Deciding whether to terminate a contract, whether at common law for an alleged repudiatory breach or under a specific term in the agreement, is rarely easy. Get it wrong and you may be in breach yourself. In several cases over the last couple of years, parties have tried to impugn their counterparty’s termination by alleging a failure to act in good faith. Recent decisions have provided important guidance on whether a requirement to act in good faith can apply when exercising termination rights.

The developing concept of good faith in English contract law

There has, traditionally, been no general duty to act in good faith towards your counterparty under English contract law, other than in a few well-established and restrictive categories of case. But *Yam Seng Pte Limited v. International Trade Corporation Limited* [2013] EWHC 111 (QB) held that in certain circumstances the court should imply a duty of good faith (or fair dealing) into the parties’ contract. Leggatt J identified joint ventures, franchises and long-term distributorship agreements as non-exhaustive examples of “relational” contracts in which an implied duty of good faith may, depending on the context, arise. However, it was unclear to what extent courts would, in future, imply obligations of good faith either into these types of contract, or more generally. The aspects of the parties’ relationship to which any implied duty of good faith would apply were, similarly, uncertain. Specifically for current purposes, must a party ever act in good faith when exercising a right to terminate the contract?

Express termination rights in the contract – are they subject to implied duties of good faith?

*Monde Petroleum SA v. Westernzagros Ltd* [2016] EWHC 1472 considered whether an express right to terminate a contract was subject to an implied term that the party terminating must act in good faith.

The parties entered an agreement for Monde (MP) to provide consultancy services to Westernzagros (WZ) to assist WZ in its negotiations with authorities in the Kurdistan region of Iraq for an oil exploration and production sharing agreement (EPSA). MP received monthly consultancy fees and, in the event that the EPSA was executed and various other conditions met, had an option to acquire a 3% interest in the project. WZ and Kurdistan signed an EPSA in 2006, but over the following months Kurdistan insisted on various amendments which made the arrangement less economically attractive to WZ. In March 2007, WZ served notice on MP to end the consultancy agreement, relying on its express termination rights under that contract. Among other issues, MP argued there was an implied term that WZ and MP would act in good faith towards each other when performing their obligations and exercising...
their rights under the consultancy agreement, including the express termination regime. MP alleged WZ had breached that implied term. It contended the termination had unconscionably deprived MP of its rights to future consultancy fees and to participate in the project (although it was speculative whether MP would ever be in a position to exercise its option).

The court held there were two insuperable obstacles to MP's case on this issue. First, even though MP argued the parties had intended their relationship to be long term and of a quasi-partnership nature, this did not automatically mean that an implied duty of good faith applied. The recent Supreme Court decision in *Marks & Spencer plc v. BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72 has reaffirmed that any term, to be implied, must be either necessary or obvious, and not inconsistent with the express terms. These requirements apply just as much to an alleged implied duty of good faith as they do to any other form of implied term. Specifically in relation to the consultancy contract, the court said:

"It is impossible…to identify any facts forming part of the commercial background, or any aspect of the relationship between the parties…which indicate that the [agreement] would lack commercial or practical coherence without the implication of a 'good faith' term…"

Secondly, the court held that the implied term proposed by MP would rarely, if ever, apply to restrict a contractual right to end the contract. It distinguished such a term from a contractual discretion. The latter generally will be restricted by an implied term that the relevant party must exercise it in good faith, for the purposes for which it is given, and not in an arbitrary, capricious or irrational way. But a discretion involves a range of options from which that party can choose. A right to terminate, on the other hand, involves a binary choice: to end the contract or not. The only issue is whether any conditions required to trigger the right to terminate have been met. So, as the judge put it:

"A contractual right to terminate is a right which may be exercised irrespective of the exercising party’s reason for doing so. Provided that the contractual conditions (if any) for the exercise of such a right (for example, the occurrence of an Event of Default) have been satisfied, the party exercising such a right does not have to justify its actions."

**Can a general contractual duty to act in good faith restrict an express right to terminate?**

Sometimes, of course, the parties expressly provide in their contract that they must act in good faith towards each other, or set out similar standards of conduct required. Without clear language, will such a provision apply to a separate but express right to terminate?

