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The importance of being relational: comparative reflections on relational contracts in Australia and the United Kingdom

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ABSTRACT

The notion of the relational contract, previously limited to academic circles, is now being articulated by some courts. The consequences are threefold. Firstly, these judicial decisions are challenging the conception of agreements in the common law. Secondly, these decisions acknowledge the particularity of some long-term commercial relationships and shift the spotlight onto the relations of the parties. Thirdly, they are being used to integrate obligations to act in good faith. This article will show how these decisions implement the developing theory of relational contracts. The article will discuss recent developments in the United Kingdom and Australia and reflect on the parallel course the two jurisdictions are taking. By providing a bird's-eye view of normative changes affecting some long-term transactions, the aim of the article is to reflect on how contract law is being reshaped by the recognition that, in some contracts, the relationship, not self-interest, is the vital thing, demonstrating a move away from traditional contract law theory.

Keywords: relational contract; good faith; legal theory; morals; implied terms.

INTRODUCTION

There is a wind of change blowing on the traditional conception of contracts in the common law. The notion of the relational contract, previously limited to academic circles, is slowly beginning to be articulated by some courts. This notion is summarised in a recent article by Zoe Gounari as:

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> at its core contract is a relationship, albeit one with legal force, and requires parties' adherence to values conducive to a relationship not only for it to come about in the first place, but also for it to be successful down the line.[1]

Until recently, relational contract theory was just a controversial academic topic. Yet, over the last decade, the notion of the relational contract has become more prominent in judicial decisions in the United Kingdom (UK). Earlier decisions, while alluding to relational contracts, had yet to fully impact contract law doctrine in the common law. Then, in March 2019, in *Bates v Post Office Ltd*,[2] the Queen's Bench Division of the UK High Court of Justice explicitly stated that relational contracts do exist and that they can be defined through a list of criteria. Justice Fraser also applied his reasoning to find the contract in dispute was relational and implied obligations of good faith which bound the Post Office. The judge articulated good faith and relational contracts as two faces of the same coin. While a first instance decision, *Bates* matters as it emphasises the relevance and importance of the relational character of the contractual relationship. The consequences are threefold. Firstly, it challenges the classification of agreements in the common law. Secondly, it supports the argument that in some contracts the long-term nature to some extent, but in particular the nature of the project and of the relationship, bear legal consequences, thereby shifting the spotlight onto the relations of the parties in that classification. Thirdly, it is being used to integrate obligations to act in good faith. While the parties to the dispute in *Bates* later settled, this case remains an important development. Not only does it further advance the discourse on the relational contract, but it is also representative of a new wave of decisions in the UK acknowledging that there is more to an agreement than its written terms, warranting a contextual approach to the interpretation of contracts, from their terms to their enforcement. While a seminal decision, the question remains: is this more than a blip in time?

The aim of this article is to argue that the decision in *Bates* is part of the recognition by the judiciary of the relevance of context in contract law theory and contract law practice. Relational contracts place the emphasis on the circumstances of the parties leading to and during the performance of the contract, while remaining true to the written terms of the agreement. Context can be hard to determine, and this is one of the reasons why the notion of relational contracting is in itself controversial. During and beyond the COVID-19 pandemic, the need to renegotiate contracts and to compromise to ensure agreements

1 Zoe Gounari, 'Developing a relational law of contracts: striking a balance between abstraction and contextualism' (2020) 41(2) Legal Studies 176, 182.

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

can be completed is becoming paramount to help economies recover. This is why this article argues that it is important to learn from recent legal developments in this area to facilitate trade and collaborative contracting.

The importance of context in interpreting contracts became even more prominent in 2020, when the World Health Organization declared the world was facing a global pandemic.[3] Within weeks, the Australian Federal Parliament released good faith principles for commercial tenancies whereby the landlord and the tenant were to discuss ways to maintain the tenancy rather than terminating for lack of funds due to the effects and uncertainties created by the pandemic. In 2020, at the height of the first wave of COVID-19, the spirit of the relational contract was also present in the code of conduct of commercial leasing which contained good faith principles.[4] This code came into effect in all states and territories from 7 April 2020 (being the date that National Cabinet announced a set of principles to guide the code to govern commercial tenancies affected by the COVID-19 pandemic), following legislation in the states and territories to implement the code.[5] Interestingly, the code's wording reminds us of the relational nature of commercial leasing contracts:

> Landlords and tenants share a *common interest in working together, to ensure business continuity*, and to facilitate the resumption of normal trading activities at the end of the COVID-19 pandemic during a reasonable recovery period … Landlords and tenants will *negotiate in good faith* … Landlords and tenants will act in an *open, honest and transparent manner*, and will each *provide sufficient and accurate information* within the context of negotiations to achieve outcomes consistent with this Code … Tenants must remain committed to the terms of their lease, subject to any amendments to their rental agreement negotiated under this Code.[6]

There is no real data on how many commercial tenancies were saved by this set of measures. Such data may not be gathered as this was only

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3 World Health Organization, 'WHO Director-General's opening remarks at the media briefing on COVID-19 – 11 March 2020'.

4 Australian Government, National Cabinet Mandatory Code of Conduct: SME Commercial Leasing Principles during Covid-19 (2020) 2.

5 Leases (Commercial and Retail) COVID-19 Emergency Response Commercial Leases Declaration 2020 (ACT); Tenancies Legislation Amendment Act 2020 (NT); Retail and Other Commercial Leases (COVID-19) Regulation 2020 (NSW); COVID-19 Omnibus (Emergency Measures) (Commercial Leases and Licences) Regulations 2020 (Vic); proposed Commercial Tenancies (COVID-19 Response) Bill 2020 (WA); COVID-19 Emergency Response Act 2020 (Qld); COVID-19 Disease Emergency (Commercial Leases) Act 2020 (Tas).

6 Australian Government (n 4 above) 2 (emphasis added).

one of the measures adopted to bring the economy out of recession.[7] Notions of collaboration, cooperation and good faith are, however, evident in these principles. These notions have also appeared in codes of conduct legislated by the Federal Australian Parliament to regulate particular industries and their trading practices. Since 2014, first through specific provisions in the Franchising Code of Conduct, and later within the newly drafted Food and Grocery Code of Conduct, the Horticulture Code of Conduct and the Dairy Code of Conduct, good faith has been expressly legislated upon.[8] This article will demonstrate that the Australian legislative approach echoes the relational contract judicial developments in the UK, even though this has not been expressly pointed out.

This article will first provide a theoretical overview on relational contracting to provide a backdrop to the judicial and statutory developments later analysed. It will then provide a chronological development of judicial decisions in the UK and in Australia. This section will use the legal issues raised in *Bates* as a case study. The article will first review the context of the agreement, the terms of the contract and the relationship between the parties in the dispute. It will lay out the factual as well as the legal landscape of the case. To consider relational contracts is to go beyond the black letter of the law, and the article will illustrate that the context and conduct of the parties take a prominent place next to the written terms. The article will then reflect on the relevance of these developments in Australia and compare them with recent changes in the regulation of some industries. The contract regulatory landscape in Australia is different to the common law approach of the UK. Therefore, while case law is analysed, it is also relevant to consider regulatory reforms which have targeted agreements in particular industries. By providing a bird's-eye view of normative changes affecting some long-term contracts in the UK and in Australia, the aim of the article is to analyse the possible social and legal implications of the growing recognition of relational contracts.

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7 Coronavirus Economic Response Package (Payments and Benefits) Rules 2020 (Cth); Coronavirus Economic Response Package (Payments and Benefits) Act 2020 (Cth).

8 Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (Cth); Competition and Consumer (Industry Codes – Horticulture) Regulations 2017 (Cth); Competition and Consumer (Industry Codes – Dairy) Regulations 2019 (Cth); Competition and Consumer (Industry Codes – Food and Grocery) Regulation 2015 (Cth).

