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# Limits on Contractual Freedom

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## Abstract

*This article is concerned with an important feature of English law that distinguishes it sharply from civilian systems of law and, to a lesser extent, from other common law systems—namely, its eschewal of an imposed duty of good faith and fair dealing. It will be shown that English law is receptive to such a standard in particular cases but that much of the ground that may be thought to be covered by good faith and fair dealing is covered instead by controls on the exercise of contractual discretion by reference to an implied contractual term that the discretion not be exercised in a way that is capricious, arbitrary, or irrational. This body of law has grown up in the last 30 years or so and has been influenced to a degree by public law considerations.*

## Introduction

Once a binding contract has been concluded, the freedom of action of contracting parties, purporting to do so in accordance with the contract, may by law be limited in two different ways. First of all, attempts to limit or exclude the liability that would otherwise arise from the written terms or circumstances surrounding the contract may be subject to controls. These may take the form of an application, more or less strict, of the *contra proferentem* rule of interpretation so as to narrow contractual language that seeks to limit or exclude liability<sup>1</sup> or of a statute that either strikes down certain restrictive language or subjects its scope to a standard of reasonableness or something of that kind.<sup>2</sup> These initiatives take aim at the language of the contract as initially concluded.

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<sup>1</sup> Note the withdrawal in recent times of the courts from the exercise of unduly narrowing the scope of contractual language in cases where the parties are simply allocating between themselves contractual risks: eg *Nobahar-Cookson v The Hut Group Ltd* [2016] EWCA Civ 128, para 16, [2016] 1 CLC 573; *Taberna Europe CDO II Plc v Selskabet AF 1. September 2008 A/S* [2016] EWCA Civ 1262, para 23, [2017] QB 663; *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373, para 57; *Interactive E-Solutions JLT v O3B Africa Ltd* [2018] EWCA Civ 62, para 14.

<sup>2</sup> Eg Unfair Contract Terms Act 1977.

My concern in this article is not with the exclusion or limitation of liability. Instead, it is with a different means of imposing limits on a contracting party's freedom to act, whether these limits might require such action to abide by the standard of good faith and fair dealing (hereinafter good faith, unless otherwise stated) or be based upon a decision to act that complies with a minimum standard of decision-making. In English law, there is little evidence of a movement towards the general imposition on contracting parties of a standard of good faith behaviour in a way that transcends honesty so as to embrace fair conduct. There are, however, some signs of a willingness to recognize a role for good faith in particular instances of close and continuing contractual relationships, and, as will also be demonstrated below, there is a substantial body of emergent case law dealing with controls on the exercise of discretion in contractual performance. To a significant extent, controlling discretion might be explained in some reported cases as a substitute for a general standard of good faith.<sup>3</sup> Its emergence might also be seen as relieving pressure on the legal system to succumb to a more ambitious and general standard for the control of contractual behaviour by reference to good faith, which might, if adopted, have unforeseeable, repercussive consequences.

As far as good faith is concerned, the literature in the common law world has now become voluminous. I shall not attempt an overall survey but shall instead pose certain questions about good faith as part of an attempt to understand why English law has been, so far, resistant to its call. This will obviously require a broad comparison with civil law systems and international instruments, such as the UN Convention on the International Sale of Goods (CISG) and the UNIDROIT Principles of International Commercial Contracts (PICC).<sup>4</sup> It is beyond the scope of this article to seek and arrive at an understanding why the standard of good faith, having already achieved recognition in the USA, is making headway in Australia and Canada. The answer may not be at all easy to find; it certainly does not lie in the apodictic character of good faith but may be explained in part, at least, by the character of the daily fare before these countries' courts, so far removed from the world of shipping, commodities, and financial dealings that are the mainstay of English commercial courts.

Turning now to contractual discretion, my concern is with a substantial body of modern law in England requiring certain decisions to comply with minimum standards of contractual decision-making. These standards in the case law, to cite language repeatedly employed almost by way of incantation,

<sup>3</sup> In the case that has pressed furthest the cause of an implied term of good faith and fair dealing, *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB), para 146 1 Lloyd's Rep 526. The Court referred to cases controlling the exercise of contractual discretion as reflecting the good faith principle. See further E McKendrick, 'Good Faith in the Performance of a Contract in English Law' and S Burton, 'History and Theory of Good Faith Performance in the United States' both in LA DiMatteo and M Hogg (eds), *Comparative Contract Law* (OUP 2016).

<sup>4</sup> Convention on the International Sale of Goods (1980), 1489 United Nations Treaty Series (1988), 3 (CISG); International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts (4th edn, 2016) (PICC).

compel the decision-maker to refrain from conduct that is ‘capricious’, ‘arbitrary’, or ‘irrational’. It might seem that these words set the bar for judicial intervention somewhat higher than would be set by good faith with its reference to fairness, but, as will be demonstrated below, some contractual decisions may fail to comply with these standards of decision-making and yet not fail a test of good faith. Nevertheless, it is arguable that discretion cases in England go part way to playing a role that might otherwise be played by good faith. So far, I have not detected a systematic body of law in other jurisdictions dealing with the exercise of contractual discretion that has developed in a similar way to the English cases.

As part of the inquiry into good faith and contractual discretion, account should be taken of the significant developments that have taken place in the last 20 years or so in the area of contractual interpretation. At the risk of over-generalization, a striking feature of these developments has been the stated willingness to go behind the language of a written contract, in order to explore the circumstantial hinterland, in aid of clarifying the meaning of the parties.<sup>5</sup> To the extent that this is done, it plays a vital part in the search for contractual meaning. In so far as that meaning can be clarified by a profounder analysis than can be achieved by simple reliance on the written word and its plain meaning, then any reference in the case law to good faith and the avoidance of arbitrary decision making is more readily justifiable as consonant with the intention of the parties rather than with any rule of conduct imposed by the courts upon the contracting parties. Under the old dispensation when courts were broadly content with the written word, any judicial invocation of good faith would more readily be seen as overriding the language of the contract as expressed in a written instrument and, therefore, on that account to be deprecated.

## Good faith

### *Good faith and codes*

There is something about codes that encourages the formulation of standards and broad principles. During the drafting of the American Restatement Second of Contracts, the principle of good faith and fair dealing was adopted so as to set a standard for the performance of contracts and to impose limits on their enforcement.<sup>6</sup> The provisions on the formation of contracts had already been settled by this date, which explains why good faith plays no role

<sup>5</sup> The case law is voluminous. See eg *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL); *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900.

<sup>6</sup> ‘§205. DUTY OF GOOD FAITH AND FAIR DEALING: Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.’ This followed on from the standard that applied to merchants in the Uniform Commercial Code, §1-201(19).

there.<sup>7</sup> As for the meaning of good faith, this is probably best expressed by Comment d to §205:

Good faith performance. Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.

This is far from being a definition. The subsequent literature sought to sound out the character of good faith, with, for example, Robert Summers seeing it as the Manichean opposite of bad faith<sup>8</sup> and Stephen Burton seeing it as an impermissible attempt to recapture a lost bargaining position.<sup>9</sup> Some, if not all, of the conduct listed in Comment d could readily be dealt with as contractual non-performance without any reference to good faith at all. Years ago, my review of the cases listed in support of §205 led me to believe that they could have been dealt with by an English court—even by an American court—under the heading of implied terms and contractual interpretation.<sup>10</sup> This leads one to question what is the purpose of introducing a formal statement of the principle of good faith, alongside the companion question of whether the purpose behind it is to permit a court to arrive at a conclusion that would otherwise not be permitted by the rules of contract law. I shall return to these questions later, but, for the moment, let us consider how good faith fits into the structure of contract law. We may begin, for comparison purposes, with the broad heading of 'Discharge'. This may be sub-classified as 'Discharge for Breach', 'Discharge by Performance', and 'Discharge by Frustration', with sub-categories under the first heading of 'Breach of Condition' and 'Breach Going to the Root of the Contract', and so on. It seems clear at the outset that 'Good Faith and Fair Dealing' cannot be insinuated into contractual structure in the same easy way; it is not just a heading of convenience that merely captures existing sub-categories of 'Implied Terms', 'Interpretation', 'Fraud', and so on.

The debate about the role of good faith in the CISG is well-trodden ground. The principle of good faith binding the contracting parties was not adopted largely, but not entirely, due to opposition from common law

<sup>7</sup> In conversation in 1983 with the reporter Allan Farnsworth, who had taken over from Rudolf Braucher. Allan Farnsworth, perhaps in a sardonic vein, also told me that the principle was introduced in order to create a 'happy campers' atmosphere among the delegates.

<sup>8</sup> RS Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code* (1968) 54 *Virginia L Rev* 195.

<sup>9</sup> SJ Burton, 'Breach of Contract and the Common Law Duty to Perform in Good Faith' (1980) 94 *Harvard L Rev* 369.

