

Contracts often include provisions that provide a unilateral discretionary power conferred on one of the parties to the contract. Such discretion may appear to be unfettered. However, English courts have sometimes used the implication of a term that qualifies the manner in which it may be exercised by concepts of good faith, and genuineness and the absence of arbitrariness, capriciousness, perversity and irrationality (often referred to as the “Braganza Duty”). In this client alert, Rob Broom (associate, Energy & Natural Resources) and Joe Abbott (senior associate, Corporate) take a closer look at the Braganza Duty, when it applies, how to fulfil it, and practical tips relating to the exercise of contractual discretion.

1. The Issue With Contractual Discretion

Unilateral discretionary powers in contracts often give rise to potential conflicts of interest arising from the significant imbalance of power between the parties. While courts will not rewrite a contractual bargain between parties, they will often seek to ensure that the powers afforded by a contract are not abused.

The courts recognise that, in such cases, they are not the primary decision-makers and that their task is to review the decision that has been made by the contracting party. The standard of review should be no higher than that developed in the context of the judicial review of administrative action, and this may require not only that the contractual decision-maker exclude extraneous considerations from the decision-making process, but that it should also be required to take into account those considerations that are obviously relevant to the decision in question. Unless the court can imply a term that the outcome be objectively reasonable (for example a reasonable price or a reasonable term), the court may imply a Braganza Duty (so called after the landmark Supreme Court case, *Braganza v BP Shipping Ltd*) to require it to be exercised honestly and in good faith, and not in an arbitrary, capricious or irrational way.¹

By implying such a duty into contracts where there is a potential for a conflict of interest, courts can restrict the ambit of these clauses and, therefore, prevent a party from abusing its decision-making powers.



2. What Is the Braganza Duty?

The Braganza Duty is an implied obligation (in the absence of clear language to the contrary) that qualifies the manner in which contractual provisions providing for a right to exercise some form of discretion should be exercised, requiring such exercise to be rational and in good faith. In other words, there must be a proper, rational decision-making process.

The Braganza Duty should be distinguished from the duty to act reasonably; the Braganza Duty is subjective, whereas the duty to act reasonably is objective. In addition, the Braganza Duty introduces an element of good faith to the process. As further elaborated in Part 3 below, there are two limbs that the courts will consider when applying the Braganza Duty:

- **First limb (the decision-making process)** – Did the decision-maker neglect or refuse to take something into account that they should have taken into account, or conversely, did the decision-maker consider something that was irrelevant?
- **Second limb (the decision itself)** – Was the decision so perverse that no reasonable person, acting reasonably, could have made it, even though the decision-making process itself could not be faulted?

3. The Braganza v BP Shipping Ltd Case

In the Supreme Court case *Braganza v BP Shipping Ltd and another 2015 UKSC 17*, the claimant's husband disappeared overnight while working on one of BP's tankers in the mid-Atlantic. His employer had a power under the contract of employment to determine the facts surrounding the death of its employee while serving on its vessel at sea: the employer decided that he had committed suicide with the result that no death-in-service payments were payable to his widow under the contract. The relevant clause of the employment contract provided that:

"... compensation for death ... shall not be payable if, **in the opinion of the company or its insurers**, the death... resulted from amongst other things, the officers' willful act, default or misconduct whether at sea or ashore."

According to Lady Hale, who gave the majority judgment of the Supreme Court:

"Contractual terms in which one party to the contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, are extremely common. It is not for the courts to rewrite the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker. Nevertheless, the **party who is charged with making decisions which affects the rights of both parties to the contract has a clear conflict of interest**. That conflict is heightened where there is a significant imbalance of power between the contracting parties as there will often be in an employment contract. The courts have therefore sought to ensure that such contractual powers are not abused. They have done so by implying **a term as to the manner in which such powers may be exercised, a term which may vary according to the terms of the contract and the context in which the decision-making power is given.**"²

Lady Hale concluded that the employer's decision-making process was subject to an implied term that the decision-making process be lawful and rational in the public law sense, and that the decision is made rationally (as well as in good faith) and consistently with its contractual purpose.³ This meant that the employer was required to exercise the contractual discretion conferred upon it in accordance with both limbs of the *Wednesbury* formulation in the rationality test⁴ (which is associated with the exercise of public law discretions), i.e. imposing requirements both as to the:

1. Decision-making process (considerations properly to be taken into account and ones not to be taken into account)⁵
2. Outcome (the result not being "so outrageous that no reasonable decision maker could have reached it")⁶



The majority in the Supreme Court held that the employer should not simply have accepted the conclusion of its investigators' report (whose purpose was to determine if its systems could be improved) in deciding whether its employee had committed suicide, and had relied on insubstantial evidence and had failed to consider all relevant matters. As a result, the employer's decision could not stand and the employee's widow was entitled to the death-in-service payment.

