Employment as a Relational Contract

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1. **A Radical Interpretation of a Cryptic Remark**.

In *Johnson v Unisys Ltd* in 2001, Lord Steyn made a striking assertion:

> "it is no longer right to equate a contract of employment with commercial contracts. One possible way of describing a contract of employment in modern terms is as a relational contract." [1]

Lord Steyn did not elucidate the concept of 'a relational contract' further. Nor did he explain how the law applicable to relational contracts differed from ordinary contract law applicable to commercial contracts. In the case in question, in his dissenting judgment Lord Steyn used the idea of a relational contract to apply a term implied by law into contracts of employment, the implied term of mutual trust and confidence, to create for the first time a common law remedy for unjustified dismissal. Lord Steyn departed further from the ordinary law of contract by insisting that the implied term was not excluded by an apparently inconsistent express term that conferred an unrestricted power on the employer to terminate the contract by giving notice. More recently, Lords Hodge and Kerr giving the majority judgment in *Braganza v BP Shipping Ltd*, [2] treated a contract of employment as a special kind of contract, which they called a relational contract, which required, in the construction of the contract, an intensification of the implied duties placed upon the employer to treat the employee with trust and confidence.[3] If employment is a relational contract to which ordinary rules of commercial law do not always apply, we need to understand better the concept of a relational contract and, in the light of that concept, what different legal rules are therefore likely to apply to contracts of employment. There seem to be two possibilities: a narrow and a more radical interpretation of the idea of employment as a relational contract.

A narrow interpretation suggests that employment contracts have certain relational qualities that should influence their construction and interpretation. Mark Freedland has pointed out how, in the eighteenth century, before personal work contracts were understood in law as much like commodity exchanges in the market, the master and servant relation included diffuse obligations that were perceived as aspects of a status relation: the servant had to be loyal and faithful to one master, and the

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[1] *Johnson v Unisys Ltd [2001] UKHL 13: [2003] 1 A.C. 518* at [20] (HL).

[2] *Braganza v BP Shipping Ltd [2015] UKSC 17: [2015] 1 W.L.R. 1661*.

[3] *Braganza v BP Shipping* Ltd *[2015] UKSC 17:* at [61].

master had to take care of the servant.[4] These relational aspects of employment were carried forward as implied obligations into the new contracts for personal work that are called today contracts of employment. These relational implied obligations were not directly connected to the core exchange of work for remuneration, but applied to more diffuse obligations owed by the parties such as implied terms about loyalty, obedience, and health and safety. Summing up this evolution of the legal institution of the contract of employment, Mark Freedland observed:

> 'the personal employment contract as an exchange transaction becomes merged or subsumed into the personal employment contract as a relational contract'.[5]

John Gardner added that too much emphasis on the reductive features of the exchange transaction in the express terms of the contract could undermine the mutual expectations to maintain and respect the social relationship of employment with its broad and diffuse roles including trust and confidence.[6] It seems likely that the presence of those diffuse obligations in employment guided the majority judgment in *Braganza v BP Shipping Ltd.*[7]

Whilst the recognition of the existence of such diffuse obligations in employment is undoubtedly correct, it is less apparent why they require any departure from the ordinary law of contract. On the contrary, recognition and enforcement of those diffuse obligations can normally co-exist with the application of the general law of contract. In the first place, the ordinary law normally produces the same outcome as a possible special law for relational contracts. For instance, the ordinary law of termination of contracts secured the banker his expected bonus in *Geys v Société Génerale,*[8] by permitting him to preserve his expectation of an on-going relationship after a repudiatory breach by the employer. In this respect, *Braganza v BP Shipping Ltd* seems unusual, because opposite outcomes resulted from the application of a relational contract and an ordinary commercial law approach. Whereas the majority favoured the claimant by using a relational contract law approach, Lord Neuburger dissented on the ground that he saw no reason to depart from the ordinary interpretation of the contract provided by commercial contract law. Second, though the relational qualities of employment are usually evidenced by its terms implied by law, these implied terms do not necessarily separate employment from the law applicable to other kinds of commercial contracts, because similar implied terms arise in analogous transactions. Duties of obedience and loyalty can be discovered in the legal relations between principal and agent,[9] duties to co-operate in good faith or and to preserve mutual

[4] *Mark Freedland, The Personal Employment Contract (Oxford: Oxford University Press, 2003)* p. 90.
[5] *Freedland, The Personal Employment Contract (2003)* p. 92.
[6] *J. Gardner, "The Contractualisation of Labour Law" in H. Collins, G.Lester, V. Mantouvalou, Philosophical Foundations of Labour Law (Oxford: Oxford University Press, 2018)* 33.
[7] *Braganza v BP Shipping Ltd [2015] UKSC 17: [2015] 1 W.L.R. 1661.*
[8] *Geys v Société Génerale, London Branch [2012] UKSC 63: [2013] 1 A.C. 523*; also using ordinary law of termination of contracts *Rigby v Ferodo Ltd [1988] I.C.R. 29, [1987] I.R.L.R. 516*.
[9] Robert Flannigan, "The [Fiduciary] Duty of Fidelity" (2008) 124 L.Q.R. 274; Andrew Frazer, "The Employee's Contractual Duty of Fidelity" (2015) 131 L.Q.R. 53.

trust and confidence are intrinsic to partnerships,[10] and the duty to take reasonable care of the employer's property was derived from rules concerning independent contracting and bailment.[11] Whilst it is correct that employment has a distinctive set of diffuse expectations that are normally protected by terms implied by law, there is not a compelling case for thinking that this interpretation of the meaning of employment as a relational contract requires any departure from the ordinary common law of contract.

A more radical interpretation of the claim that employment is a relational contract is needed to explain Lord Steyn's remark quoted at the beginning. Recall that he relied on the concept of a relational contract to break free of the common law of contract in two decisive ways: to insert an implied term to protect against unjustified dismissals, contrary to the common law's tradition of permitting termination for any reason and in any manner on giving reasonable notice, and to insist that the implied term could not usually be excluded by an inconsistent express term. Lord Steyn's cryptic description of employment as a relational contract seems better interpreted as proposing a more radical taxonomy for the law of contract. Reading his assertion in context whilst sticking to the exact text, he advances two propositions: first, there is a division in the law of contracts between relational contracts and ordinary commercial contracts; and, second, that the contract of employment should be included in the category of relational contracts. Two decades ago, when discussions of the idea of relational contracts were largely confined to scholarly literature,[12] this broader possible interpretation of Lord Steyn's observation was not widely apprehended. Today, however, when, as we shall see in the next section, the category of relational contracts has been frequently invoked for the purpose of the resolution of contractual disputes in a commercial context,[13] there is much less difficulty in perceiving the potential implications of the classification of contracts of employment not as a variant of ordinary contracts but rather as falling into the genus of relational contracts that are regulated by the law in a way that is distinct from ordinary contracts. The accuracy and implications of this bolder view that relational contracts have a distinct regulatory regime in contract law that applies to this family of contracts that includes contracts of employment will be explored in this article. My principal question is: what makes the contract of employment a relational contract rather than an ordinary contract and what are the legal consequences of that classification?

We commence the enquiry by first exploring the concept of a relational contract as it has emerged in the case-law. The article proceeds to examine the actual and potential legal implications of the

[10] *Const v Harris (1824) Turn. & R. 496, 37 E.R. 1191*; *Floydd v Cheney [1970] Ch 602, [1970] 1 All E.R. 446*.
[11] *Lister v Romford Ice & Cold Storage Co [1957] AC 555, [1957] 1 All E.R. 125 (HL).*
[12] E.g. I. R. Macneil, "Contracts: Adjustment of Longterm Economic Relations Under Classical, Neoclassical and Relational Contract Law" (1978) 72 *Nw. U. L. Rev.* 854, and other works collected in *Ian Macneil, The Relational Theory of Contract: Selected Works of Ian MacNeil (ed David Campbell) (London: Sweet & Maxwell, 2001)*; C. J. Goetz and R. E. Scott, "Principles of Relational Contracts" (1981) 67 Va. L. Rev. 1089; R. E. Scott, "A Relational Theory of Default Rules for Commercial Contracts" (1990) 19 J.L.S. 577.
[13] *H. Collins, "Is a Relational Contract a Legal Concept?" in S. Degeling, J. Edelman, J. Goudkamp (eds), Contract and Commercial Law, (Sydney: Thomson Reuters, 2016)* p. 37.

classification of a contract as a relational contract. The distinctive legal rules and principles of relational contracts appear to concern in particular: (1) the interpretation of contracts in a deeply contextual way; (2) the dynamic variation and adjustment of contractual obligations; (3) the recognition of binding intermittent contracts in the context of a long-term, on-going business relationship; and (4) the application of a mandatory obligation to perform the contract in good faith. It will be contended that the classification of a contract of employment as a relational contract better explains many aspects of the common law of contracts of employment and exposes the main source of the problems encountered by the common law in addressing some complex issues in connection with personal work contracts.

2. The Emerging Concept of a Relational Contract

In recent years, more than a handful of cases have been decided by English courts using a legal category of relational contracts. How has the category been described? Judges have given examples of relational contracts and indicated some features that they may have. "Examples of such relational contracts might include some joint venture agreements, franchise agreements and long term distributorship agreements".[14] Features often mentioned are: the expectation of a longer-term business relationship; investment of substantial resources by both parties; implicit expectations of cooperation and loyalty that shape performance obligations in order to give business efficacy to the project; and implicit expectations of mutual trust and confidence going beyond the avoidance of dishonesty.[15] These are all helpful indications of the existence of a relational contract, but they do not provide precise guidance on the contours of this class of contract. In the absence of a clear definition, courts must use a multi-factor approach for discerning the probability that a contract is properly classified as a relational contract.

