.R. 562 went through that very process. They examined the existing law of landlord and tenant, in particular that relating to easements, to see if it contained the solution to the problem: and, having found that it did not, they imposed an obligation on the landlord to use reasonable care. In these relationships the parties can exclude or modify the obligation by express words; but unless they do so, the obligation is a legal incident of the relationship which is attached by the law itself and not by reason of any implied term.

Likewise, in the general law of contract, the legal effect of frustration does not depend on an implied term. It does not depend on the presumed intention of the parties, nor on what they would have answered, if asked: but simply on what the court itself declares to amount to a frustration: see *Davis Contractors Ltd. v. Fareham Urban District Council* [1956] A.C. 696, 728 by Lord Radcliffe and *The Eugenia* [1964] 2 Q.B. 226, 238, 239.

(ii) The second category

The second category comprehends those cases which are not within the first category. These are cases — not of common occurrence — in which from the particular circumstances a term is to be implied. In these cases the implication is based on an intention imputed to the parties from their actual circumstances: see *Luxor (Eastbourne) Ltd. v. Cooper* [1941] A.C. 108, 137 by Lord Wright. Such an imputation is only to be made when it is necessary to imply a term to give efficacy to the contract and make it a workable agreement in such manner as the parties would clearly have done if they had applied their mind to the contingency which has arisen. These are the “officious bystander” types of case: see *Lister v. Romford Ice and Cold Storage Co. Ltd.* [1957] A.C. 555, 594, by Lord Tucker. In such cases a term is not to be implied on the ground that it would be reasonable: but only when it is necessary and can be formulated with a sufficient degree of precision. This was the test applied by the majority of this court in *Liverpool City Council v. Irwin* 1 [1976] Q.B. 319. and they were emphatically upheld by the House on this point: see [1976] 2 W.L. R. 562, 571D–H by Lord Cross of Chelsea; p. 578G–579A by Lord Edmund-Davies.

There is this point to be noted about *Liverpool City Council v. Irwin*. In this court the argument was only about an implication in the second category. In the House of Lords that argument was not pursued. It was only the first category.

Into which of the two categories does the present case come? I am tempted to say that a solus agreement between supplier and buyer is of such common occurrence nowadays that it could be put into the first category: so that the law could imply a term based on general considerations. But I do not think this would be found acceptable. Nor do I think the case can be brought within the second category. If the Shell company had been asked at the beginning: “Will you agree not to discriminate abnormally against the buyer?” I think they would have declined. it might be a reasonable term, but it is not a necessary term. Nor can it be formulated with sufficient precision. On this point I agree with Kerr J. It should be noticed that in the *Esso* case Mocatta J. also

refused to make such an implication: see [1966] 2 Q.B. 514, 536–541; and there was no appeal from his decision. In the circumstances, I do not think any term can be implied.”

43. A parallel development in Australia arose out of a judgment of the Lords of the Judicial Committee of the Privy Council in the appeal preferred from the Full Court of the Supreme Court of Victoria in *B.P. Refinery (Westernport) Proprietary Limited vs. The President Councillors and Ratepayers of the Shire of Hastings*⁸. On the implication of the terms of contraction five conditions were laid down and a reference was, once again, made to the *The Moorcock* (supra), *Reigate vs. Union Manufacturing Co. (Ramsbottom) Ltd.* (supra) and *Shirlaw v. Southern Foundries* (supra) in the following terms:

“40. Their Lordships do not think it necessary to review exhaustively the authorities on the implication of a term in a contract which the parties have not thought fit to express. *In their view, for a term to be implied, the following conditions (which may overlap) must be satisfied:* (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.

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[1977] UKPC 13

41. Their Lordships venture to cite only three passages - albeit they are familiar to every student of this branch of the law. In *The Moorcock* (19) Bowen LJ said:

"I believe if one were to take all the cases, and they are many, of implied warranties or covenants in law, it will be found that in all of them the law is raising an implication from the presumed intention of the parties with the object of giving to the transaction such efficacy as both parties must have intended that at all events it should have. In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men. . . ."