RELATIONAL CONTRACTS: A SOCIAL CONCEPT WITH LEGAL CONSEQUENCES

Reclassifying contracts using a spectrum

Contracts are based on the parties' intention to enter into an agreement, and their relations are dictated on their own terms. Freedom to contract and party autonomy have dominated contract law theory. Parties express their intention by exchanging promises and by regulating their own dealings in their own terms. This ideal scenario is illustrated by the idea that, according to economic theory, each party to a contract is a rational actor. A person decides to enter into a legal agreement if the advantages outweigh the costs. Therefore, the goal of the transaction is to see it successfully performed. In this theoretical situation, both parties gain from the transaction because they are 'self-interested egoists who maximise utility'.[9]

Contract law involves more than just protecting party autonomy.[10] The ideal scenario is not often realised in practice. This might be because there is an imbalance of power between the parties, or one party might be more knowledgeable than the other. Where a party acts opportunistically and seeks to take advantage of the other party, some limits are placed upon autonomy. Worthington identifies different types of constraints.[11] For instance, general constraints prevent a party from hiring an assassin. Perhaps most significantly, there are constraints in contract law itself, as illustrated by the importance of consent and legal interventionism to protect the idea that consent should be freely given. The doctrine of unconscionability is a particularly relevant example of this restraint.[12] This intervention is not only apparent in the development of vitiating factors including unconscionability but also in the limits placed on the exercise of contractual powers during performance and termination of the contract. There are several examples

9 Cento G Veljanovski, 'Economic approach to law: a critical introduction' (1980) 7 British Journal of Law and Society 158, 162.

10 This is demonstrated by the legal literature: see Reinhard Zimmermann, *Roman Law, Contemporary Law, European Law: The Civilian Tradition Today* (Oxford University Press 2001) 174.

11 Sarah Worthington, 'Common law values: the role of party autonomy in private law' in A Robertson and M Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (Hart 2016) 303–306.

12 Competition and Consumer Act 2010 (Cth), sch 2 Australian Consumer Law, ss 20–22; *Commercial Bank of Australia Ltd v Amadio* [1983] HCA 14; *Alec Lobb (Garages) Ltd v Total Oil* (Great Britain) Ltd [1983] 1 WLR 87; see also Ying Khai Liew and Debbie Yu, 'The unconscionable bargains doctrine in England and Australia: cousins or siblings?' (2021) 45(1) Melbourne University Law Review (advance copy).

of this phenomenon, including the implications of terms in fact[13] and in law,[14] the limits placed on the enforceability of exclusion clauses,[15] and penalty clauses[16] and the rejection in some countries, such as Australia, of the efficient breach.[17] Party autonomy is also limited by complaints of unfair dealing.[18] This shows that there are limits to how far a contractual party can exercise its autonomy. The foundations for such rejection can be found in the primacy of the promise, as well as the infiltration of moral values into the regulation of contractual dealings. How much these values impact on contract drafting, conduct of the parties and enforcement of agreements depends on the type of contract.

The term relational contract was coined by Ian Macneil.[19] His theory is based on two main pillars: the length of the contract and the relationship between the parties. According to him, the life of the contract is not entirely predictable; therefore, the agreement will always be, to some extent, incomplete. He adds that '[t]he more relational an exchange, the less likely the parties plan and allocate risks effectively'.[20] Macneil identifies 10 norms that define a contract as relational: (1) role integrity (requiring consistency, involving internal conflict, and being inherently complex); (2) reciprocity (the principle of getting something back for something given); (3) implementation of planning; (4) effectuation of consent; (5) flexibility; (6) contractual solidarity; (7) the restitution, reliance and expectation interests (the

13 *BP Refinery (Westernport) Proprietary Limited v Shire of Hastings (Victoria)* [1977] UKPC 13; *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72; *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337.

14 *Liverpool City Council v Irwin* [1976] UKHL 1; *Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169.

15 *Davis v Pearce Parking Station Pty Ltd* [1954] HCA 44; *Sydney City Council v West* (1965) 114 CLR 481; *Renard Constructions (ME) Pty Ltd v Minister for Public Work* (1992) 26 NSWLR 234; *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373.

16 *Paciocco v ANZ Group Ltd* [2016] HCA 28 - 258 CLR 525; *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67; see also Mary Arden and James Edelman, 'Mutual borrowing and judicial dialogue between the apex courts of Australia and the United Kingdom' (2022) 138 Law Quarterly Review 217.

17 *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* [2009] HCA 8 [13]; for a review of the UK, see also Solène Rowan, 'Abuse of rights in English contract law: hidden in plain sight? (2021) 84(5) Modern Law Review 1066, 1067.

18 Paul Finn, 'Fiduciary and good faith obligations under long term contracts' in Kanaga Dharmananda and Leon Firios (eds), *Long Term Contracts* (Federation Press 2013) 137.

19 Ian R Macneil, *The New Social Contract: An Inquiry into Modern Contractual Relations* (Yale University Press 1980) 10.

20 Robert A Hillman, *The Richness of Contract Law: An Analysis of Critique of Contemporary Theories of Contract Law* (Kluwer 1998) 256.

'linking norms'); (8) creation and restraint of power (the 'power norm'); (9) propriety of means; and (10) harmonisation with the social matrix, that is, with 'supracontract norms'.[21] These elements are at odds with the classical view of contracting, or 'egoist' contracting.[22] These norms echo notions of cooperation, communication and transparency between the parties. These parties are respectful, loyal and take into consideration the interests of the other party. To be clear, this does not mean that parties determine their actions based on the interests of the other party, ie a fiduciary relationship. Macneil has summarised his arguments in four main strands:

> First, every transaction is embedded in complex relations.
>
> Second, understanding any transaction requires understanding all essential elements of its enveloping relations.
>
> Third, effective analysis of any transaction requires recognition and consideration of all essential elements of its enveloping relations that might affect the transaction significantly.
>
> Fourth, combined contextual analysis of relations and transactions is more efficient and produces a more complete and sure final analytical product than does commencing with non-contextual analysis of transactions.[23]

Macneil's theory, although it was never intended to become one, has been fiercely criticised.[24] The categories laid out by Macneil are not finite. This means that not all commercial contracts will be relational.[25] The long-term nature of the contract is one but not the only criterion.[26] This relational approach has been criticised by those who consider that these standards decrease predictability, with the ultimate consequence of increasing transaction costs.[27] For some, it is one reason for the lack of doctrinal impact, in so far as that Macneil's notion of relational contract was developed not as a theory, but as a sociological contractual phenomenon. It has been described as a simple matter of 'spotlight

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21 Ian Macneil, 'Relational contract theory, challenges and queries' (2000) 94 Northwestern University Law Rev 877, 879–80.

22 See Veljanovski (n 9 above).

23 Ibid 881.

24 For a review of the use of the theory, see Josetta McLaughlin, Jacqueline McLaughlin and Raed Elaydi, 'Ian Macneil and relational contract theory: evidence of impact' (2014) 20(1) Journal of Management History 44.

25 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [705], [714].

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

27 For a review, see James Gordley, 'The moral foundations of private law' (2002) 47 American Journal of Jurisprudence 1.

orientation',[28] emphasising the relationship rather than the exchange itself.

Tan, in his seminal article on relational contracts, provides a framework to grasp relational contract theory's possible doctrinal ramifications through three pathways. The first is re-interpretive relationalism, meaning other established concepts already reflects.[29] The second is re-orientative relationalism explained by Tan as involving 'intra-doctrinal salience and additional alteration'[30] using Leggatt J's judgment in *Yam Seng* as a prime example of this development.[31] The third and final pathway is reconstructive relationalism, where contractual doctrines are remodelled,[32] as illustrated by the Canadian judgment of *Bhasin*.[33]

Each of Tan's pathways show that the notion of the relational contract makes it clear that the terms of the agreement are only part of the equation. This point is also shared by the contextualism movement. According to Hugh Collins, there are three levels of social relations that shape contracts.[34] First, the written contract represents the frame of reference. Second, the economic relations illustrate the rational self-interest of the parties. Third, trust impacts on every social interaction between the parties. Economic relations and trust form the core of the implicit dimensions of a contract. The cement between these elements is the legitimate expectations of the parties,[35] meaning an expectation that a benefit or right will be obtained as the contract is performed. For example, parties rely on the good faith of the other.

The notion of good faith is well known to civil law lawyers. Teubner famously describes good faith as a legal irritant, whose implementation in English law through European Union directives would start a domino effect in contract law that would 'irritate British legal culture considerably'[36] and also 'trigger deep, long-term changes from highly formal rule-focused decision-making in contract law towards a more

28 Sandrine Tisseyre, *Le rôle de la bonne foi en droit des contrats – Essai d'analyse à la lumière du droit anglais et du droit européen* (LGDJ 2012) 280.

29 Zhong Xing Tan, 'Disrupting doctrine? Revisiting the doctrinal impact of relational contract theory' (2019) 39 Legal Studies 98, 105.

30 Ibid 107.

31 Ibid 108; *Yam Seng Pte Limited v International Trade Corporation Limited* [2013] EWHC 111 (QB) [142].

32 Ibid 111.

33 *Bhasin v Hrynew* [2014] 3 SCR 494.