Among the list of factors to be taken into account during the process of classification, however, there is one that appears necessary, even though it is not on its own sufficient to identify a relational contract. This factor is that the terms of the contract use indeterminate descriptions of both the expected performance obligations and the hoped-for outcomes of the transaction. Fraser J. has eloquently described this feature of relational contracts: "The spirits and objectives of their venture may not be capable of being expressed exhaustively in a written contract.'[16] Incompleteness often occurs in relational contracts for the same reason as indeterminacy is sometimes a feature of long-term contracts: because contingencies and necessary adaptations cannot always be foreseen.[17] In most long-term contracts, however, the goal is certain, even if the road there is littered with unexpected contingencies. What is distinctive about relational contracts is that even the destination is indeterminate in the sense

[14] *Yam Seng Ptd Ltd v International Trade Corporation Ltd* [2013] EWHC 111: [2013] All ER (Comm) 1321 (QB) [171] per Leggatt J.
[15] Fraser J. lists a similar nine factors in *Bates v Post Office No 3*, [2019] EWHC 606 (QB), at [725].
[16] *Bates v Post Office (No. 3) [2019] EWHC 606 (QB*), at [725].
[17] Goetz and Scott, "Principles of Relational Contracts" (1981) 67 Va. L. Rev. 1089, 1091.

that the precise outcome or product that may be achieved through co-operation is not defined in advance and can be reconfigured in the light of experience during performance of the contract. In relational contracts, though planning for contingencies in the long-term may be incomplete as in other long-term contracts, they embrace a more profound uncertainty about the precise goal or purpose of the transaction. Many contracts may be rather vague about the details of the transaction as a result of hasty agreements and brief communications. But many vague contracts, such the sale of goods in *Hillas & Co Ltd v Arcos Ltd,*[18] are, in principle, capable of complete specificity about quantity, quality, and price. In contrast, in relational contracts it is not possible to devise a completely specified contract. Relational contracts are thus 'incomplete by design'.[19] As a consequence, this indeterminacy is typically accompanied with mutual expectations of co-operation to bring about a successful outcome of the transaction. The presence of significant investments in the transaction by the parties often induces them to accept binding expectations of co-operation and special arrangements for governance of the contract because those investments may not be recoverable on termination.[20]

For instance, in a recent case concerning a relational contract, one party to the contract published textbooks on learning to fly and the other party wrote software programmes.[21] By combining their knowledge and expertise, the parties planned to create an on-line learning experience for aspiring pilots, but without being certain at the outset about the form and content of the package before commencing their co-operation. The final product to be marketed would only emerge through co-operation and trial and error. Relational contracts have a greater degree of indeterminacy than long-term contracts because the precise contributions to the co-operation required to make the project successful and what will be regarded as a successful outcome cannot be fully described in advance, but will necessarily emerge during performance of the contract. This indeterminacy is neither a failure of contractual draftsmanship, nor caused by an inability to foresee contingencies, but is rather a feature of a co-operative business venture in which methods and goals will be revised in the light of experience.[22] Economists might say that the specification of the required outcome is prohibitively costly, but it seems more insightful to observe that the parties are unsure what might emerge from their co-operation and in order to take advantage of the pooling of expertise for the purpose of innovation they prefer to specify the desired outcome in broad and vague terms. As incompleteness by design is a necessary feature of relational contracts, it follows that not all long-term contracts are relational contracts, for most will be

[18] *Hillas & Co Ltd v Arcos Ltd [1932] All E.R. Rep. 494, (1932) 147 L.T. 503 (HL).*
[19] *Hugh Collins, Regulating Contracts (Oxford: Oxford University Press, 1999)* p. 161.
[20] *Oliver E. Williamson, The Economic Institutions of Capitalism (New York: The Free Press, 1985)* pp.71-79 ("asset specificity" in relational contracts).
[21] *Bristol Groundschool Ltd v Intelligent Data Capture Ltd & Ors [2014] EWHC 2145 (Ch).*
[22] In some long-term contracts that are for the most part specific about their goals, there may nevertheless remain aspects of the outcome project that remain indeterminate. In such cases, parties to commercial contracts usually add a provision for that aspect of the transaction that requires good faith in performance or best endeavours: e.g. *Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS Trust [2013] EWCA Civ 200: [2013] B.L.R. 265*; *Petromec Inc v Petroleo Brasileiro SA Petrobas [2007] EWCA Civ 1371: [2008] 1 Lloyd's Rep. 305.*

specific about the expected outcomes of performance. Furthermore, it follows that it is possible that not all joint venture agreements, franchise agreements, distributorships and similar contract types will be properly classified as relational contracts; the classification turns not on the purpose of the business venture, but on the indeterminacy of the parties' performance obligations and shared goal.

Institutional economics explains that relational contracts provide a particular institutional structure for the organisation of production and the division of labour, which occupies a middle ground between markets and organisations (or firms).[23] In markets, contracts for specific goods and services are made between parties with opposing interests. In order to secure those interests, the contract sets out in specific detail their respective rights and obligations. Within organisations, however, though there is a network of contracts that binds the parties together, such as contracts of employment, share ownership, and directorships, most of these contracts are supplemented by a framework that requires co-operation from everyone involved to maximise the profits of the organisation itself, the profits then being distributed according to the remuneration formula set by the contracts.[24] The law reflects the economic logic of the collective organisation by imposing duties of loyalty on its productive members: the directors of a company owe fiduciary duties, employees and managers duties of loyalty and good faith. From this perspective, relational contracts combine some features of ordinary market transactions with the more open-ended commitment to a shared goal that guides the legal obligations within organisations.[25] These hybrids, as they are sometime called,[26] create productive organisations that remain arm's length contracts, but because they require indeterminate types of co-operation in order to achieve the purpose of the contract, they must also draw on the general duties of good faith and loyalty that apply within organisations.

Businesses may be drawn to entering relational contracts for a variety of reasons. They permit the pooling of capital and expertise without sharing ownership as is likely to be the case in companies and partnerships. Where innovation is a key ingredient in the goals of the project, a loose formal co-

[23] R H. Coase, "The Nature of the Firm" (1937) 4 *Economica N.S.* 386; *Williamson, The Economic Institutions of Capitalism: Firms, Markets and Relational Contracting (1985*) 90. Institutional economics can be unhelpful to the legal analysis, however, because in some research relational contracts are defined as informal agreements that are not legally enforceable: e.g. G. Baker, R. Gibbons and K. J Murphy, "Relational Contracts and the Theory of the Firm" (2002) 117 *Quarterly Journal of Economics* 39.

[24] "The parties are not aiming at utility-maximization directly through performance of specified obligations; rather, they are aiming at utility-maximization indirectly through long-term co-operative behaviour manifested in trust and not in reliance on obligations specified in advance." David Campbell and Don Harris, "Flexibility in Long-term Contractual Relationships: the Role of Co-operation" (1993) 20 *Journal of Law and Society* 166, 167.

[25] W. W. Powell, "Neither Market nor Hierarchy: Network Forms of Organisation" (1990) 12 *Research in Organisational Behaviour* 295; *M. Amstutz and G. Teubner (eds), Networks: Legal Issues of Multilateral Co-operation (Oxford: Hart Publishing, 2009*); *Gunther Teubner, Networks as Connected Contracts* (*ed H. Collins) (Oxford: Hart Publishing, 2011).*

[26] *G. Teubner, 'Piercing the Contractual Veil? The Social Responsibility of Contractual Networks', in T. Wilhelmsson (ed), Perspectives of Critical Contract Law (Aldershot: Dartmouth, 1993)* pp. 211-212; *Collins, Regulating Contracts* (1999) p.248.

operative contract may offer the most appropriate framework.[27] In many types of transactions there may be competitive advantages arising from the strange mixture of business logic for the parties both to co-operate and yet compete with each other for the surplus produced by their efforts.[28] In a business format franchise, for instance, the franchisor and franchisee have opposing interests in the sense that the franchisor seeks to maximise its income from the license to use its format. At the same time, the parties need to co-operate with each other to make the franchise successful by trying out new products and new marketing techniques. To make the franchise work optimally they must also share information and be willing to adapt to changing circumstances. They must co-operate whilst at the same time protecting their own interests.

Does a contract of employment fit into this model of a relational contract? Most employment relations have the twin features of relational contracts identified above: the precise performance obligations and the desired outcome are indeterminate and that as a consequence the contract requires co-operation to achieve a successful outcome for both parties. It is because these details have been left indeterminate in contracts of employment that one party, the employer, acquires the right and the power to control what outcomes are required and how the work should be performed within the loose constraints of the terms of the contract. Although the express terms of the contract of employment are likely to specify the nature of the job, such as healthcare assistant, staff nurse, occupational therapist, or consultant paediatrician, they will not go into much detail about the objectives and requirements of the job. Moreover, the express terms are also likely to contain a flexibility clause that permits the employer to adjust the duties of the job from time to time in the light of changing goals. The framework of the express terms thus leaves the goals of the job and the manner in which it should be performed indeterminate. The vagueness is resolved by an employer's right to control and direct work, which is usually regarded as a hall-mark of contracts of employment.

