

Controlling contractual discretions

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A History

1. The law on contractual discretions is of comparative recent origins. *Westlaw*, for example, returns 100 judgments using the term, all from 1996 onwards. What accounts for the popularity of this contractual drafting technique, and the flurry of case law concerning attempts to control it? Possible causes include:
 - a. an increasing prevalence of long term contracts, with contractual discretions serving as a “hedge” against changing commercial conditions over the life of the contract;
 - b. certain supplies or functions which were previously the preserve of state entities moving into the private sector (energy, telecommunications), but with discretions on the part of the supplier retained from their public law origins;
 - c. an increasing number of contexts (stock exchanges, mutual associations) in which private bodies exercise quasi-administrative powers.
2. See generally Hugh Collins “Discretionary Powers in Obligations” in David Campbell, Hugh Collins and John Wightman *Implicit Dimensions of Contract* (Hart Publishing, 2003) ch. 8.

B What is a contractual discretion?

3. While contractual discretions are a relatively modern phenomenon, the control by the courts of fiduciary powers emphatically is not. Fiduciary powers are powers granted to a fiduciary to enable the fiduciary to achieve the entrusted purpose (*Snell's Equity* 33rd para. 10-009). For that reason, there are not only fiduciary duties to be observed when the power is exercised, but a duty under the rule in Pitt v Holt [2013] UKSC 26 to consider whether to exercise the power from time to time, and power holders are not permitted to fetter themselves or their successors as to the manner of exercise of the power: *Snell's Equity* para. 10-016.
4. Contractual discretions, by contrast, are non-fiduciary powers, granted by one contracting party to another. They are non-fiduciary because they have been granted to the discretion-holder in whole or in part for its own purposes rather than as a means of advancing the interests of the other party, or as a means of giving effect to the wishes of some third party akin to the settlor in a trust context. Nonetheless, a succession of cases from the early 1990s onwards has fashioned a series of implied terms which control the exercise of true contractual discretions, referred to by HHJ Waksman QC as “Braganza duties” after the Supreme Court decision in Braganza v BP and by me as “discretion obligations” (David Foxton, “A Good Faith Goodbye?” [2017] LCMLQ 360).

5. Those implied terms typically embrace:
 - a. An obligation to exercise the discretion honestly or in good faith.
 - b. An obligation not to exercise the discretion capriciously or perversely or arbitrarily, or, as it is sometimes put, an obligation to exercise it rationally or in a manner which is reasonable in the Wednesbury sense (c.f. the distinction between reasonableness and rationality: Lord Sumption in Hayes v. Willoughby [2013] UKSC 17, [14]).
 - c. An obligation to exercise the contractual discretion for a permissible purpose (more often expressed as an obligation not to exercise the discretion for an impermissible purpose).
6. These discretion obligations can be interpreted as free-standing duties which sound in damages, or as a contractual pre-condition to a valid exercise of the power (cf. the debate alluded to without resolution in IBM United Kingdom Holdings Ltd. v. Dalgleish [2014] EWHC 980 (Ch) at [372] and [2017] EWCA Civ 1212 at [29]. This question may be of considerable importance in determining the relief granted in the event of breach, and is likely to turn on the nature of the discretion and the terms in which it is expressed. This topic is returned to below.
7. Finally, alongside the fiduciary power and the contractual discretion we have the “absolute contractual right”, a term which describes a right arising under a contract which is not subject to either fiduciary or discretion obligations. We owe the term to Jackson LJ’s judgment in Mid Essex Hospital Services NHS Trust v. Compass Group UK and Ireland Ltd. (trading as Medirest) [2013] EWCA Civ 200 at [83], [91]-[92].
8. One difficulty is that the word “discretion” often appears in contractual terms creating absolute rights. For example, the Singapore Government Conditions of Contract COC Goods and Services form July 2017 contains the following “discretions”:
 - a. Clause 12.2: “The Authority shall have the right, at its sole discretion, to elect to claim general damages in common law from the Contractor instead of imposing liquidated damages under this Clause 12”.
 - b. Optional Clause A3.4 “Each Option to Purchase may be exercised one or more times, to be determined in the Authority’s sole discretion, provided always that the aggregate number of Option Items purchased pursuant to this Clause A3 shall not exceed the quantity specified in Annex [X]”.
9. However, there is no clear test for identifying what is a contractual discretion and what is an absolute contractual right. Relevant considerations are:
 - a. Whether the clause provides its own control mechanisms to police exercise of the right, in which case it is unlikely to attract discretion-obligations: Mid Essex at [136], [139]; Property Alliance Group Limited v. Royal Bank of Scotland Plc. [2016] EWHC 1156 (Ch) at [277].