<sup>10</sup> M Bridge, 'Does Anglo-Canadian Law Need a Doctrine of Good Faith?' (1984) 9 *Canadian Business LJ* 385.

countries.<sup>11</sup> That was by no means the end of the matter since a duty to abide by the standard of good faith was imposed by Article 7(1) on courts and tribunals in aid of promoting the integrity of international trading. The impact of such a duty is, to say the least, unclear, and some decisions appear to have resorted to the duty in order to constrain the conduct of contracting parties themselves. Moreover, other courts, seeking to fill perceived gaps in the CISG, have, in accordance with Article 7(2), resorted to an unstated yet immanent principle of good faith underlying the CISG as a whole, bearing directly on the contracting parties. The Secretariat commentary on the 1978 draft of the CISG identified a considerable number of its provisions and might well in the same spirit of generality have identified yet more, making one wonder about the usefulness of a principle that explained life, the universe, and everything. Whether Article 7(1) or 7(2) has been adopted by a court or tribunal, the impression given by the case law as a whole is one of legal banality and judicial expediency. The following examples of good faith do not comprise the whole but are reasonably representative.

Taking, first, Article 7(1), it has been held to be against good faith for a court to give effect to a jurisdiction clause on the back of a contractual document when a contracting party would not expect to see it there.<sup>12</sup> It is easier and more direct to say that a party is not bound by a contractual clause in the absence of consent. Article 7(1) has also been used to justify an award of damages against a buyer for abuse of the legal process arising out of the way it conducted litigation based on a meritless claim.<sup>13</sup> A costs order against the buyer is more direct and appropriate. As for Article 7(2), good faith is sometimes called into play for no explained reason at all.<sup>14</sup> Good faith has also been invoked to justify the principle of estoppel, which does not need such support since it can stand on its own as a general principle underlying the CISG.<sup>15</sup> Again, good faith has been invoked when ordinary principles of interpretation in Article 8 have been in play.<sup>16</sup> Good faith has been relied upon to set an interest rate<sup>17</sup> (why?) and to require, when Article 35 on the quality standard of goods is more than adequate for the task, that flour supplied be of an international standard.<sup>18</sup> In one case, it was held that a seller was in bad faith who launched proceedings for the price of goods shortly after the due date without

<sup>11</sup> See M Bridge, 'Good Faith, the Common Law and the CISG' (2017) 22(1) *Uniform L Rev* 98.

<sup>12</sup> See OLG Celle, 24 July 2009, CISG-Online 1906 (Pace); LG Neubrandenburg, 3 August 2005, CISG-Online 1190 (Pace); BGH, 31 October 2001, CISG-Online 617 (Pace); OLG München, 14 January 2009; Rb Rotterdam, 25 February 2009; Audiencia Provincial de Navarra, 27 December 2007 (Pace).

<sup>13</sup> Cour d'appel de Grenoble, 22 February 1995, CISG-Online 151 (Pace).

<sup>14</sup> See eg MKAC Arbitral Tribunal Case no 95/2004, 27 May 2005, CISG-Online 1456 (Pace).

<sup>15</sup> See eg OLG Karlsruhe, 25 June 1997, CISG-Online 263 (Pace); Internationales Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft, 15 June 1994, SCH-4366, CISG-Online 120 (Pace); Handelsgericht des Kantons Zürich, 30 November 1998, CISG-Online 415 (Pace).

<sup>16</sup> *Primo Tribunal Colegiada en Materia Civil del Primo Circuito*, 10 March 2005, CISG-Online 1004 (Pace).

<sup>17</sup> *Ibid.*

<sup>18</sup> Hof's-Gravenhage, 23 April 2003, CISG-Online 903 (Pace).

giving the buyer a chance to explain:<sup>19</sup> a matter better dealt with, if at all, by a stay of proceedings or a costs order.

Despite its practical redundancy in the world of the CISG, good faith carries a great deal of support, perhaps due in no small measure to the romano-canonical antecedents of the modern civil law. It has been enthroned in the PICC as an express general principle binding on the parties.<sup>20</sup> In addition, despite the stated limitations on the PICC, which are presented as not amounting to a binding instrument,<sup>21</sup> the PICC, nevertheless, prohibit any attempt to exclude good faith.<sup>22</sup> If it were possible, it would be as pertinent for the PICC as it was for the CISG to explore the practical effect of good faith in the decisions of courts and tribunals. Nevertheless, because the PICC have but rarely appeared in judicial decisions, and may not be discerned in the unpublished, confidential world of arbitration, in the case of Article 1.7 we are looking at the equivalent of a Potemkin village, consisting of a building frontage with no development behind it.

In civil law systems, the role of good faith in German law, assisted by the catastrophic devaluation of the currency in the early 1920s, is too well known to need much exposition here. The great commentaries on the German Civil Code provide a monumental coverage of the principle, which appears as a rule of interpretation<sup>23</sup> as well as a duty on the contracting parties.<sup>24</sup> What should be noted, however, is the way that treatment of the subject rests not upon a broad and undifferentiated coverage of good faith but, rather, upon a systematic and highly developed analytical coverage of good faith in its various, recognized aspects. Good faith has, in fact, been systematized and worked thoroughly into the body of German law. Good faith also makes an appearance in the French Civil Code, though its practical impact over the years appears to have been less important than is the case with the German code. Initially limited to contractual performance,<sup>25</sup> it was extended by the courts to deal with contractual negotiations and formation, a position now entrenched in the recent reform of the code that, in new Article 1104, makes this both explicit and also a matter of public policy.<sup>26</sup> As so often is the case with

<sup>19</sup> Tribunale di Padova, 25 February 2004, CISG-Online 819 (Pace).

<sup>20</sup> PICC (n 4) art 1.7.

<sup>21</sup> Introduction to the 1994 Edition: '[T]he Governing Council is fully conscious of the fact that the UNIDROIT Principles, which do not involve the endorsement of Governments, are not a binding instrument and that in consequence their acceptance will depend upon their persuasive authority.'

<sup>22</sup> PICC (n 4) art 1.7(2).

<sup>23</sup> BGB §157.

<sup>24</sup> BGB §242.

<sup>25</sup> Former art 1134.

<sup>26</sup> Case law prior to the reform had extended good faith to contractual termination, controlled by the court and not the autonomous act of a contracting party, but art 1104 does not recognise this extension. See generally S Rowan, 'The New French Law of Contract' (2017) 66 *Intl & Comparative LQ* 805.

good faith, there is no definition of what it means.<sup>27</sup> The Chinese Contract Law of 1999 also contains a principle of good faith.<sup>28</sup> Although this provision is not applicable to contractual negotiations and contract formation, good faith is separately included in a provision dealing with pre-contract liabilities.<sup>29</sup> Good faith also appears in provisions dealing with the cancellation of contracts with persons of limited capacity<sup>30</sup> and of contracts concluded by unauthorized agents.<sup>31</sup> It surfaces again in provisions dealing with performance<sup>32</sup> and the post-discharge relations of the contracting parties,<sup>33</sup> in both cases making reference to notification, assistance, and confidentiality. Although there is no general definition of good faith, as might have been useful in a final provision calling for good faith in the interpretation of contracts,<sup>34</sup> these references to notification, assistance, and confidentiality provide some small degree of specificity, though the practical effect of good faith in general is hard to gauge.

Given this general commitment to a largely undefined principle, the obvious question to ask is why good faith is needed—or better still, wanted—in these civil law instruments. Part of the explanation lies in path dependency, stemming from the romano-canonical history of civil codes, but this seems threadbare when we look at instruments like the Chinese Contract Law that, while to a degree imitative of other instruments, cannot be said to be the inheritor of this history. A better explanation lies in the character of codes and the character of legal rules typified by codes. In the closed world of the code, especially in a code that either discourages or prohibits law-making by the judge,<sup>35</sup> there is an evident need for one or more escape clauses allowing the code to breathe and develop over time. The closest equivalent of this in the common law systems is a well-known provision in sale of goods legislation that permits references to the uncodified common law so far as it is not contradictory of the statute.<sup>36</sup> This legislation, often referred to as codifying legislation, is not a true code since it is not a world of its own but, instead, is linked to the uncodified common law. A further characteristic of true codes is that their systematic and comprehensive character tends towards generality<sup>37</sup> and away from the detail that is characteristic of casuistic common law systems.<sup>38</sup> Putting it another way, civil law and common law systems tend to draw the line separating

<sup>27</sup> In the case law, good faith has been said to mean cooperation, loyalty and coherence (whatever this last item may mean).

<sup>28</sup> Contract Law of the People's Republic of China (1999) art 1.6 (Contract Law): 'The parties shall abide by the principle of good faith in exercising their rights and performing their obligations.'

<sup>29</sup> Ibid art 42 (iii).

<sup>30</sup> Ibid art 47.

<sup>31</sup> Ibid art 48.