34 See Hugh Collins, 'Discretionary powers in contracts' in David Campbell, Hugh Collins and John Wightman (eds), *Implicit Dimensions of Contract: Discrete, Relational, and Network Contracts* (Hart 2003) 250.

35 Ibid.

36 Gunther Teubner, 'Legal irritants: good faith in British law or how unifying law ends up in new divergences' (1998) 61 Modern Law Review 11, 20.

discretionary principle-based judicial reasoning'.[37] Interestingly, in France, good faith and relational contracts have been analysed. For instance, Busseuil developed a definition of the relational contract using two main pillars: the legal link between the contractual obligation and the relationship and the notion of *favor contractus*.[38] Parties do not mind owing each other favours[39] if this means that the contractual relationship is maintained and even flourishes: the contractual link between the parties will prevail. From this perspective, Busseuil considers that good faith has an important role to play to ensure the contract is adapted to comply with a new set of circumstances or to remedy the absence of some terms in the contract. While good faith is a principle of contract law well known to civil lawyers, its place if any in common law jurisdictions is less certain.[40]

Community standards, morals and contract law

No matter the jurisdiction, reasons for entering the relationship can be implied by standards from a specific industry, the broader business context, and the general community or even the idealised general community.[41] This is also very close to social relationship theory which emphasises the importance of the societal context, and the reality faced and understood by the community, in the shaping of contract law. This approach 'confines expectations and is imbedded in conventions, norms, mutual assumptions and unarticulated expectations'.[42]

Laws and morals are traditionally two different notions.[43] According to an old English legal doctrine, 'From a dishonourable cause, an action

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37 Ibid 21.

38 Guillaume Busseuil, *Contribution à L'étude De La Notion De Contrat En Droit Privé Européen* (LGDJ 2008) 350.

39 Jan B Heide and George John, 'Do norms matter in marketing relationships?' (1992) 56(2) Journal of Marketing 32, 39.

40 Teubner (n 36 above); Wayne Courtney, 'Good faith and termination: the English and Australian experience' (2019) 1 Journal of Commonwealth Law 185; Martin Hogg, 'The implication of terms-in-fact: good faith, contextualism and interpretation' (2018) 85(6) George Washington Law Review 1660; Ewan McKendrick, 'Good faith in the performance of a contract in English law' in Larry DiMatteo and Martin Hogg (eds), *Comparative Contract Law: British and American Perspectives* (Oxford University Press 2015) 196; recent cases in Canada have been slowly canvassing an organising principle of good faith ever since *Bhasin v Hrynew* [2014] SCC 71 and more recently *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District* [2021] SCC 7.

41 Jeannie Paterson, 'The standard of good faith performance: reasonable expectations or community standards?' in Michael Bryan (ed), *Private Law in Theory and Practice* (Routledge-Cavendish 2007) 158.

42 Hugh Collins, 'Introduction' in Campbell et al (eds) (n 34 above) 2.

43 Beatrice Jaluzot, *La Bonne Foi dans les Contrats: Etude Comparative des Droits Francais, Allemand et Japonais* (Dalloz 2001) 62.

does not arise.'[44] This means that there is a need for a breach of law for a remedy to be available; a breach of morals is not sufficient. The word 'morals' is said to have originated from the Latin *moralis*, coined by Cicero.[45] Morals vary from one person to another and are mostly imposed by individuals upon themselves.[46] There is 'a fundamental difference between the law that expresses a moral principle and that law that is only a social regulation'.[47] Morals and law have different aims: on the one hand, morals are linked to the individual, whereas law is addressed to society. They have different sources: morals come from the conscience of the individual and law is imposed by external institutions. Finally, morals are broader and vaguer, while law enacts precise rules. As Devlin explains: 'Legalisation is seen as the natural enemy of morality, for morality is at its best when each case is judged entirely on its merits.'[48]

To provide context to the debate surrounding the understanding of the notion of good faith in contracts, it is important to reflect on the origins of the distinction between law and morals to demonstrate that they have always been intertwined. Aristotle did not use the notion of good faith but identified three virtues: liberality, fidelity and commutative justice. Firstly, Aristotle understood liberality as using resources sensibly.[49] This meant, for instance, that people should not be prodigal, that is, waste their substance (their money).[50] Secondly, breaking a promise was being unfaithful to one's word.[51] An example of the second virtue can be found in article 1104 of the French Civil Code. The renewed attention given to this French Civil Code provision after the Second World War[52] and the increasing impact of morality on different relationships, including contractual relations, slowly led to the development of new obligations and duties of parties, such as the duties to disclose information and to cooperate in the negotiation and

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44 *Ex turpi causa non oritur actio*.

45 *Chambers Dictionary of Etymology* (Chambers 2008).

46 Jaluzot (n 43 above) 61.

47 Patrick Devlin, *The Enforcement of Morals* (Oxford University Press 1965) 60.

48 Ibid 46.

49 James Gordley, 'Some perennial problems' in James Gordley (ed), *The Enforceability of Promises in European Contract Law* (Cambridge University Press 2001) 4.

50 Aristotle, *Nicomachean Ethics* (first published 350 BC) book IV.

51 Gordley, 'Some perennial problems' (n 49 above) 6. Primary source: Cajetan, *Commentaria to Thomas d'Aquinas Summa Theologiae* (Padua 1698) pt II-II, q 88, art 3; q 110.

52 Philippe Le Tourneau and Matthieu Poumarède, 'Bonne foi' (2009) Repertoire Civil nn 3–4, n 18.

performance of the agreement.[53] The developments have contributed to good faith being applicable to all stages of the contract in article 1104 following reform in 2016. These obligations all mirror the Aristotelian virtues of fidelity and commutative justice, the latter being associated with equitable fairness.[54] These ideas are also echoed in the common law commentary. For instance, Andrew Gold discusses the relationship between morality and loyalty:

> Promises might also ground a morally significant loyalty obligation, depending on one's theory of loyalty. For example, there may be cases in which an individual promises to be loyal, thus creating a moral duty to be loyal in light of that promise. Accordingly, even if loyalty lacks a moral basis as a general matter, in specific contexts loyalty can take on a moral dimension – loyalty and morality are at least sometimes linked.[55]

The idea that promises should be kept was also shared by Thomas Aquinas,[56] in the same way that Aristotle asked parties in a contractual relationship to keep to their word.[57] Thirdly, the idea of commutative justice or the will to exchange resources of equivalent value, so that neither party is enriched at the expense of the other, was also reinforced by Thomas Aquinas.[58] Therefore, the three Aristotelian virtues were maintained during the medieval period.[59] Reflecting this philosophy, contracts were classified under two broad categories: liberalities or donations and commutative justice,[60] referring to contracts as the Romans understood them, that is, consensus contracts.[61]

The understanding of the doctrine of good faith was revived by the works of Baldus, a leading medieval Roman law scholar of the fourteenth century in Italy. Before then, good faith was understood as consisting

53 Muriel Fabre-Magnan, *Droit des Obligations* 2nd edn (PUF 2010) 63; Rémy Cabrillac, *Droit Européen Comparé des Contrats* (LGDJ 2012) 3; Busseuil (n 38 above) 552.

54 James Gordley, 'Good faith in contract law in the medieval *ius commune*' in Reinhard Zimmermann and Simon Whittaker (eds), *Good Faith in European Contract Law* (Cambridge University Press 2000) 107; Anton-Hermann Chroust and David L Osborn, 'Aristotle's conception of justice' (1942) 17 Notre Dame Law Review 129, 136.

55 Andrew S Gold, 'Accommodating loyalty' in Paul B Miller and Andrew S Gold (eds), *Contract, Status, and Fiduciary Law* (Oxford University Press 2016) 5.

56 Gordley, 'Some perennial problems' (n 49 above) 4. Primary source: Thomas Aquinas, *Summa Theologiae* pt II-II, q 88, art 3, ad 1; q 110, art 3, ad 5.