It is because the implication of a term rests on the presumed intention of the parties that the primary condition must be satisfied that the term sought to be implied must be reasonable and equitable. It is not to be imputed to a party that he is assenting to an unexpressed term which will operate unreasonably and inequitably against himself.

In *Reigate v. Union Manufacturing Co.* (20), Scrutton LJ said:

"A term can only be implied if it is necessary in the business sense to give efficacy to the contract i.e., if it is such a term that it can confidently be said that if at the time the contract was being negotiated some one 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.'"

In *Shirlaw v. Southern Foundries (1926) Ltd.* (21), MacKinnon LJ said:

"Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the

parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common, 'Oh, of course.'” (Emphasis supplied)

44. The next development, was in *Investors Compensation Scheme Ltd. vs. West Bromwich Building Society*⁹. Lord Hoffmann, in his majority opinion, prefaced his explanation of reasons with some general remarks about the principles which contractual documents are nowadays construed – common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of ‘legal’ interpretation was observed to have been discarded, and the principles summarized as follows:

“(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the “matrix of fact,” but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document

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(1998) 1 All ER 98

would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see *Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd.* [1997] A.C. 749.

(5) The “rule” that words should be given their “natural and ordinary meaning” reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Compania Naviera S.A. v. Salen Rederierna A.B.* [1985] A.C. 191, 201:

“if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to

business commonsense.’”

45. Once again, Lord Hoffmann, now sitting on the Privy Council, in *Attorney General of Belize and Ors. vs. Belize Telecom Ltd. and Anr.*¹⁰, dealt with the implied terms of the contract in the context of the Articles of Association of a company. It has been observed as under:

“16. Before discussing in greater detail the reasoning of the Court of Appeal, the Board will make some general observations about the process of implication. The 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: see *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 , 912–913. 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.

17. The 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. Otherwise, the express provisions of the instrument are to continue to operate

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(2009) 1 WLR 1988

undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.

18. In some cases, however, the reasonable addressee would understand the instrument to mean something else. He would consider that the only meaning consistent with the other provisions of the instrument, read against the relevant background, is that something is to happen. The event in question is to affect the rights of the parties. The instrument may not have expressly said so, but this is what it must mean. In such a case, it is said that the court implies a term as to what will happen if the event in question occurs. But the implication of the term is not an addition to the instrument. It only spells out what the instrument means.

19. The proposition that the implication of a term is an exercise in the construction of the instrument as a whole is not only a matter of logic (since a court has no power to alter what the instrument means) but also well supported by authority. In *Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601 , 609 Lord Pearson, with whom Lord Guest and Lord Diplock agreed, said:

“the court does not make a contract for the parties. The court will not even improve the contract which the parties have made for themselves, however desirable the improvement might be. The court’s function is to interpret and apply the contract which the parties have made for themselves. If the express terms are perfectly clear and free from ambiguity, there is no choice to be made between different possible meanings: the clear terms must be applied even if the court thinks some other terms would have been more suitable. An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract: it is not enough for the court to find that such a term would have been adopted by the parties as reasonable men if it had been suggested to them: it must

have been a term that went without saying, a term necessary to give business efficacy to the contract, a term which, though tacit, formed part of the contract which the parties made for themselves.”

20. More recently, in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 , 459, Lord Steyn said: “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.”

21. 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. It will be noticed from Lord Pearson’s speech that this question can be reformulated in various ways which a court may find helpful in providing an answer—the implied term must “go without saying”, it must be “necessary to give business efficacy to the contract” and so on—but these are not in the Board’s opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?