<sup>32</sup> Ibid art 60.

<sup>33</sup> Ibid art 92.

<sup>34</sup> Ibid art 125.

<sup>35</sup> Eg, French Code civil, art 5.

<sup>36</sup> Sale of Goods Act 1979, s 62(2).

<sup>37</sup> Cf the Prussian Allgemeines Landrecht 1794, which contained over 17,000 articles, including detailed rules on breast feeding.

<sup>38</sup> See B Nicholas, *The French Law of Contract* (2nd edn, OUP 1992) 18.

law and the factual application of law in different places. A common law court may see when assessing damages for breach of contract a complex array of rules, whereas a civil law court may be guided instead by general rules: for example, the requirements that loss be caused by a breach of contract and that compensation be full (or integral), seeing their application to particular circumstances as essentially factual in character.

### *Good faith and English law*

Turning now to English law, its resistance in the past to good faith has been, for those who would seek to instil in the law so-called 'community values', a notorious fact. So far as the matter has been discussed in the case law, there are signs of the same phenomenon that one comes across in civil law and international instruments—namely, a failure to provide a general definition of good faith. In the casuistic world of the common law, this is not surprising since the issue will be raised in particular circumstances: for example, the question of whether contractual negotiations may be broken off unilaterally. The position to date is that any notion of good faith, in the sense of fairness, has been resisted in the world of pre-contractual negotiations since it would be inconsistent with the arm's-length relationship of parties in such a position, where each is permitted to consider only its own self-interest.<sup>39</sup> This does not appear to be likely to change. English law has not seen fit to adopt a notion of *culpa in contrahendo*; the absence of both a contractual vehicle to carry such a notion,<sup>40</sup> and an expansive law of tort giving protection against economic loss that would do the same,<sup>41</sup> may be seen as responsible for this. There has also, in the past, been strong resistance to recognizing agreements to agree or to negotiate in good faith, part of the reason for this being due to concerns about the meaning and certainty of such agreements.<sup>42</sup> There are clear signs of this resistance being overcome as long as the agreement is not an open-ended one.<sup>43</sup> The paramount importance of giving effect to agreements intended to be binding should always trump doubts about the meaning of agreements.

Beyond the pre-contractual stage, a version of good faith may be seen in particular relationships, such as contracts of the utmost good faith (essentially, insurance contracts), employment contracts, and contracts giving rise to

<sup>39</sup> *Walford v Miles* [1992] 2 AC 128 (HL).

<sup>40</sup> There are exceptional cases where a collateral contract might be devised (see *Warlow v Harrison* (1859) 1 E&E 309 (semble); cf *Harris v Nickerson* (1873) LR 8 QB 286) but the doctrine of consideration generally precludes liability, as where an offer unsupported by consideration may be revoked even when the offeror has promised to keep it open (*Offord v Davies* (1862) 12 CBNS 748).

<sup>41</sup> This is due to long-standing limits on liability for pure economic loss.

<sup>42</sup> *Eg, May & Butcher Ltd v R* [1934] 2 KB 17n (HL).

<sup>43</sup> See *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2005] EWCA Civ 891, para 121, [2006] 1 Lloyd's Rep 161; *Rosalina Investments Ltd v New Balance Athletic Shoes (UK) Ltd* [2018] EWHC 1014 (QB), para 48ff.

fiduciary relationships, such as partnership agreements, or relationships of a fiduciary character.<sup>44</sup> The interesting question that is now presenting itself, as we shall see below, is whether a further, quasi-fiduciary category of relational contracts should be recognized as vehicles for carrying a good faith obligation. A version of good faith may also be seen in particular contractual clauses, such as confidentiality clauses. And there are various other examples, judicial and legislative, of intervention in contracts that might be regarded as piecemeal examples<sup>45</sup> that could be clustered under a general banner of good faith. If a contractual duty were expressly to require a contracting party to act in good faith, an English court could now be counted on to give meaning to it in the particular circumstances.<sup>46</sup> Apart from express agreement on good faith, its existence or not as a general rule in English law may be seen as dependent upon two principal questions: first, would it provide us with a better understanding of the law we have, acting thus as a general organizing principle of the law, and second, is it needed to counter established rules and attitudes so as to bring about different outcomes in certain cases? The issue, therefore, at least as far as this second question is concerned, is really about whether, in the absence of agreement, an expansive duty of good faith should be imposed on contracting parties without consideration, in a fine-grained way, of the contract and its background circumstances that could justify the appearance of good faith as intended by the parties in particular cases.

The central area for the discussion of this question is occupied by implied terms and contractual interpretation. Beginning with the former, the House of Lords, in the 1970s, firmly ruled against the incorporation in a housing contract of an implied term for the sole reason that it would be reasonable to do so.<sup>47</sup> This brings into focus a distinction of some considerable importance—namely, between terms implied in fact and terms implied in law. The former are based on the intention of the parties—a point underlined by recent developments that, for a time, treated them as merely an aspect of contractual interpretation.<sup>48</sup> More recent developments still, in a body of law that by the standards of English law has displayed unusual volatility, insist on their

<sup>44</sup> Eg, the particular relationship of banker and customer that arose in *Lloyd's Bank Ltd v Bundy* [1975] QB 326 (CA).

<sup>45</sup> Bingham MR in *Interfoto Picture Library Ltd v Stiletto Visual programmes Ltd* [1989] QB 433 (CA).

<sup>46</sup> For a recent example, see the referral agreement in *Health & Case Management Ltd v The Physiotherapy Network Ltd* [2018] EWHC 869 (QB), paras 107ff, a case where there was a misuse of confidential data anyway. See also *Lehman Brothers Special Finance v National Power Corp* [2018] EWHC 487 (Comm), paras 60ff, [2019] 3 All ER 53 (determining the close-out amount in the 2002 ISDA Master Agreement by requiring good faith to be exercised in determining a reasonable amount); *Berkeley Community Villages Ltd v Pullen* [2007] EWHC 1330 (Ch), paras 95–7 (land development agreement requiring 'utmost good faith'); *CPC Group Ltd v Qatari Diar Real Estate Investment Co* [2010] EWHC 1535 (Ch), para 246.

<sup>47</sup> *Liverpool City Council v Irwin* [1977] AC 239 (HL).

<sup>48</sup> *Attorney General Belize v Belize Telecommunications Ltd* [2009] UKPC 10, para 21, [2009] 1 WLR 1988 (Lord Hoffmann).

separate treatment<sup>49</sup> for reasons that will become apparent. Before this is done, it ought to be stressed that terms implied in law are not dependent on the intention of the parties but, rather, are general terms characteristic of particular types of contract. They are the sorts of terms that, when a body of law is codified, as is the case with the law of sale, for example, are set down in the statute, though they may be more or less excluded by the parties in a given case. Not all types of contract, however, are codified—employment law being a good example—which means that an employee's duty of fidelity and an employer's duty to provide a safe system of work do not appear as such in a statute. Returning to terms implied in fact, a distinction is drawn between terms that are so obvious that the parties feel no need to express them and terms whose presence in the contract is needed to give the contract 'business efficacy'.<sup>50</sup> These are terms that the parties may not have put their mind to at all but that, in accordance with the overall intention of the parties to create a workable contract, are incorporated in the contract pursuant to tacit agreement.<sup>51</sup> It is this overall intention that prevents these business efficacy terms from being viewed in a different light as terms implied in law. This is significant for the purpose of determining what scope, if any, should be given to an implied term of good faith or, to pick up the other area of concern in this article, an implied term to exercise a contractual discretion according to at least a minimum standard.

### *Lord Justice Leggatt's initiative*

Lord Justice Leggatt has taken a prominent role in promoting the imposition of a standard of good faith in contract, though so far there is little sign of his overall initiative bearing fruit in English law,<sup>52</sup> not least because the very generality of the term means that it is unlikely to be reconciled with all of the express terms in a written contract.<sup>53</sup> It is useful, nevertheless, to look at a few instances where he has been making the case.

<sup>49</sup> *Marks & Spencer plc v BNP Paribas Security Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742.

<sup>50</sup> *The Moorcock* (1889) 14 PD 64 (CA).

<sup>51</sup> A good test is to ask oneself what exactly was the term implied in *The Moorcock* (answer: a duty to inspect the river bed to see if it was safe for a moored vessel to take the ground at low tide, or, in the absence of such inspection, to advise users of the jetty that no such inspection had been undertaken).

<sup>52</sup> See *Hamsard 3147 Ltd v Boots UK Ltd* [2013] EWHC 3251 (Pat), para 86 (no implied term of good faith even for 'nascent joint venture in the course of negotiation'); *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch), para 108; *Greenclose Ltd v National Westminster Bank plc* [2014] EWHC 1156 (Ch), [2014] 2 Lloyd's Rep 169, para 150 ('there is no general doctrine of good faith in English contract law and such a term is unlikely to arise by way of necessary implication in a contract between two sophisticated commercial parties negotiating at arms' length'); *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland* [2013] EWCA Civ 200, para 105, [2013] BLR 265. But see now *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB), paras 702ff. For termination cases, see below.

