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# In Practice

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## Everyone for themselves?

The English High Court applies an objective standard of reasonableness in relation to finance documents.

Historically, where a contract has given one party a discretion the exercise of which would affect both parties the English courts have opted to impose few restrictions on the party's decision-making powers, requiring only that a decision must be made, "honestly and in good faith," and that discretion not be exercised, "arbitrarily, capriciously or unreasonably" – *Socimer International Bank Ltd (in liquidation) v Standard Bank London Ltd* [2008] EWCA Civ 116. Therefore, contracting parties often seek to curtail such powers by requiring that the discretion holder "act reasonably" in exercising such power. Despite its popularity in finance documents, there had existed a degree of ambiguity as to what an obligation to "act reasonably" actually entails.

### BARCLAYS BANK PLC V UNICREDIT BANK AG AND OTHERS [2012] EWHC 3655 (COMM)

The defendants were subsidiaries of the Unicredit banking group (the "Defendants"). In connection with the synthetic securitisation of pools of loans held by them, the Defendants entered into guarantee agreements with Barclays Bank plc ("Barclays") (the "Guarantees"). Under the Guarantees, Barclays would receive an annual fee. The Defendants could terminate the Guarantees on a number of grounds if Barclays gave its consent, "such consent to be determined by Barclays acting in a commercially reasonable manner." Just 14 months later, the Defendants requested that Barclays consent to early termination of the Guarantees as regulatory changes meant the Defendants were no longer receiving capital relief by holding them. Barclays indicated that it would only consent to the early termination in exchange for the discounted present value of five years' fees, being approximately €82m (the "Fees"). Rejecting this request, the Defendants argued that it was not reasonable for Barclays to withhold its consent given the severity of the impact of the regulatory change on them. The Defendants argued that Barclays' unreasonable refusal of consent amounted to a waiver of the consent requirement, and they purported to terminate the Guarantees. Barclays applied to court for an order that the Guarantees had not been validly terminated.

### THE ISSUES

Considering the extent of a party's duty to act reasonably, Mr Justice Popplewell concluded:

- where there is no qualification that the party must "act reasonably", provided that the discretion is exercised honestly and in good faith for the purposes for which it was conferred and that it is not capricious or arbitrary, the courts will not intervene;
- where an express requirement to act reasonably is included, a party must meet an objective standard of reasonableness by arriving at a decision which a reasonable man in the circumstances could have made. However, there is no requirement to show that the decision

is, "right or justifiable," nor is one required to take the commercial interests of the counterparty into consideration, unless the failure to do so would be so disproportionate as to be unreasonable;

- previous case law has held that the standard of objective reasonableness may apply in commercial contracts, including finance documents – *Porton Capital Technology Funds and others v 3M UK Holdings Ltd and another* [2011] EWHC 2895 (Comm); and
- as such, in a finance document where the parties have expressly elected to constrain a party's decision-making power by reference to reasonableness, the objective standard shall apply.

### HAD BARCLAYS ACTED UNREASONABLY?

Mr Justice Popplewell considered that Barclays had satisfied an objective standard of reasonableness in requiring payment of the Fees before agreeing to early termination, as: First, evidence of negotiations suggested that at the time the Guarantees were entered into, Barclays had honestly believed: (i) that it would be able to withhold consent until it was paid the Fees; and (ii) that the Defendants had shared this understanding. The judge observed that it would be a surprising result if the court held that no reasonable person could have exercised its discretion in a way in which Barclays honestly and reasonably believed, at the time the Guarantees were entered into, that both parties expected it to be exercised. Secondly, the majority of the other termination provisions ensured that Barclays would receive five years' fees on termination, reflecting the parties' acceptance that this was Barclays' minimum expected return. Indeed, the agreement contained an anti-penalty clause which stated that five years' fees were a "reasonable pre-estimate of loss."

### CONCLUSIONS

This case provides useful guidance on the scope of a contracting party's responsibility to "act reasonably". While acknowledging this will go beyond showing, "merely that the decision was made in good faith," it also makes clear the limited constraints that "acting reasonably" imposes. Although the decision-making party must show that a reasonable man in the same circumstances could have arrived at the same decision, it is not required to show that its decision is "justifiable" or "right", nor that it has considered the impact of its decision on its counterparty's commercial interests. This would seem to rule out a commercial duty of care. Parties should note that the judge observed that an entire agreement clause would not restrict evidence of the parties' pre-contractual intention from consideration as to whether a commercially reasonable decision had been made; such a clause only determines what forms the terms of the agreement. As a result, any failure to correct a party's mistaken belief about how and when discretion can be exercised may inform the court's judgment as to the reasonableness of that decision. ■

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