Feature

KEY POINTS

- Whether a Braganza duty of good faith is to be implied into a commercial contract is a matter of context and construction.
- Where the contract confers an unqualified right of termination the court is very unlikely to imply a Braganza duty.
- Where the right of termination depends on a condition precedent, a duty of good faith may be implied in circumstances requiring the exercise of a contractual discretion.
- Care must be taken in drafting termination clauses and events of default as certain forms of words can introduce a subjective or discretionary element which may give rise to an implied duty of good faith impacting an otherwise unqualified right of termination.

Authors Charlotte Eborall and Sarah Parker

Bragging rights: termination clauses and implied duties of good faith

In this article, the authors consider the circumstances in which termination clauses in a commercial contract might be subject to a so-called *Braganza* duty of good faith and the practical issues that might follow from this.

In the recent decision in *Lombard North Central Plc v European Skyjets Limited* [2022] EWHC 728 (QB), Foxton J considered the defendant's submission that Lombard's decision to exercise a right of termination constituted the exercise of a contractual discretion to which a *Braganza* duty of good faith applied. The judge held that:

> "Lombard's decision is what is sometimes described as an 'absolute contractual right' for it to exercise for its own purposes, as it sees fit. The issue of whether rights to terminate and analogous rights could be subject to *Braganza* duties was the subject of careful consideration by His Honour Judge Pelling QC in *TAQA Bratani Limited v Rockrose UKCS8 LLC* [2020] EWHC 58 (Comm), [44]-[53], who rejected the argument that rights of termination were to be analysed as contractual discretions. That reasoning is compelling, and I gratefully adopt it." ([152])

At first blush, this paragraph suggests that the decision to terminate a contract is by its nature an absolute contractual right and thus may never be subject to a *Braganza* duty. In this article we will unpack this point further and consider whether such a duty might ever arise in the context of a decision to terminate and what the practical consequences of that might be.

THE *BRAGANZA* DUTY

In *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661 (*Braganza*), the Supreme Court considered the nature of the duty on contractual decision-makers where one party to a contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, which affects the rights of both parties, and where that gives rise to a clear conflict of interests (at [17] and [18]). *Braganza* concerned the entitlement of an employee's widow to death in service benefits where it was for the employer to determine whether the employee had died by suicide. The court imported the two-limbed *Wednesbury* test for reasonableness from *Associated Provincial Picture Houses Ltd v Wednesbury Corpn* [1948] 1 KB 223, 233-234 namely whether: (i) the decision-maker has taken into account matters that they ought not to have taken into account or neglected matters which they ought to have taken into account; and (ii) even so, the conclusion is not so unreasonable that no reasonable decision-maker could have reached it (see *Braganza*, at [30], [53] and [103]). In considering that test, the court referred, at [102], to *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] Bus LR 1304 (*Socimer*):

> "a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. The concern is that the discretion should not be abused." (at [66])

The mechanism of limiting the parties' contractual discretions is by implying a term into the contract. Such a term may "vary according to the contract and the context in which the decision-making power is given" (*Braganza*, at [18]).

DECISION IN *TAQA*

In relation to the decision to terminate a contract, in *Skyjets* Foxton J highlighted a distinction between the exercise of a contractual discretion such as arose in *Braganza* and *Socimer* and the exercise of "absolute contractual rights" (at [152]). Skyjets suggested that in *electing* to terminate a contract, Lombard had exercised its discretion to do so and as such should have done so in good faith. In rejecting this, Foxton J referred to the judgment of HHJ Pelling QC in *TAQA Bratani Limited* (*TAQA*).[1]

In *TAQA*, the court was concerned with determining the validity of termination notices given to operators of certain oil and gas field blocks in the North Sea. The defendants sought, *inter alia*, to imply a term that "qualifies the manner in which [the express termination provision of the contract] may be exercised by concepts of good faith, and genuineness and the absence of arbitrariness, capriciousness, perversity and irrationality" (at [30]). They relied on *Socimer* and *Braganza*.

The court held that the termination clauses conferred an unqualified right to terminate the operator role (at [34]). Given the meaning and effect of the express terms, it was not necessary to imply a *Braganza* duty as it was neither necessary to give business efficacy to the agreement, nor was it so obvious that it went without saying (at [45]). HHJ Pelling QC held that the authorities make it clear that *Braganza* has "no application to unqualified termination clauses within expertly drawn complex commercial contracts between sophisticated commercial parties" (at [46]).

Whether termination clauses in any particular contract confer an absolute

contractual right or a contractual discretion will therefore be a matter of construction subject to the usual rules of contractual construction and the implication of terms.[2] Whether the right of termination is absolute will depend on the process of construction which "takes account of the characteristics of the parties, the terms of the contract as a whole and the contractual context, not a starting point intrinsic to the term itself" (*Equitas Insurance Limited v Municipal Insurance Limited* [2020] QB 418, at [113] *per* Males LJ cited in *TAQA*, at [51]).