<sup>53</sup> *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch), paras 109ff.

The first of these cases is *Yam Seng Pte Ltd v International Trade Corp Ltd*,<sup>54</sup> where the parties had entered into an agreement<sup>55</sup> for the distribution of fragrances<sup>56</sup> in stated territories. The claimant distributor contended that it was entitled to terminate the agreement, citing various breaches of contract by the supplier of fragrances.<sup>57</sup> Not all the alleged breaches gave rise to a right to terminate, but the claimant was allowed to terminate for the supplier's clear repudiation of the contract at a later date. After a broad-ranging inquiry covering developments in the civil law, international instruments, and other common law jurisdictions, the judge invoked a rule of good faith in the performance of contracts to trigger two implied terms in the particular contract. One was that the fragrances should not be sold on in the designated territories for less than the duty-free price agreed upon with the supplier;<sup>58</sup> the other was that the distributor should not knowingly provide the supplier with false information on which the supplier was likely to rely.<sup>59</sup> Although he recognized that good faith was an 'incident' of employment contracts and contracts of a fiduciary character, it is noticeable that Leggatt J (as he then was) did not, at this stage, consider that good faith should be implied as a matter of law in all commercial contracts. Instead, it should be implied in accordance with 'the established methodology of English law for the implication of terms in fact' as 'based on the presumed intention of the parties'.<sup>60</sup> Quite rightly, the learned judge held that a duty to act in good faith in the sense of honesty accorded with the traditional tests for implying a term in fact—namely, that it should either go without saying or give business efficacy to the contract, though it hardly needs an invocation of good faith to add explanatory power to the conclusion that the distributor was under a duty to act honestly.

Leggatt J was sensitive in *Yam Seng* to contractual context, which obviously militates against any comprehensive definition of good faith. He saw honesty as laying at the core of good faith, but was prepared to go beyond mere honesty so as, for example, in applying the objective standard of 'reasonable and honest people', to capture evasiveness.<sup>61</sup> The sharing of information and co-operation were central to distribution agreements, even though it might not be said that they fell within the somewhat narrow boundaries of fiduciary

<sup>54</sup> [2013] EWHC 111 (QB), [2013] 1 CLC 662.

<sup>55</sup> Described as a 'skeletal document which does not attempt to specify the parties' obligations in any detail'. *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB), para 161, [2013] 1 Lloyd's Rep 526.

<sup>56</sup> Bearing, perhaps implausibly, the brand name 'Manchester United', suggesting the playing field rather than the boudoir.

<sup>57</sup> The claimant also contended that it had been induced to enter into the contract by a misrepresentation and recovered damages under s 2(1) of the Misrepresentation Act 1967.

<sup>58</sup> This term was not breached.

<sup>59</sup> This term was breached.

<sup>60</sup> *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB), para 131, [2013] 1 Lloyd's Rep 526.

<sup>61</sup> Leggatt J also saw value in adding the rider of 'fair dealing' to good faith in order to emphasise its objective character. *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB), para 150, [2013] 1 Lloyd's Rep 526.

relations.<sup>62</sup> Above all, Leggatt J was adamant that he was not seeking to change the direction or character of English law. In an important passage, he said:

[B]ecause the content of the duty is heavily dependent on context and is established through a process of construction of the contract, its recognition is entirely consistent with the case by case approach favoured by the common law. There is therefore no need for common lawyers to abandon their characteristic methods and adopt those of civil law systems in order to accommodate the principle.<sup>63</sup>

He did not see good faith as detracting from the right of contracting parties to pursue their own self-interest or from contractual certainty. Overall, the judgment is valuable as a sort of textbook treatment for placing good faith in the context of English law, but one is left with the thought that good faith provides only a background explanation for why English law reaches certain conclusions by more finely grained means, and the further thought that a general resort to good faith in certain categories of contract would be a blunt instrument, arriving in some instances at a conclusion that the more finely-grained approach would disallow. Good faith, on this account, adds nothing to the implication of terms implied in fact.<sup>64</sup>

In *Al Neyahyan v Kent*,<sup>65</sup> sitting at first instance, Leggatt LJ gave further thought to good faith in the context of what have come to be called relational contracts. The particular contract was a joint venture concerning hotels and an online travel service, followed by a so-called framework agreement as part of a corporate restructure. It was the defendant's contention, *inter alia*, that the framework agreement had been procured in breach of a contractual requirement of good faith. While concluding that the claimant owed no fiduciary duty to the defendant, Leggatt LJ drew upon his observation in *Yam Seng* that this did not preclude the presence of a duty of good faith in a contract involving close dealings between the parties, 'collaborating with each other, typically on a long term basis, in ways which respect the spirit and objectives of their venture but which they have not tried to specify, and which it may be impossible to specify, exhaustively in a written contract'.<sup>66</sup> The duty of good faith, set against the background of trust and confidence in a 'relational' contract of this type, did not require a party to sacrifice self interest. The duty was to be implied in the present contract as a matter of business efficacy.<sup>67</sup> More disturbingly, Leggatt LJ had, earlier in the case, described the duty as a 'normative' one and he then went on to say that he would have arrived at the same conclusion by means of a term implied in law 'on the basis that the nature of the

<sup>62</sup> Note, however, the more cautious approach of the Court of Appeal in *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA 396, para 67, [2016] 1 CLC 712, when ruling that even a general requirement of good faith should not dispense with the need to look at the particular terms of the contract, which might repel a general duty of good faith.

<sup>63</sup> [2013] EWHC 111 (QB), para 147, [2013] 1 Lloyd's Rep 526.

<sup>64</sup> See *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch), [2016] 1 BCLC 719, para 40.

<sup>65</sup> [2018] EWHC 333 (Comm), [2018] 1 CLC 216.

<sup>66</sup> *Ibid* para 167.

<sup>67</sup> *Ibid* para 174.

contract as a relational contract implicitly requires (in the absence of a contrary indication) treating it as involving an obligation of good faith.<sup>68</sup> As with the general label of good faith itself, the danger of a broad heading of relational contracts is that the duty of good faith will cross the line separating terms implied in fact from terms implied in law as in fact it has done in the present case. This danger is particularly pronounced in so far as the expression ‘relational contract’ is not a term of art yielding to precise definition.

The further development of good faith in *Al Nehayan* bore fruit in a subsequent case—*Bates v Post Office Ltd (No. 3)*<sup>69</sup>—where a first instance judge launched a robust criticism of the leading text on contract law for its failure to take account of the role of good faith and fair dealing in relational contracts.<sup>70</sup> The notion of a relational contract was considered by the judge to now be an established feature of English law.<sup>71</sup> Reference was made to examples given in earlier cases, such as long-term franchising and distribution contracts.<sup>72</sup> The examples given, in their totality, do not quite match the degree of conviction expressed by the judge as to the existence of both good faith transcending honesty and a defined category of relational contracts. Moreover, the conclusion that ‘some contracts will be categorised as relational contracts, and this has the effect of implying a term of good faith’, leaves a fair number of questions unanswered. The most important question is whether such a term will be one implied in fact or implied in law. If it is the former, and it is based on a close consideration of the particular contract, then there is nothing remarkable about this. On balance, it would seem that the Court comes down in favour of this approach.<sup>73</sup> But if the term is one to be implied in law in relational contracts but not in commercial contracts in general, then there is most certainly a problem if we do not have a closely defined definition of what amounts to a relational contract. Further questions would follow on from this. Would a clause excluding this term survive judicial scrutiny under the Unfair Contract Terms Act 1977? Would a clear attempt to convert, by drafting, a long-term relationship into a series of short-term sequential contracts be permissible?<sup>74</sup>

<sup>68</sup> Ibid para 174.

<sup>69</sup> [2019] EWHC 606 (QB), paras 702ff.

<sup>70</sup> HG Beale (ed), *Chitty on Contracts* (33rd edn, Sweet & Maxwell 2018) ch 1 (Whittaker).

<sup>71</sup> Among the authorities cited are *Amey Birmingham Highway Ltd v Birmingham City Council* [2018] EWCA Civ 264, para 92 (Jackson LJ), where the Court recites the existence of the notion but then recoils from venturing into ‘those contentious issues’.

<sup>72</sup> *Bates* (n 52) itself concerned sub-postmastership contracts.

<sup>73</sup> Ibid para 721: ‘[The cases considered above] all demonstrate in my judgment that there is no general duty of good faith in all commercial contracts, but that such a duty could be implied into some contracts, where it was in accordance with the presumed intention 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.’

<sup>74</sup> As occurred in *Baird Textile Holdings Ltd v Marks & Spencer Plc* [2001] EWCA Civ 274, [2001] CLC 999.