22. There are dangers in treating these alternative formulations of the question as if they had a life of their own. Take, for example, the question of whether the implied term is “necessary to give business efficacy” to the contract. That formulation serves to underline two important points. The first, conveyed by the use of the word “business”, is that in considering what the instrument would have meant to a reasonable person who had knowledge of the relevant background, one assumes the notional reader will take into account the practical consequences of deciding that it means one thing or the other. In the case of an instrument such as a commercial contract, he will consider whether a different construction would frustrate the apparent business purpose of the parties. That was the basis upon which *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408

was decided. The second, conveyed by the use of the word “necessary”, is that it is not enough for a court to consider that the implied term expresses what it would have been reasonable for the parties to agree to. It must be satisfied that it is what the contract actually means.

23. The danger lies, however, in detaching the phrase “necessary to give business efficacy” from the basic process of construction of the instrument. It is frequently the case that a contract may work perfectly well in the sense that both parties can perform their express obligations, but the consequences would contradict what a reasonable person would understand the contract to mean. Lord Steyn made this point in the *Equitable Life* case, at p 459, when he said that in that case an implication was necessary “to give effect to the reasonable expectations of the parties”.

24. The same point had been made many years earlier by Bowen LJ in his well known formulation in *The Moorcock* (1889) 14 PD 64, 68:

“In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men ...”

25. Likewise, the requirement that the implied term must “go without saying” is no more than another way of saying that, although the instrument does not expressly say so, that is what a reasonable person would understand it to mean. Any attempt to make more of this requirement runs the risk of diverting attention from the objectivity which informs the whole process of construction into speculation about what the actual parties to the contract or authors (or supposed authors) of the instrument would have thought about the proposed implication. The imaginary conversation with an officious bystander in *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 206 , 227 is celebrated throughout the common law world. Like the phrase “necessary to give business efficacy”, it vividly emphasises the

need for the court to be satisfied that the proposed implication spells out what the contract would reasonably be understood to mean. But it carries the danger of barren argument over how the actual parties would have reacted to the proposed amendment. That, in the Board's opinion, is irrelevant. Likewise, it is not necessary that the need for the implied term should be obvious in the sense of being immediately apparent, even upon a superficial consideration of the terms of the contract and the relevant background. The need for an implied term not infrequently arises when the draftsman of a complicated instrument has omitted to make express provision for some event because he has not fully thought through the contingencies which might arise, even though it is obvious after a careful consideration of the express terms and the background that only one answer would be consistent with the rest of the instrument. In such circumstances, the fact that the actual parties might have said to the officious bystander "Could you please explain that again?" does not matter.

26. In *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 , 282–283 Lord Simon of Glaisdale, giving the advice of the majority of the Board, said that it was "[not] necessary to review exhaustively the authorities on the implication of a term in a contract" but that the following conditions ("which may overlap") must be satisfied:

"(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."

27. The Board considers that this list is best regarded, not as series of independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means, or in which they

have explained why they did not think that it did so. The Board has already discussed the significance of “necessary to give business efficacy” and “goes without saying”. As for the other formulations, the fact that the proposed implied term would be inequitable or unreasonable, or contradict what the parties have expressly said, or is incapable of clear expression, are all good reasons for saying that a reasonable man would not have understood that to be what the instrument meant.”

46. There were, once again, parallel developments in India during this period in various High Courts but the views of this Court can be found expression in *M/s. Dhanrajamal Gobindram vs. M/s. Shamji Kalidas and Co.*¹¹:

“19.Commercial documents are sometimes expressed in language which does not, on its face, bear a clear meaning. The effort of Courts is to give a meaning, if possible. This was laid down by the House of Lords in *Hillas & Co. v. Arcos Ltd.* [(1932) All ER 494] , and the observations of Lord Wright have become classic, and have been quoted with approval both by the Judicial Committee and the House of Lords ever since. The latest case of the House of Lords is *Adamastos Shipping Co. Ltd. v. Anglo-Saxon Petroleum Co. Ltd.* [(1959) AC 133] There, the clause was “This bill of lading”, whereas the document to which it referred was a charter-party. Viscount Simonds summarised at p. 158 all the rules applicable to construction of commercial documents, and laid down that effort should always be made to construe commercial agreements broadly and one must not be astute to find defects in them, or reject them as meaningless.”

