

Insights

NOT TO BE SNIFFED AT... IMPLIED TERMS IN THE CONTEXT OF TERMINATION

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SUMMARY

Waste projects are sometimes perceived as the less glamorous side of our construction and infrastructure practice. That does them a disservice: they involve innovative technologies and the development of sustainable infrastructure solutions. The interface of those technologies with the allocation of risk for design and construction can present interesting and knotty contractual issues. For example, the failure to meet the contractual performance requirements is sometimes blamed on the plant being fed the “wrong waste”, leading to disputes over the allocation of design risk, interpretation of performance requirements, delay and **termination**.

Essex County Council v UBB Waste (Essex) Ltd (No.2) concerns such a project. The council and UBB entered into a 25-year PFI contract for the construction and operation of a mechanical biological waste treatment plant to reduce the volume of household waste sent to landfill and to generate energy from the production of “solid recovered fuel”.

The contract allocated design risk to UBB, including the assumed composition of the feed waste. The Services Period would commence upon issue of the Acceptance Test Certificate. UBB was required to complete the Acceptance Tests by the Acceptance Longstop Date of 12 January 2017, but it never managed to do so. Cutting through the detail of his analysis of the parties’ respective cases, the judge considered that this was as a result of failures in UBB’s design – in particular errors in its assumptions for the composition of the feed waste. He declared that the council was in turn entitled to terminate the contract after the Acceptance Longstop Date.

The judgment addresses a number of interesting issues, together with some important points on the use of factual and expert witnesses that practitioners should note. I focus here on the judge’s analysis of **implied duties and terms** in the context of the council’s entitlement to terminate the contract and, in respect of each, Pepperall J considered the authorities relevant to the assessment of whether terms are to be implied into a contract, including the test set out in **BP Refinery (Westernport) Pty Ltd v Shire of Hastings**.

UBB argued that three implied terms constrained the council's entitlement to terminate the contract.

Implied "Braganza" term to exercise powers and discretion in good faith

UBB asserted that, in holding UBB to Acceptance Test regimes prescribed by the contract, the council was in breach of an implied term to exercise a contractual power or discretion in **good faith** and to not act arbitrarily, capriciously or irrationally.

Pepperall J recognised the implied term but reaffirmed the position set out in **Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Trading Ltd**, that there is no scope for such a term to be implied where a party is exercising an "absolute contractual right". In respect of each relevant decision that the council had made, Pepperall J found that it had such an absolute contractual right to do so and so the implied term not to do so arbitrarily, capriciously or irrationally could not be used to undermine that contractual right.

Implied duty of good faith arising under a relational contract

UBB argued that the council was in breach of an overarching duty of good faith arising from a "relational contract" between the parties. In considering the relevant authorities (in particular that of **Yam Seng Pte Ltd v International Trade Corporation Ltd** and **Bates v Post Office (No.3)**), Pepperall J concluded that the 25-year PFI contract satisfied the non-exhaustive list of characteristics set out in *Bates* and was a "paradigm example" of a relational contract in which the law implies a duty of good faith. In doing so, he confirmed that the sole remedy and entire agreement clauses in the contract were not inconsistent with such an implied term.

As to the nature and content of the implied term and duty, the judge confirmed that one must consider whether the relevant conduct would be regarded as "commercially unacceptable" by reasonable and honest people. He confirmed that this is an objective test having regard to contractual and factual context of each case. On the facts of this case, Pepperall J determined that the council had not acted in breach of its duty of good faith. Rather, referring to his observations of the conduct of UBB's main factual witness (and unguarded contemporaneous emails within UBB – a lesson in itself), the judge noted the irony in UBB's allegations given that it was certainly arguable that it had acted in breach of that duty.

Implied term limiting the right to terminate

Finally, UBB argued that the council's right to terminate was subject to an implied term that it must do so within a reasonable period of time of that right accruing. As at the date of the hearing, some two and a half years had passed from the Acceptance Longstop Date but the council had not exercised its right of termination. UBB argued that the council had therefore lost any entitlement that it may have had.