Furthermore, contracts of employment require co-operation in the performance of the contract. The principal manifestation of the requirement of co-operation is an employee's obligation to obey lawful instructions from the employer. Expectations of co-operation, however, extend beyond that hierarchical structure. If a manager is hired to run a business, the manager needs to develop a business strategy and work out how best to achieve that goal, no doubt learning from experience and making adjustments to changing market conditions. The contract makes no attempt to specify exactly what the manager should do or what the ultimate goal should be beyond making the business profitable. At most, the contract provides a loose framework of obligations and an incentive bonus scheme to try to align the interests of the manager and the business. The manager is expected to act in a way that promotes and is loyal to the purpose of the business. Can the same be said about an expectation of co-operation

[27] Gillian K. Hadfield and Iva Bozovic, "Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation" (2016) Wisc. L. Rev. 981.
[28] *H. Collins, "Introduction", in Teubner, Networks as Connected Contracts (*2011) pp. 21-25.

for workers lower down in the organisational hierarchy? Although their autonomy is more constrained, these workers are not machines but exercise some discretion in the performance of their jobs. Even in very routine jobs employees can to some extent set the pace of work and influence the quality of the outcomes. In exercising such discretion, employers expect employees to co-operate and to promote the interests of the business or employing organisation. At the same time, employees expect their employers to co-operate in the sense of providing adequate information and training to perform the job, only requiring a reasonable workload within the competence of the employee, and more generally for the employer to treat employees fairly. Once these expectations of co-operation are dashed, the parties are likely to consider termination of the contract: the employee may feel there has been unfair treatment and the employer will object to any shirking or withdrawal of goodwill.

The main difference between contracts of employment and other types of relational contract is the mechanism for securing co-operation and providing greater specificity to the contractual obligations. In contracts of employment, an employer acquires the authority unilaterally to instruct employees on the method of performance of work and the goals to be achieved. That feature of subordination is much less likely to arise in other relational contracts, though certainly some appear to contain aspects of a power relation as in the example considered below of the subordination of sub-postmasters to the Post Office revealed in *Bates v Post Office* (No. 3).[29] But this authority relation does not remove the need for co-operation and fair dealing in order to promote the (indeterminate) objectives of the transaction. The parties need to co-operate in good faith even if one, the employer or core business, has the authority under the contract to make most of the crucial decisions.

If correct, the classification of the contract of employment as a relational contract marks a radical, though in my view welcome, departure from the conventional taxonomy of the law of contracts. Under this new scheme of classification, the law of the contract of employment is neither part of general contract law nor a special contract that is partly governed by general law and partly based on special rules that are unique to the contract of employment. The radical interpretation of Lord Steyn's claim is that special rules apply to relational contracts as a class. These rules have been developed both in relation to contracts of employment and to various kinds of commercial contracts such as franchises, concessions, distributorships, and some joint ventures. Those special rules for relational contracts extend beyond terms implied by law. Indeed, the rules and legal methods applicable to relational contacts challenge some of the foundational doctrines in ordinary contract law.

In order to grasp the special character of rules and practices applicable to relational contracts, as mentioned above, this article examines four contexts in which the categorisation of the contract as relational is likely to produce reasoning and results that are considerably at variance with ordinary contract law. These special characteristics of relational contracts will be illustrated primarily using personal work contracts, but the distinctive legal approach should apply to all kinds of relational

[29] *Bates v Post Office (No. 3*) *[2019] EWHC 606 (QB*).

contracts. The four contexts where the classification of a contract as relational is likely to be most noticeable are all linked to its key feature: indeterminacy by design. Given the indeterminate guidance about the obligations of the parties to the contract provided by the express terms, interpretation of the contract requires a broader range of tools for its construction than the ordinary methods of interpretation of commercial contracts. The indeterminacy of the contract also renders the sharp distinction drawn in connection with other commercial contracts between performance of a contract and its variation by agreement inappropriate. The indeterminacy of relational contracts sometimes raises the question of whether the parties have made a contract at all. In such cases, there does not appear to be a precise exchange that would satisfy the common law doctrine of consideration. Instead, there are mutual expectations of performance combined with intermittent work and outcomes that appear to further the purpose of the arrangement. These examples of relational contracts present the issue of whether the doctrine of consideration is a suitable test for their legal enforceability. Finally, the indeterminacy of relational contracts may have to be resolved by a court fleshing out the details of the expectations of co-operation in the light of what has happened. In such cases, a court must construe the contract or imply a suitable term that addresses the commercial necessity of resolving the issue of whether the parties have co-operated in an appropriate way. Such an implied term is usually described as a requirement of performance in good faith or a duty to preserve mutual trust and confidence between the parties.

3. **Deep Contextual Interpretation**

A legal scholar, Ian Macneil, is usually credited with having invented the idea of relational contracts.[30] Certainly, Macneil introduced the idea that contracts are to varying degrees "relational". His main point was that the classical law of contract tends to describe and think about contracts as isolated constructions. From the classical legal perspective, the parties make an agreement and the terms fix a new set of legal obligations where none existed before. It is a discrete, one-off, arrangement between strangers. Macneil observed, however, that contracts are made in the context of all kinds of norms and expectations that are already shared by the parties. Even a single purchase of a coffee from a retail outlet relies upon informal understandings about the quality of the product, appropriate standards of performance, and when payment is due. As Macneil noted, those norms and reasonable expectations are at least as important in guiding our behaviour as any formal terms of the contract. In other words,

[30] Macneil, "Contracts: Adjustment of Longterm Economic Relations Under Classical, Neoclassical and Relational Contract Law" (1978) 72 Nw. U. L. Rev. 854.

all contracts are embedded in social practices and norms.[31] Those standards guide the behaviour of the parties far more than the minimal legal obligations highlighted by the classical law of contract in its exclusive focus on the express terms of the contract. Macneil further observed that in many kinds of contracts, such as long-term contracts, the ability to address every eventuality in the express terms of the contract becomes increasingly difficult. The parties must therefore rely even more on informal norms and expectations. He suggested that a neo-classical contract law had developed some features in response to this need to address gaps and make necessary adjustments in contracts in order to apply the law to long-term contracts.

Finally, Macneil argued that in a smaller class of contracts, which were subsequently labelled as relational contracts, the parties appreciate from the outset that, in the face of uncertainty about their goals and mutual obligations, the only way to manage their future exchange relationship is to rely on co-operation and discretion during performance. He described employment as 'an extremely relational contract, no matter how strenuously a party tries to make it discrete'.[32] The contract of employment is relational in this sense of relying on co-operation and discretion, because it confers on the employer the right to direct the performance of the employee within a loose framework set by the terms of the contract of employment.[33] In relational contracts, the parties reasonably expect that the informal norms that are already shared between them will govern the standards required in the performance of the contract and that the express terms of the contract should be far less important than is usual in commercial transactions. In other words, in contracts that are incomplete by design and require co-operation in order to achieve performance, the express terms of the contract are unlikely to provide a reliable and comprehensive guide to the norms that the parties expect will govern their relationship and permit them to achieve the expected result. In such cases, the contract must be understood by examining it in its context of social and economic relations, while attaching reduced significance to the express terms of the contract.

Since Lord Hoffmann's judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society,*[34] it has become commonplace to say that in accordance with the principles set out in that case, interpretation of contracts should be approached in a contextual way.[35] But this view of contextualism is far narrower than the approach advocated in the theory of relational contracts.[36] Lord

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[31] S. Macaulay, 'Non-Contractual Relations in Business' (1963) 28 *American Sociological Review* 45; M. Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness" (1985) 91 *American Journal of Sociology* 481; *David Campbell, 'The Relational Constitution of the Discrete Contract' in David Campbell and Peter Vincent-Jones (eds), Contract and Economic Organisation: Socio-legal Initiatives (Aldershot: Dartmouth Publishing, 1996).*

[32] I. R. Macneil, "Relational Contract: What We Do and Do Not Know" (1985) *Wisc. L. Rev.* 483.

[33] R. C. Bird, "Employment as a Relational Contract" (2005) 8 U..Pa. J. of Labor and Employment Law 148.

[34] *Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 W.L.R. 896, [1998] 1 All E.R. 98 (HL).*

[35] E.g. *Arnold v Britton [2015] UKSC 36: [2015] A.C. 1619*; *Wood v Capita Insurance Services Limited [2017] UKSC 24: [2017] A.C. 1173.*

[36] *H. Collins, 'The Contract of Employment in 3D' in D. Campbell, L. Mulcahy, S. Wheeler (eds), Changing Concepts of Contract, (Basingstoke: Palgrave Macmillan, 2013)* p. 65.