47. In *The Union of India vs. M/s. D.N. Revri & Co. and*

¹¹ (1961) 3 SCR 1020

*Ors.*¹², P.N. Bhagwati, J. (as he then was), speaking for the Bench of two Judges said in para 7 as under:

“7. It must be remembered that a contract is a commercial document between the parties and it must be interpreted in such a manner as to give efficacy to the contract rather than to invalidate it. It would not be right while interpreting a contract, entered into between two lay parties, to apply strict rules of construction which are ordinarily applicable to a conveyance and other formal documents. The meaning of such a contract must be gathered by adopting a common sense approach and it must not be allowed to be thwarted by a narrow, pedantic and legalistic interpretation.....”

48. Lastly in *Satya Jain (Dead) Through LRs. and Ors. vs.*

*Anis Ahmed Rushdie (Dead) Through LRs. and Ors.*¹³,

Ranjan Gogoi, J., elucidated the well established principles of the classic test of business efficacy to achieve the result of consequences intended by the parties acting as prudent businessmen. It was opined as under:

“33. The principle of business efficacy is normally invoked to read a term in an agreement or contract so as to achieve the result or the consequence intended by the parties acting as prudent businessmen. Business efficacy means the power to produce intended results. The classic test of business efficacy was proposed by Bowen, L.J. in *Moorcock* [(1889) LR 14 PD 64 (CA)] . This test requires that a term can only be implied if it is necessary to give business efficacy to the contract to avoid such

¹² (1976) 4 SCC 147

¹³ (2013) 8 SCC 131

a failure of consideration that the parties cannot as reasonable businessmen have intended. But only the most limited term should then be implied—the bare minimum to achieve this goal. If the contract makes business sense without the term, the courts will not imply the same. The following passage from the opinion of Bowen, L.J. in Moorcock [(1889) LR 14 PD 64 (CA)] sums up the position: (PD p. 68)

“... In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are businessmen; not to impose on one side all the perils of the transaction, or to emancipate one side from all the chances of failure, but to make each party promise in law as much, at all events, as it must have been in the contemplation of both parties that he should be responsible for in respect of those perils or chances.”

34. Though in an entirely different context, this Court in *United India Insurance Co. Ltd. v. Manubhai Dharmasinhbhai Gajera* [(2008) 10 SCC 404] had considered the circumstances when reading an unexpressed term in an agreement would be justified on the basis that such a term was always and obviously intended by and between the parties thereto. Certain observations in this regard expressed by courts in some foreign jurisdictions were noticed by this Court in para 51 of the Report. As the same may have application to the present case it would be useful to notice the said observations: (SCC p. 434)

“51. ... ‘... “Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander, were to suggest some express provision for it in their agreement, they would testily suppress him with a common ‘Oh, of course!’” *Shirlaw v. Southern Foundries (1926) Ltd.* [(1939) 2 KB 206 : (1939) 2 All ER 113 (CA)]

, KB p. 227.'

* * *

‘... An expressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract: it is not enough for the court to find that such a term would have been adopted by the parties as reasonable men if it had been suggested to them: it must have been a term that went without saying, a term necessary to give business efficacy to the contract, a term which, although tacit, formed part of the contract which the parties made for themselves. *Trollope and Colls Ltd. v. North West Metropolitan Regl. Hospital Board* [(1973) 1 WLR 601 : (1973) 2 All ER 260 (HL)] , All ER p. 268a-b.’”

35. The business efficacy test, therefore, should be applied only in cases where the term that is sought to be read as implied is such which could have been clearly intended by the parties at the time of making of the agreement.....”