The judge considered a number of shipping cases in which, as a matter of business efficacy and fairness, the party seeking to terminate a charterparty was required to do so promptly. Some of those cases reached that conclusion on the basis of an implied term, while others did so on the basis of the common law doctrines of **waiver** and **estoppel**. Acknowledging the debate over the juridical basis of requiring a terminating party to act promptly, Pepperall J chose to “tread warily” in approaching the issue. However, he rejected the proposition that there was an “immutable rule of law that all rights of termination must be exercised within a reasonable time after such right first arises.”

Instead, the judge returned to first principles in assessing whether the alleged term should be implied. He rejected the implication of the term in this case on the basis that it was not necessary to ensure that the contract had commercial or practical coherence, nor was it obvious. Indeed, in circumstances where the parties agreed that the plant was still unable to pass the Acceptance Tests, the judge considered that in this case to imply such a term would operate **against** the efficacy of the contract on its existing terms.

Furthermore, the judge found that it was not necessary to imply a term to exercise the right of termination within a reasonable time given the existence of the common law doctrine of waiver by election. He then went on to consider the application of the doctrine in this case and by reference to the authorities summarised in **Tele2 International Card Co SA v Post Office Ltd**:

- The exercise of a right to terminate is an election that the innocent party must make.
- To do so, the innocent party must be aware of the relevant facts and of the right itself.
- The innocent party must make a decision.
- Where the innocent party acts in a manner that is consistent with an election one way or the other, it will be held to have made such an election.
- That election can be communicated to the other party through words or conduct, but this must be in unequivocal terms where the right to terminate has arisen upon the occurrence of defined events.

In the two and half years after the Acceptance Longstop Date (when the council’s right to terminate the contract arose), the council continued to operate the contract while reserving its position as to its right to terminate. Despite that reservation, the judge considered that the continued inability of the plant to pass the Acceptance Test saved the council from losing the right to terminate the contract by waiver. Had the plant in fact passed the Acceptance Tests, it seems that the matter may have ended differently.

When should you terminate?

This case reminds us of the delicate balance to be struck in difficult cases such as this, between:

- The need for a terminating party to be clear, decisive and consistent when electing whether or not to exercise a right of termination.
- The practical and commercial realities where the parties are engaged in an expensive and long-term contractual relationship involving innovative (and sometimes unproven) technology.

As we all know, exercising that right is a severe and irreversible step to take. Given the complexities of the technology sometimes involved, it is not always clear that a right of termination has arisen. As recently demonstrated in the case of **PBS Energo AS v Bester Generacion UK Ltd and another**, getting it wrong carries significant consequences.

One can therefore sympathise with the decision of an owner to continue efforts with the contractor to try and remedy issues so as to meet the contractual performance requirements and continue the venture.

The question then remains – how long and in what manner can and should one participate in that process before you are deemed to have elected to waive your contractual right of termination? Two and half years seems a long while. It is in this respect that I find the judge’s analysis of UBB’s arguments on implied terms and the interplay of those terms (and duties arising from them) with the exercise of contractual rights and discretion set out in a comprehensive PFI contract interesting.

The assertion of implied terms by UBB was far from dismissed out of hand in this case. Indeed, the judge recognised in principle the implied duty of good faith in the exercise of contractual powers and discretion and readily categorised this as a relational contract importing duties of good faith. However, it seems that the underlying merits and the operation of the express contractual rights and remedies was an important factor in this case. That should be of no surprise and on that basis, Pepperall J dismissed UBB’s assertion that the council’s conduct amounted to termination for convenience in disguise.

In the current economic climate where parties might be looking for a way out of unprofitable contracts, one can imagine that these implied terms could be of greater importance and application if the underlying contractual right is not as solid.

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