- b. Whether the right can be regarded as a final stage in the previously incomplete definition of the contractual performance, in which case it is likely to be absolute (for example options as to quantity to be sold or purchased in contracts of sale, or as to loading and discharge ports in charterparties).
 - c. Whether the right can be regarded as an optionality “priced in” to the consideration, in which case it is likely to be an absolute right (as with the bank’s right to extend the period of a swap in Greenclose Ltd. v. National Westminster Bank Plc [2014] EWHC 1156 (Ch)).
 - d. Where the right is as to a choice between alternative remedies for breach (e.g. clause 12.2 of the COC Goods and Services form: “the Authority shall have the right at its sole discretion to elect to claim general damages in common law from the Contractor instead of imposing liquidated damages under this Clause 12”): where one party’s choice arises as a result of the other’s breach, this is indicative of an absolute contractual right.
10. It was suggested by Jackson LJ in Mid Essex that absolute rights involve “*a simple decision whether or not to exercise an absolute contractual right*” – in effect a binary choice – whereas contractual discretions involve an “*assessment or choosing from a range of options*”. However, the distinction between the binary choice and the range of choices does not provide an easy point of distinction. It would not explain the contractual quantity or port nomination cases where the choice is not so confined, and it is easy to conceive of absolute rights which are not binary – for example when in particular circumstances a party can terminate, suspend or carry on with a contract. Subsequent cases have laid less emphasis on this means of distinguishing absolute rights and contractual discretions: e.g. Property Alliance Group at [277].

C Types of contractual discretion?

A right to vary the counterparty’s performance?

- 11. One category of discretion cases involves rights conferred on one party to the contract to vary the contractual performance which the other party is obliged to provide. A classic example is the right given to a lender under most loans to vary the rate of interest payable by the borrower.
- 12. In Paragon Finance Plc v. Nash [2002] 1 WLR 865, the Court implied a term that the lender’s discretion to vary interest rates would not be exercised “*dishonestly, for an improper purpose, capriciously or arbitrarily*” ([32]) or irrationally [41]. Here:
 - a. The discretion to vary interest rates reflects the difficulty in fixing this feature of the contract for all time at the outset, unless the borrower is prepared to assume the upfront disadvantages inherent in borrowing on fixed rate terms, and the fact that the external features which are relevant to the determination of an appropriate rate will be in a state of flux throughout the life of the contract.
 - b. The case raises the distinction between complaints about the outcome of the exercise of a discretion and complaints about the process by which the

decision as to how to exercise the discretion is reached, something which the judgments do not always clearly do.

- c. An interest rate which was simply far too high, however and for whatever reason arrived at, would presumably be objectionable as an irrational outcome: e.g. Dyson LJ's statement at [31] that "*in the absence of an implied term, there would be nothing to prevent the claimant from raising the rate ... to exorbitant levels*".
 - d. What about a differential treatment between rates payable by particular borrowers? This might be inappropriate if arrived at for an impermissible reason: perhaps what Dyson LJ had in mind when saying that the implied term would prevent the lender "*raising the rate to a higher level than that required of other similar borrowers for some improper purpose*" [31].
 - e. Provided the rate was objectively reasonable for that type of borrower, it seems improbable a defect in process would be contractually significant (e.g. a failure to consider a relevant consideration).
13. Some discretions can readily be characterised both as a right to vary the performance required from the other party and as a right to vary one's own performance: eg. Ludgate Insurance Co. Ltd. v. Citibank NA [1998] Lloyd's Rep IR 221 at [35] (is the bank's right to retain excess margin if it concludes certain requirements are met a right to vary the bank's obligation to return excess margin, or the client's obligation to post margin?) And yet the case law has historically treated the right to vary the counterparty's performance, and the right to vary one's own performance, differently.

A right to vary one's own contractual performance?

14. Historically, clauses which gave a contracting party a right to vary its own performance have been treated differently to the right to vary the performance required of the counterparty, because of their close resemblance to clauses which exclude or restrict liability in the event of a breach of contract. For a time, the doctrine of fundamental breach was used as a basis for holding that such clauses could not override the "fundamental" terms of the contract defining the required contractual performance (eg. Karsales v Wallis [1956] 1 WLR 936 (CA) and Anglo-Continental Holidays Ltd. v. Typaldos Lines (London) Ltd. [1967] 2 Lloyd's Rep. 61 (CA)).
15. Such rights are subject to statutory control for certain classes of contract in England and Singapore by the Unfair Contract Terms Act 1977 and the Unfair Contract Terms Act Chapter 396 respectively, section 3(2)(b)(i) of which provides that where one party deals with another as a consumer or on its own standard terms of business, he cannot rely on any contract term to "*claim to be entitled to render a contractual performance substantially different from that which was reasonably expected of him*", save insofar as the term meets the statutory requirement of reasonableness. However, it has been held that the section does not apply to clauses giving that party the right to vary the other party's contractual obligations: Paragon Finance Plc. v. Nash at [75].
16. Outside of s.3(2) UCTA 1977, clauses giving a right to vary a party's own performance have attracted the imposition of discretion obligations: e.g. JML Direct

v. Freesat UK Ltd. [2010] EWCA Civ 34 at [14] and McKay v Centurion Credit Resources LLC [2012] EWCA Civ 1941 at [21].