57 Aquinas (n 56 above). Primary source: Cajetan, *Nicomachean Ethics* book IV, ch vii, 1127a–1127b.

58 Aquinas (n 56 above) Q 61, art 3.

59 Ibid.

60 Ibid art 5.

61 Cause and consideration may be different but seek to achieve the same goal: the promise is binding and has a reason to exist.

of three obligations:[62] to keep to one's word, to not take advantage by misleading or driving too harsh to a bargain,[63] and to abide by obligations an honest person would recognise.[64] The first obligation has always been part of the development of good faith and led to *pacta sunt servanda*.[65] Baldus revived the works of Thomas Aquinas and Aristotle to arrive at a better understanding of the notion of good faith. He understood the concept as an obligation not to become enriched at the expense of the other party.[66]

This echoes some of the recognition that can be found in Australia. For instance, there is a difference between acting in the interests of another and taking their interests into consideration. The concept of good faith only applies in the latter situation and must be differentiated from fiduciary duties.[67] Fiduciary duties are equitable duties that can exist together with contractual duties.[68] Fiduciaries must not profit from their position and must avoid and disclose conflicts of interest. Remedies may be restitution (disgorging profits) and compensation if a breach results in loss to the beneficiary. The express fiduciary duty is to act in the interest of another. In *McKenzie v McDonald*,[69] this duty was defined as one party having powers and discretions that affect the interests of the other, the latter putting trust and confidence in the actions of the former. The category is open-ended and can overlap with other doctrines such as unconscionability.

This analysis shows that the traditional division between law and morals does not consider the necessary convergence between the two notions. While they have different characteristics, laws should not go against morals and some laws find their source in morals.[70] As Rowan explains, 'depending on the context, the right-holder can be required to refrain from acting dishonestly, outside the limits of the

62 Gordley (n 54 above) 94.

63 Ibid 99–101.

64 See Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Oxford University Press 1990) 664–671.

65 See eg Ulpian, *Digest* 2, 14, 77; for a longer discussion see also Alexis Keller, 'Debating cooperation in Europe from Grotius to Adam Smith' in William Zartman and Saadia Touval (eds), *International Cooperation: Extents and Limitations of Multilateralism* (Cambridge University Press 2010) 19.

66 Baldus de Ubaldis, *Consilia, Sive Responsa* (1575); Gordley (n 54 above) 93, 94.

67 Paul Finn, 'The fiduciary principle' in T G Youdan (ed), *Equity, Fiduciary and Trusts* (Carswell 1989) 4, cited in Andrew Terry and Cary Di Lernia, 'Franchising and the quest for the holy grail: good faith or good intentions' (2009) 33 Melbourne University Law Review 542, 554.

68 J W Carter and M P Furmston, 'Good faith and fairness in the negotiation of contracts part I' (1994) 8 Journal of Contract Law 1, 6; Finn (n 67 above) 4, cited in Terry and Di Lernia (n 67 above) 554.

69 [1927] VLR 134 (Dixon J).

70 Jaluzot (n 43 above) 63.

rights, inconsistently with the purpose for which it was conferred or without a legitimate interest or any proper basis'.[71] The concept of good faith is an example of this convergence. In France it has moved from moral rule to legal norm: 'good faith is one of the means used by the legislature and the courts to allow the moral rule to penetrate in law'.[72] The doctrine of good faith protects the legitimate expectations of the parties and ensures both procedural and substantive fairness in contractual dealing. It regulates behaviours[73] and, while the intention of the parties is interpreted objectively, the notion of legal expectation is what comes closest to the theory of subjective rights as it is known in civil law.[74] In common law countries, the moral view of contract law is that the good person should deal fairly.[75] The pragmatic view is that keeping faith does not matter.[76] But this is a contrarian view in the common law. The doctrine of good faith faces opposition with opponents insisting that it is difficult to decide where morals stop and where law begins.[77] Yet, the first part of this article has shown how actions based on good faith can be used to broaden justice and to punish fraudulent behaviour, including misleading or taking advantage of the other party.[78] *Carter v Boehm*, a landmark case in insurance contract law, led to the recognition of the doctrine of good faith in UK insurance contracts. It demonstrates the importance of the concept through the duty of disclosure: 'the reason of the rule which obliges parties to disclosure, is to prevent fraud, and to encourage good faith'.[79] This shows that good faith is also about fidelity to the bargain and that such fidelity is required and encouraged in some transactions including insurance contracts.

Good faith and relational contract: two sides of one coin

The discussion above illustrates that one underpinning of the spectrum of contracts is the influence of moral values on contracting.

71 Rowan (n 17 above) 13, at 1068; See *Braganza v BP Shipping Ltd* [2015] UKSC 17 (SC); *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Garry Rogers Motors (Aust) P/L v Subaru (Aust) P/L* (1999) 21 ATPR 41-703.

72 Jaluzot (n 43 above) 65. Georges Ripert, *La Règle Morale Dans Les Obligations Civiles* (LGDJ 1949) 157: 'la bonne foi est l'un des moyens utilisés par le législateur et les tribunaux pour faire pénétrer la règle morale dans le droit'.

73 Jaluzot (n 43 above) 66.

74 Busseuil (n 38 above) 587.

75 Devlin (n 47 above) 43.

76 This is where an efficient breach occurs.

77 R Goode, 'The concept of "good faith" in English law' (Centro di Studi e Richerche di Diritto Comparato e Straniero, Saggi, Conferenze e Siminari 2, Rome 1992).

78 Gordley (n 54 above) 100.

79 *Carter v Boehm* (1766) 3 Burr 1905, 1162, 1165.

This is further demonstrated by the idea that any 'exchange behaviour includes a combination of the ten common contract norms, containing at a minimum solidarity and reciprocity'.[80] Therefore, the cooperative nature of the exchange is seen as a 'given' in relational contract theory if the contract is deemed relational. Cooperation itself is a well-known contract law principle. Understanding the importance given to the contractual promise and the moral limits to party autonomy provides valuable insights into the understanding of good faith in contract law.[81] But beyond this, solidarity keeps creeping into contractual exchanges, meaning that '[p]arties are committed to improvements that may benefit the relationship as a whole, and not only the individual parties'.[82] This reasoning is consistent with the idea that parties need to take into consideration the interests of the other party. Good faith is presented as an economic expectation of the parties, whereby cooperative norms actually lower costs.[83]

Good faith does not require altruism, or subjugation of self-interest.[84] But breaking a promise goes against the notion of parties sticking to their bargain: 'The aim of contract law ... is to make things better.'[85] In principle, parties to a contract enter into the contract to see it performed.[86] If we accept that the promise is at the core of the theory of contractual obligation then, according to Fried, there is a moral obligation to make a promise binding.[87] Fried argues that good faith requires loyalty to the promise and that contract law imposes legal obligations that are convergent with moral obligations.[88] Reciprocity and contractual solidarity bring ideas of fairness and justice into contract law. Good faith is seen as the moral and legal obligation to ensure parties cooperate. Not only is anti-cooperative behaviour discouraged,[89] but parties are encouraged to cooperate. This has led to the judicial recognition of some principles of fairness in contracting.

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80 Chapi F Cimino, 'The relational economics of commercial contracts' (2015) 3 Texas A&M Law Review 91, 100.

81 Finn (n 18 above) 149.

82 Ibid.

83 Cimino (n 80 above) 114.

84 Liam Brown, 'The impact of section 51AC of the TPA on commercial certainty' (2004) 28 Melbourne University Law Review 589, 605.

85 Liam B Murphy, 'The practice of promise and contract' in Gregory Klass, George Letsas and Prince Saprai (eds), *Philosophical Foundations of Contract Law* (Oxford University Press 2014) 153.

86 See Ibid.

87 Charles Fried, *Contract as Promise* (Oxford University Press 2015) 146; see also Hillman (n 20 above) 12.

88 Fried (n 87 above) 147.

89 Ian Macneil, 'Efficient breach of contract: circles in the sky' (1982) 68 Virginia Law Review 947, 968.

A CHRONOLOGY OF JUDICIAL DEVELOPMENTS: TWO STEPS FORWARD, ONE STEP BACKWARD?

While the reasonable exercise of discretionary rights and the notions of cooperation and collaboration have been the subject of many court decisions which examined the behaviour of contractual parties in the performance of their contract, the concept of the relational contract is only emerging.

Pre *Bates*: the hesitancy of the courts

While the notion of relational contract has been known since Macneil's seminal piece, it has not been used in judicial decisions in Australia to the same extent it has recently been in the UK. In *Johnson v Unisys Ltd*,[90] Lord Steyn suggested the contract of employment could be described as a relational contract.[91] In the antipodes, Finn J in *GEC Marconi Systems* articulated that a relational contract is a contract which 'involves not merely an exchange, but also a relationship, between the contracting parties'.[92]

It is the UK decision of *Yam Seng*[93] that truly reignited the possibility that some long-term contractual relationships 'between parties who make a substantial commitment' have a special status:

> While it seems unlikely that any duty to disclose information in performance of the contract would be implied where the contract involves a simple exchange, many contracts do not fit this model and involve a longer term relationship between the parties which they make a substantial commitment. Such 'relational' contracts, as they are sometimes called, may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements.[94]

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90 [2003] 1 AC 518. See Matthew Boyle, 'The relational principle of trust and confidence (2007) 27(4) Oxford Journal of Legal Studies 633; Hugh Collins, 'Is a relational contract a legal concept?' in S Degeling, J Edelman and J Goudkamp (eds), *Contracts in Commercial Law* (Thomson Reuters 2016) 37; Gabrielle Golding, 'Employment as a relational contract and the impact on remedies for breach' (2021) 30(2) Griffith Law Review 270; Douglas Brodie, 'Relational contracts' in M Freeland et al (eds), *The Contract of Employment* (Oxford University Press 2016) 145.