4. When Will Courts Be More Likely to Imply a Braganza Duty?

While it is not possible to characterise every contractual decision as the exercise of a discretion to which the Braganza Duty applies, the key indicators that suggest a court will imply a Braganza Duty are as follows:

- **The contractual provision itself** – It must bestow a contractual discretion rather than merely provide a party a contractual right to act in a certain way. For example, in *Shurbanova v Forex Capital Markets Limited*,⁷ it was held that in the context of an agreement between a foreign exchange broker and a retail customer, a contractual right for the broker to revoke a transaction due to abusive trading was not constrained by a Braganza Duty.
- **The presence of a conflict of interest** – In *Watson and Others v Watchfinder.co.uk*,⁸ the High Court considered the terms of a share option that could be exercised only with majority board consent. The High Court held that a clause in a share option agreement that stipulated that the option could only be exercised with the consent of a majority of the board of directors was subject to a qualification that it be exercised in a way that was not arbitrary, capricious or irrational. The High Court also elaborated that there was an obvious conflict of interest as far as the existing shareholders in the company were concerned, since "the grant of further shares would dilute their own holdings and/or restrict at least to some extent their availability for other investors who may have to pay much more." As the company could not provide any board minutes detailing the decision to veto the exercise of the options and, therefore, could not demonstrate that it discharged its duty properly, accordingly, the High Court granted specific performance to the option holders.

² *Braganza v BP Shipping Ltd and another 2015 UKSC 17* at [18]

³ *Braganza v BP Shipping Ltd and another 2015 UKSC 17* at [30]

⁴ laid down in *Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948] 1 KB 223*

⁵ *Braganza v BP Shipping Ltd and another 2015 UKSC 17* at [30]

⁶ *Braganza v BP Shipping Ltd and another 2015 UKSC 17* at [24]

⁷ *Shurbanova v Forex Capital Markets Limited [2017] EWHC 2133 (QB)*

⁸ *Watson and Others v Watchfinder.co.uk [2017] EWHC 1275 (Comm)*

- **Does the party exercising the discretion have a range of options it can impose on the other? Does the party have the power to estimate, value or impose fees and costs?** – In *BHL v Leumi ABL Limited*,⁹ the exercise of discretion granted a finance provider the right to recover fees of “up to 15%” of the receivables recovered. Waksman J considered that the clause was intended to “capture or estimate in some way” the finance providers’ future costs and expenses in the collection of receivables and when it decided to charge the full 15% without making any attempt to calculate its likely cost recovery, it had breached the Braganza Duty. In effect, the discretion had to be subject to some qualification; otherwise, it could be exercised oppressively and abusively. In this case, it has held that 4% would have been the maximum permitted recovery.

In addition, courts are unlikely to apply a Braganza Duty to absolute rights (including, but not limited to, absolute rights to terminate relationships and roles) conferred by professionally drawn or standard form contracts between well-resourced parties. This was seen in a recent High Court case, *TAQA Bratani Limited and Others v Rockrose*,¹⁰ concerning joint operating agreements (JOAs) for five oil production blocks within the Brae Field in the North Sea, in which the claimants invoked a change of operator clause in the agreements that was conditional on approval of the discharge by unanimous vote of the non-operating parties. In *Rockrose*, the right to discharge the operator was assimilated to the right to terminate a contract and the High Court refused to limit or restrict the power of the claimants to exercise their termination rights under the JOAs on the basis that the Braganza Duty had no application to unqualified termination provisions in expertly drafted, complex commercial agreements between sophisticated commercial parties. The High Court distinguished the *Braganza* case on the basis that in *Rockrose*, the clause in question permitted the exercise of an “absolute contractual right.” In the *Braganza* case, the discretion involved making an assessment or choosing from a range of options in which the interests of both parties had to be taken into account.

- **Nature of the contractual relationship/inequality of bargaining power** – It is more likely for a Braganza Duty to be implied in a contract where one party has significant autonomy over the relationship. Applicable examples can include a contract of employment or a tenancy agreement rather than less “relational” contracts, such as mortgages.

In *UBS AG v Rose Capital Ventures Ltd*,¹¹ where the agreement was entered into in the context of commercial lending and the borrower was a large commercial entity in a strong bargaining position, capable of borrowing elsewhere on more attractive terms, the High Court refused to apply the Braganza Duty to the contractual discretion to demand a full repayment of the loan before the end of the term provided it gave three months’ notice to the borrower (Rose Capital).

5. Concluding Thoughts

While implying a Braganza Duty can act as a useful method to restrict the ambit of clauses conferring a discretion to a contracting party, recent cases have confirmed that there is a high hurdle to establish a breach of this duty when it is applied. Parties exercising such discretion should consider some practical points, though, such as:

- Considering the purpose of the discretion in the contract in the first place. What was the discretion originally supposed to achieve?
- Keeping records to support the decision-making process and specifically detailing what factors were considered (and ensuring only those factors that are relevant to the decision-making process are considered).
- Ensuring that there are rational grounds to make the decision in question.

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⁹ *BHL v Leumi ABL Limited* [2017] EWHC 1871 (QB)

¹⁰ *Taqa Bratani & Ors v Rockrose UKCS8 LLC* [2020] EWHC 58 (Comm)

¹¹ *UBS AG v Rose Capital Ventures Ltd* [2018] EWHC 3137 (Ch)