Hoffmann's method concerns semantics. He said correctly that the meaning of words depends in many cases on the context in which they are uttered. In order to ascertain the meaning of the express terms of a contract, therefore, it is necessary for a court to place those words in the context in which they were written or spoken. The ordinary meaning of the words used may be displaced when interpreted in the light of their context. Relational contract theory advocates a more radical approach to the use of context.[37] Given the indeterminacy of the express terms of relational contracts, no amount of exegesis of the sparse written text may produce an answer. Instead, the approach to determining what obligations the parties have undertaken in a relational contract is to ask: what were the reasonable expectations of the parties in the light of the purpose of the contract? The express terms of the contract, however they may be interpreted, can provide at most a framework that loosely governs the contractual relationship. Far more important as a guide to the parties' reasonable expectations is likely to be the informal norms and expectations of cooperation on which the transaction is based. Nor is this approach the same as interpreting the terms from the perspective of commercial common sense, for that approach usually only functions to resolve ambiguities in the meaning of express terms.[38] In contrast, relational contract theory suggests that the correct approach to an understanding of the mutual obligations of the parties is not to confine attention to the express terms of the contract, but rather to start with the implicit expectations of the parties regarding their transaction and business relation. Having discerned the content of those implicit obligations, it is only then appropriate to turn to the express terms of the contract to discover whether they modify or limit in some way the reasonable expectations of the parties arising from their agreement.[39]

This contrast between ordinary contextual interpretation in commercial law and the radical form of contextual interpretation that may be more appropriate for relational contracts is apparent in *Autoclenz Ltd v Belcher*.[40] The question in this case was whether the valeters in a hand car wash qualified as "workers" under the statutory definition of a worker for the purpose of the National Minimum Wage Regulations 1999 and the Working Time Regulations 1998. According to the literal meaning of the terms of the written contracts of the valeters, they were not "workers" but rather "sub-contractors", in part because of the express content of their duties, and in part because the contract described them repeatedly as sub-contractors throughout its boilerplate terms. Having recited the ordinary rules for the interpretation of commercial contracts, the Supreme Court held that a different approach should be adopted for contracts of employment. This approach was summarised thus:

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[37] *Collins, 'The Contract of Employment in 3D' in D Campbell, L. Mulcahy, S. Wheeler (eds), Changing Concepts of Contract,* (2013) p.67. For a survey and critique of this deep contextual approach*: Hugh Beale, "Relational Values in English Contract Law" in D Campbell, L. Mulcahy, S. Wheeler (eds), Changing Concepts of Contract, (Basingstoke: Palgrave Macmillan, 2013)* p. 116.

[38] *Rainy Sky SA v Kookmin Bank [2011] UKSC 50: [2010] 1 W.L.R. 2900; Arnold v Britton [2015] UKSC 36: [2015] A.C. 1619.*

[39] R. E. Speidel, 'The Characteristics and Challenges of Relational Contracts' (2000) 94 Nw. U. L. Rev. 823.

[40] *Autoclenz Ltd v Belcher [2011] UKSC 41.*

> 'So the relative bargaining power of the parties must be taken into account in deciding whether the terms of any written agreement in truth represent what was agreed and the true agreement will often have to be gleaned from all the circumstances of the case, of which the written agreement is only a part. This may be described as a purposive approach to the problem.'[41]

This statement is remarkably similar to the approach to interpretation that is advocated for relational contracts. The real or true agreement is not to be found in the express terms, interpreted in the light of their context. Instead, the express terms are likely to be peripheral to the true agreement between the parties, and in some cases, such as *Autoclenz,* downright misleading. The true agreement is what obligations the parties reasonably expected from each other. The purposive approach mentioned in the judgment is surely about what the parties reasonably expected to be the nature or purpose of their relationship. In *Autoclenz,* the car valeters were hired by a company that cleaned cars and were expected to work there most days for a fixed wage, wearing the uniforms and using the equipment of the company. The reasonable expectation of the parties coincided with most definitions of employment: payment of a wage in return for a promise to supply work performed personally under the direction and control of the employer. The contract may state that the worker can provide a substitute to perform the job or even refuse the work altogether, but if in reality that will never happen because it is contrary to the reasonable expectations of the parties, following *Autoclenz,* a court should ignore the express term of the contract as a sham and rather enforce the reasonable expectations of the parties. The theory of relational contracts explains that this approach to the interpretation of contracts of employment is correct, not because there is inequality of bargaining power, for there is inequality of bargaining power in other types of contracts such as consumer contracts, to which this approach will not apply.[42] Nor is it solely a special rule for contracts of employment.[43] A deeply contextual approach is appropriate because employment is a relational contract.

The idea that courts should focus on the reasonable expectations of the parties to ascertain the content of the legal obligations in relational contracts clearly differs from a search for the meaning of express terms. It is less evident how courts should go about searching for those reasonable expectations. The terms implied by law into the contract are a good starting-point, because they contain the typical core expectations, the essential normative framework for relational contracts. The standard form contract that was side-lined in *Autoclenz* was devoted to the selective exclusion of some of those implied terms in contracts of employment, such as the normal expectation of personal performance of work. The true agreement discovered by the court was in fact the normal expectations of the parties to a

[41] *Autoclenz Ltd v Belcher [2011] UKSC 41,* [35].
[42] In other contexts, such as consumer contracts, the courts have left the problems for weaker parties entirely to Parliament to deal with: G. Pitt, "Crisis or Stasis in the Contract of Employment?" (2013) 12(2) *Contemporary Issues in Law* 193.
[43] The position forcefully advocated in Bogg, "Sham self-employment in the Supreme Court" (2012) 4 I.L.J. 328.

contract of employment as set out in the terms implied in law. Similarly, in *Johnson v Unisys Ltd*,[44] Lord Steyn interpreted the contract by reference to the implied terms. Although there is an implied term that requires reasonable notice prior to dismissal, there is also the implied term of mutual trust and confidence, and so the reasonable expectations would have to combine and reconcile those expectations in order to ascertain the true agreement. In contrast, Lord Hoffmann in *Johnson v Unisys Ltd* used the normal approach to the interpretation of contracts by giving priority to the express term of permitting termination on giving notice, and used that express term to exclude any implied term regarding the manner of termination of the contract.

To sum up this discussion of the correct approach to the interpretation of relational contracts, the central point is that a court should examine the social and economic context and the purpose of the transaction in order to understand the reasonable expectations and implicit understandings of the parties. This approach differs from the weak contextual approach to interpretation in commercial law, which merely uses context to resolve ambiguities in the meaning of the express terms. In relational contracts, the express terms of the contract provide only unreliable and incomplete evidence of the true agreement between the parties. Instead, in contracts of employment, a court should discover the reasonable expectations of the parties in the normal terms implied by law, the customs and practices of the workplace as they evolve, and (as will be explained in the next section) the staff handbook. Although not understood as such at the time, with its emphasis on the purpose of the transaction, the decision of the Supreme Court in *Autoclenz* is, I suggest, a paradigm of the correct approach to interpretation in relational contracts.

4. Dynamic Variation and Adjustment

The theory of relational contracts also explains why the general law of variation of contracts that applies in commercial contracts is inappropriate for relational contracts such as the contract of employment.[45] In ordinary commercial contracts, to achieve a variation of the express terms of the contract, leaving aside some narrow exceptions such as waiver of breach, it is normally necessary for the parties to make an express agreement supported by fresh consideration.[46] But such a formal classical approach, which regulates modifications to contracts by the rules that apply to the creation of a new contract, is inappropriate for relational contracts because the core obligations are derived in part from the reasonable expectations of the parties in the light of the purpose of their transaction. "A hallmark of relational contracts is that the parties do not regard their written contract as a more or less complete

[44] *Johnson v Unisys Ltd [2001] UKHL 13*.
[45] A point first recognised in *Freedland, The Personal Employment Contract (2003)* p. 268.
[46] *Foakes v Beer (1883-84) LR 9 App Cas 605 (HL*), though the rule requiring consideration is under pressure: *MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2016] EWCA Civ 553, [2017] QB 604, [2016] 2 Lloyd's Rep 391*; *Mindy Chen-Wishart, Contract Law 6th edn (Oxford University Press, 2018)* 129-138.

statement of their rights and obligation, but expect that these obligations will evolve and be refined as the project develops." [47] To discover whether the parties have varied their contractual undertakings in relational contracts, it is necessary to examine how those reasonable expectations may have evolved in the light of contingencies and changing circumstances. Whether or not the parties have agreed a change in the indeterminate express terms and provided fresh consideration is unlikely to be relevant to that enquiry.

In a relational contract, it will be the parties' current reasonable expectations that form the substance of the obligations of the parties, not their historical expectations, and probably not inconsistent express terms of the contract. This approach to variation in contracts of employment was confirmed by Smith L.J. in *Firthglow Ltd v Szilagyi*,[48]and again in the Court of Appeal in *Autoclenz*,[49] when she recognised that the true intentions or expectations of the parties should be ascertained not only at the inception of the contract but also "as time goes by". To understand the actual legal obligations of the parties, the court must consider evidence of "how the parties conducted themselves in practice and what their expectations of each other were."[50] Similarly, Lord Hoffmann has observed that where a contract for work was partly formed in writing and partly through words and conduct, the obligations arising under the contract may be "partly left to evolve by conduct as time went on."[51] In other words, variation of relational contracts occurs through an adjustment of the reasonable expectations of the parties during the cooperative performance of the contract. Variation of relational contracts including contracts of employment should not require an explicit agreement for fresh consideration.