Our View:

49. We now proceed to apply the aforesaid principles which have evolved for interpreting the terms of a commercial contract in question. Parties indulging in commerce act in a commercial sense. It is this ground rule which is the basis of *The Moorcock* test of giving ‘business efficacy’ to the transaction, as must have been intended at all events by both business parties. The development of law saw the ‘five condition test’ for an implied condition to be read into the

contract including the ‘business efficacy’ test. It also sought to incorporate ‘The Officious Bystander Test’ [*Shirlaw vs. Southern Foundries* (supra)]. This test has been set out in *B.P. Refinery (Westernport) Proprietary Limited vs. The President Councillors and Ratepayers of the Shire of Hastings* (supra) requiring the requisite conditions to be satisfied: (1) reasonable and equitable; (2) necessary to give business efficacy to the contract; (3) it goes without saying, i.e., The Officious Bystander Test; (4) capable of clear expression; and (5) must not contradict any express term of the contract. The same penta-principles find reference also in *Investors Compensation Scheme Ltd. vs. West Bromwich Building Society* (supra) and *Attorney General of Belize and Ors. vs. Belize Telecom Ltd. and Anr.* (supra). Needless to say that the application of these principles would not be to substitute this Court’s own view of the presumed understanding of commercial terms by the parties if the terms are explicit in their expression. The explicit terms of a contract are always the final word with regards to the intention of the

parties. The multi-clause contract *inter se* the parties has, thus, to be understood and interpreted in a manner that any view, on a particular clause of the contract, should not do violence to another part of the contract.

50. The pricing of the coal is, if one may say, the crux of the problem. It is no doubt true, as contended by the first respondent, that while submitting the financial bid, clause 2.7.1.4(3) of the RFP required the tariff to be quoted in Format-1 of Annexure 4 to be an ‘all inclusive tariff’ and provided that no exclusion shall be allowed. This clause has already been extracted aforesaid. The bidder/appellant was, thus, required to take into account all costs, including capital and operational costs, statutory taxes, etc.. The same clause also provides that the availability of inputs necessary for generation of power should be ensured by the seller at the ‘Project Site’, which must be reflected in the quoted tariff. The significant aspect is that the working of the contract is on the basis of ‘Project Site’. It has to be, however, simultaneously kept in mind that the present project is in the nature of a Case-2

project which provides for a fuel specific procurement, having a pre-identified site.

51. The contract did not provide for a fixed energy charge, or a periodic revision of that charge, as the formula for energy charge was designed in such a manner that it would be influenced by the actual cost of coal. Thus, the basis is the actual cost incurred with regards to the coal. Of course, a major controversy has arisen as to whether the cost of coal has to be determined on the basis of the purchase price from SECL at the ‘mine-end’, when the property is supposed to pass to the appellant, or whether it is the cost of coal to be used for the plant as incurred by the appellant at site of the project, or the ‘project-end’.

52. Schedule 7 of the PPA provides for tariff payment and its computation. The monthly energy charges form part of clause 1.2.3 of the 7th Schedule. This clause is extracted as under:

“1.2.3 Monthly Energy Charges

The Monthly Energy Charges for Month “m” shall be calculated as under:

$$MEP_n = AEO_m \times MEP_n$$

Where:

AEO_m is the Scheduled Energy during the month m (in kWh)

Monthly Energy Charges

$$MEP_n = \frac{NHR_n \times F^{COAL}_n}{PCV_n}$$

where,

NHR_n is the Net Heat Rate for the Contract Year in which month “m” occurs expressed in kCal/kwh and is equal to the Quoted Net Heat Rate of the Contract Year in which month “m” occurs, as provided in Schedule 11.

F^{COAL}_n is the weighted average actual cost to the Seller of purchasing, transporting and unloading the coal most recently supplied to and at the Project before the beginning of month “m” (expressed in Rs./MT in case of domestic coal)

PCV_n is the weighted average gross calorific value of the coal most recently delivered to the Project before the beginning of month “m” expressed in kcal/kg.”