91 *Johnson v Unisys Ltd* [2003] 1 AC 518 at 532 [20].

92 *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* [2003] FCA 50; (2003) 128 FCR 1 [224].

93 *Yam Seng PTE v International Trade Corp Ltd* [2013] EWHC 111 (QB) [131], [142], [145].

94 Ibid [142].

This definition was followed in *D&G Cars* and led to parties' duty to act honestly and with integrity in executing the contract.[95]

In the 2018 decision of *Sheikh Al Nehayan v Kent*,[96] LJ Leggatt emphasised that relational contracts are about the commitment of the parties to collaborate, supported by the idea that parties will 'act with integrity and in a spirit of cooperation. The legitimate expectations which the law should protect in relationships of this kind are embodied in the normative standard of good faith.'[97] The same year, the concluding remarks of LJ Jackson in *Amey Birmingham Highways Ltd v Birmingham City Council* also characterised the contract in dispute as a relational contract but did not venture into developing this more broadly, fearing to engage in further 'contentious considerations'.[98]

The notion of the relational contract was also more recently mentioned and discussed in Australia in Commonwealth *Bank of Australia v Barker*.[99] In their joint judgment, Chief Justice French, Justice Bell and Justice Keane referred to Lord Steyn's judgment in *Johnson v Unisys Ltd*.[100] This case also provided relevant *dicta* on good faith, although this legal principle had not been argued by the parties themselves and the court did not have to decide on the application of good faith in that situation.

While good faith has been discussed in Australia, the notion of relational contracts has rarely been mentioned in Australian case law. Recently, parties have argued that the agreement at the heart of the legal dispute was a relational contract, where the contract 'involves not merely an exchange but also a relationship between the contracting parties',[101] quoting *GEC Marconi*. In *Binaray Pty Ltd v RAMS*, the designation of a franchise agreement as relational did not import any special rules of construction that would not otherwise apply.[102] There are also other topical illustrations of the use of relational contracting. The notion of relational contracting is also surfacing in defence contracts, although the data on this phenomenon is limited.[103] Beyond the notion of the relational contract itself, Australian courts

95 *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB) [174]–[176].
96 [2018] EWCH 333 (Comm).
97 Ibid [167].
98 [2018] EWCA Civ 264 [92].
99 *Commonwealth Bank of Australia v Barker* [2014] HCA 32.
100 Ibid [17].
101 *Centreplex Pty Ltd v Noahs Rosehill Waters Pty Ltd* [2019] WASC 252 [102].
102 *Binaray Pty Ltd (ACN 119 724 211) as Trustee for the Allen Family Trust v RAMS Financial Group Pty Limited* (ACN 105 207 538) [2019] QSC 33 [92].
103 Bruce McLennan, 'How Australia's Department of Defence harnessed the power of the relationship' (16 August 2018) Contracting Excellence Journal; Kate Vitasek, 'Relational contracting on the rise with the success of the Australian navy' (*Forbes*, 30 November 2016).

have enforced parties' duty to cooperate,[104] and the duty not to exercise a discretionary contractual right arbitrarily,[105] capriciously or for an external purpose.[106] Most of the disputes have related to performance and termination, two aspects of the life of the contract that are interlinked.[107] Beyond this, some Australian courts have enforced a duty on parties to act in good faith,[108] although the duty can still be excluded through contract drafting.[109] Meanwhile in the UK, the Supreme Court decision in *Bates v Post Office* explicitly brought good faith and relational contract together. The confident decision by Fraser J merits closer attention.

Bates or the explicit linking of good faith and relational contracting

Facts, context and relationship

Bates v Post Office dealt with 550 claimants, including Bates, who were responsible for running Post Office branches. Most of the claimants were sub-postmasters, but some were also employees. The difference matters as each group had different contractual terms. The March 2019 decision focuses on the former group. The years 1999 and 2000 saw the rollout of a new electronic point of sale and accounting system using software called Horizon. The Post Office made it mandatory for the claimants to use the system.[110] There was, however, an issue with the way the system operated. The claimants argued that the new system contained many coding errors, leading to discrepancies in branches' accounting and ultimately shortfalls, first of hundreds of pounds and then of thousands within months.[111] Some claimants went broke, some were locked out of their Post Offices, and some contracts were terminated abruptly. The claimants claimed the Post Office's

104 *Butt v McDonald* (1896) 7 QLJ 68.

105 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234.

106 *Garry Rogers Motors (Aust) P/L v Subaru (Aust) P/L* (1999) 21 ATPR 41-703.

107 Courtney (n 40 above).

108 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 246; *Sigiriya Capital Pty Ltd v Scanlon* [2013] NSWCA 401; *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558; *Bundanoon Sandstone Pty Ltd v Cenric Group Pty Ltd* [2019] NSWCA 87.

109 *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15; *Growthbuilt Pty Ltd v Modern Touch Marble & Granite Pty Ltd* (2021) [2021] NSWSC 290 [60]–[62].

110 There was no opt-out option, although, as Fraser J stated, it is understandable for a large company not to take a piecemeal approach: *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [7].

111 No claims were brought against ICL or Fujitsu who then owned the software.

actions were harsh and unfair.[112] There were numerous claims and cases dealing with this dispute, including damages for financial loss, personal injury, deceit, duress, unconscionable dealing, harassment and unjust enrichment as well as criminal actions all brought against the Post Office.[113] The March decision dealt with the nature of the contract and the terms it contained.

Limitation clauses and burden of proof

The first issue to be determined was whether the claimants had to pay the Post Office in cases of financial shortfalls. Fraser J made it clear this was not about determining the existence of these shortfalls. Fraser J would later find that there had been shortfalls and that these were due to a system that was not robust enough.[114] But first, since the Post Office had demanded payment and taken drastic action, the judge looked into the agreement. As with any written agreement, the first issue was to examine the express provisions in the contract itself. After re-emphasising the importance of objective interpretation, the judge determined that the contract was very detailed but that the sub-postmasters had no control over the terms and their negotiation.[115]

The *contra proferentem* rule, which holds that a term should be interpreted against the one who is arguing it, is no longer applied in the UK.[116] Fraser J considered the rule a 'historical remnant',[117] instead preferring to rely on the natural meaning of the words. He quoted Lord Neuberger MR's judgment of 2011, stating: 'the words used, commercial sense and the documentary and factual context, are and should be normally enough to determine the meaning of a contractual provision'.[118] This was then echoed in *Arnold v Britton*[119] and *Persimmon Homes Ltd v Ove Arup & Partners Ltd*[120] in which Jackson LJ determined that in commercial contracts where there is equal bargaining power the *contra proferentem* rule has a limited role. However, as Fraser J rightly pointed out, the sub-postmasters were not able to negotiate the contract. Leaning on the natural meaning of the words,[121] the court considered that, under the contract, the sub-

112 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [20].
113 Ibid [10].
114 Ibid.
115 Ibid [638].
116 Ibid [638], [653].
117 Ibid [635].
118 *K/S Victoria Street v House of Frazer (Stores Management) Ltd* [2011] EWCA Civ 904 [63].
119 [2015] UKSC 36.
120 [2017] EWCA 373.
121 *Bates v Post Office Ltd* (No 3) [2019] EWHC 606 (QB) [646].

postmasters would only be liable financially if the loss was due to their own negligence, carelessness or error and the Post Office had to prove that the loss fell in that category.[122] The newer contract contained a much broader limitation clause according to which the sub-postmasters would be liable for any loss unless it was due to criminal acts the sub-postmasters could not have prevented.[123] However, the Post Office did not demonstrate an actual and real loss, meaning a loss and resulting shortfall – only a loss according to Horizon data.[124] Furthermore, the Post Office did not satisfy the reasonableness test under the Unfair Contract Terms Act 1977 (UK).[125]

Recognising the contract as a relational agreement

The question of whether the contracts in the dispute were relational contracts was one of the most important issues of the litigation and judgment.[126] Would such a determination lead to the implication of particular terms in the contract? Would these include the 21 different terms laid out by the claimants before the court?[127] To what contractual powers, discretions and/or functions do such terms apply? For Fraser J, taking a contextual approach was key to deciding the case.