Discretion-conditioned benefits

17. Many discretions in contracts do not involve the variation of a pre-existing right or obligation, but arise as controlling mechanisms exercisable by one party in clauses intended to benefit the other party. The fact that the prospective benefit features in the contract at all is a clear indication that the discretion is intended to be circumscribed by some form of legal obligation, otherwise it would do no more than anticipate the extra-contractual request which any contracting party can always make of the other and which the other is always free to reject. These rights have come before the courts most frequently in the context of bonus schemes which exist as part of the parties' contractual relationship alongside more conventionally defined rights and obligations.
18. For example in Clark v. Nomura [2000] LRLR at [40]-[41], Burton J. held that the employer's discretion to award a bonus in that case was subject to two constraints: as a matter of express term, that the bonus was to be assessed on the basis of individual performance, and, as a matter of implication, that the discretion should not be exercised irrationally, perversely or capriciously. Horkulak v. Cantor Fitzgerald International [2004] EWCA Civ. 1287 also concerned a discretionary bonus scheme for employees, and the Court of Appeal upheld an obligation on the employer's part to perform a *bona fide* and rational exercise of the discretion. In MGA International Pte Ltd. v. Wajilam Exports (Singapore) Pte Limited [2010] SGHC 319, Belinda Ang Saw Ean J. implied discretion obligations to a discretion on the part of one party to a contract to determine the commission payable to the other (at [102]-[106]).
19. A key context to the obligations imposed on the exercise of the discretions in these cases is the fact that the payment of bonuses formed part of the remuneration structure in a highly competitive employment context. In Commerzbank AG v. Keen [2006] EWCA Civ. 1536 at [47] it was noted that "*in the industry the core of a proprietary trader's pay is from his bonus*".
20. The fact that the discretion arises as an incident of a term intended to provide a benefit to the other party to the contract strongly supports the implication of some form of obligation as to the exercise of the term, reflecting the law's general hostility to attempts at "derogation from grant", or giving with one hand and taking away with another: see Nicholls LJ in Johnston & Sons Ltd. v. Holland [1988] 1 WLR 264 at 267; Younger LJ in Harmer v. Jumbil (Nigeria) Tin Areas Limited [1921] 1 Ch. 200 at 225-226 and Lord Denning MR in Moulton Buildings Limited v. City of Westminster [1975] 30 P&CR 182 at 186.
21. Another important feature of the employment bonus cases is the obligation of trust and confidence which "*buttress[es]*" the employer's duties in relation to the granting of a discretionary bonus, and "*inform[s] and regulate[s] the contours of any contractual discretion*" (Brogden v. Investec Bank Plc [2014] EWHC 2785 (Comm) at [92]-[93] and [100] per Leggatt J).
22. Outside of the employment context, discretion-conditioned benefits are also to be found in cases in which the contract allows a party to take a particular step – very often a right of assignment – but subject to a requirement that the consent of the other

party is first obtained: e.g. Lymington Marina Ltd. v. McNamara [2007] EWCA Civ. 151: “*the parties clearly intended that the holder of the licence should have power to grant sub licences under clause 3(k)(ii)*” and “*if the licence holder is to obtain the proper benefit of that clause LML should not be in a position to withhold its approval in bad faith or capriciously*” ([47] per Arden LJ).

Determination discretions

23. There are other cases when the parties’ respective rights and obligations depend on whether a particular state of affairs has come to pass, or on the existence of an objective fact, but where the determination of the existence of that state of affairs or fact is made a matter for the decision of one of the parties rather than court: referred to here as “determination discretions”. These were described by Baroness Hale in Braganza v. BP Shipping Ltd. [2015] UKSC 17 at [18] as a power “*to form an opinion as to relevant facts*”.
24. The Product Star [1993] 1 Lloyd’s Rep. 397 is one of the best known of the determination discretion cases in a commercial context (determination by Master of whether port at which vessel had been ordered to load or discharge was dangerous).
25. A common example of a determination discretion is the discretion to value assets or trading positions in the event of termination or default given by many financial instruments, such as the Forward Sale Transactions Agreement between two banks in Socimer International Bank v. Standard Bank London Ltd. [2008] EWCA Civ. 116 (valuation of the securities transferred to Standard on Socimer’s default be performed by Standard) and the loan agreement in Edwards Jason Glenn v Australia and New Zealand Banking Group Ltd. [2012] SGHC 61 at [99]-[101].
26. The most striking determination discretion to have come before the courts was that considered in Braganza v. BP Shipping Ltd. and another [2015] UKSC 17. A death in service benefit ordinarily payable to the family of a deceased employee was not to be payable “*if in the opinion of the Company or its insurers, the death ... resulted from ... the Officer’s wilful act, default or misconduct*”. Discretion obligations attached to the employer’s determination that Mr Braganza’s death was the result of suicide.