In contracts of employment, much of the indeterminacy of the contractual relationship is resolved by instructions issued by the employer under the authority conferred by the contract. A staff handbook, works rules, or other documents provide guidance on how the cooperative relation should proceed. Orthodox contract law draws a sharp distinction between terms of the contract of employment and instructions issued by the employer: terms can only be changed by mutual agreement, whereas instructions can be withdrawn or modified at the will of the employer. By diminishing the significance of the express terms of the contract, the theory of relational contracts also plays down this contrast between terms and discretionary instructions. Indeed, the employer's instructions may provide greater evidence and support for the reasonable expectations of the parties about how their contract is to function. As evidence of the 'true agreement', the staff handbook or works rules may provide much more reliable guides than the abstract and one-sided terms of the contract. The significance of the

[47] *Collins, "Is a Relational Contract a Legal Concept?" in S Degeling, J Edelman, J Goudkamp (eds), Contract and Commercial Law (2016)* at p.55
[48] *Firthglow Ltd v Szilagyi [2009] EWCA Civ 98: [2009] I.C.R 835* [50].
[49] *Autoclenz Ltd v Belcher [2009] EWCA Civ 1046: [2010] I.R.L.R. 70* [52].
[50] *Autoclenz Ltd v Belcher [2009] EWCA Civ 1046*: [53], approved at *Autoclenz Ltd v Belcher [2011] UKSC 41,* [31-32].
[51] *Carmichael v National Power Plc [1999] 1 W.L.R. 2042, [1999] 4 All E.R. 897 [1999] I.C.R. 1226, 1234 C (HL).*

discretionary instruction for the expectations of the parties was recognised indirectly by the Court of Appeal in *French v Barclays Bank*.[52] The court held that although the bank was entitled to withdraw its discretionary support for the costs of relocation by offering cheap mortgages, it could only do so in a manner consistent with the implied term of mutual trust and confidence. One could say that the effect of the decision was to turn the discretionary benefit into part of the true agreement between the parties, so that as a reasonable expectation it could not be withdrawn without agreement or a lengthy period of notice.

In contrast, in *Bateman v ASDA Stores*,[53] the EAT ultimately deviated from a relational contract law approach. The tribunal's initial step in accepting the argument that a provision in the staff handbook should be regarded as a term of the contract fits into the relational contract law approach on account of its recognition that the handbook recorded many of the reasonable expectations of the parties including the pay scales for all staff. The term in question stated that ASDA "reserved the right to review, revise, amend or replace the contents of this handbook, and introduce new policies from time to time reflecting the changing needs of the business." In reliance on this term, ASDA changed the pay scales of about 16,000 employees without securing their consent in advance. One issue in the case was whether ASDA could acquire through express terms of the contract the power to vary pay unilaterally. The EAT held that it could, provided that the express term of the contract was sufficiently clear and explicit. That decision upholds the approach of ordinary commercial law to stick to the plain meaning of the express terms, even in the teeth of contrary implicit understandings. In a relational contract approach, however, looking for the true agreement between the parties, one could argue that the 16,000 staff had a reasonable expectation that the pay scales would not be altered without their consent or at least would not be altered to their disadvantage without their consent. The expectation of employees that their wages will not be reduced unilaterally by the employer is usually a core, implicit understanding, on which mutual trust and confidence is based. For that reason, the courts have been extremely reluctant to infer consent by employees to an adverse change in their terms of employment by reference to their conduct of continuing to work as normal for the employer.[54] A relational contract law approach to the dispute in ASDA would have reached the conclusion, in my view, that despite the one-sided express term in the contract that purported to confer sweeping powers on the employer to vary the contract, the reasonable expectation that employers should not impose pay cuts unilaterally should have restricted the scope of that power to adjust the terms of the contract, so that it could only be exercised for purposes and in the circumstances that were reasonably expected by the staff.

[52] *French v Barclays Bank* Plc [1998] I.R.L.R. 646 (CA).
[53] *Bateman v ASDA Stores UKEAT/0221/09/ZT: [2010] I.R.L.R. 370 (EAT*).
[54] *Abrahall & Ors v Nottingham City Council & Anor [2018] EWCA Civ 796: [2018] I.C.R. 1425, [2018] I.R.L.R. 628.*

5. Intermittent Contracts and Expectations of Long-term Relations

The idea of a 'relational contract' has also been invoked by legal scholars in connection with long-term business relationships that consist of a series of intermittent transactions.[55] An example of such a long-term business relationship is a 'requirements contract', under which one party agrees to meet any orders for goods made by the other party in accordance with a price list and other terms and conditions. A requirements contract is unlikely to be regarded by the common law as a legally enforceable contract, because the purchaser has not in fact agreed to purchase anything yet. When the purchaser places an order, there will be a sale of goods, but before then, there is at most a standing offer by the seller to meet all orders at a fixed price.[56] Although such requirements contracts may not be legally enforceable, they are nevertheless vital in business and in general are treated by merchants as if they were binding.[57] There is considerable advantage to the purchaser in having a reliable source of supplies at predictable prices, and the seller will be pleased to have an on-going relationship with a major customer, even if there is no guarantee that any orders will be made. In a type of economic theory based on game theory, economists have developed models that demonstrate why these long-term business relationships, called (perhaps confusingly for lawyers) "relational contracts" even though they may not in law be binding contracts, are stable or "self-enforcing" owing to the economic incentives for the parties to maintain their on-going business relationship.[58] In a requirements contract, for instance, it is in the long-term economic interest of both parties to nurture and stay loyal to the business relationship, even though in a particular instance, it might be cheaper to acquire the supplies from elsewhere.

The same analysis can be applied to examples of casual work and zero-hours contracts. Here casual work is offered by an employer, but only when work is required, which, depending on customer demand, may be every day or may be only every few days, or perhaps once in a week or not at all. The existence of contracts for intermittent work illustrates the game theory model by demonstrating that both employer and employee value the economic relationship of casual work and are likely to remain loyal to it in the sense of preserving it by regularly offering and accepting work. It is also evident that like a requirements contract, it will be hard to establish that the long-term arrangement or "umbrella contract" is legally binding and supported by consideration.[59] The conventional legal analysis may conclude that since the employer has not guaranteed any offers of work and since the employee has not

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[55] E.g. R. E. Speidel, "The Characteristics and Challenges of Relational Contracts" (2000) 94 Nw. U. L. Rev. 823; *D. Brodie, 'Relational Contracts' in M. Freedland et al, eds, The Contract of Employment (Oxford: Oxford University Press, 2016)* 145, p.157.

[56] *Great Northern Railway Co v Witham (1873) LR 9 CP 16*.

[57] Macaulay, "Non-Contractual Relations in Business" (1963) 28 *American Sociological Review* 45, 60; *Collins, Regulating Contracts (1999)* p. 108.

[58] *James M. Malcomson, "Relational Incentive Contracts" in Robert Gibbons and John Roberts (eds), The Handbook of Organizational Economics (Princeton: Princeton U.P., 2012)* 1014, 1015; J. Levin, "Relational Incentive Contracts" (2003) 93 *American Economic Review* 835. L. G. Telser, "A Theory of Self-enforcing Agreements" (1980) 53 *Journal of Business* 27.

[59] A.C.L. Davies, "The Contract for Intermittent Employment" (2007) 36 I.L.J. 102.

promised to accept any assignment offered, there is no consideration to support a long-term umbrella contract.[60] In some instances, however, consideration may be found in connected promises, such as a promise by the employer to offer work exclusively to the worker if the need arises and a promise by the employee not to accept work from anyone else.[61] But the dominant approach of the courts to intermittent contracts is that expounded in the House of Lords in *Carmichael v National Power Plc*.[62] Speaking for the whole House, Lord Irvine treated the issue of the existence of a long-term umbrella contract that was binding in between specific engagements to work on a particular day as entirely determined by the interpretation of the express terms of the agreement. Because the parties had objectively agreed to casual work without binding commitments to any particular amount of work or any work at all, an umbrella contract could not exist.

In the course of his judgment, however, Lord Irvine of Lairg L.C. observed:

> "The parties incurred no obligations to provide or accept work but at best assumed moral obligations of loyalty in a context where both recognised that the best interests of each lay in being accommodating to the other."[63]

These "moral obligations of loyalty" are, of course, exactly the relational dimension of intermittent contracts that binds the parties together and that ensures the productive success of such contracts. A relational approach to the analysis of intermittent work arrangements would foreground these informal reasonable expectations of continuing performance and the pay-offs the arrangement brings to both parties, and pay less attention to the restrictive express terms. Something close to that relational approach was in fact adopted by the Court of Appeal in *Carmichael*,[64] which enabled the court to reach the opposite result by finding an implied term to offer work based upon the reasonable expectations of the parties.[65]

It is suggested that in the context of relational contracts, provided both parties reasonably expect a regular on-going business relation, that expectation should be sufficient to satisfy an appropriate legal test of enforceability for relational contracts.[66] In *Nethermere (St Neots) Ltd v Gardiner*,[67] for instance, it was thought possible for well-founded expectations of continuing work to harden into enforceable

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[60] *O'Kelly v Trusthouse Forte [1984] Q.B. 90, [1983] 3 All E.R. 456 (CA*).
[61] Connected implied promises were found in *Nethermere (St Neots) Ltd v Gardiner [1984] I.C.R. 612, [1984] I.R.L.R. 240 (CA).*
[62] *Carmichael v National Power Plc [1999] I.C.R. 1226, [1999] 1 W.L.R. 2042, [1999] 4 All E.R. 897 (HL).*
[63] *Carmichael v National Power Plc [1999] I.C.R. 1229E*.
[64] *Carmichael v National* Power Plc *[1998] I.C.R. 1167, [1998] I.R.L.R. 301 (CA).*
[65] In a similar vein, Brodie argues that it may be possible to find an implied contract based upon the conduct of the parties during their long-term relationship: *D. Brodie, 'Relational Contracts' in M. Freedland et al, eds, The Contract of Employment (2016)* 145, p.157.
[66] To similar effect, though using different terminology, see Freedland, *The Personal Employment Contract* (2003) 104. The reasonable expectation could probably be negatived by express declarations of an absence of an intention to create legal relations, as in *Baird Textile Holding Ltd v Marks & Spencer Plc [2001] EWCA Civ 274, [2002] 1 All E.R. (Comm) 737*.
[67] *Nethermere (St Neots) Ltd v Gardiner* [*1984] I.C.R. 612 (CA*), 627A, per Stephenson L.J.

contracts by a regular giving and taking of work.[68] Similarly, the EAT has recognised that the damage to the on-going relation arising from not providing work on the one hand and not performing it on the other might be sufficient to support the crystallisation of expectations into legal obligations.[69] If consideration needs to be discovered here, it is composed of the mutual reasonable expectation of an on-going relationship combined with an implied obligation of mutual trust and confidence between the parties. On the other hand, when that reasonable expectation of a continuing relationship disappears, the long-term relational contract would cease to be binding, though it would have been binding up till that time. Its existence would have generated an implied obligation of the parties to an intermittent relational contract to perform in good faith,[70] the final feature of relational contracts to which we now turn.