The claimants claimed that:

> The [sub-postmaster] contracts were replete with power and discretion in the hands of the Defendant. In all the circumstances, they included an implied term of trust and confidence and/or were relational contracts imposing obligations of good faith on the Defendant (including duties of fair dealing and transparency, trust and confidence and co-operation). There were also implied terms, including obligations on the Defendant: not to act in an arbitrary, irrational or capricious manner in decision making affecting the Claimants; to provide adequate training and support to the Claimants (particularly if and when it imposed new working practices or systems or required the provision of new services); properly to execute all transactions which the Claimants effected; properly to account for, record and explain all transactions and any alleged shortfalls which were attributed to the Claimants; and properly and fairly to investigate any such alleged shortfalls.[128]

The parties agreed to the implication of two implied terms.[129] The first implied term required each party not to take any step to inhibit or prevent the other party from complying with its obligations under

122 Ibid.
123 Ibid [682].
124 Ibid [687].
125 Ibid [1108]–[1110].
126 Ibid [31].
127 Ibid [45].
128 Ibid [326].
129 Ibid [698].

or by virtue of the contract. The second term required each party to provide the other with such reasonable cooperation as necessary to the performance of the other's obligations under or by virtue of the contract. These are non-contentious provisions that are already part of contract law in the UK.[130]

The issue was that the claimant then asked for another 21 terms. The Post Office considered that these were too many to be implied. The judge made sure not to take into consideration hindsight when determining whether the terms would be implied.[131] The court focused on business efficacy and

> what notional reasonable people, in the position of the parties at the time at which they had been contracting, would have agreed and that it was a necessary but not sufficient condition for implying a term that it appeared fair or that the court considered that the parties would have agreed it if it had been suggested to them.[132]

This is in line with the decision in *Marks and Spencer plc v BNP Paribas*.[133] The judge ultimately recognised 17 terms that were implied into the agreement. However, to reach this conclusion, the judge first considered the nature of the contract, namely its relational characteristic, as the implications of these terms depended on it.

The Post Office argued there was no such type of contract. It relied upon *Chitty on Contract* to justify its position and restrict good faith to honesty. But Fraser J disagreed and considered that good faith was more than honesty. He used the judgment of Dove J in *D&G Cars Ltd v Essex Police Authority* and referred to integrity and the need to maintain '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'.[134] After acknowledging the persuasive effect of academic learning in the common law,[135] the judge disagreed[136] with Chitty's position that 'the implication of such an implied term applicable generally (or even widely) to commercial contracts would undermine to an unjustified extent English law's general position rejecting a general legal requirement of good faith'.[137] The judge used case law to support this determination.[138]

130 *Mackay v Dick* (1881) 6 App Cas 251; *Stirling v Maitland* [1864] 122 ER 1043.
131 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [745].
132 Ibid [694].
133 [2015] UKSC 72.
134 *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB) (Dove J) [175].
135 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [709].
136 Ibid [710]–[711].
137 Ibid [708].
138 Ibid [712]–[721].

Fraser J first acknowledged that the lack of equal standing of the parties is not what makes a relational contract, before using *Yam Seng* as a springboard to lay out a set of criteria to determine what makes a contract relational.[139]

> 1. There must be no specific express terms in the contract that prevents a duty of good faith being implied into the contract.
>
> 2. The contract will be a long-term one, with the mutual intention of the parties being that there will be a long-term relationship.
>
> 3. The parties must intend that their respective roles be performed with integrity, and with fidelity to their bargain.
>
> 4. The parties will be committed to collaborating with one another in the performance of the contract.
>
> 5. The spirits and objectives of their venture may not be capable of being expressed exhaustively in a written contract.
>
> 6. They will each repose trust and confidence in one another, but of a different kind to that involved in fiduciary relationships.
>
> 7. The contract in question will involve a high degree of communication, co-operation and predictable performance based on mutual trust and confidence, and expectations of loyalty.
>
> 8. There may be a degree of significant investment by one party (or both) in the venture. This significant investment may be, in some cases, more accurately described as substantial financial commitment.
>
> 9. Exclusivity of the relationship may also be present.[140]

Fraser J stated that the list was not definitive and that no criterion was determinative except for the one that there should not be an express provision to prevent the duty of good faith being implied.[141] By considering more than the written agreement between the parties, Fraser J adopted a position akin to the contextualists who base their theory on the fact that there is more than just an agreement between the parties.[142] The judgment also shows that a contractual situation is made up of a written agreement as well as some implicit understandings. These understandings need to be considered to ensure that the intentions of the parties, and their reasons for entering the relationship, are clearly reflected. According to Macaulay, the concept

139 Ibid [722].
140 Ibid [725].
141 Ibid [726].
142 See eg Campbell et al (eds) (n 34 above).

of the relational contract can be used in different situations: either as a way to encourage settlement between parties and to interpret indeterminate legal principles; or to reduce the costs associated with a long-term relationship due to the lack of foreseeability associated with it.[143] *Bates* illustrates the latter point as the sub-postmasters could not have foreseen the discrepancies that resulted from the rollout of the Horizon software.

Furthermore, the relationship between the parties was more than 'purely commercial' because the Post Office is required by the government to maintain a broad network of branches across the country, even in locations that are not viable. The role of the Post Office as a public service to the community at large was therefore taken into consideration, and justifiably so. The notion of trust between the Post Office and the sub-postmasters is essential and this was submitted by both parties.[144] Trust was also seen as paramount in the Post Office-related activities carried out by the sub-postmasters and members of the public wishing to use that Post Office branch. Not only did the benefits provided under the sub-postmasters' contracts have similarities with an employment relationship,[145] including the entitlement to holiday substitution allowance, but it required from the sub-postmasters a major degree of investment and significant personal financial commitment to running that branch,[146] with the Post Office conducting thorough checks on the applicants before they became sub-postmasters. A relational contract does not need an imbalance in power between the parties, although there clearly was one in this instance.[147] Other non-essential features of the relationship that were taken into consideration included the residential accommodation in which the sub-postmasters themselves (and potentially other family

143 See Stewart Macaulay, 'The real and the paper deal' in Campbell et al (eds) (n 34 above) 83.

144 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [728]. In the UK, trust and confidence are implied as a matter of law in employment contracts, see *Malik and Mahmud v Bank of Credit and Commerce International SA* [1997] UKHL 23. This has been rejected in *Australia in Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169.

145 As noted at n 144 above, the notions of trust and confidence are implied as a matter of law in all employment contracts.

146 'The Post Office knew not only of the size of this investment, but the source of an incoming SPM's funds, as these were included in the business plans submitted by the SPMs. If the source of funds was not identified, this information would be sought by the Post Office.' *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [728].

147 Ibid [724].

members) lived,[148] and the fact that the Post Office shares features with a public body.[149]

Bates is an important decision because it further acknowledges the notion of relational contract as an important part of contract law and not, as Collins suggested, a 'passing fad'.[150] Furthermore, and despite being a case of first instance, it is the first judicial decision that provides a list of clear criteria for a relational contract in law. By considering the duration and the context of the contractual relationship, decisions such as *Yam Seng* and *Bates* add a new dimension to contract law doctrine. It is not the type of party that matters, such as tenant–landlord, consumer–business, employer–employee,[151] but the relationship itself.

For Fraser J, the formula to determine whether a contract is relational consists of three elements: one must take into consideration the relations between the parties, the terms of the contract and the context of the transaction. This will determine whether the contract is a relational one.[152] Ultimately, the judgment provides some guidance on the notion of the relational contract, but also blurs the boundaries by stating that the list of criteria is not exhaustive and that just because the contract is long term or, for instance, a franchise does not mean it is in fact relational. This leaves many pondering the broader implications if any for contract law. One clear implication of a contract being deemed relational is that it is likely that a duty to perform in good faith will be implied in law into the agreement.

Implying good faith

Bates illustrates that doctrines such as cooperation and good faith are included in the implicit dimensions of contracts.[153] The court found that the contract did not contain terms that excluded good faith. Since the contract was held to be relational in nature, the terms included an implied obligation of good faith.