DUTIES OF GOOD FAITH IN THE CONTEXT OF TERMINATION

It is clear from the discussion in *TAQA* that Foxton J's statement in *Skyjets* should not be read as authority for the proposition that termination clauses should be understood as absolute contractual rights by their very nature. Rather, where as a matter of construction a contract provides for an unqualified right of termination, that right does not entail the exercise of a contractual discretion. Writing extra-judicially, Foxton J appears to have taken the stronger view suggested in the *Skyjets* passage quoted above.[3] However, his reference in *Skyjets* to the subsequent case of *TAQA* suggests a more nuanced position.

Clearly, a duty of good faith might arise as an express provision of the contract. This might be because a contract explicitly provides that the decision to terminate the contract will be made by the terminating party in good faith, or it might be because a contractual discretion is built into the termination clause in some other way.[4] Nevertheless, it is not enough that the contract provides generally that parties' performance under the contract will be governed by a duty of good faith; the duty will need to specifically encompass the right of termination (see *TSG Building Services PLC v South Anglia Housing Ltd* [2013] EWHC 1151 (TCC), at [42] and [51]).[5]

Alternatively, while a contract might provide for an unqualified right of termination, that right might only arise in circumstances which require the exercise of a contractual discretion, for example in cases where the relevant event of default which triggers the right of termination requires the exercise of the terminating party's judgment or a finding of fact. In *Skyjets*, the Loan Agreement at cl 9.1(p) provided for an event of default where "in the opinion of the Lender, a material adverse change occurs in the business, assets, condition, operations or prospects of any Group Company or any Credit Support Provider". Lombard submitted that the opinion had to be honest and rational, although it was unnecessary for it to be objective, and Foxton J accepted that submission (which accorded with earlier authority, namely *Çukurova Finance International Ltd v Alfa Telecom Turkey Ltd* [2016] AC 923 at [55]) (*Skyjets*, at [121]).

It is important to remember in that context that there are two stages. First, determining whether an event of default has occurred and second, deciding whether to terminate as a consequence. Although a contract might contain an unqualified right of termination which is not subject to a duty of good faith, nevertheless, the terminating party may find itself bound by an implied term of good faith at the earlier default stage when the terminating party is considering whether its right to terminate has been triggered.[6] This is not to smuggle the implied term into the decision to terminate, nor into events of default as a category, rather, the event of default must incorporate the element of discretion, or opinion, for the implied term to bite.

Once again, construction is key. An event of default which might superficially introduce an element of discretion could contain its own measure which would render the implied term otiose. In *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200, the Court of Appeal held that where the company was required to demonstrate certain matters "to the reasonable satisfaction of the Trust" the introduction of the word "reasonable" to qualify the "satisfaction" of the Trust introduced an objective rather than subjective test and, moreover, contained its own intrinsic control mechanism which did not require the implication of a *Braganza* duty (at [94]).

Similarly, in *Bates v Post Office Ltd* [2019] EWHC 606 (QB) (*Bates*) the court held that the qualification of the notice period by the words "not less than" involved some "conscious thought" as to the period of notice to give and that decision should not be taken arbitrarily (at [894]). The qualification of the minimum notice period in the circumstances of that case implied a term of good faith.

The nature of the contractual relationship might also be relevant. In *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB) (*Yam Seng*) Leggatt J considered that the requirements that parties to a contract will behave honestly, in accordance with generally accepted standards of commercial dealing, and with fidelity to the parties' bargain fulfilled the test for an implied term (at [137]-[139]):

> "… there seems to me to be no difficulty, following the established methodology of English Law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intentions of the parties." (at [131])

Commercial contracts are made against a background of shared norms and values (at [134]). This is particularly so in what Leggatt J described as longer term "relational contracts" where a high degree of communication, co-operation and predictable performance based on mutual trust and confidence and expectations of loyalty may be required (at [142]).[7] However, the implication of such a term, including in relational contracts, will still depend on the construction and context of the contract. It is "not a reflection of a special rule of interpretation for [relational contracts]" (see *Globe Motors Inc v TRW Lucas Variety Electric Steering Limited* [2017] 1 All ER (Comm) 601, at [67] to [68]).

The implication of terms of good faith was given extensive consideration in *Bates* where the court noted that "… there is no general duty of good faith in all commercial contracts, but … such a duty could be implied into some contracts, where it was in accordance with the intentions of the parties. Whether any contract is relational is heavily dependent upon context, as well as the terms. The circumstances of the relationship, defined by the terms of the agreement, set in its commercial context, is what decides whether a contract is relational or not" (at [721]).