6. Good Faith in Performance

It is notorious that the ordinary law of contract in English common law has rejected a general mandatory duty to perform contracts in good faith.[71] English law is an outlier in this respect. Such a general duty of good faith in performance applies, for instance, in France, Germany, Canada, many states in the USA, and to some extent in Australia. The most frequent objection to a requirement to perform in good faith is that this open-ended standard generates uncertainty and unpredictability in the law.[72] It is often claimed that the main reason why English law is the preferred law of international commerce and finance is precisely because it is more certain and predictable as a consequence of the absence of a vague and abstract obligation to perform in good faith. In my view, the claim that good faith in performance is absent in English common law is misleading. Most of the problems that in other countries are addressed by the obligation of good faith in performance are dealt with in English law by the technique of implied terms.[73] Furthermore, deliberate bad faith in the form of fraud and misrepresentation is certainly sanctioned. What is true, however, is that certain kinds of obligations of co-operation and disclosure are not usually accepted in English contract law.[74] The philosophy of robust individualism that underlies the classical common law of contract is believed to exclude principles that require some concern to be shown for the interests of others.

A clear exception to this general rule against good faith in contractual performance is the contract of employment in which there is an implied term of mutual trust and confidence. This implied

[68] See also *Addison Lee Ltd v Gascoigne UKEAT/0289/17/LA: [2018] I.C.R. 1826 (EAT).*
[69] *St Ives Plymouth Ltd v Haggerty UKEAT/107/08* (unreported) 22 May 2018 (EAT) [29].
[70] In this context, the obligation to perform in good faith is likely to require disclosure of any intention to abandon the on-going relational contract: *Abrahall & Ors v Nottingham City Council & Anor [2018] EWCA Civ 796: [2018] I.C.R. 1425, [2018] I.R.L.R. 628,* [110] Elias LJ.
[71] *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989] Q.B. 433, [1988] 1 All E.R. 348 (CA).*
[72] M. Bridge, "Doubting Good Faith" (2005) 11 N. Z. Business Q. 430.
[73] H. Collins, "Implied Terms: The Foundation in Good Faith and Fair Dealing" (2014) 67 C.L.P. 297.
[74] H. Collins, "Implied Duty to Give Information During Performance of Contracts" (1992) 55 M.L.R.556.

term may not require exactly the same standards as an implied term of good faith in performance, but it occupies similar ground. It can be invoked against duplicitous behaviour,[75] failure to disclose information,[76] and high-handed action.[77] As Lord Nicholls observed in *Eastwood v Magnox Electric Plc*,

> "The trust and confidence implied term means, in short, that an employer must treat his employees fairly. In his conduct of his business, and in his treatment of his employees, an employer must act responsibly and in good faith".[78]

In the same case, Lord Steyn added that it would be more conducive to clarity if the courts used the terminology of an implied obligation of good faith.[79] Nevertheless, courts and tribunals continue to use the terminology of mutual trust and confidence in a manner that presents it as peculiar to the contract of employment.

The two propositions that there is no general duty to perform contracts in good faith and that the implied term of mutual trust and confidence is exclusive to the contract of employment are no longer completely true (if they ever were). In recent years, in England and Wales the High Court has developed principles that apply both duties to perform a contract in good faith and a duty to preserve mutual trust and confidence to certain kinds of commercial contracts. At the instigation of Leggatt J., as he then was, these commercial contracts have been labelled as relational contracts. This development supports my proposed taxonomy that special rules of contract law apply to the contract of employment, not because of its unique qualities, but rather because it fits into the broader category of relational contracts. The category of a relational contract, if it applies to a particular contract, requires terms to be implied by law that include good faith and mutual trust and confidence. Before attempting further to clarify the nature of the good faith obligations arise in relational contracts, it may be helpful to describe briefly two of the many commercial cases where the concept of relational contracts has been invoked.

The first commercial contract case where the concept of relational contract was used as part of the ground for the decision in English law was *Yam Seng v I.T.C.* [80] The distributorship agreed between the two businessmen, trading as small companies, was brief and relatively informal. It described how the defendant had a worldwide license to manufacture and sell fragrances under the Manchester United brand name and agreed that the claimant would have exclusive rights to market the fragrances in particular locations including duty-free shops in airports in South East Asia. As well as complaining about misrepresentations made by the defendant prior to entry into the contract, the claimant argued

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[75] *Post Office v Roberts [1980] I.R.L.R. 347 (EAT).*
[76] *Visa International Service Association v* Paul [2004] I.R.L.R. 42 (EAT).
[77] *Bournemouth University Higher Education Corporation v Buckland [2010] EWCA Civ 121: [2010] I.C.R. 908.*
[78] *Eastwood v Magnox Electric Plc [2004] UKHL 35: [2005] 1 A.C. 503, [2004] I.C.R. 1064, [2004] I.R.L.R. 732* at [11].
[79] *Eastwood v Magnox Electric Plc [2004] UKHL 35:* at [50].
[80] *Yam Seng Ptd Ltd v International Trade Corporation Ltd [2013] EWHC 111, [2013] All ER (Comm) 1321 (QB).*

that the defendant had committed a breach of contract when it permitted sales of the branded fragrances in ordinary shopping outlets in Singapore at prices as much as 20% below those specified for sales in the duty-free airport outlets where the claimant was marketing the products. Leggatt J. found that although the defendant had not deliberately permitted this under-cutting of the prices charged in the duty-free shops by other distributors, he had failed to cooperate either by stopping the undercutting or by alerting the claimant to his inability to prevent it. This failure undermined the business model of this particular distributorship under which the claimant would be able to market the goods in duty-free outlets at discounted prices and it also put him in breach of contract with the duty-free retailers. Although the case was decided in favour of the claimant on the ground of misrepresentation, Leggatt J. also held that in this relational contract there was a repudiatory breach of contract based on breach of an implied term requiring honest conduct, because 'the nature of the dishonesty, on a matter of commercial importance…, was … such as to strike at the heart of the trust which is vital to any long term commercial relationship, particularly one which is dependent as this relationship was on the mutual trust of two individuals.'[81] The reasoning proceeds from a finding that the distribution agreement was a relational contract, to the insertion of implied term requiring good faith in the sense of honest disclosure of material information needed for the success of the commercial enterprise by maintaining trust.

A more recent case, *Bates v Post Office (No 3),*[82] concerned litigation between a group of former sub-postmasters and the Post Office. Although sub-postmasters are independent contractors, they were required to complete their accounts using a software system supplied by the Post Office. When various kinds of discrepancies in the accounts arose, the Post Office demanded reimbursement from some sub-postmasters, others it dismissed and sued for the alleged cash shortfall, and in some cases sub-postmasters were prosecuted, convicted and imprisoned for fraud. Some shortfalls started in the hundreds of pounds, and moved into the thousands, and then tens of thousands of pounds over a few months. Throughout these events the sub-postmasters proclaimed their innocence and insisted that there must be a problem with the software in the accounting system. The Post Office denied that it was possible for the software to cause such errors; the only possible explanation was error or fraud by the sub-postmasters. The Post Office also insisted to each sub-postmaster individually that they were the only one or only one of a few where discrepancies had appeared in their accounts. In fact, the problem affected hundreds of sub-postmasters. Eventually, one sub-postmaster worked out what the main bug was with the software, formed an action group, and eventually the scandal was exposed on television and in a parliamentary select committee enquiry. The part of the litigation in trial No 3 concerned the claim brought by 550 sub-postmasters for compensation for breach of contract. Amazingly, the Post Office continued to deny to the bitter end that there were any technical problems and bugs with the

[81] *Yam Seng Ptd Ltd v International Trade Corporation Ltd [2013] EWHC 111:* [171].
[82] *[2019] EWHC 606 (QB).*

software and refused to accept any legal liability. The claimants could not point to breach of an express term in the contract with the Post Office, which was of course a one-sided document that, whilst conferring on the Post Office enormous powers including the power of criminal prosecution, placed few obligations on the Post Office itself. Instead, the claimants relied on implied terms. More than twenty such implied terms were proposed. Most of these implied terms were accepted by Fraser J. as articulations of the duty to perform in good faith in relational contracts, of which the sub-postmasters' contracts for running the Post Office franchise were an example. Following the judgment that the Post Office had broken these implied terms, it settled for nearly £60 million.[83]