D Termination clauses

27. Contracts frequently give one party a right to terminate the contract, either as an alternative to such rights to terminate as arise at law, or as a “complete code”. For example the Singapore Government Conditions Of Contract Goods and Services July 2017 provides:
 - a. Under clause 12, a right to cancel all Goods and Services without compensation if the Contractor fails to deliver the Goods or complete the Services by the specified date.
 - b. Under clause 18, the right to terminate the Contract if the Contractor is in breach and fails to remedy the breach within a specified time of receiving notice to do so, or if one of the conditions in clause 18.2 occurs.
28. Attempts have made to argue that the exercise of termination rights should also be subject to discretion obligations. The argument proceeds as follows:

- a. The authorities suggest discretion obligations are “*likely to be implicit in any commercial contract under which one party is given the right to make a decision on a matter which affects both parties whose interests are not the same*”: JML Direct v. Freesat UK Ltd. [2010] EWCA Civ 34 at [14].
- b. A termination right is a right given to one party to make a decision which has very important effects on both parties.
- c. The right to terminate should, therefore, be controlled by discretion obligations.

The position in Australia

29. In Australia, discretion obligations have been attached to rights to terminate. A key case is Renard Construction (ME) Pty Ltd. v. Minister of Public Works (1992) 26 NSWLR 234 in the New South Wales Court of Appeal. A clause in a long-term construction contract (“clause 44”) provided that if the contractor defaulted “*in the performance or observance*” of any term or refused or neglected to comply with any direction which the principal or superintendent was entitled to give, the principal could suspend payment and give notice requiring the contractor to show cause to the satisfaction of the principal as to why the principal should not take over all or any part of the work or cancel the contract. Priestley and Handley JAA (Meagher JA dissenting) held that the powers in clause 44 had to be exercised reasonably. Priestley JA thought there should be an implication “in fact” that the principal would give reasonable consideration as to whether cause had been shown, and, if it concluded it had not, reasonable consideration as to whether to exercise the power of cancellation (at p.257) Priestley JA held that such a term was also to be implied as a matter of law into any similar long-term complex construction contract (p.261).
30. In Burger King Corporation v. Hungry Jack’s Pty Ltd. [2001] NSWCA 187 the New South Wales Court of Appeal concluded that “*obligations of good faith and reasonableness will be more readily be implied in standard form contracts, particularly if such contracts contain a general power of termination*” (at [163]). There have also been a series of injunctions granted in support of a cause of action, held or conceded to be arguable, that a contractual right of termination has to be exercised in good faith See e.g. Garry Rogers Motors (Aust) Pty Ltd. v. Subaru (Aust) Pty Ltd. [1999] FCA 903 at [34] (Finkelstein J.): motor dealership; NA Retail Solutions Pty Ltd v. St George’s Bank Ltd [2010] FCA 259 at [22] ((Flick J.), [2010] FCA 290 at [70] (Cowdroy J): loan facility; Kellogg Brown & Root Pty Ltd. v. Australian Aerospace Ltd. [2007] VSC 200 at [49], [61] (Hansen J.): long term training and support contract. Expert evidence given as to the law of New South Wales before a New Zealand court was supportive of a duty of good faith in relation to termination clauses (Dymocks Franchise Systems (NSW) Pty Ltd. v. Todd [2002] UKPC 50 at [54] (expert evidence supportive of such a duty was given by Sir Laurence Street QC and Professor John Carter)). J.W. Carter, E. Peden and G.J. Tolhurst, *Contract Law in Australia* (LexisNexi, 2007) at [2-02] suggest that “*in most contracts (perhaps all contracts) a requirement of good faith must be implied, at least in connection with termination pursuant to an express term of a contract*”, although this view reflects a well-founded prediction as to the content of Australian contract law then the reflection of a settled issue.

The position in employment contracts

31. The case for attaching discretion obligations to a contractual right of termination would seem to be stronger for employment contracts than for any other type of contract, given the significance attached in employment contracts to the implied obligation of trust and confidence, and their relational nature. However, it is well-established that the right to terminate employment is absolute. Eg Malloch v. Aberdeen Corp. [1971] 1 WLR 1571 at 1581 (Lord Reid): “*a master is not bound to hear his servant before he dismisses him. He can act unreasonably or capriciously if he chooses but the dismissal is valid*”.
32. See also the Privy Council in Reda v. FLAG [2002] UKPC 38. Two senior executives whose contracts were terminable without cause were dismissed, in circumstances in which, had their employment continued, they would have been entitled to participate in a lucrative stock option plan. The Privy Council rejected the contention that the exercise of the right of termination was vitiated because it had been exercised for a collateral purpose because:

“in the present context there is no such thing as a ‘collateral’ or improper purpose; a power to dismiss without cause is a power to dismiss for any cause or none” ([43]).