A different case altogether is the (clearly) non-relational contract in *MSC Mediterranean Shipping Co SA v Cottonex Anstalt*,<sup>75</sup> which concerned a shipper's inability, in circumstances over which it had no control, to return containers to a carrier.<sup>76</sup> The contract provided that, in the event of delay beyond a stipulated grace period, the hire charge would toll from day to day and the shipper saw this sum mounting up and surpassing the value of the containers themselves. At trial, Leggatt J was of the view that the carrier had no legitimate interest in claiming these daily sums by way of debt;<sup>77</sup> there was, thus, no need to determine whether the rule against penalties could be applied to debt claims or to other payments arising out of non-breach events. The Court of Appeal reached the same conclusion on legitimate interest but went on to conclude that the contract had been frustrated. The application of the doctrine of frustration dispensed with any judicial restriction of a contracting party's unimpeded right to affirm or terminate a contract in the face of a repudiatory breach, but is controversial in finding that a contract can be frustrated in circumstances where the obligor is also in breach of contract.<sup>78</sup> A better way to resolve the dispute would have been to take the disputed clause and pose the question whether, in the light of modern standards of contextual contractual interpretation, the parties genuinely intended that the *per diem* payments would continue to toll until the crack of doom. The carrier could hardly have insisted upon continuing payments if they had been destroyed in a fire. The parties' joint intention might fairly have been expressed as cutting off payment at the cost of replacement of the containers, given that the parties, in agreeing to the clause, contemplated delay and not impossibility in the return of the containers.

For present purposes, the remarks of Leggatt J in the *MSC* case on good faith are significant, not least because he went beyond the debt claim itself to confront unqualified rights to terminate a contract or keep it on foot. Drawing on the 'increasing recognition in the common law world of the need for good faith in contractual dealings',<sup>79</sup> he saw the legitimate interest restriction on debt claims as being akin to good faith and he saw good faith as a 'general organizing principle of the common law of contract which underpins and informs more specific rules and doctrines'.<sup>80</sup> Now, if good faith can apply so as to prevent the exercise of a right expressly permitted by the contract, it has gone

<sup>75</sup> [2016] EWCA Civ 789, [2016] 2 Lloyd's Rep 494.

<sup>76</sup> There was a complex dispute involving the consignee and the financing bank.

<sup>77</sup> Drawing upon the seminal judgment of Lord Reid in *White and Carter (Councils) Ltd v McGregor* [1962] AC 413, 431 (HL) (Sc). If this decision in favour of the pursuers had been unanimous, instead of three to two, with Lord Reid making up the majority, it is unlikely that Lord Reid's legitimate interest qualification would have had the influence that it has subsequently exercised.

<sup>78</sup> See M Bridge, 'Debt Instead of Damages' in L DiMatteo and Lei Chen, *Chinese Contract Law: Perspectives* (CUP 2018) Ch 17.

<sup>79</sup> *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* [2015] EWHC 283 (Comm), para 97, [2015] 1 Lloyd's Rep 359.

<sup>80</sup> Drawing on the decision of the Supreme Court of Canada in *Bhasin v Hrynew* 2014 SCC 71, [2014] 3 SCR 494.

some way beyond the parties' intentions. (One might also wonder whether an interest in exercising a right can be illegitimate when the contract clearly awards that right.) It did not matter, in the opinion of Leggatt J, whether the right to terminate a contract arose by operation of law or was conferred by the contract itself. It was caught by the good faith rule—more particularly, by the specific rule flowing from it that governed the exercise of contractual discretion, as discussed below. It may be that certain expressly agreed rights of an apparently unqualified nature, when seen within the matrix of fact surrounding the contract, were intended by the parties to be qualified, perhaps by a standard of reasonableness.<sup>81</sup> It is quite different, however, to strike down these rights, especially when they are conferred by operation of law,<sup>82</sup> by reference to a standard of conduct imposed by law in circumstances where no basic rule of public policy is in play.<sup>83</sup> In *Yam Seng*, the learned judge had accepted the need for contractual certainty, had recognized the piecemeal character of good faith in English law, and had accepted the right of contracting parties to act in a self-interested way. His subsequent remarks on good faith, if they were to be adopted and become law, would strike at the heart of all of these values. The *MSC* case was about as far from a relational contract as one can imagine. It is comforting to see that the Court of Appeal did not welcome these remarks:

The recognition of a general duty of good faith would be a significant step in the development of our law of contract with potentially far-reaching consequences and I do not think it is necessary or desirable to resort to it in order to decide the outcome of the present case...[T]he better course is for the law to develop along established lines rather than to encourage judges to look for what the judge in this case called some 'general organising principle' drawn from cases of disparate kinds.<sup>84</sup>

As far as English law goes, this is where good faith stands at present. It is not accepted as a standard imposed by operation of law or as a general organizing principle of the law.<sup>85</sup> It does not, as so many past cases attest, control the exercise of termination rights.

<sup>81</sup> See M Bridge, 'Freedom to Exercise Contractual Rights of Termination' in L Gullifer and S Vogenauer (eds), *English and European Perspectives on Contract and Commercial Law* (Hart 2014) 87.

<sup>82</sup> Eg, a right to reject goods and terminate a contract for breach of a statutory condition in ss 13–14 of the Sale of Goods Act 1979.

<sup>83</sup> Note that Leggatt J himself considered that an implied term of good faith could be excluded between the parties.

<sup>84</sup> *MSC* (n 79) para 45, Moore-Bick LJ (with whom Tomlinson LJ and Keenan J agreed), drawing on the rejection of a general rule of good faith in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland* [2013] EWCA Civ 200, para 105, [2013] BLR 265.

<sup>85</sup> *Monde Petroleum SA v Westernzagros Ltd* [2016] EWHC 1472 (Comm), para 249, [2016] 2 Lloyd's Rep 229 (affd without reference to the issues in this article at [2018] EWCA Civ 25, [2018] 2 All ER (Comm) 867); *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA 396, [2016] 1 CLC 712; *Hamsard 3147 Ltd v Boots UK Ltd* [2013] EWHC 3251 (Pat).

## Contractual discretion

In the last 20 years or so, increasing emphasis has been placed in English law on the exercise of so-called contractual discretion, so that, drawing initially on public law notions, a discretion should not be exercised in a way that is 'capricious', 'arbitrary', or 'irrational' (hereinafter, the discretion standard).<sup>86</sup> As will be shown, in order for this standard to be exercised, it first has to be shown that the contractual right in question is intended by the parties not to be an unqualified, absolute right. Consequently, the standard that is being applied by the courts to contractual conduct in such cases is being applied to a term implied in fact rather than in law. On first appearance, the discretion standard is less exacting than a standard of fair dealing, so often annexed to good faith. It should not be assumed, nevertheless, that this restriction on contractual action is but, and only but, a pallid form of good faith. There is some overlap, in the sense that the application of a good faith standard would have led to the same conclusion as was reached by the discretion standard in a number of the cases discussed below. But, as we shall see, this body of law in some instances goes beyond any notion of fair dealing. Moreover, whereas good faith appears to be a somewhat preventative doctrine, stopping contracting parties from taking certain actions or exercising supposed rights, controls on the exercise of a discretion seem more to point in the direction of requiring a party invested with a discretion to act in a particular way.

Turning to public law, the well-known *Wednesbury* doctrine<sup>87</sup> applies to strike-down decisions of public authorities that no reasonable decision-maker could have reached, which is not to say that there is a requirement that decisions reached have to be reasonable. Decisions are quashed primarily through the prerogative order of *certiorari*, the outcome of which is to require the authority to reconsider its actions. It is not an outcome that requires a particular decision to be taken instead, though that will, in fact, occur in many cases where the application has been successful. It must be emphasized that the court does not stand in lieu of the public authority, taking the decision on behalf of the authority. A further branch of the *Wednesbury* principle, in some danger of being overlooked, may be termed the evidential arm of that decision. The public authority's decision may be struck down, even if not wholly unreasonable, if the decision-taker has considered evidence or factors that it ought not to have taken into account or omitted to consider evidence or factors that it should have taken into account.

As inspirational as *Wednesbury* might initially have been in developing the case law on discretion, care must be taken not to infuse private contract law with public law values. A contract is a shared endeavour in which the interests of private parties come together in aid of proceeding to a mutually beneficial outcome. The desired outcome of one party, however, may not be that of the

<sup>86</sup> See M Bridge, 'The Exercise of Contractual Discretion' (2019) 135 LQ Review 227.

<sup>87</sup> Taking its name from *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223 (CA).

other. This same combination and accommodation of interests is absent in the relationship of citizen and State. The State takes certain actions for the general welfare of a group or all of its citizens, often at the expense of certain groups and individuals. There is no true scope in public law for an allocation of risks between State and individual citizens.