(a) The Meaning of Good Faith

What does the obligation of performance in good faith in relational contracts require? In *Bates v Post Office (No. 3),* having examined the various authorities, Fraser J. described the view of the learned editors of Chitty that the obligation of performance in good faith merely requires honesty as "simply wrong."[84] He held that the requirement of good faith "means that the parties must refrain from conduct which in the relevant context would be regarded as commercially unacceptable by reasonable and honest people."[85] He also cited with approval the view expressed by Dove J. in an earlier case concerning a relational commercial contract that breach of the obligation of good faith could be made by acts that

> "would compromise the mutual trust and confidence between the parties in this long-term relationship without necessarily amounting to the telling of lies, stealing or other definitive examples of dishonest behaviour."[86]

In another case concerning a type of joint venture,[87] Leggatt J. drew on Australian authorities[88] to point to what seems to me to be the key guiding tool of good faith in relational contracts: the common purpose of the parties in entering the transaction. The obligation to perform in good faith can be described as:

> an obligation to act honestly and with fidelity to the bargain; an obligation not to act dishonestly and not to act to undermine the bargain entered or the substance of the contractual benefit bargained for; and an obligation to act reasonably and with fair dealing having regard to the

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[83] https://www.bbc.co.uk/news/business-50741916 (last accessed 13/07/2020). On October 2nd 2020, the Post Office stated that it would not contest appeals against criminal convictions of the vast majority of sub-postmasters, thereby opening the way for the Court of Appeal to quash the convictions after about 12 years: https://www.bbc.co.uk/news/business-54384427 (last accessed 19/10/2020).

[84] *[2019] EWHC 606 (QB)* at [710].

[85] Citing *Bristol Groundschool Ltd v Intelligent Data Capture Ltd & Ors [2014] EWHC 2145 (Ch)* at [196], which in turn cited *Royal Brunei Airlines Sdn v* Tan [1995] 2 A.C. 378, [1995] 3 All E.R. 97 (PC); *Yam Seng Ptd Ltd v International Trade Corporation Ltd* [*2013] EWHC 111* at [144]; *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest) [2013] EWCA Civ 200* at [150] (Beatson L.J.).

[86] *D&G Cars Ltd v Essex Police Authority [2015] EWHC 226 (QB)* [175].

[87] *Sheikh Al Nehayan v Kent [2018] EWHC 333 (Comm).*

[88] *Paciocco v Australia and New Zealand Banking Group Limited [2015] F.C.A.F.C. 50,* para 288, Allsop C.J.

interests of the parties (which will, inevitably, at times conflict) and to the provisions, aims and purposes of the contract, objectively ascertained.

Good faith does not only mean honesty, but nor does it require one party to put the interests of the other ahead of its own. Instead, good faith requires that the parties must support and not subvert the aims and purposes of the contract through cooperation and disclosure of information.

These descriptions of the obligation of good faith that arises in relational contracts should be familiar to experts on the common law of the contract of employment. There is reference in these cases concerning commercial contracts to the standard of mutual trust and confidence, but in addition there is a version of the implied obligation placed on employees to be loyal to their employer's interests. As Buckley LJ said in *Secretary of State for Employment v ASLEF (No. 2),*[89] there is an implied term of the contract to serve the employer faithfully within the requirements of the contract. The common law of the contract of employment has also developed duties of disclosure of information that resonate with the requirements implied into the distributorship in *Yam Seng v ITC*. In *Scally v Southern Health and Social Services Board*,[90] the House of Lords devised an implied term that required an employer to notify employees about beneficial terms of employment of which they might reasonably be unaware. In both contracts of employment and (other) relational contracts the core meaning of the requirement of good faith is to avoid actions and omissions that are likely to prevent the normal functioning of the contractual relationship viewed as a productive activity.

A particular application of the duty of performance in good faith that arises frequently in contracts of employment concerns the exercise of discretionary powers conferred on employers. Many of the cases concern decisions by an employer not to grant a discretionary bonus.[91] Invoking a questionable public law analogy, [92] the courts have held that the discretion should not be exercised capriciously, arbitrarily, or irrationally. In answer to the question of how could it be irrational for an employer to save the cost of a huge discretionary pay-out, the courts insist that the bonus must be exercised within the confines of the purpose envisaged in the contract.[93] That purpose is likely to be to incentivise and reward significant contributions to the profits of the organisation. The emphasis on the purpose of the contract fits and illustrates the core meaning of good faith in relational contracts. Good

[89] *Secretary of State for Employment v ASLEF (No. 2*) [1972] I.C.R. 19 [1972] 2 All E.R. 949 (CA).
[90] *Scally v Southern Health and Social Services Board [1992] 1 A.C. 294, [1991] I.C.R. 771, [1991] 4 All E.R. 563 (HL).*
[91] *Horkulak v Cantor Fitzgerald International [2004] EWCA Civ 1287, [2005] I.C.R. 402*; D. Brodie, "Legal Coherence and the Employment Revolution" (2001) 117 L.Q.R. 604.
[92] J. Morgan, "Against Judicial Review of Discretionary Contractual Powers" [2008] L.M.C.L.Q. 230; E. Lim and C. Chan, "Problems with Wednesbury Unreasonableness in Contract Law: lessons from public law" (2019) 135 L.Q.R. 88; M. Bridge, "The Exercise of Contractual Discretion" (2019) 135 L.Q.R. 227.
[93] *H Collins, "Discretionary Powers in Contracts", in D Campbell, H Collins and J Wightman (eds), Implicit Dimensions of Contract (Oxford: Hart Publishing, 2003)* p. 219; *H. Collins, K.D. Ewing, A. McColgan, Labour Law 2nd edn (Cambridge: Cambridge University Press, 2019)* p. 149; P. Sales, "Use of Powers for Proper Purposes in Private Law" (2020) 136 L.Q.R. 384.

faith in performance is not only about dishonesty and arbitrariness, but also about remaining faithful to the purpose of the contract.

The obligation to perform the contract in good faith can be presented as an implied term (either of fact or in law), or merely as favouring a particular "purposive" approach to the interpretation of a contract of employment. In *Braganza v BP Shipping Ltd*,[94] the question was whether the employer had misused its power under the contract to determine whether an employee was entitled to in-service death benefits. The employer had denied those benefits to a widow on the ground that it suspected suicide, though in fact there was no evidence of suicide or any other cause of death. Lords Hodge and Kerr approved Lord Steyn's dictum that employment contracts are a species of relational contract. The classification of a contract of employment as a relational contract was used to justify a more rigorous control over the discretionary power by requiring the employer's decision should not take into account irrelevant considerations or fail to take into account relevant considerations. In this case, the term relational contract was also used in the older and narrower sense to signify that employment involves a personal relationship between employer and employee, so that an employer's decision that the employee had committed suicide, thereby losing all death-in-service benefits, would be a breach of the duty of trust and confidence unless it was made on the basis of cogent evidence, because such a decision would carry a stigma.[95] Lord Neuberger dissented from that proposition.[96] He held that the ordinary rule of commercial contracts applicable to the exercise of contractual discretionary powers should be applied, and that since the employers had not behaved irrationally or capriciously, their decision should not be overturned. In my view, Lord Neuberger made the error of believing that only a narrow meaning of good faith as honesty applies to the performance of contracts, but in relational contracts at least, a much broader objective standard of good commercial practice applies to performance obligations. For the majority of the Supreme Court, the classification of the contract as a relational contract, rather than an ordinary commercial contract, changed their approach towards the interpretation of the contract and the intensity of the scrutiny of the employer's exercise of its contractual power.

(b) **Is good faith mandatory**?

One debated issue regarding the obligation to perform in good faith is whether or not it is a mandatory obligation in relational contracts such as the contract of employment.[97] If the obligation to perform the contract in good faith is merely a matter of interpretation or an implied term, under ordinary contract

[94] *Braganza v BP Shipping Ltd [2015] UKSC 17: [2015] 1 W.L.R. 1661[2015] I.C.R. 449,* at [54].
[95] *Braganza v BP Shipping Ltd [2015] UKSC 17*: at [61].
[96] *Braganza v BP Shipping Ltd [2015] UKSC 17: at* [104]
[97] D. Brodie, "Beyond Exchange: The New Contract of Employment" (1998) 27 I.L.J. 79; *Freedland, The Personal Employment Contract (2003)* pp.164-166; D. Brodie, "Mutual Trust and the Values of the Employment Contract" (2001) 30 I.L.J. 84; *H. Collins, "Implied Terms in the Contract of Employment" in M. Freedland (Gen ed) The Contract of Employment (Oxford: Oxford University Press, 2016)* 471, 483-490.

law any obligation to perform in good faith should be possible to exclude by suitable explicit terms in the contract.[98] On the other hand, given the feature of relational contracts that they are indeterminate by design, it is hard to imagine how they could function commercially unless the parties agree either expressly or impliedly to co-operate in good faith.[99] In practice, of course, there are surely few contracts where there is an express term of the kind that explicitly excludes any requirement to perform in good faith.