(emphasis supplied)

53. The variable component of ' F^{COAL}_n ' refers to the 'actual' cost to the seller/appellant of the three components, i.e., (a) purchasing; (b) transporting; and (c) unloading the coal. The first respondent is thus right that there may be different aspects before the coal is used in the plant which are not required to be reimbursed by the first respondent. The illustrations given by the first respondent are of sizing of coal, crushing of coal, sprinkling and moisturisation of coal for stacking and storage, etc. being activities required to be undertaken prior to generation. Thus, there is no hesitation in our concluding that in view of the specific formula provided, only three aspects relating to coal would determine the particular co-efficient.

54. These three expressions are thereafter followed by the stipulation that the coal has to be recently supplied "to and at the project." The question is, what is the meaning of this expression? The word 'to' obviously would have reference to transporting while the word 'at' would have relationship with unloading since it would be 'transporting to' and 'unloading

at'. Any other construction will fail to make grammatical sense. Not only that, all the three, i.e., purchasing, transporting and unloading, have a reference to "the Project." Thus, the definition of F^{COAL}_n is the weighted average actual cost incurred by the appellant of purchasing the coal and transporting it to the project site and thereafter unloading the coal at the project site. The fact that the property in coal passed on to the appellant vis-à-vis SECL, on delivery being taken at the mine-end would not change the definition of coal pricing as is required for the purposes of calculation of the tariff.

55. Mr. Mukul Rohatgi, learned Senior Advocate, thus, rightly took support of the maxim for interpretation, '*Reddendo*

Singula Singulis' This principle is set out as under:
"387. *Reddendo Singula Singulis* principle¹⁴

Where a complex sentence has more than one subject, and more than one object, it may be the right construction to *render each to each*, by reading the provision distributively and applying each object to its appropriate subject. A similar principle applies to verbs and their subjects, and to other parts of speech."

56. In 'Principles of Statutory Interpretation' by Justice G.P.

¹⁴

Francis Bennion – Statutory Interpretation (Butterworths – 1984, London); (Part XXII, pg. 842)

Singh (former Chief Justice, Madhya Pradesh High Court), it has been expressed as under:

“(e) Reddendo Singula Singulis¹⁵”

The rule may be stated from an Irish case in the following words Where there are general words of description, following an enumeration of particular things such general words are to be construed distributively, reddendo singula singulis; and if the general words will apply to some things and not to others, the general words are to be applied to those things to which they will, and not to those to which they will not apply; that rule is beyond all controversy¹⁶". Thus, 'I devise and 'bequeath' all my real and personal property to A' will be construed, reddendo singula singulis by applying 'devise' to 'real' property and 'bequeath' to 'personal' property¹⁷ and in the sentence: 'If any one shall draw or load ant sword or gun' the word 'draw' is applied to 'sword' only and the word 'load' to gun only, because it is impossible to load a sword or draw a gun.¹⁸”

57. The aforesaid also refers to *Koteswar Vittal Kamath v. K.*

*Rangappa Balia & Co.*¹⁹, which in turn has referred to the

Black’s Interpretation of Laws to define this expression as:

¹⁵ Principles of Statutory Interpretation by Justice G.P. Singh (former Chief Justice M.P. High Court) Fourth Edition 1988

¹⁶ M’Neill v. Crommelin (1858) 9 Ir CLR 61 : 62 Digest, p. 672.

¹⁷ OSBORNE: Concise Law Dictionary, p. 269

¹⁸ WHARTON: Law Lexicon, 14th Edition, p. 850.

¹⁹ (1969) 1 SCC 255

“Where a sentence in a statute contains several antecedents and several consequences, they are to be read distributively; that is to say, each phrase or expression is to be referred to its appropriate object.”

58. We have thus, also endeavoured to read the provision distributively, by applying each object, to the appropriate subject. Thus, the relevant preposition has been applied to the relevant activity.