This point did not arise in the *Monde* case, as the consultancy agreement contained no general good faith requirement. But the court reviewed an earlier decision suggesting that general good faith (or similar) wording is unlikely to restrict an otherwise clear contractual right to terminate. Thus, in *TSG Building Services plc v. South Anglia Housing Ltd* [2013] EWHC 1151 (TCC), the parties entered a four-year contract for TSG to provide gas servicing and associated work covering some 5,500 properties owned by SAH. Clause 1 stated:

"The [parties] shall work together and individually in the spirit of trust, fairness and mutual co-operation for the benefit of the Term Programme, within the scope of their agreed roles, expertise and responsibilities as stated in the Partnering Documents…and in all matters governed by the Partnering Contract they shall act reasonably and without delay."

The Partnering Objectives included "trust, fairness, mutual co-operation, dedication to agreed common goals and an understanding of each other’s expectations and values".

The court refused to interpret these terms as restricting a separate clause in the contract entitling either party to
terminate the contract on three months' notice. Indeed, the existence of the express standards of behaviour persuaded the court that it should not imply a more general duty of good faith applying to the right to terminate. The judge stated:

"The parties have gone as far as they wanted in expressing terms...about how they were to work together in a spirit of 'trust, fairness and mutual co-operation' and to act reasonably. Even if there was some implied term of good faith, it would not and could not circumscribe or restrict what the parties had expressly agreed...that either of them for no good or bad reason could terminate at any time..."

Is a common law right to terminate for repudiatory breach subject to requirements of good faith?

The cases mentioned above concerned express contractual rights to terminate. But what is the position where a party has a common law right to terminate the contract for repudiatory breach? The innocent party can then elect to accept the breach and end the contract or affirm the agreement and keep the parties' respective rights and obligations alive. Must it make that decision in good faith?

This point came up in *MSC Mediterranean Shipping Co SA v. Cottonex Anstalt* [2016] EWCA 789. The carrier under a contract for the international carriage of goods had the right to terminate for the shipper's repudiatory breach. Due to a dispute between the shipper and consignee about who had title, the goods effectively remained embargoed at the port. The shipper was in repudiatory breach as it could not return the containers to the carrier. But the carrier elected to affirm and keep the contract alive, purely so it could claim liquidated damages in the form of demurrage. These payments were due at a daily rate, without limitation in time.

At first instance, Leggatt J held the carrier had not been entitled to affirm, principally because it had no legitimate interest in keeping the contract on foot as there was no prospect of the shipper performing its remaining obligations. But the court also said that a party must decide whether to exercise its common law right to terminate for repudiatory breach in good faith, effectively applying the same test as for exercise of an express contractual discretion.

The Court of Appeal has now considered the case. It decided the substantive issue on the basis that, on the facts, there was eventually deadlock between the parties. The contract in its agreed form was no longer capable of performance and had, in effect, become frustrated. The contract had terminated automatically at that point and the continuing right to demurrage with it.

Addressing the good faith point, the Court of Appeal said it was neither "necessary [nor] desirable" to resort to that principle to decide the case. More generally, it suggested it was better for the law to develop along established lines rather than to seek out what Leggatt J had suggested was a "general organising principle" drawn from cases of very different kinds. The Court of Appeal thought the cases on express contractual discretions - and the implied good faith restrictions on their exercise - provided no help when considering the exercise of a right to terminate arising at common law.

Practical implications

These cases are significant because, especially when taken together, they suggest the courts will rarely if ever accede to an argument that a right to terminate has to be exercised in good faith - unless the parties have expressly provided for this.

It seems logical that an express contractual right to terminate should not be subject to an implied requirement to
exercise it in good faith, and that general good faith wording in the contract should not, properly interpreted, restrict such a right. This is especially so where the party exercising that right will, by definition, be acting against the interests of the counterparty. But take care if you do include in your contract a general requirement for the parties to act towards each other in good faith (or set a similar standard of conduct). It may still be safer to state expressly if other specific rights are exceptions from such general duties rather than rely on the court’s interpretative powers to achieve that result.

MSC has provided useful clarification when considering whether to exercise a common law right to terminate. You still need to analyse whether the counterparty is indeed in repudiatory breach. But the decision whether to elect to end or affirm the contract is not akin to the exercise of an express contractual discretion. It therefore is not generally subject to a requirement to act in good faith.

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