Fraser J determined that there

> is a specie of contracts, which are most usefully termed 'relational contracts', in which there is implied an obligation of good faith (which is also termed 'fair dealing' in some of the cases). This means that the parties must refrain from conduct which in the relevant context would be regarded as commercially unacceptable by reasonable and honest

148 Ibid [729].
149 Ibid [730].
150 Ibid [736] with a reference to Collins (n 90 above) 38.
151 Gabrielle Golding, 'Employment as a relational contract and the impact on remedies for breach' (2021) 30(2) Griffith Law Review 270.
152 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [721].
153 Macaulay (n 143 above) 52.

> people. An implied duty of good faith does not mean solely that the parties must be honest, but also '[t]ransparency, co-operation, and trust and confidence'.[154]

Once the contracts formed between the Post Office and sub-postmasters were designated as relational contracts, then there was an implied duty of good faith in the agreements. That implied duty of good faith applies to both parties to the contract.[155] In this instance, however, it was the conduct of the Post Office that was found to breach good faith.

> The Post Office is not therefore entitled to rely upon the Branch Trading Statements, for any period in respect of which a SPM notified a dispute to the Helpline, as a settled account between agent and principal. … Nor do SPMs bear the burden of demonstrating that the Branch Trading Statement is wrong for such a period.[156]

There is no restriction upon the Post Office in terms of how this discretion can be exercised, other than that the discretion available to the Post Office should be exercised for a proper purpose and in accordance with the implied duty of good faith. The fact that the case extensively deals with the implied duty to act in good faith further advances the reform of contract law, even though its recognition is not (yet?) a *fait accompli*. While the concept of good faith is controversial, the notion that a party to the contract should behave decently when performing its contractual obligations is less of a burning issue. But, if good faith means more than cooperation, and cooperation is one of the only parts of good faith to be enforced before the courts, why would parties act in good faith? The need for consequences is driving the slowness of the recognition of good faith in some long-term contracts. This hesitancy is further demonstrated by more recent decisions.

Post *Bates*: the reluctance on the qualification of relational contracts remains

On 12 November 2019, Lord Coulson rejected the appeal from the Post Office on the grounds there was little realistic prospect of success. He highlighted the conduct of the Post Office during the trial and agreed with Justice Fraser that the contract was relational and that a duty of good faith was applicable, after analysing the context of the relationship between the Post Office and the sub-postmasters.[157] On 11 December 2019, the Post Office and the claimants released a joint statement terminating the litigation after the parties agreed to

154 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [711].
155 Ibid [1113].
156 Ibid [1116].
157 *Bates v Post Office* (Judgment on PTA, 22 November 2019, A1/2019/1387/PTA) (Coulson LJ).

resolve the dispute through mediation.[158] A few days later, the court released its judgment on the Horizon issues.[159] It decided that there had been bugs in the system.[160] Changes to the system since 2010,[161] the settlement out of court and the fact that the sub-postmasters were cleared of corrupting data in early 2021 show that the case is now closed. But will the March decision make an impact on the further development of the relational contract in UK contract law? Recent cases show that identifying a contract as relational is still a difficult process, and courts are hesitant to fully engage with it. This issue has already been pointed out in discussions of relational contracts. Indeed, it seems that relational contract theory also places a high reliance upon judicial capacity to evaluate and interpret norms,[162] despite their possible lack of expertise in particular commercial circumstances.[163] The difficulty is also exemplified by Fraser J's statement that, while the list of criteria was useful, it was not necessarily exhaustive.

These criticisms were tested when the High Court had to decide on relational contracts one year later. The test laid out in *Bates* was referred to and applied in *Cathay Pacific*,[164] but the court determined that a long-term aircraft engine agreement was not a relational contract because the spirit and objective of the venture had been clearly expressed in the contract and the parties did not rely on trust and confidence. The relationship was nothing more than a good working relationship, and the parties did not trust each other 'beyond what would normally expect in any commercial relationship'.[165] While the flexibility and adaptability of the notion of the relational contract have been brought forward against its development as a legal concept, the UK High Court showed that the test laid out in *Bates* could be articulated and applied to the facts before the court. While there is no one-size-fits-all approach, as Justice Fraser, throughout his judgment, refers to not only the terms of the contract, but also the context and

158 Joint Press Statement – Resolution to the Group Litigation Proceedings (Bates v Post Office Limited) (Post Office, 11 December 2019).

159 *Bates v Post Office (No 6)* [2019] EWHC 3408 (QB).

160 Ibid [936].

161 Ibid [693].

162 Ibid 153.

163 Macaulay (n 143 above) 66, 68, referring to Robert Scott on commercial law, common law and code methodologies, cited in Jody Kraus and Steven Walt, 'The jurisprudential foundations of corporate and commercial law' (2000) 94 Northwestern University Law Review 847. See also Lisa Bernstein, 'The questionable empirical basis of article 2's incorporation strategy: a preliminary study' (1999) 66 University of Chicago Law Review 710, 730.

164 *Cathay Pacific Airways Ltd v Lufthansa Technik AG* [2020] EWHC 1789 (Ch) [206], [225]–[236].

165 Ibid [232].

the relation of the parties seeing them as the key in determining the issues before the court. This flexible approach is key as context will change depending on the parties, the agreement and the context of the contract. And, according to Justice Fraser, this goes hand in hand with the duty to act in good faith. In *Taqa Bratani Ltd v Rockrose*, Pelling J did not refer to *Bates* and only quoted *Yam Seng* before stating that the contract was relational without attempting to define it further.[166] Pelling J also questioned whether such a designation necessarily entailed that a duty of good faith is implied. In *Essex County Council v UBB Waste (Essex) Limited*, Pepperall J used *Yam Seng* as well as the *indicia* laid out in *Bates* to determine that the contract in dispute was indeed relational by emphasising the long-term relationship, the close collaborative working relationship, the trust and confidence of the parties, the high degree of communication and cooperation, the significant investment by both parties and the exclusive nature of the agreement.[167] Consequently, a duty of good faith was implied.[168] A breach of the duty was examined objectively according to what would be considered 'commercially unacceptable by reasonable and honest people'.[169] In *Skeikh Tahnoon v Kent*, Lord Justice Leggatt further confirmed the relevance of the relational contract as a bridge between fiduciary relationships and discrete commercial transactions,[170] thereby further supporting the idea that contracts exist on a spectrum. In this instance, and relying on his judgment in *Yam Seng*, Lord Justice Leggatt found that an implied duty of good faith to a joint venture agreement recognised as relational had been breached.[171]

There has been a slow and incremental recognition of relational contracts as a category of contract law and of the consequences of implying a duty of good faith. Yet the contours of both this category of contracts and the implied term of good faith (if it exists at all) remain uncertain.[172] While decisions are still trying to articulate these concepts, the discussion in each of these decisions reflects norms of trust and solidarity, further illustrating McNeil's norms of contracting. While the above discussion has focused on case law and the UK, arguably a similar development is occurring in contract law in Australia but through targeted regulation instead of judicial decisions, which for

166 *Taqa Bratani Ltd v Rockrose* UKCS8 LLC [2020] EWHC 58 (Comm) [56].
167 *Essex County Council v UBB Waste (Essex) Limited* [2020] EWCH HC 1581 (TCC) [112]
168 Ibid [113].
169 Ibid [116]. The duty was not breached in this case.
170 *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Ioannis Kent* [2018] EWHC 333 (Comm) [167]
171 Ibid [176].
172 *UTB LLC v Sheffield United Limited* [2019] EWHC 2322 (Ch) [202].

now reflect a very conservative and classical approach to contracting in Australia.[173]

ACKNOWLEDGING THE IMPLICIT DIMENSIONS OF THE CONTRACT THROUGH INDUSTRY-SPECIFIC STATUTORY REGULATION IN AUSTRALIA

A slow recognition of good faith and relational contract theory seems to be taking place when regulating and adjudicating some long-term contracts. Some commercial contracts are deeply party-centric, and the relational contract approach acknowledges the relevance of this character, at least in some transactions. The main difference between the approach in Australia and that of the UK is the source of the renewed interest in relational contract theory. Yet, the commonality remains the incremental, slow and careful approach taken. Finn classifies good faith, unconscionability and fiduciary duties as part of a 'three-tier hierarchy of protective responsibility'.[174] Acknowledging and respecting the interests of the other party are common characteristics of this hierarchy,[175] albeit the fiduciary principle requires deference to the other party's interests. But there is a spectrum from the discrete transaction to the fiduciary principle. Relational contracts are within that spectrum but do not require parties to sacrifice their self-interest. Finding the balance between self-interest and consideration of the other party is arguably the most challenging part of articulating relational contracts and good faith. Over the last 10 years, Australia has articulated this dynamic tension through targeted legislation.