The argument that the exercise was a breach of the employer’s duty of trust and confidence was also rejected because “*in common with other implied terms, it must yield to the express provisions of the contract ... [and] cannot sensibly be used to extend the relationship beyond its agreed duration [or] to circumscribe an express power of dismissal without cause*” (at [45]).

Recent English cases

33. The run of recent English cases attempting to impose discretion-obligations on contractual rights of termination began in Lomas v. JFB Firth Rixson Inc. [2012] EWCA Civ 419 in the unpromising territory of the ISDA Master Agreement. The occurrence of an Event Default in relation to one party (in this case LBIE’s entering into administration) allowed the other party to designate an Early Termination Date at which all outstanding obligations would be closed out and valued. An argument that the designation of an Early Terminate Date was a contractual discretion which had to be exercised in good faith and in a manner which was not arbitrary, capricious or unreasonable received short shrift from the Court of Appeal

“The right to terminate is no more an exercise of discretion, which is not to be exercised in an arbitrary or capricious (or perhaps unreasonable) manner, than the right to accept repudiatory conduct as a repudiation of a contract ... No one would suggest that there could be any impediment to accepting repudiatory conduct as a termination of the contract based on the fact that the innocent party can elect between termination and leaving the contract on foot. The same applies to elective termination”.

34. In TSG Building Services plc v. South Anglia Housing Ltd. [2013] EWHC 1151 (TCC), clause 1.1 of a building and maintenance services contract provided that the parties would work together “*in the spirit of trust, fairness and mutual co-operation*” and in all matters governed by the contract “*they shall act reasonable and without*

delay”. Clause 13.3 contained a mutual right of termination on notice. Aikenhead J. rejected the contention that the right to terminate had to be exercised reasonably, whether because of clause 1.1 or as a result of an implied term of good faith. Clause 1.1 did not extend to the right to terminate, which was clearly “*an unqualified right available to either party*” (at [42]).

35. The suggestion that rights of termination – in that case, those arising at common law for repudiatory breach – might be subject to discretion obligations received support from Leggatt J. in MSC Mediterranean Shipping Company S.A. v. Cottonex Anstalt [2015] EWHC 283 (Comm). He referred to the contractual discretion cases, which he noted were concerned with a discretion conferred “*by the express terms of the contract, whereas the choice whether or not to terminate the contract in response to a repudiatory breach is one which arises by operation of law*” but said he could not see: “*why this should make any difference in principle. 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. The same reason exists in each case to imply some constraint on the decision-maker's freedom to act purely in its own self-interest*”.
36. That decision was upheld on different grounds in the Court of Appeal, in a judgment which doubted the utility of an appeal to a contractual obligation of good faith in answering the issue under consideration: [2016] EWCA Civ. 789.
37. In Monde Petroleum SA v. Westernzagros Limited [2016] EWHC 1472 (Comm) a written agreement for consulting services contained various rights of termination if particular conditions arose (but not at the client’s convenience). The deputy judge rejected the argument that these rights were subject to discretion obligations. He held that there was no general duty of good faith under English law and that “*a contractual right to terminate is a right which may be exercised irrespective of the exercising party’s reasons for doing so*” (at [261]). He identified a number of reasons for this conclusion. The first was that a right to terminate was not a discretion, which he said arose “*where there was a range of options*”, whereas a right to terminate was a binary choice. Second, he held the right to termination “*was a different kind of right to the sort of rights which may arise in the course of that contract’s performance*” because it was a “*right to bring an end to the parties’ shared endeavour*” (at [272]).
38. In Monk v. Largo Foods Ltd [2016] EWHC 1837 (Comm), a commercial agency contract provided that it would “*operate for a three-year period subject to the completion of a successful review in January 2012. Assuming both parties are satisfied with the arrangement following this review, both parties will commit to a further two-year consultancy period*”. The claimant’s argument that the decision not to renew was subject to discretion obligations was rejected. The deputy judge noted that not every decision which a party makes under a contract can properly be characterised as a contractual discretion, and held that it would not ordinarily be appropriate to subject a right to terminate to discretion obligations (at [54]). The argument that a different outcome might be justified because the principal owed the agent a duty of good faith was also rejected, there being “*real difficulty in applying the duty of good faith to the exercise of rights of termination where the principal and*

agent are no longer engaged in what may be characterised as a joint endeavour, but considering whether that joint endeavour should continue.” (at [87](ii)).