In *Bates*, Fraser J set out the characteristics of a relational contract, the first of which is that "there must be no specific express terms in the contract that prevents the duty of good faith being applied into the contract".[8] A duty of good faith can only be implied into a contract where the express terms of the contract would permit it.[9]

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Biog box
Charlotte Eborall and Sarah Parker are both barristers practising from 3 Verulam Buildings, Gray's Inn, London. Email: sparker@3vb.com and ceborall@3vb.com

However, while a relational contract may lead to the implication of such a term, such a relational contract is not necessary. Fraser J found that the contracts existing between the sub-postmasters and Post Office are relational, and as such are subject to an implied term of good faith, but he then went further:

> "… if I am wrong that these terms are consequential upon that finding, then I find that these [terms] would be implied into the contract in any event, and separately from the issue of relational contracts, as being necessary to give business efficacy to the contracts." (at [757])

He tested this against the consequence of the Post Office's position in denying that a term of good faith can be implied:

> "The Post Office's submission amounts to one that it is contractually entitled to suspend and/or terminate [sub-postmasters] arbitrarily, capriciously, irrationally and without reasonable or proper cause and to exercise contractual powers other than honestly." (at [761])

Accordingly, the critical point here for the implication of an implied term of good faith is not that the contract is a "relational" one *per se* but, instead, whether the context and construction of the contract itself allows for the implication of such a term. Where it does, then the term may be implied to give business efficacy to the contract, even in the context of termination. These comments of Fraser J in *Bates*, open the door a little wider to implied duties of good faith than Foxton J's paragraph in *Skyjets* would suggest.

THE FLOODGATES ISSUE

One of the reasons given for resisting the implication of a *Braganza* duty into unqualified termination clauses in the way contended for in *TAQA* is that there would be "almost no contractual provision which would not attract them" which would "have profound implications for English commercial and contract law" (*TAQA*, at [46]). Taking too permissive an approach to the implication of a duty of good faith would introduce, it is feared, unacceptable levels of uncertainty into the performance of contracts.

However, this in itself is no reason to reject the approach to good faith as it is understood in *Yam Seng* and *Bates*. Duties of good faith are no more uncertain than the process of contractual interpretation (*Yam Seng*, at [152]) and putting the position the other way around as Fraser J does in *Bates*, it becomes clear that such duties may be implicit in commercial agreements where the context would make it clear that capricious, perverse, arbitrary or irrational termination would be contrary to the presumed intentions of the parties.

Parties do enter into agreements containing unqualified rights of termination and will expect to be able to rely on those clauses for their full effect. In those circumstances, as in *Skyjets*, the authorities suggest that it is highly unlikely that a court would imply a *Braganza* duty or duty of good faith. Passing the usual rules of interpretation of contracts and the implication of terms is still a high bar and one which the courts are used to applying. However, in considering the context of a contract, where the circumstances of the case involve an egregious violation of ordinary norms of commercially acceptable behaviour, that may justify the implication of a term notwithstanding the unqualified nature of the right to terminate contained in the contract. Where those boundaries might lie, and what the content of any implied term of good faith might be, will be highly context dependent, but it is clear from *Skyjets* that it will not usually include a decision to terminate a contract arising from a failure to pay instalments under a loan (*Skyjets*, at [100]).

CONCLUSION

Commercial contracts are entered into against a backdrop of commercial rationality and honesty and, that being so, the door is not closed on the exercise of a right of termination being subject to a duty of good faith. However, context and construction are critical. Care should be taken in the construction of both termination clauses and events of default in a commercial contract where the right to terminate is intended to be an absolute contractual right. Further, it is important in those circumstances that the party with greater exposure to such a clause be aware that an unqualified right of termination on the part of the other party is likely to be exactly that, and appropriate risk-management steps should be taken on that basis. ■

1 In which Mr David Foxton QC had made submissions on this issue as Counsel.
2 *TAQA* contains a helpful summary of the authorities at paras 26-29.
3 Foxton, D: 'A good faith goodbye? Good faith obligations and contractual termination rights' [2017] LCMLQ 360.
4 See for example *Essex County Council v UBB Waste (Essex) Ltd* [2020] EWHC 1581 (TCC) at [397].
5 Cited in Pliener, D and Carmichael, S 'Are English courts still hostile to a doctrine of good faith?' (2017) 1 JIBFL 19, p 20.
6 This was accepted in Foxton, D 'A good faith goodbye? Good faith obligations and contractual termination rights' p 383.
7 See also his extra-judicial writing 'Contractual Duties of Good Faith', COMBAR lecture 18 October 2016.
8 Fraser J lists nine characteristics in total, although these are not exhaustive (*Bates v Post Office Ltd* [2019] EWHC 606 (QB) at [725]). See also [737]. These were briefly considered in *Essex County Council v UBB Waste (Essex) Ltd* at [106].
9 Fraser J's approach to the question of good faith and relational contracts was considered by Coulson LJ in determining the Post Office's application for permission to appeal. The decision contains no neutral citation as it cannot be cited pursuant to *Practice Direction (Citation of Authorities)* [2001] 1 WLR 1001 but can be found at https://www.jfsa.org.uk/uploads/5/4/3/1/54312921/post_office_approved_judgment_2.pdf (cited in Haward Soper, C: 'Occam's razor or Leggatt's multiblade – good faith or a clean shave?' JBL 2021, 7, 580-595.)

Further Reading:

- Waiving goodbye to termination rights in default scenario negotiations (2022) 7 JIBFL 446.
- Implied Obligations of Good Faith and Proper Purpose (2019) 1 JIBFL 9.
- Contractual Discretion or Absolute Right (2019) 5 JIBFL 296.