Industry-specific regulation such as codes of conduct and standards have helped answer industry-specific questions and legal issues. They consider the context and special characteristics of the relationship between the parties and its implicit dimensions. This is especially relevant in some ongoing, or long-term, business relations. Franchise agreements are long-term contracts whose relational characteristics initially led to a movement to imply a duty of good faith as a matter of

173 *Workpac Pty Ltd V Rossato & Ors* [2021] HCA 23; *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1; *Zg Operations & Anor V Jamsek & Ors* [2022] HCA 2.

174 Finn (n 18 above) 142.

175 Ibid 136.

law.[176] The Franchising Code of Conduct is one of seven mandatory industry codes prescribed under the Competition and Consumer Act 2010 (Cth), section 51AE. Recognising 'the inherent and necessary imbalance of power in franchise agreements in favour of the franchisor, where abuse of this power can lead to opportunistic practice, a statutory duty to act in good faith'[177] would 'promote business integrity and ethics'.[178] Since its enactment in 2014, the Franchising Code of Conduct has included a duty on parties to act in good faith.[179] Since then, more codes of conduct have been regulated, and they also include a duty of good faith. Discussions on the recognition of a duty to act in good faith led to the reform of the mandatory Horticulture Code of Conduct[180] and the introduction of a new mandatory Dairy Code of Conduct.[181] The explicit purpose of the voluntary Food and Grocery Code of Conduct is 'to promote and support good faith in commercial dealings between retailers, wholesalers and suppliers'.[182] It imposes a duty to act in good faith at all times on the retailer and the supplier.[183] These examples further demonstrate what could be characterised as the particular need to regulate some long-term contracts, where the relationship of the parties is paramount. Each of these new industry codes also promotes good faith as an explicit enforceable obligation. These codes place the emphasis on notions of business integrity, ethics and the relationship between the parties. Good faith forms an integral part of this recognition. Each of these commercial contexts also have the potential to be considered relational, although the imbalance of power that is often found in these transactions is not in itself a criterion for a relational contract.

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176 *Garry Rogers Motors (Aust) P/L v Subaru (Aust) P/L* (1999) 21 ATPR 41-703; *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187; *Far Horizons Pty Ltd v McDonalds Australia Ltd* [2000] VSC 310; *AMC Commercial Cleaning v Coade* [2011] NSWSC 932; Bill Dixon, 'What is the content of the common law obligation of good faith in commercial franchises?' (2005) 33(3) Australian Business Law Review 207, 222.

177 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not Opportunism: Improving Conduct in Australian Franchising* (Senate Printing Unit 2008) 101.

178 Tony Piccolo MP, Economics and Finance Committee, Parliament of South Australia, quoted in ibid 107.

179 Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (Cth), cl 6; *Australian Competition and Consumer Commission v Ultra Tune Australia Pty Ltd* [2019] FCA 12.

180 Competition and Consumer (Industry Codes – Horticulture) Regulations 2017 (Cth).

181 Competition and Consumer (Industry Codes – Dairy) Regulations 2019 (Cth).

182 Competition and Consumer (Industry Codes – Food and Grocery) Regulation 2015 (Cth), s 2.

183 Ibid s 28(3).

Voluntary industry standards have also been drafted in the construction industry and a recent review of building standards has proposed a new explicit obligation on the principal and contractor 'to act reasonably in a spirit of mutual trust and cooperation, and generally in good faith towards the other'.[184] Here again the focus is on the legitimate interests of the parties and the need to come together with the ultimate aim to complete the agreement through performance. Unfortunately, the reform of these building standards has been put on hold indefinitely because it did not represent fully stakeholders' interests.[185] In late 2020, the adversarial nature of contracting in construction contracts was advanced as one of the reasons for the state of the building industry and the need for reform to embrace cooperation and collaboration.[186] In March 2021, the NEC 4 suite of contracts, well known in the UK, was introduced in the Australian construction industry. One of its core clauses contains a duty to act with mutual trust and cooperation, which has been associated with good faith.[187]

Applying *Yam Seng* to each of the transactions and relationships discussed in this section, they could arguably be said to include a

> high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements.[188]

The elements laid out in *Bates* also point towards these contracts being relational ones.[189] They are long-term relationships. The parties intend that their respective roles will be performed with integrity and with fidelity to their bargain. The parties are likely to be committed to collaborating with one another in the performance of the contract. There are implicit dimensions to their venture that may not be expressed in a written agreement. Each party is likely to repose trust and confidence in the other, without subordinating their

184 Building Standard AS11000:2015 cl 2.1. See also Alexander Di Stefano, 'Good faith in the AS11000: has the eagle landed?' (2016) 33 Building and Construction Law Journal 13; Joseph Biagio Xuereb, 'Is it time for an express term of good faith in Australian construction contracts' (2021) 36 Building and Construction Law Journal 229.

185 Standards Australia, Press Release (4 April 2017).

186 David Mosey, C*ollaborative Construction Procurement and Improved Value* (Wiley Blackwell 2019); Jennifer Clarkson, 'Covid-19 and construction law: comparing the UK and Australian response' (2021) International Construction Law Review 5.

187 *Mid Essex Hospital Services NHS Trust v Compass Group UK & Ireland Ltd (trading as Medirest)* [2013] EWCA Civ 200.

188 *Yam Seng PTE v International Trade Corp Ltd* [2013] EWHC 111 (QB) [142].

189 *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB) [725].

self-interest to the interests of the other party. These examples are likely to involve a high degree of communication, cooperation and predictable performance, based on mutual trust and confidence and expectations of loyalty. In most of these examples, there will be a degree of significant investment by one party and possibly exclusivity. Finally, not only is good faith not excluded, but through these codes of conduct it is expressly mandated. These examples demonstrate an incremental approach that is challenging classical contract theory in some well-defined situations. However, this piecemeal approach does not in itself justify changing Australian contract law principles.

CONCLUSION

With a renewed interest in the concept of the relational contract and the call for further empirical research,[190] Macneil's concept of the relational contract does have implications not only for contractual practice and management, but also for contract law itself. The parties to some long-term agreements and the written terms of the contract are surrounded by other forces that guide their relationship and their behaviour when performing their obligations. Taking the context and these forces into account leads to the recognition of the implicit dimensions of a contract. In spite of the classical hegemony of party autonomy in regulating their contractual terms, the need for fairness and justice in contract law has crossed over boundaries. The liberalist view, predominant in contract law, led to the classical theory of contract law and is exemplified by notions such as business efficacy, efficiency, freedom to contract and autonomy of the parties. Yet, morals have crept into the application of the law to soften its contours.

While the classic English contract law might have been the epitome of liberalism, current judicial developments demonstrate a change in the rationale for regulating contract law. A new species of contract is making an appearance, namely the relational contract. This notion, that was once relegated to academic debate, is now argued before the courts, and judges are actively using it as a lens to determine whether parties have breached their contractual obligations. The rationale for this movement can be found in the idea, summarised by Shand, that '[a] man must stick to his bargain, for otherwise social relations would not be possible'.[191] Parties who join in a contract must stick to the promises they have made. They have a duty to be faithful to the bargain.[192] It is reasonable for one party to the contract to expect

190 Cimino (n 80 above).

191 John Shand, 'Unblinkering the unruly horse: public policy in the law of contract' (1972) 30(1) Cambridge Law Journal 144, 147.

192 Finn (n 18 above) 148.

that the other party who entered the contract is willing to perform its obligation. Reasonable expectations go further in that they provide certain limits to the exercise of discretionary powers within the contract. Furthermore, a duty to act in good faith seems to be implied into some long-term transactions. The recent English case of *Bates* could have broad implications for contract law in that jurisdiction but also beyond. It does represent one of the stepping-stones to a doctrinal impact of the notion in contract law. Albeit in different ways, both the UK and Australia have had to regulate aspects of contract law to promote fairness in contractual dealings. While the approach in Australia has been more piecemeal and statutory, a bird's-eye view of the codes of conduct shows that the impetus to develop regulation that specifically targets some long-term contracts is growing.

What does this mean for the legal professional of today? Commercial contracts must be drafted more carefully, and lawyers must be aware, and possibly wary, of the consequence of a contract being considered relational by the courts: namely the impact on the interpretation and the difficulty of relying exclusively on the terms of the agreement. The context of the agreement and the relationship between the parties will matter, although to what extent is still an open question.