### *The meaning of 'discretion'*

A note of caution is in order. In the past, the word discretion, in contract law at least, connoted an entitlement to take action without having to account for that action or its consequences.<sup>88</sup> It would now be perilous to use such language in a contract. The same may be said in advocacy, as is demonstrated in one case where counsel for a factor, which had reserved to itself the right to retain 'up to 15 per cent' of the value of a debt as a collection cost in the event of having directly to collect a debt itself, claimed that the factor had a discretion to charge any sum up to the 15 per cent limit.<sup>89</sup> It was the factor's practice to always charge the full 15 per cent. The Court's conclusion was that the factor's discretion was reviewable in accordance with the discretion standard and that the factor was permitted to charge only a substantially lesser amount. On this last point, it should be appreciated that, unlike certiorari proceedings, the factor was not invited to revisit its decision. The Court did the calculation for it. A further noticeable feature of the case was the Court's conclusion that the clause in question was not penal: since it was inherently limited by the contractual discretion standard, how could it be? Had the fatal words 'up to' been omitted, it is unlikely that the clause would have been struck down in the light of the Supreme Court's recent ruling on penalty clauses.<sup>90</sup>

A clear line has to be drawn between contractual rights and powers that are subject to review according to the discretion standard and those that are not, whether because they are inherently free from control or because the contract expressly frees them from this type of judicial review.<sup>91</sup> Although the language of the Court may not have been entirely apt, the reference in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland* to a hospital's trust's 'discretion' to exercise an 'absolute contractual right'<sup>92</sup> represents an attempt to capture actions that are not reviewable. A better way to explain the case, perhaps, is that the contract set out a detailed scheme of decision-making that pre-empted any need for a court to control any abuse of contractual discretion in the case of a party applying that scheme. In this case, a

<sup>88</sup> See J Beatson, 'Public Law Influences in Contract Law' in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (1995) 267.

<sup>89</sup> See *BHL v Leumi ABL Ltd* [2017] EWHC 1871 (QB).

<sup>90</sup> *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172.

<sup>91</sup> See eg a clause permitting one party's decisions to be taken 'in its absolute discretion'. *Interserve Construction Ltd v Hitachi Zosen Inova AG* [2017] EWHC 2633 (TCC).

<sup>92</sup> [2013] EWCA Civ 200, para 91, [2013] BLR 265.

hospital trust was entitled to deduct so-called failure points in determining the overall remuneration of a service provider. The detailed scheme for assessing failure and remuneration militated against any general standard of review for abuse of contractual discretion carried out by the court, in broadly the same way as detailed terms of a contract tend to repel broad implied terms.

The Court, in *Mid Essex*, also sought to lay down a criterion for drawing the line between reviewable and non-reviewable actions. In the case of so-called 'binary choices', the action was said not to be reviewable, as opposed to actions where multiple choices exist, which were reviewable.<sup>93</sup> Although this distinction might appear helpful—for example, in those cases where an employer is exercising a reviewable discretion about the size of an employee's bonus<sup>94</sup>—there are examples where a range of choices are not reviewable<sup>95</sup> and, contrariwise, cases where a choice between two outcomes is reviewable.<sup>96</sup> The distinction between binary and multiple choice, therefore, is unhelpful. It is when we come to termination for breach, as discussed below, that the question to review or not comes into sharpest focus.

### *Some examples of intervention*

Before considering termination, it is useful to consider a number of examples to see if a common thread can be discerned. A contract may confer on one of the parties a power to take action that increases its contractual entitlement as initially established. In *British Telecommunications plc v Telefónica O2 UK Ltd*, which concerned an interconnection contract between a telephone company and various mobile network operators, the telephone company was empowered by the contract to require the operators to pay the charges 'specified from time to time in the...price list', which might be varied unilaterally by the company. The agreement was concluded against the background of primary legislation transposing an European Union directive calling for competition and choice in the interests of consumers. The company's power to set prices had to be exercised both in good faith and in a way that did not abuse its contractual discretion, which was determined in accordance with its contractual purpose as set by the terms of the directive. In other words, the boundaries of the Court's review were laid down by the contractual matrix as amplified by the terms of the directive. Imagining now a contract in an unregulated field, an interesting, but unresolved, question is whether the limits imposed on the

<sup>93</sup> This distinction was followed in *Monde Petroleum SA v Westernzagros Ltd* [2016] EWHC 1472, para 266 (Comm), [2016] 2 Lloyd's Rep 229.

<sup>94</sup> Eg, *Horkaluk v Cantor Fitzgerald International* [2004] EWCA Civ 1287, [2005] ICR 402; *Clark v Nomura International Plc* [2000] IRLR 766.

<sup>95</sup> It is highly unlikely that a seller's choice in a commodities contract to select a quantity with a +/- 5 or 10 per cent range would ever be subject to review.

<sup>96</sup> As where an employer makes a decision as to whether the widow of an employee is entitled to a death in service benefit. *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661, discussed below.

evidence that may be considered in interpreting a contract<sup>97</sup> should apply equally in this case. There is every reason why they should, since cases on the abuse of contractual discretion are at root cases on contractual interpretation.

Another example is *Paragon v Nash*.<sup>98</sup> A mortgage contained a variable interest rate clause that, over a period, allowed the mortgagee to exceed the rate charged by a leading building society by a margin first of 2 per cent and then later 5 per cent. In reviewing the mortgagee's varied interest rates, the Court was guided by the officious bystander test for an implied term and not by any requirement that the mortgagee's action be reasonable. The mortgagee occupied a weaker position in the market than the building society and itself had to pay higher rates in the money markets. Its decisions, in the circumstances, did not amount to an abuse of discretion given the difficult financial circumstances in which it found itself.<sup>99</sup> The assertion of self-interest in increasing contractual remuneration when exercising a unilateral power is, therefore, not an abuse of contractual discretion *per se*.

In what is not quite the reverse of the above coin, other cases concern contracts where one party has the power to impose an added burden on the other, as happened in *Ludgate Insurance Co Ltd v Citibank NA*.<sup>100</sup> In this case, offshore reinsurers had to provide margin to cover claims made on American insurance policies. The margin took the form of a letter of credit issued by a bank on behalf of a pool of reinsurers. Under the terms of the credit contract, the reinsurers had to retain deposits in an account with the bank as cover for its prospective liability under the letters of credit. Owing to an overall deficit in the pool's gross margin, the bank demanded that the deposit of the particular reinsurer in this case be increased to an amount in excess of its own exposure, the bank justifying its action under the terms of a power entitling it to act 'as it considers appropriate in all circumstances' to meet its overall exposure in respect of the pool. The exercise of the power was held not to be abusive; the particular reinsurer was well aware that its margin requirements depended upon the state of the pool as a whole.

A case going the other way is *The Product Star*,<sup>101</sup> where the terms of a charter party called for the charterers to nominate an alternative port if, in the 'discretion' of the shipowner, it was 'dangerous or impossible' to proceed to the nominated port. The shipowner was held to have abused this power because the decision had been taken at short notice and without consulting the

<sup>97</sup> Eg, not taking into account pre-contractual negotiations except when determining the meaning of certain expressions.

<sup>98</sup> [2001] 1 WLR 1466, [2002] 1 WLR 685 (CA) (*Paragon*); see also *Lombard Tricity Finance Ltd v Paton* [1989] 1 All ER 918, para 18 (CA).

<sup>99</sup> 'The claimant is not a charitable institution. Its aim is to make a profit by lending money. It follows that, if it encounters financial difficulties, it may feel obliged to raise the interest rates paid by its borrowers. In deciding whether to raise interest rates, it will have to make fine commercial judgments.' *Paragon* (n 98) para 47.

<sup>100</sup> [1998] EWHC 1144 (Comm), [1998] Lloyd's Rep IR 221.

<sup>101</sup> *Abu Dhabi National Tanker Co v Product Star Shipping Ltd (The Product Star) (No 2)* [1993] 1 Lloyd's Rep 397 (CA).

master, there was no evidence of vessels being under attack in the area of the nominated port, and the shipowner was continuing to trade in the same area under another charter party. Even self-interested actions must, therefore, comply with a minimum level of justification.