Termination and the Unfair Contract Terms Act 1977

39. Support for the view that termination clauses are different from other contractual rights when it comes to the issue of controlling their exercise can be derived from those cases considering whether a termination clause is subject to s.3.2(b)(i) Unfair Contract Terms Act 1977 and its Singapore equivalent. As noted above, this regulates contractual clauses by which one party “*claims to be entitled ... to render a contractual performance substantially different from that which was reasonably expected of him*”. This issue first came before the courts in Timeload Ltd. v. British Telecommunications Plc. [1995] EMLR 459, an interlocutory appeal in which the issue was whether the application of the Act to a termination clause was sufficiently arguable to justify granting an injunction. The respondent argued that the customer could not reasonably expect that which the contract did not purport to offer, namely an indefinite contract. Sir Thomas Bingham observed “*that may well be so*”, but he did not find the construction of the section clear, and he held that it was at least arguable that, building on that statutory intervention, the common law might develop its own means of controlling the operation of termination clauses.
40. Other cases have rejected the argument that s.3 applies to termination clauses. In Brigden v. American Express Bank Ltd. [2000] IRLR 94 (QBD) Morland J. held that a clause which provided that “*an employee may be dismissed by notice and/or payment in lieu of notice during the first 2 years of employment, without implementation of the disciplinary procedure*” was not a clause entitling the defendants to render a contracted performance substantially different from that which was reasonably expected of them but a “*clause setting out the claimant's entitlement and the limits of his rights*”. In Hadley Design Associates Limited v. The Lord Mayor, [2003] EWHC 1617 (TCC) at [84]-[85], HH Judge Richard Seymour QC also expressed the view that a contractual termination clause did not fall within s.3.2(b)(i):

“I am inclined to think that the doubts of Sir Thomas Bingham as to whether the terms of Unfair Contract Terms Act 1977 s3(2)(b)(i) could apply in any event to the determination of a contract in accordance with a power contained in the contract were also well-founded, for it is very difficult to see how the issue of what was the duration of the performance of a contractual obligation which could reasonably be expected could be determined other than by reference to the terms of the contract as to duration”.

E Possible limitations on the exercise of contractual discretions

Pre-conditions

41. Some contractual discretions only arise on or after the happening of a particular state of affairs. An issue of construction may arise as to whether the existence of a state of affairs is a matter for the discretion-holder to determine (as a determination discretion) or an objective fact whose existence is to be determined by the court.
42. For example, where a right to value retained property arises on the termination of a contract, the question of whether the termination of the contract has arisen will ordinarily be a matter for the court to determine as a matter of objective fact. But a

right to select an alternative discharge port if a shipowner concludes that the nominated port is dangerous involves (a) a determination discretion as to whether the nominated port is dangerous, as a pre-condition to (b) a right to select an alternative port.

Purpose

43. A number of cases recognise that a discretion may be conferred for a particular purpose, in which case it will be a breach of contract to exercise it for another purpose (see e.g. Indulge Food Pte Ltd. v. Torabi Marashi Bahram [2010] SGHC 22 at [14] (Belinda Ang Saw Ean J). For example, many leases only allow assignment on consent, such consent not to be unreasonably withheld. The purpose of the requirement of consent is “to protect the lessor from having his premises used in an undesirable way, or by an undesirable tenant or assignee”, and consent cannot be withheld for some other purpose: International Drilling Fluids Ltd. v. Louisville Investments (Uxbridge) Ltd. [1986] 1 Ch. 513, 519-521. The withholding of consent was held to have been in breach of contract for this reason in Bromley Park Garden Estates Ltd v. Moss [1982] 1 WLR 1019 when consent to assignment of a lease for a residential flat was refused because the landlord wished to let the whole building to another tenant.

Reasonableness or rationality of outcome

44. Where the contract allocates a decision to one particular party, the Court will give effect to that allocation by only substituting its own decision for that of the party where the decision falls outside the range of rational decisions open to that party. Lord Sumption in Hayes v. Willoughby [2013] UKSC 17 stated at [14]:

“Rationality is not the same as reasonableness. Reasonableness is an external, objective standard applied to the outcome of a person's thoughts or intentions. The question is whether a notional hypothetically reasonable person in his position would have engaged in the relevant conduct for the purpose of preventing or detecting crime. A test of rationality, by comparison, applies a minimum objective standard to the relevant person's mental processes. It imports a requirement of good faith, a requirement that there should be some logical connection between the evidence and the ostensible reasons for the decision, and (which will usually amount to the same thing) an absence of arbitrariness, of capriciousness or of reasoning so outrageous in its defiance of logic as to be perverse”.

See also at ABN AMRO Clearing Bank NV v 1050 Capital Pte Ltd. [2016] 1 SLR 271, [72]-[73] (George Wei J).