What occurs more frequently is that it is claimed that the express terms of the contract are sufficiently clear and comprehensive to rule out any implication of a term requiring performance in good faith.[100] In *Johnson v Unysis Ltd*,[101] Lord Hoffmann applied such ordinary contract law principles to hold that the express term that permitted termination on merely giving a period of notice was inconsistent with and therefore excluded an implied term that required dismissal to be made in good faith. In contrast, Lord Steyn, having adopted the classification of a relational contract, did not permit the exclusion of the implied term of mutual trust and confidence. That reasoning indicates that some implied terms in relational contracts, particularly those concerned with good faith, may have a stronger role than being default rules that can be excluded by inconsistent express terms. The mandatory force of such terms is further supported by Lord Steyn's rejection of the majority's view that Parliament impliedly intended to occupy the field of the 'manner of dismissal' through the statutory law of unfair dismissal, thereby impliedly pre-empting the common law of contract. Although the position is not entirely clear, it appears that in relational contracts, unlike ordinary commercial contracts, express terms that might be regarded as excluding a proposed implied term of good faith in performance on the ground that they would be inconsistent will be given a restricted meaning in order to protect at least a minimum content for the obligation of mutual trust and confidence.[102]

That approach was applied in *Stevens v Birmingham University*.[103] Under the terms of his contract of employment, Professor Stevens was entitled to be accompanied to a disciplinary hearing by either a colleague or a trade union official. This term duplicated his statutory right under s. 10 Employment Relations Act 1999. Since he had no suitable colleague and was not a member of a trade union, he was not permitted by the University to be accompanied by someone else (a representative of the Medical Defence Union, which is not a trade union). The High Court held that, although it could not imply a term that permitted him to be accompanied by anyone he chose, because that would be inconsistent with the express term, the express terms had to be interpreted in a way that was consistent

[98] *Marks and Spencer Plc v. BNP Paribas Securities Services Trust Co (Jersey) Limited [2015] UKSC 72: [2016] A.C. 742.*
[99] *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust [2012] EWHC 781 (QB*) at [41] Cranston J.
[100] Eg: *TAQA Bratani Ltd v Rockrose UKCS8 Llc [2020] EWHC 58 (Comm)*; *TSG Building Services Plc v. South Anglia Housing Limited [2013] EWHC 1151 (TCC*).
[101] *Johnson v Unisys Ltd* [*2001] UKHL 13.*
[102] *United Bank Ltd v Akhtar [1989] I.R.L.R. 507 (EAT*).
[103] *Stevens v Birmingham University [2015] EWHC 2300: [2017] I.C.R. 96, [2015] Med LR 489 (QB).*

with the 'overriding obligation of trust and confidence',[104] which required him to be permitted a representative. As well as using the implied term of mutual trust and confidence to modify the express terms, by implication, as pointed out by Astrid Sanders,[105] the court also rejected the argument endorsed by the majority in *Johnson v Unisys Ltd* that the common law should not circumvent restrictions on statutory rights. This decision illustrates how courts will be extremely reluctant to permit express terms to exclude aspects of the requirement of good faith or mutual trust and confidence in relational contracts including employment.

Mark Freedland has suggested that it is possible that some of the normal requirements of the implied term of mutual trust and confidence such as disclosure of information might be excluded where appropriate in a particular work setting, but that it should not be possible to remove the obligation entirely.[106] That view is supported by the concept of relational contracts developed here. Good faith in performance is required in relational contracts because the express terms of the contract deliberately leave many important issues to be resolved by co-operation and the exercise of discretion. To remove that obligation to cooperate towards the purpose of the contract in good faith would constitute a measure that was calculated to make the relational contract fail. In *Yam Seng v I.T.C.* for instance, the supplier's conduct in permitting others to undercut the distributor completely undermined the business venture and so there was no point in continuing with it. Similarly, if employers could deny discretionary bonuses or in-service death benefits merely on the basis of self-interest, that conduct subvert the purpose of those provisions and the reasonable expectations that they generate. Although not every breach of the implied term of mutual trust and confidence in the contract of employment could be said to undermine the purpose of the contract completely, to the extent that the breach subverts some key provisions or expectations, attempts to exclude or modify the obligation would be inconsistent with the nature of relational contracts.

(c) Application to 'worker' contracts

Finally, it is sometimes doubted that the implied term of mutual trust and confidence or performance in good faith applies or applies fully to contracts for the performance of work or services outside the common law category of contracts of employment.[107] In particular, it is questioned whether such implied terms apply to contracts for the personal performance of work that do not qualify as

[104] *Stevens v Birmingham University [2015] EWHC 2300:* [88] Andrews J.
[105] A. Sanders, "Fairness in the Contract of Employment" (2017) 46 I.L.J. 508, 521.
[106] *Freedland, The Personal Employment Contract (2003)* pp. 164-6.
[107] *Freedland, The Personal Employment Contract (2003)* p. 177; D Cabrelli and J D'alton, "Furlough and Common Law Rights and Remedies" UK Labour Law Blog, https://uklabourlawblog.com/2020/06/08/furlough-and-common-law-rights-and-remedies-by-david-cabrelli-and-jessica-dalton/ citing inter alia *Jani-King (GB) Ltd. v Pula Enterprises Ltd.* [2008] 1 All E.R. (Comm) 451 (franchise agreement).

employment but do fit within the statutory definitions of the concept of a 'worker'.[108] The recognition of the category of relational contracts provides an answer to this question.

If a contract for the personal performance of work can be classified as a relational contract, which will usually be the case, the implied term of performance in good faith must be part of the contractual undertakings. That is illustrated by the application of performance in good faith and mutual trust and confidence to the sub-postmasters in *Bates v Post Office (no 3*), who were independent contractors, not employees of the Post Office. The statutory category of 'worker' applies to persons whom the common law would classify as independent contractors rather than employees, but who work under arrangements that are similar in many respects to those experienced by employees. If the contractual arrangements are incomplete by design in the same way as other relational contracts, an implied term of good faith in performance is likely to be required to make the contract effective. It is possible that some short-term contracts for the performance of work that is fully specified in the express terms of the contract might be classified as 'worker' contracts under the statute. In such a case of a fully specified contract, the worker contract would not be classified as a relational contract and an obligation to perform in good faith would likely be excluded. So far, however, as in *Pimlico Plumbers Ltd v Smith*,[109] the interpretations placed on the statutory concept of worker have emphasised the need for similar features to those of employment, such as subordination to the employer and a requirement to work exclusively for that employer.[110] If that trend of requiring a close approximation of statutory "workers" to employees continues, it seems likely that the implied term of performance in good faith will apply to all 'workers' under the statutory definition because they will be engaged in a relational contract.

7. Conclusions

In recent years, the legal category of relational contracts has been recognised in commercial law. The concept has been applied to contracts such as franchises, distributorships, and joint ventures, which concern productive activities that use contractual frameworks with some organisational elements in order to achieve a shared, though incompletely specified, purpose of the parties. Although many factors may be taken into account in assessing whether a contract should be classified as a relational contract, the key element, it has been argued, is that both the performance obligations and the desired outcome of the transaction are deliberately incompletely specified. It has been further argued that the contract

[108] Employment Rights Act 1996, s. 230(3)(b) a contract whereby "the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual…"
[109] *Pimlico Plumbers Ltd v Smith [2018] UKSC 29: [2018] I.C.R. 1511.*
[110] *Byrne Bros (Formwork) Ltd v Baird [2002] I.C.R. 667, [2002] I.R.L.R. 96 (EAT)*; *H. Collins, "Dependent Contractors in Tax and Employment Law" in G. Loutzenhiser and R. de la Feria (eds), The Dynamics of Taxation (Oxford: Oxford University Press, 2020)* 117.

of employment is an example of a relational contract because of its structural features that the employer obtains the right to determine what work needs to be done and how it should be performed and that both parties are expected to co-operate in good faith to fulfil the purpose of the contract. Accordingly, the special legal features of the common law of the contract of employment are best understood as the application of rules and principles that are shared with other kinds of relational contracts. The core feature of the distinctive principles governing the category of relational contracts is that the parties are required to support the purpose of the contract through co-operation in good faith. That co-operation can require various kinds of actions that cannot be specified in advance, such as disclosure of information, the avoidance of conflicting interests, and the performance of duties that go beyond contract in the sense of the requirements set out in the express terms of the contract.

The classification of the contract of employment as a relational contract is confirmed by the deep contextual approach or purposive interpretation of contracts of employment in *Autoclenz Ltd v Belcher*. It is also confirmed by the emphasis on the reasonable expectations of the parties to determine whether variations in their obligations have taken place and whether unilateral variations of staff handbooks should be effective. The classification of employment as a relational contract provides a reason for favouring the Court of Appeal's decision in *Carmichael v National Power* over that of the House of Lords, for the former recognised that reasonable expectations of an on-going relationship might be in effect an alternative to the requirement of consideration to establish the binding quality of the agreement. Viewing employment as a type of relational contract also confirms the approach of Lord Steyn in *Johnson v Unisys Ltd*. It explains why obligations to perform in good faith apply to both parties. It explains why the obligation of good faith or mutual trust and confidence is not so much about dishonesty as about objective standards of fair dealing in accordance with the purpose of the contract. Furthermore, within the category of relational contracts, the obligation to perform in good faith cannot be excluded entirely without risking the prevention or subversion of the purpose of the contract. It must also follow from the categorisation of employment as a relational contract that similar rules and principles are likely to apply to other contracts for the performance of work, such as the independent contractor arrangement for sub-postmasters, provided the contract shares the key features of a relational contract.