A contract may invest one of the parties with a power to define its stated entitlement, giving rise to the exercise of judgment. In *Socimer International Bank Ltd v Standard Bank London Ltd*,<sup>102</sup> a bank went into liquidation, which triggered the termination of its trading agreement with another bank. The securities held by the non-insolvent bank then had to be valued in order to determine the outstanding liabilities of the insolvent bank. Treating the exercise of the non-insolvent bank's action as a matter of discretion or judgment, operating by way of an implied term, the Court came to the conclusion that the bank's valuation did not have to be based purely on the market valuation of the securities; it was entitled to depress the valuation by an amount corresponding to the fact that it now carried a market risk that it thought it had transferred to the other bank. The non-insolvent bank had the right to measure that risk as part of the valuation process. As one in the position of a forced seller in difficult market circumstances, the bank was permitted to conduct the valuation of the securities in a subjective, though rational, way.<sup>103</sup>

Cases have also arisen in respect of a contracting party's power to define the other party's entitlement under the contract. In *Watson v Watchfinder.co.uk*,<sup>104</sup> the claimant, who had provided business consultancy services to a company, was granted a share option that was subject to the approval of the company's directors. This approval was refused for unstated reasons and, hence, was held to be an abuse of the company's contractual discretion. Unlike cases such as *British Telecommunications plc v Telefónica O2 UK Ltd*,<sup>105</sup> there was nothing in the option agreement to guide the Court as to how the discretion should be exercised. The defendant company asserted that its approval turned upon the suitability of the claimant as a shareholder in the company, but the Court substituted its own view of why the option was granted, which was whether the claimant had made a 'a real or significant contribution to the progress or growth'<sup>106</sup> of the company. The case will be discussed further below, but there is clearly some danger in a court's intervention taking the form of putting words in the mouths of taciturn contracting parties. If, however, the question were put in the form of an implied term in fact—did the company have the right to reject the exercise of the option without having to justify itself?—the decision appears more acceptable. Moreover, going beyond a mere explanation, an unqualified right to veto the grant of the shares would have made the

<sup>102</sup> [2008] EWCA Civ 116, [2008] Bus LR 1304; see also *Lehman Brother International (Europe) v Exxonmobil Financial Services BV* [2016] EWHC 2699 (Comm), [2016] 2 CLC 578; *Fondazione Enasarco v Lehman Brothers Finance SA* [2015] EWHC 1307 (Ch).

<sup>103</sup> [2008] EWCA Civ 116, [2008] Bus LR 1304, paras 111ff.

<sup>104</sup> [2017] EWHC 1275 (Comm).

<sup>105</sup> [2014] UKSC 42, [2014] 4 All ER 907.

<sup>106</sup> *Ibid* para 113.

option meaningless, converting it instead into a right to petition the company for a grant of the shares.

In *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd*,<sup>107</sup> a treaty of reinsurance stated that ‘no settlement and/or compromise shall be made and liability admitted [by the insurer] without the prior approval of reinsurers’. The insurer, nevertheless, agreed a claim without obtaining approval and the question now turned on whether that approval might have been denied. The approval was held not to be unqualified and indeed turned upon whether ‘any withholding of approval...should take place in good faith after consideration of and on the basis of the facts giving rise to the particular claim and not with reference to considerations wholly extraneous to the subject-matter of the particular reinsurance’.<sup>108</sup>

In *Greenclouse Ltd v National Westminster Bank plc*,<sup>109</sup> an interest rate hedging contract gave a bank the right to extend an interest rate collar for a further two years.<sup>110</sup> The bank’s right to do so was an unqualified one. Contracts of this kind, turning upon market considerations, are examples of a zero-sum game. The same may be said about the grant of an option. The holder of the option, in a case where the asset has appreciated greatly in value, is not to be required to consider any hardship accruing to the other party for having entered into a disadvantageous agreement.

Overall, these cases are, above all, cases concerning the clarification of contracts, often to be conducted in the light of changed circumstances, where it would be either unduly difficult or impossible to carry out the exercise in advance.

### *Objective decisions*

A theme that has arisen in the case law is that the court, in controlling the abuse of contractual discretion, will not impose its own ‘objective’ decision based upon reasonableness on the party invested with the discretion. Instead, it will only police the outer limits of a discretion by insisting that it not be exercised in an ‘irrational’, ‘arbitrary’, or ‘capricious’ way. The extent to which this restraint is, in fact, exercised is brought into focus in cases where the evidentiary aspect of the *Wednesbury* case comes into play, as it did in *Braganza v BP Shipping Ltd*.<sup>111</sup> An employer had decided that an employee had committed suicide so as to be ineligible for death in service benefits. The employee, a ship’s

<sup>107</sup> [2001] CLC 1103 (CA).

<sup>108</sup> The issue of extraneous considerations is discussed below. Another case involving a judgment call and therefore subject to review is *Shurbanova v Foreign Capital Markets Ltd* [2017] EWHC 2133 (QB); see also *The Vainqueur José* [1979] 1 Lloyd’s Rep 557.

<sup>109</sup> [2014] EWHC 1156 (Ch), [2014] 2 Lloyd’s Rep 169.

<sup>110</sup> By which neither of two parties, A and B, makes payments to the other if the base interest rate stays within a stated range, but payments are made by A to B as the rate falls below a stated ‘floor’ and by B to A as it rises above a stated ‘cap’.

<sup>111</sup> [2015] UKSC 17, [2015] 1 WLR 1661.

engineer, had disappeared in unexplained circumstances without trace from an ocean-going vessel in normal weather. The employer conducted a review of the safety of the vessel, in the course of which it ruled out the possibility of an accident, and came to the conclusion that the employee must have committed suicide. Its conclusion was reached after some considerable deliberation but, nevertheless, was overturned by a majority of the Supreme Court on the ground that it was not based on the cogent evidence needed for such a serious conclusion to be reached. It could not be said that the decision was tainted by the non-evidentiary limb of the *Wednesbury* rule: the decision was not arbitrary, capricious, or irrational. Moreover, in the words of *Wednesbury* itself, the employer had not overlooked relevant evidence<sup>112</sup> or taken account of matters that it should have disregarded. It was the absence of evidence that was fatal for the employer's case. Having overturned the employer's decision, the Court's conclusion was not that the employer should think again but that the employee's widow was entitled to the benefit. Although the Court accepted the principle that the employer's decision was not objectively reviewable in terms of reasonableness, in the sense of permitting the Court to answer for itself the question whether the employee committed suicide, the outcome in the case, despite the majority's protestations to the contrary,<sup>113</sup> seems indistinguishable from one reached by such an objective review. *Braganza* demonstrates that the first, or evidentiary, limb of the *Wednesbury* case may pose the larger threat to the integrity of private contract law, at least where the discretion is an open-ended one that does not refer to stated criteria.<sup>114</sup>

In emphasizing due process<sup>115</sup> and the conflict of interest arising between employer and employee,<sup>116</sup> *Braganza* diverts attention from the private law approach of implied term analysis. The case itself treats employment contracts as though they were a branch of public law rather than private law.<sup>117</sup> Indeed, it has subsequently been said that the detailed scrutiny of the decision-making process appropriate for public law cases is not a requirement for private law.<sup>118</sup> Nevertheless, the employment law firewall has been breached. In *Watson v Watchfinder.co.uk*, as seen above, the directors, in refusing to approve the exercise of a share option, did not exercise their discretion in accordance with the purpose of the discretion as defined for them by the Court.

<sup>112</sup> But the Court does take account of the religion of the deceased (Roman Catholic), which treated suicide as a mortal sin. [2015] UKSC 17, para 41, [2015] 1 WLR 1661. This is hardly 'evidence'.

<sup>113</sup> [2015] UKSC 17, para 22ff (Lady Hale), para 52 (Lord Hodge), [2015] 1 WLR 1661.

<sup>114</sup> See *Lombard Tricity Finance Ltd v Paton* [1989] 1 All ER 918 (CA).

<sup>115</sup> [2015] UKSC 17, para 29, [2015] 1 WLR 1661.

<sup>116</sup> *Ibid* para 18.

<sup>117</sup> Lord Hodge states that employment contracts may justify a more 'intense scrutiny' than commercial contracts (*ibid* para 55); Lady Hale also advises caution in taking the evidentiary road laid down in *Wednesbury* for commercial cases (*ibid* para 32).

<sup>118</sup> *Lehman Brothers International (Europe) v Exxonmobil Financial Services BV* [2016] EWHC 2699 (Comm).

The Court granted specific performance of the option agreement, apparently on the basis that the claimant must have made a contribution to the company that required the directors to approve the exercise of the option. This outcome amounts to the imposition of an objectively reasonable decision, arrived at by acting for directors who had abdicated their discretion.<sup>119</sup> If it were to be said that the court is filling a gap created by the directors' failure to exercise a discretion, one response is that the extent of the claimant's contribution to the company should have been assessed—by a new trial, if necessary. This would approximate to a direction to a public authority to reconsider its decision.

*BHL v Leumi ABL Ltd*<sup>120</sup> is another case that appears to impose a reasonable, objective decision. The factor in that case was not permitted to recover as a direct collection cost the full 15 per cent of each invoice. Instead, the Court took on the task of calculating the amount that the factor ought to have charged had it properly exercised its discretion. The factor was awarded 4 per cent of the invoice amount, somewhat in excess of its actual collection costs. By contrast, in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd*,<sup>121</sup> the Court did not usurp the reinsurer's judgment on whether to improve a settlement made by the insurer but allowed its judgment to stand as guidance for the parties themselves to resolve the matter.