Process

45. The extent to which contractual discretions are subject to discretion obligations not simply as to the rationality of the outcome, but as to the process followed in arriving at that outcome, is controversial.
46. There are a number of decisions recognising such an obligation in the employment context. In Commerzbank v. Keen, for example, Mummery LJ observed that “consistent with this duty an employer ought to supply an employee with an explanation of the reasons for the exercise of a discretion in respect of additional pay. Unless there is a good reason to the contrary the explanation ought to be given by the

person(s) responsible for the decision affecting additional pay.” (2006] EWCA Civ. 1536 at [44] and Moses LJ at [110]).

47. Further, in Braganza v BP Baroness Hale suggested that both limbs of the Wednesbury test applied to the contractual discretion in that case (at [29]-[30]):

“If it is part of a rational decision-making process to exclude extraneous considerations, it is in my view also part of a rational decision-making process to take into account those considerations which are obviously relevant to the decision in question. It is of the essence of “Wednesbury reasonableness” (or “GCHQ rationality”) review to consider the rationality of the decision-making process rather than to concentrate on the outcome. Concentrating on the outcome runs the risk that the court will substitute its own decision for that of the primary decision-maker.

It is clear, however, that unless the court can imply a term that the outcome be objectively reasonable—for example, a reasonable price or a reasonable term—the court will only imply a term that the decision-making process be lawful and rational in the public law sense, that the decision is made rationally (as well as in good faith) and consistently with its contractual purpose. For my part, I would include both limbs of the Wednesbury formulation in the rationality test. Indeed, I understand Lord Neuberger PSC (at para 103 of his judgment below) and I to be agreed as to the nature of the test”.

48. If applied outside the employment sphere, the recognition of this two-limbed constraint on the exercise of contractual discretions could have very significant consequences, because it would mean that the failure to consider any relevant factor, or the consideration of any irrelevant factor, would render the decision a breach of contract. However, the scope for a process requirement to be imposed outside the employment contest seems limited. In Lehman Brothers International (Europe) v. Exxonmobil Financial Services BV [2016] EWHC 2699 (Comm), Blair J. rejected an argument that a process requirement should be applied to a contractual discretion to value under a repurchase agreement, noting that Braganza at [286] had “*expressly left open the question of the extent to which procedural judicial review objections could arise in commercial contracts*” and (at [287]):

“The contractual discretion in the present case is given to a commercial party to a contract with another commercial party on the wholesale financial markets where the decision is as to the valuation of securities in the case of default. The decision is one which can be (and may need to be) taken without delay, and in which the non-Defaulting Party is entitled to have regard to its own commercial interests. In this kind of situation, I do not agree with LBIE that Braganza requires the kind of analysis of the decision-making process that would be appropriate in the public law context”.

49. This echoes comments made in one of the first commercial cases in which a decision under a contract had been challenged. In The Vainqueur José [1979] 1 Lloyd’s Rep. 557 at 577. Mocatta J. observed:

“It would be a mistake to expect [of the committee] the same expert, professional, and almost microscopic investigation of the problems, both factual and legal, that is demanded of a suit in a Court of Law”.

Reasonable expectations

50. In public law, it has long been recognised that one factor which might render the decision of an administrative body irrational is when insufficient regard has been paid to the legitimate or reasonable expectation of someone affected by the decision (e.g. CCSU v. Minister for the Civil Service [1985] A.C. 374 and O’Reilly v Mackman [1983] 2 AC 237).
51. This ground of challenge to the exercise of contractual discretions has been carried over to the employment context. For example, the level of bonuses paid year-on-year, and the reasonable expectations to which they give rise, have been held to be relevant factors when assessing the rationality of a decision to award a particular level of bonus: Hills v. Niksun Inc. [2016] EWCA Civ 115 at [19]; Brogden v. Investec Bank Plc. [2014] EWHC 2785 at [115]-[117].
52. The reasonable expectations of employees have also been held relevant to the rationality of the exercise of a contractual discretion in relation to an employment pension scheme (IBM v. Dalgleish [2014] EWHC 980 (Ch) overturned at [2017] EWCA Civ 1212 at [224]-[225] on the weight to be attached to such expectations as part of the decision-making process, but recognising that reasonable expectations would be a relevant factor).
53. Outside these specific contexts, it is questionable whether there is any room for the argument that anything short of an enforceable promise (whether by way of contract or promissory estoppel) can create a reasonable expectation controlling the exercise of a contractual discretion. The threshold of unequivocality before a contractual right can be overridden reflects a fundamental assumption of contract law, and unless that threshold is met, mere regularity of practice should not itself limit the exercise of contractual rights. This is particularly so when contracts provide that a waiver will only have effect for the instance and purpose for which it is given (eg. Clause 27 of the Singapore Government Conditions Of Contract Good and Services form). While there are similarities between the underlying sense of fairness underpinning the public law protection of legitimate expectations and the private law principle of estoppel (e.g. Lord Templeman in Preston v Inland Revenue [1985] 1 AC 835 at 866G-867C), there are significant differences in their application.

