

Lenders' Discretion and the Limitation of the Braganza Duty



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Where a lender has the absolute discretion to do something under a loan, their position will be protected according to the recent High Court decision in *UBS AG v Rose Capital Ventures Limited, Dr Vijay Mallya, Mrs Lalitha Mallya, Mr Sidartha Vijay Mallya [2018] EWHC 3137 (Ch)*. The Court provided some comfort to secured (and possibly, by extension, unsecured) lenders by confirming that the “Braganza duty” will not generally apply where a lender is entitled to perform a unilateral act at their own discretion.

Background

The first Defendant, Rose Capital Ventures Limited (“**RCVL**”) purchased a property in London (the “**Property**”). The Property was uninhabitable so RCVL planned to carry out reinstatement works. The intention was that the second Defendant would live in the Property with his family, the third and fourth Defendants (together the “**Family**”). The Family were connected to RCVL because the family trust owned RCVL’s parent company.

The Mortgage

In order to carry out the works to the Property, RCVL borrowed

£20.4 million from the Claimant, UBS AG (“UBS”). The key provisions of the mortgage were:

1. it was for a term of 5 years (unless terminated earlier);
2. it was described as an ‘interest only, uncommitted and on-demand facility’;
3. it was not regulated by the FSA (now FCA); and
4. UBS could terminate the mortgage at any time by giving 3 months’ notice at its absolute discretion.

Four years after the drawdown of the mortgage, UBS served notice on RCVL demanding repayment of the loan.

Application to the Court

UBS subsequently issued possession proceedings against the Defendants. RCVL filed a lengthy defence to the proceedings and UBS made an application to strike out elements of the defence on the basis that certain arguments were bound to fail.

The Braganza Duty

Where a party has the power under a contract to make a decision that will affect the rights of both parties to that contract it has a clear conflict of interest, particularly where there is an imbalance of power. Therefore, the Courts are entitled to imply a term that the decision must be made rationally, in good faith and not arbitrarily or capriciously. This is known as a Braganza duty.

In the judgment, the Court considered when the Braganza duty applies and outlined the following:

1. it will not apply to every contractual power or discretion;
2. the language of the contract will influence whether it does apply;
3. it will apply where the decision is made by a party given a role in the on-going performance of the contract, not where they have a unilateral right to act in a particular way (i.e. to terminate the contract);
4. it is more likely to apply where there is an imbalance of power between the parties; and
5. the scope of the term applied will vary depending on the circumstances and the terms of the contract.

In this particular case, the terms of the loan agreement were clear; the loan was provided on an uncommitted, on demand basis. UBS had absolute discretion to terminate the loan and were not required to have a ‘purity of purpose’ when they did so.

Duty to act in good faith

It was not denied that a lender has a duty to act in good faith. RCVL argued that the FCA handbook places a strict duty to act in good faith on all lenders. However, the mortgage was not regulated, meaning that the heightened duty did not apply.

As the Defendants gave no particulars of bad faith (outside of the Braganza duty or FCA handbook), the Court did not explore this issue in detail.

Decision

The Court noted that the common place for the Braganza duty was in disputes about employment contracts and this case, concerning a loan agreement, was of a 'different character'. The Court held that the terms of the loan agreement were clear; USB provided the loan to RCVL on an uncommitted, on demand basis; UBS' termination was a unilateral act; and the balance of power between the parties was relatively equal.

With regard to the duty to act in good faith, the Court held that, as the loan was terminated four years into a five year term, there was nothing, at first blush, facie irrational or in breach of duty about the decision to terminate. Therefore, the application to strike out elements of the defence was successful in ten out of eleven of the points raised by UBS.

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