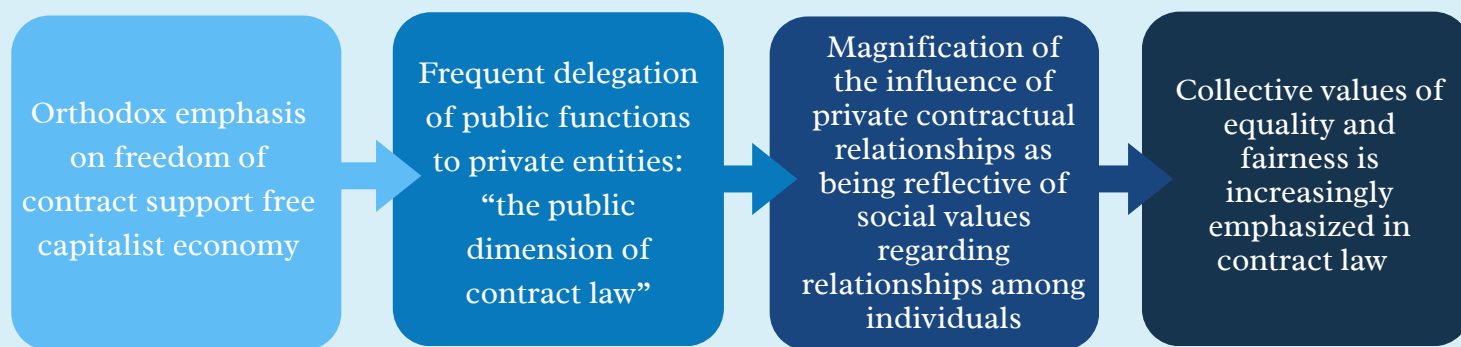


PARALLEL CONTROLS OF CONTRACTUAL DISCRETION: THE DOCTRINES OF RATIONALITY AND GOOD FAITH

Introduction: The Problem of Discretion

- *What is it?* Granting one party sole power to make decisions affecting both parties' rights (e.g., determining bonus payouts, loss calculations, cause of death for insurance).
- *The Risk:* High potential for abuse, opportunism, and frustration of the bargain's purpose.
- *Judicial Response:* Despite a traditional commitment to freedom of contract, English courts actively imply duties to control this power: the duty of rationality and the duty of good faith, moving towards a normative shift emphasizing fairness and fidelity.



Above: Normative Shift of Contract Law to Incorporate Values of Equality and Fairness

Doctrine 1: The Duty of Rationality

Core Principle: A decision must be made consistently with the contractual purpose and must not be "irrational, arbitrary, or capricious."

Key Defense: The high Wednesbury standard applied in contractual scenarios (the threshold of "a decision must be so unreasonable that no reasonable authority would have ever come to it) is justified

Criticism: It's a public law standard, ill-suited for private contracts.

Rebuttal: The test has been flexibly modified for commercial contexts. Its intensity varies based on:

- Contractual framework and purpose
- Parties' commercial sophistication
- Need for certainty
- Market disciplines

Conclusion: It acts as an internal constraint (tied to the contract's purpose), not an external imposition.

Courts readily imply the Braganza duty by:

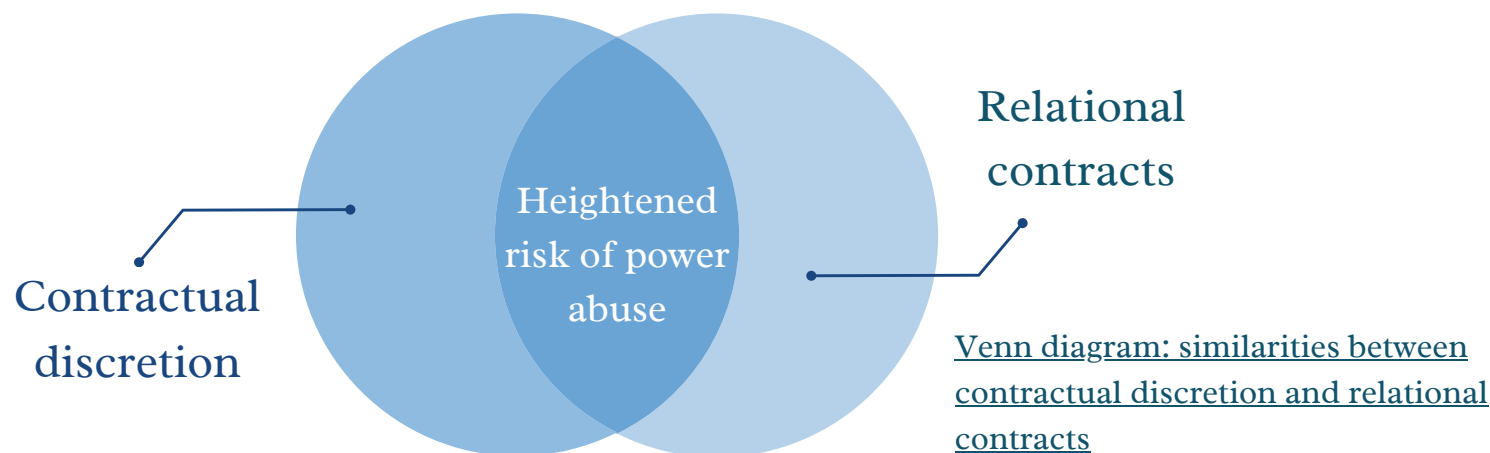
- **Broad Interpretation:** "Conflict of interest" is interpreted widely to include practical, not just legal, conflicts.
- **High Bar for Exclusion:** Describing a power as "sole" or "absolute" is insufficient to exclude the duty. Total exclusion is "extremely difficult."

Doctrine 2: The Doctrine of Good Faith

Core Principle: Requires honesty, fidelity to the bargain, and adherence to objectively reasonable commercial standards.

Current Law is Incoherent:

- Implied either in fact (case-specific) or in law (as a legal incident of a relationship type, e.g., relational contracts).
- The test for "relational contracts" (*Bates v Post Office*) is ambiguous and applied inconsistently by courts.



Proposal: Imply Good Faith in Law for Contractual Discretion

- *Justification by Analogy:* good faith is implied in law in relational contracts. Contractual discretions share key traits, thus good faith should be implied in law in these as well.
- *Relational Contracts:* parties in a relational contract establish a quasi-integrated production relationship with heightened contradictory pressures both to cooperate and to compete for self-interest. However, due to their typical long-term nature, it is often impractical for parties to spell out their contractual obligations in full.
- *Similarities:*
 - a. **High Risk of Purpose Frustration:** One party can easily abuse its power.
 - b. **Contractual Incompleteness:** Parties often cannot exhaustively define all limits of discretion in advance (for flexibility/bargaining reasons).
- *Benefits of implying the duty of good faith in law:*
 - **Increased Certainty:** Automatic implication if the Braganza threshold is met.
 - **Systemic Coherence:** Creates a unified standard for discretionary contracts.

Keeping the two doctrines distinct

Table below: Comparison between the duty of rationality and the duty of good faith

Feature	Duty of Rationality	Duty of Good Faith
Core focus	Proper purpose	Honesty & fidelity
Legal test	Contextual, subjective (modified Wednesbury Test)	Objective (view from a reasonable person)
Normative goal	Prevent arbitrary/irrational decisions	Prevent dishonest, unfaithful, or exploitative conduct
Relationship	They are complementary, not interchangeable. A decision can be irrational but honest, or rational but dishonest.	

Merging them would force a choice between tests, sacrificing either **deference to the decision-maker (rationality)** or **objective certainty (good faith)**.

Conclusion

- English law is undergoing a normative shift, balancing freedom of contract with fairness in areas of high vulnerability such as contractual discretions.
- The duty of rationality is a well-established, context-sensitive control justified by contractual purpose.
- The law should develop to imply a duty of good faith in law for contractual discretion, creating a clearer and more coherent framework.
- These two distinct, parallel duties together provide a robust and nuanced system for controlling discretionary power, protecting the bargain's fidelity without undermining party autonomy.

Selected References

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