G Remedies

54. The remedies available when the exercise of a public law discretions is successfully impugned include the power by injunction to prevent the body acting on the decision, or a quashing order nullifying the decision (and requiring it to be taken again). What are the consequences of a successful challenge to a contractual discretion?
55. In most cases, the remedy claimed is damages which in turn requires an assessment of what the outcome would have been if the discretion had been exercised lawfully. In some cases, the Court performs an independent calculation (e.g. Clark v Nomura at [81]-[82] where Burton J calculated what the “proper” level of bonus would be). However, other cases recognise that the approach “*would not permit the judge simply*

to unsubstituted his own view of what would have been a reasonable payment for the employer to make, but required him to put himself in the shoes of those making the decision, and consider what decision, acting rationally and not arbitrarily or perversely they would have reached as to the amount to be paid” (Horkulak at [51]).

56. Where there are a range of reasonable decisions open to the discretion-holder, is there any room for the operation of the doctrine of minimum performance (under which, where the contract-breaker has alternative modes of performance open to him, damages are assessed on the basis that the least onerous option would have been chosen)? In the recent case of BHL v. Bank Leumi ABL [2017] EWHC 1871 (QB) HHJ David Waksman QC appears to have adopted a similar argument, suggesting that that “*the exercise here is to determine the highest percentage fee which Leumi could have charged without being in breach of its Braganza duty*” ([158] and see also [193]).

57. However, it is questionable whether this is the right approach. In Horkulak the Court of Appeal rejected the argument that the doctrine of minimum performance applied to the different ways in which an employer might rationally have exercised a discretion to determine an employee’s bonus because (at [68]):

“The company is not free to choose from a “range of reasonable methods” of performance. There is only one method of arriving at a decision: that is, negotiation, followed (in the absence of mutual agreement) by a decision by the president of the parent body. The fact that the final decision is to be made by someone other than the employing company, or its officers, emphasises the objectivity of the process. It seems to us implicit that the president will pay due regard to the interests of both employer and employee, rather than simply to that of achieving the “minimum burden” for the company. The task of the court is to put itself in his shoes”.

58. What happens, therefore, where the breach arises from the failure to take into account a relevant factor, or the taking into account of an irrelevant factor? In Braganza this issue did not arise, because BP conceded that if the breach of contract in reaching the decision not to pay the death-in-service benefit was established, the benefit would be payable. Absent such a concession, it would have been necessary to prove that considering the ignored funding would have altered the decision. In Pacific Basin IHX Ltd v Bulkhandling Handymax A/S [2011] EWHC 2862 (Comm), owners of a vessel were entitled to refuse to go to a port which in their reasonable judgment was exposed to “war risks”. While not finding that there was an independent duty to make proper enquiries, as opposed to a duty to arrive at a reasonable outcome, Teare J. said (at [55]):

“The effect of that clause is that the Owners must make a judgment. It must be made in good faith; otherwise it would not be a judgment but a device to obtain a financial gain. Further, the judgment reached must be objectively reasonable. An owner who wishes to ensure that his judgment is objectively reasonable will make all necessary enquiries. If he makes no enquiries at all it may be concluded that he did not reach a judgment in good faith. But if he makes those enquiries which he considers sufficient but fails to make all necessary enquiries before reaching his judgment I do not consider that his judgment will on that account be judged unreasonable if in fact it

was an objectively reasonable judgment and would have been shown to be so had all necessary enquiries been made.

59. The analysis so far has assumed that the consequence of breach of a discretion obligation involves a counterfactual causation analysis and damages for any resulting loss. In some cases however – for example where the discretion is as to the withholding of a benefit or a variation of a party’s obligations – the “conditional rights” approach identified above is a possible analysis (i.e. that the discretion-holder does not owe discretion-obligations as such, but that compliance with discretion obligations is a condition of a right to withhold consent, vary the contract etc), such that the failure to comply with discretion obligations is that consent cannot be withheld, the contract cannot be varied etc.
60. In Watson v Watchfinder UK Limited [2017] EWHC 1275 (Comm). HHJ Waksman QC considered an option which could only be exercised with consent of majority of board. He noted at [126]:
- “It is common ground that if there was the Braganza Duty and Watchfinder failed to comply with it, the Court must proceed as if consent had been given and accordingly the Claimants succeed on their claim for specific performance of the Option Agreement”.*
61. Was this concession rightly made? In the landlord and tenant consent, it has been held that where a landlord’s consent is required to assign or sub-let, and the consent is unreasonably withheld in breach of contract, the tenant can proceed with the assignment or sub-letting: Rendall v. Roberts & Stacey (1959) 175 E.G. 275; Mills v Cannon Brewery Co. Ltd. [1920] 2 Ch. 38. This reflects a line of authority going back to Treloar v Bigge (1873-74) L.R. 9 Ex 151. These cases provide an alternative, and as yet unexplored, method of giving effect to some discretion obligations.

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