59. Once we obtain clarity on the aforesaid formula for calculation of the energy charges, the prior activity of ‘washing’, before receiving the coal at the project site would be part of the pricing of coal and cost of purchasing the same. The appellant did seek to obtain clarity on the issue of the quality of coal to be used, to which the first respondent did answer that it would have to be ‘washed’ coal. In fact, this was in conformity with the Notification issued by the MoEF since the travel distance was more than 1,000 kilometers. The reference to coal in the formula would, thus, be only a reference to ‘washed’ coal and not to ‘unwashed’ coal.

60. The appellant has correctly sought to point out that the

manner in which the first respondent seeks to read the definition is different from the actual definition by giving the following illustration:

“Actual definition in the PPA: F^{COAL}_n is the weighted average actual cost to the Seller of purchasing, transporting and unloading the coal most recently supplied to and at the Project

PSPCL’s Interpretation: F^{COAL}_n is the weighted average actual cost to the Seller of purchasing ***unwashed*** coal, transporting ***washed*** and unloading the ***washed*** coal most recently supplied to and at the Project”

- 61.** The fact that the clarification made it clear that the appellant had to “arrange” the washing of coal, did not imply that the cost of washing the coal had to be borne by the appellant, as the energy charge formula alone would have to be referred to for the purposes of calculation of the coal price. The operating cost in clause 2.7.1.4(3) of the RFP would refer to the activities mentioned therein and the operation and maintenance of the power plant which would not alter the formula of the energy charges which contains the cost of coal. The principle of ‘business efficacy’ would also require us to read the ‘Monthly Energy Charges’ formula in a manner as

would be normally understood.

62. The plea of the first respondent that the fuel supply agreement and the fuel transportation agreement are part of the ‘project documents’ which does not include the component of ‘washing’, does not hold much water for the reason that ‘washed’ coal is a necessity for the project as a quality requirement for the formula envisaging the requisite quality of coal to be obtained at the project site and, thus, including all the relevant costs up to that quality. The mere term ‘coal’, therefore, would have to mean ‘washed’ coal, as no other type of coal could be used in the matter at hand.

63. Now turning to the transportation cost, once again, what is sought to be excluded is taking the coal for ‘washing’ as well as the last mile to the project, on account of the Railway siding not being located at the project site for a certain specified period of time. It is for that period of time that the actual transportation cost through road is sought to be recovered by the appellant.

64. We fail to appreciate as to how these costs can be

excluded, as the transportation costs to the project site have to be compensated to the appellant. It is not qualified by the methodology of transfer, i.e., railways or road. It is also a matter of necessity, since the railway siding had not reached the project site due to some complications in acquisition of land. It is really the transportation cost from point to point which would be involved and the mere mention in the RFP under project related activity/milestone about Railway siding and the Railway lines from nearby station to site cannot imply that the Railways is the only mode of transportation when the siding has not been made, albeit on account of land acquisition problems.

- 65.** The plea of the first respondent that despite the absence of rail siding, if the appellant proceeded to operate the plant, that was their 'business decision', cannot be sustained for the reason that the project was set up for obtaining electricity for the first respondent and as a prudent business decision for both, it would be required to operate the plant at the earliest. The complication in obtaining land by the State Government,

cannot imply that the project should be on hold for two years, causing loss to everyone and lack of availability of electricity. Such a plea would be in defiance of the very object of the setting up of the power plant.

66. Now turning to the other aspect of the GCV of the coal. If the issue is one of SECL billing for higher Calorific Value while actually supplying a low Calorific Value of coal, that would be a matter between the appellant and the SECL and the first respondent cannot be blamed for the same. That does not take away from the application of the formula for energy charge which provides for PCV_n as the weighted average Gross Calorific Value delivered to the project. This Calorific Value of coal would have to be, thus, on the same parameter determined at the project site.