### *Termination of contract*

Termination is, here, being treated as a separate case because of the importance of the issue when it comes to freedom of contract and contractual certainty. Let us begin by noting in the most cursory form the circumstances in which a contract may be terminated for breach. Essentially, a contract may be terminated if a breach goes to the root of the contract—a test that is broadly the same as determining whether the terminating breach has, in fact, been deprived of substantially the whole benefit of the contract. In addition, certain terms of the contract are assumed in all cases to lead to this severity of outcome, either because the parties in designating them as promissory conditions have said so<sup>122</sup> or because the legislature, in so designating them, has reached the same conclusion. A future breach threatened by a party's renunciation of its obligations, or by its prospective incapacity to fulfil them, will also be treated by anticipation as justifying termination as long as the threatened outcome goes to the root of the contract or the term in question is a promissory condition. Let it be noted at the outset that the test of a breach going to the root of the contract requires so severe an outcome that it is hard to imagine a credible

<sup>119</sup> Cf *Lehman Brother International (Europe) v Exxonmobil Financial Services BV* [2016] EWHC 2699 (Comm), para 278, [2016] 2 CLC 578.

<sup>120</sup> [2017] EWHC 1871 (QB).

<sup>121</sup> [2001] CLC 1103 (CA).

<sup>122</sup> *Bettini v Gye* (1876) 1 QBD 173.

case where the injured party should be restrained from exercising termination rights,<sup>123</sup> even assuming that the court has the power to intervene to restrain abusive contractual termination. Moreover, if a term has been designated as a condition by the legislature, which, furthermore, also provides for the control of abusive termination, there is no ground for allowing further intervention by the court.<sup>124</sup>

There is a debate about whether the decision of a contracting party to terminate a contract is even a matter of discretion to be controlled by a court.<sup>125</sup> English commercial law has long condoned the exercise of termination rights notwithstanding the impure motives of contracting parties seeking to regain lost contractual opportunities on a market that has swung against them. Yet, in *MSC Mediterranean Shipping Co v Cottonex Anstalt*,<sup>126</sup> this long-settled law was disturbed by certain dicta of Leggatt J when he denied the existence of any difference between the exercise of discretionary powers and the exercise of termination rights 'conferred by law'; in each case, 'one party to the contract has a decision to make on a matter which affects the interests of the other party to the contract whose interests are not the same'. Thus, 'the line of authority dealing with the exercise of an option to terminate the contract and the line of authority dealing with the exercise of a contractual discretion [are] concerned with materially identical questions and as establishing essentially the same test'.<sup>127</sup> In the *MSC* case, the inordinate delay of a shipper in redelivering containers, though not a breach of condition, went to the root of the contract. In view of the severity of the test, as stated above, it is hard to see why the shipowner, had it chosen to do so, should have been prevented from terminating the contract on the ground that it was abusing a discretionary power. More to the point, the exercise of an unqualified right to terminate should not be subject to control as an abuse of discretion in the first place.

Leggatt J's assertion has fallen on stony ground. The exercise of a termination right has been subsequently said not to be qualified by reference to the reasons for doing so.<sup>128</sup> In *Lomas v FJB Firth Rixson Inc*,<sup>129</sup> the Court of Appeal went so far as to say that it was 'hopeless' to argue that an express right to terminate under an International Swaps and Derivatives Association agreement was subject to discretionary control.<sup>130</sup> It also said that '[t]he right

<sup>123</sup> *Eg. Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha* [1962] AC 26 (CA); *Cehave NV v Bremer Handelsgesellschaft mbH* [1976] QB 44 (CA).

<sup>124</sup> See Sale of Goods Act 1979, s 15A (slight breach of certain promissory conditions by sellers in non-consumer cases, so that the buyer might not reject the goods and terminate the contract).

<sup>125</sup> See Hooley, 'Controlling Contractual Discretion' [2013] Cambridge LJ 65, 66 (no 'material distinction between the discretion cases and the termination cases'). *Contra* Foxton, 'A Good Faith Goodbye? Good Faith Obligations and Contractual Termination Rights' [2017] Lloyd's Commercial LQ 360, 383.

<sup>126</sup> [2015] EWHC 283, para 97 (Comm), [2015] 1 CLC 143.

<sup>127</sup> *Ibid.*

<sup>128</sup> *Monde Petroleum SA v Westernzagros Ltd* [2016] EWHC 1472 (Comm), para 261, [2016] 2 Lloyd's Rep 229.

<sup>129</sup> [2012] EWCA Civ 419, [2012] 2 Lloyd's Rep 548.

<sup>130</sup> *Ibid* para 46.

to terminate is no more an exercise of discretion...than the right to accept repudiatory conduct as a repudiation of the contract.<sup>131</sup> An election to choose between two remedial positions is, therefore, not the same as an exercise of discretion. Relatedly, as mentioned above, there has been resistance to a duty to act in good faith as a general organizing principle by operation of law.<sup>132</sup> If termination rights were ever to be routinely the subject of discretion control, the implications of such a step for other areas of contract law would be enormous. What about a decision to insist on performance in a particular place even if it would avail the obligee equally to have performance rendered in a different place?<sup>133</sup> What about the rule that a party may cite a bad reason for terminating a contract provided that a good reason exists?<sup>134</sup> Or the rule that a contracting party with a choice between two methods of performance may select the less onerous one?<sup>135</sup> Or the rule that a penalty that is not excessive may be enforced in full?<sup>136</sup> Or the right to the insistence upon compliance with a non-assignment clause?<sup>137</sup> This list merely scratches the surface; many more examples could be cited.

A qualifying statement is, nevertheless, in order. The broader modern approach to contractual interpretation might suggest, in some cases, that an express promissory contractual right was never intended by the parties to be unqualified.<sup>138</sup> If, behind the express wording of the contract, there is a manifest intention that the right to terminate would be exercised only in the event of repeated breaches or in particularly serious cases, a recognition of the qualified nature of the right to terminate, as implicitly agreed by the parties, would provide a better outcome than a refusal to recognize that the term in question was a promissory condition in the first place.<sup>139</sup>

<sup>131</sup> Ibid; see also *Sucden Financial v Fluxo-Cane Overseas Ltd* [2010] EWHC 2133 (Comm), para 50. On a refusal to subject a decision to terminate to a good faith standard, see further *TSG Building Service v South Anglia Housing Ltd* [2013] EWHC 1151 (TCC); *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch), [2016] 1 BCLC 719.

<sup>132</sup> Eg, *Monde Petroleum SA v Westernzagros Ltd* [2016] EWHC 1472 (Comm), para 249, [2016] 2 Lloyd's Rep 229; *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA 396, [2016] 1 CLC 712; *Hamsard 3147 Ltd v Boots UK Ltd* [2013] EWHC 3251 (Pat).

<sup>133</sup> *Petrograde Inc v Stinnes Handel GmbH* [1995] 1 Lloyd's Rep 142.

<sup>134</sup> Eg, *Boston Deep Sea Fishing and Ice Co v Ansell* (1888) 39 Ch D 339 (CA).

<sup>135</sup> *Reardon Smith Line Ltd v Ministry of Agriculture Fisheries and Foods* [1963] AC 691, HL.

<sup>136</sup> *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172. It is certainly worth asking if the obligee has a 'legitimate interest' in claiming the full amount.

<sup>137</sup> *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85 (HL); cf *Lymington Marina Ltd v Macnamara* [2007] EWCA Civ 151.

<sup>138</sup> See the above discussion of *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* [2016] EWCA Civ 789, [2016] 2 Lloyd's Rep 494.

<sup>139</sup> See *Rice v Great Yarmouth Borough Council* (2001) 3 LGLR 4 (CA); *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 (HL).

## Conclusion

In this article, I have argued that there is no need in English law for the introduction of a general principle of good faith and fair dealing imposed upon contracting parties. They should remain free, within the limits of certainty, to impose it on themselves. Moreover, such a duty may arise, in particular cases, as a term implied in fact, turning upon their true intention. An imposed principle, even if we could define in general terms what it meant, would not add to our understanding of contract law. It would also be conducive of uncertainty, especially since the temptation to move down the slippery path from terms implied in fact to terms implied in law might prove alluring for some courts. I have also looked at recent case law on the controls exercised by courts over contractual discretion, seeking to identify those cases, based again upon the intention of the parties, where the discretion is bounded by restrictions so that it may not be exercised in the interests of only one of the parties. Broadly, such cases exist where one of the parties is, under the contract, entrusted with a measure of judgment to be exercised in pursuance of the goals provided for by the contract. This is not the case where a party's choice is unfettered, as when it is faced with a choice between affirming and terminating a contract. Such controls on the exercise of discretion may not be pitched as high as the control that might be imposed by a standard of good faith and fair dealing, but there are cases where they lead to a measure of intervention in the contract over and above that supplied by a standard of good faith and fair dealing that merely prohibits certain actions.