

## Constraints on "binary" rights

A UK Court has held that case law establishing constraints on the exercise of contractual powers and discretions does not apply to a contractual right of cancellation.

*\*Stuart Dalzell, Partner and Rebecca Richter, Law Clerk discuss the case.*

### The case

The case, *Monde v Westernzagros Ltd* (EWHC, 28 June 2016), arose out of what the Judge described as "the scramble by Western companies, in the period following the fall of Saddam Hussein, to exploit the natural resources of the Kurdistan region of Iraq." Monde - a British Virgin Islands-registered consultancy - sued WZL following the termination of its consultancy services agreement (CSA) with WZL in 2007. The Judge held that Monde was entitled to a 3% option in the Kurdamir field for "misrepresentation" but otherwise suffered no substantial recoverable loss.

A point at issue however was whether the CSA contained implied terms constraining the right to terminate the contract, such that WZL could not validly bring the contract to an end in bad faith and/or in any manner which "unconscionably deprived Monde of its accrued and/or future rights arising under the [CSA]...."

### The reasons

The Court held that the CSA contained no such implied terms firstly because the suggested terms did not meet the legal standard for implication of terms, and secondly, because termination involved no exercise of discretion to be exercised rationally and in good faith.

### Standard for implication of terms not met

As the Court acknowledged, the case law on constraints on unilateral rights is

well-established: requiring such rights to be exercised in good faith and not arbitrarily or capriciously. See *British Telecommunications plc v Telefonica O2 UK Ltd* (2014, UK Supreme Court); and for a New Zealand example, *Olsen Consulting Ltd v Goodman Fielder New Zealand Ltd* (HC Auckland CIV 2011-404-5622, 23/11/2011, Keane J).

Nonetheless, the Court held that normal principles as to the implication of terms applied, so that such constraints will be implied if, but only if, the contract would lack commercial or practical coherence without it and where, properly construed, the language of the contract permits such a term.

That was not the case here, because in the Judge's view, there was nothing in the text or context of the agreement which supported the term for which Monde contended. The CSA was a "detailed and professionally drafted agreement, in relation to which both sides were advised by lawyers...Monde [was] an independent contractor [with] freedom to act for any other party...or to carry on any other business." The agreement was arm's length and provided for Monde to be remunerated by monthly payments, success fees and options provided for in the CSA. There were no obligations of loyalty such as might point to an obligation of good faith.

### No exercise of discretion

Moreover, the Judge held, the choice whether or not to terminate the CSA was "binary", ie the terminating party could either terminate or affirm the contract.

It was thus not a case of a contractual power or discretion giving rise to a choice from a range of options. Termination was therefore to be "constrained only by the objective contractual requirements which limit the

circumstances in which that choice can be made."

In addition, the Judge held that the suggested term had nothing to do with performance of the agreement. Rather, it was to do with its termination. He said: "The purpose of a contractual right to terminate is to give the party on whom that right is conferred the power to bring the contract to an end...In my judgment, it is unlikely that the hypothetical reasonable commercial man or woman would expect the party exercising that right to be obliged to consult anyone's interest but its own."

### Comment

The Courts' concern is that discretions should not be abused, and notably the UK Court of Appeal has recently warned against underestimating the "potency of the limits implied by courts on the exercise of contractual discretions": *Evangelou & Others v McNicol* (2016).

However, if and to the extent a party has an express contractual right, which it exercises, to bring their contract to an end, there is a strong argument that ought to be an end of the matter. There is no rule, either in English or New Zealand contract law, that every termination must be justified based on concepts of rationality and good faith. Likewise, if there is a "substantial breach" giving rise to a right of cancellation under s7 of the Contractual Remedies Act 1979 (NZ).

The judgment may be persuasive to New Zealand courts.

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