67. On behalf of the first respondent an endeavour has been made to make a distinction between ‘at the site’ and ‘to the project’ in the definition of F^{COAL}_n and PCV_n . However, this is not of much assistance to the first respondent, in our view, as delivery ‘to the project’ could only mean ‘at the site of the project’. It cannot be at the mine site. In fact, this is a

fundamental issue where the first respondent seems to be altering the basic concept of the formula by seeking to replace the wordings in the formula relating to the project-site to the mine-site.

68. In view of our discussion we have no hesitation in concluding that the point at which the Calorific Value of the coal is to be measured is at the project-site. The plea of the first respondent that there is no such methodology of measuring the Calorific Value at the project-site is belied by the sample reports of different financial years filed by the appellant along with the synopsis, which itself referred to the joint sampling and testing of the coal received and is duly signed by both sides. It is surprising how such a bald denial was made despite the position existing at the site. These sample reports are for years 2014, 2015, 2016 and 2017.

69. We are, thus, of the view that the reading of the energy formula leads to only one conclusion that all costs of coal up to the point of the project site have to be included and the Calorific Value of the coal has to be taken as at the project-site.

70. We may notice that there are certain other essential costs sought to be claimed by the appellant such as the transit and handling losses, third party testing charges, liaising charges. We have already held that the formula contains only three elements and thus, the appellant cannot be permitted to plead that any other element, other than those would also incidentally form a part of the formula. In fact, such claims would be hit by RFP clause 2.7.1.4(3) and the energy charges have to be calculated only on the basis of the formula understood in a business sense. Thus, these claims are rejected.

71. Last but not the least is the claim for interest. It is undisputed that no such claim has been laid so far, at any stage. The appellant claims to rely upon clause 11.3.4 read with clause 11.6.8. We have extracted the relevant clause aforesaid. No doubt there is a provision for a late payment surcharge in the event of delay in payment of a monthly bill but in the present case it is not as if there are undisputed bills remaining unpaid. There were serious disputes regarding the interpretation of the contractual clauses itself. We do not think

that the present one is a fit case where the principle of compensation for deprivation should enure for the benefit of the appellant as a measure of restitution. More so as it has not been claimed by them at any stage. It does appear that this inclusion in the written synopsis does seem to arise as canvassed by the learned Senior Advocate for the first respondent on account of the Tribunal not finding favour with such claim in the remand proceedings by reason of no claim being laid towards the same. We are, thus, not inclined to grant this claim.

72. We may, however, in the end, extend a word of caution. It should certainly not be an endeavour of commercial courts to look to implied terms of contract. In the current day and age, making of contracts is a matter of high technical expertise with legal brains from all sides involved in the process of drafting a contract. It is even preceded by opportunities of seeking clarifications and doubts so that the parties know what they are getting into. Thus, normally a contract should be read as it reads, as per its express terms. The implied terms is a concept,

which is necessitated only when the Penta-test referred to aforesaid comes into play. There has to be a strict necessity for it. In the present case, we have really only read the contract in the manner it reads. We have not really read into it any 'implied term' but from the collection of clauses, come to a conclusion as to what the contract says. The formula for energy charges, to our mind, was quite clear. We have only expounded it in accordance to its natural grammatical contour, keeping in mind the nature of the contract.

Conclusion:

73. We, thus, partly allow the appeal to the extent that the appellant is held entitled to the washing cost of coal, the transportation from the mine site via washing of coal to the project site inclusive of cost of road transportation for the period where it was necessary. The Calorific Value of the coal would have to be taken at the project site. All other claims in appeal stand rejected. The amount payable to the appellant as the consequences thereof be remitted within a period of three (3) months from the date of this order, failing which it would carry interest @ 12 per cent per annum (simple interest). No

costs.

.....**J.**
(Rohinton Fali Nariman)

.....**J.**
(Sanjay Kishan Kaul)

New Delhi.
October 05, 2017.