Rethinking Long-Term Contracts

The architecture of aligned relationships

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Contracts are the trellis on which the vine of civil and commercial society grows. They form the essential architecture of connections between organisations and people. The sum-total of the expression of obligations and exchange captures a considerable portion of human endeavour and the vast bulk of the measured size of the economy.

By extension, the lawyer's role in drafting contracts ought not be underestimated. This is true when we zoom in and understand the lawyer's role as co-creating the frameworks that support right relations between the parties, and when we zoom out and consider the impact of the profession on society as a whole.

This article:

1. proposes that lawyers serve their clients most effectively when they seek clear instructions on the values and governing principles that are intended to underpin long-term relationships and make them explicit in the instrument
2. identifies the professional and ethical obligations that shape this responsibility and
3. provides practical steps lawyers can take to assist their clients to remain aligned during performance of long-term relationships.

No relationship is values-neutral

'Our natural tendency is to project onto other people our own belief and value systems, in ways in which we are not even aware.'[2]

When drafting long-term commercial agreements, solicitors may imagine themselves documenting their clients' arrangements in a purely rational and value neutral way. In this narrow respect, lawyers underestimate their own contribution. The meeting of minds which a contract represents cannot sensibly conclude without assessing the commonality (or divergence) of the parties' beliefs, values and guiding principles.

The standard approach to construing commercial contracts was recently reiterated by the WA Court of Appeal:

"Because a question of construction is one of law, there is only one true construction, and the task of [the] court … on a question of construction is to determine for itself the proper construction of the instrument."[3]

"Absent a contrary intention, the court approaches [commercial] contracts on the basis that the parties intended to produce a result which makes commercial sense. … However, it must also be borne in mind that business common sense may be a topic on which minds may differ."[4]

The range of possible interpretations of business common sense is multiplying in an increasingly multi-cultural society with diverse moral codes and values. The task is made much more difficult if the instrument is silent on the shared values intended to govern the performance of the contract.

"Business is personal, it's the most personal thing in the world"[5]

A common assumption that underpins commercial contract is that both parties will be driven consistently by self-interest and wish to maximise their freedom to act to advance that interest. Lawyers may assume their duty is to preserve that capacity for their clients. That assumption is informed by very specific values and may be misplaced, particularly in long-term relationships. Testing the assumption makes sense for reasons including:

- Organisations are increasingly prioritising the expression of their purpose and values consistently throughout their operations. This includes their procurement practices, stakeholder engagement and even conflict resolution strategies. Lawyers are expected to reflect the organisation's purpose and values in the advice they provide and the contractual models they propose.[6]
- Many organisations are strengthening their collaborative mechanisms. The pace of change and complexity of the challenges clients face fundamentally alters the nature of relational frameworks that serve their best interests.[7] Clients form alliances to activate their strategic priorities and expect frameworks that promote trust and facilitate faster feed-back loops for more agile learning and self-organising change.[8]
- There is growing awareness of the costs of conflict. Assertion of contractual rights in a way that feels unfair will commonly prompt reciprocal behaviours and shading[9] that escalate tensions. The transaction costs associated with leveraging ambiguity and changed external factors to the benefit of one and the detriment of the other are considerable.[10]

Solicitors have access to the subjective intentions of their clients. This generates a responsibility to explore and reflect those

intentions when choosing contractual mechanisms to frame the relationship. That extends to identifying preferred values to govern the agreement from among the available options that motivate different commercial people.

Failure to test alignment between the parties on their values and guiding principles has predictable consequences:

- assuming each party wishes to maximise the freedom to act in their immediate self-interest misses the opportunity to introduce agreed flexible mechanisms to accommodate unanticipated change grounded in shared project objectives and values;
- there may well be a mismatch of intentions between the parties that undermines project outcomes, generates friction and reduces trust. This readily escalates to blame-shifting and combative conflict; and
- if the court is called on to resolve that conflict, it will apply its own version of business common sense which may or may not reflect the intent of one or more of the parties. Litigation is often characterised by considerable expense, uncertainty and emotion and often irreversibly alters the nature of the relationship between the parties from collaborators to combatants. It narrows the range of available resolution options and ordinarily results in relatively binary outcomes. Only in rare cases will the long-term objectives of the original bargain survive litigation.

Many will recall the fallout between France and Australia following the 2021 decision by the Morrison Government to cancel the French submarine contract in favour of AUKUS. The expectation of the French (though perhaps not the Australians) was illustrated by then French ambassador to Australia:

*"It was really a true relation of **partnership**, a true relation of **confidence**, of **trust** between two major countries in the Indo-Pacific."*[11]

Expectation gaps ought to be addressed prior to execution, not during performance. It is neither necessary, nor perhaps even an effective discharge of a lawyer's obligations to his or her client, to assume that transactional contract architecture will suffice when framing a long-term commercial arrangement.

Common law is forged in the fire of burning relationships

Courts adjudicate conflict between contracting parties who have been unable to cultivate their relationship to withstand the pressures of real life. It represents a decision to transfer control from the parties and their advisers to the judicial arm of the state. A court seeking to construe a contract has none of the advantages that a solicitor has at the front-end. The court must *infer* the intent of the parties:

- after the event
- in an essentially adversarial context
- based on its understanding of "business common sense", notwithstanding that "minds may differ" on what this norm requires.

To accommodate these limitations, courts have developed a range of mechanisms to hold society's evolving values in tension when construing private arrangements. These include:

- Defining special categories of fiduciary relationship where, notwithstanding the explicit contractual terms agreed by the parties, obligations are imposed to reflect social norms of what is just in circumstances of vulnerability and dependence;
- Identifying commercial relationships where a duty of good faith is implied. In the 30 years since *Renard Constructions (ME) Pty Ltd v Minister for Public Works*[12] (a term of good faith ought to be implied if it is *'necessary to give business efficacy to the contract'*)[13], Australian courts are still not settled on when such obligations will be implied or precisely what they require. Perhaps the clearest we have seen is that the obligation of good faith requires the parties to:
  - act honestly;
  - act with fidelity to the bargain;
  - not to act dishonestly and not to act to undermine the bargain;
  - act reasonably and with fair dealing; and
  - have regard to the interests of the other party.[14]
- English courts have recently recognised a category of 'relational contract',[15] being an agreement which involves a longer-term relationship between the parties requiring trust and confidence and in which the parties make a substantial commitment.[16] In such relationships, the parties are subject to implied duties of good faith, fair dealing, transparency, co-operation and trust and confidence.

The judiciary must necessarily balance the universal and the particular in ways that parties need not when crafting their agreements.

Professional ethics in action

Lawyers' professional and ethical obligations promote proactive engagement on how parties' values underpin their relational architecture.

The primary ethical obligation in WA is expressed as follows:

"A solicitor's duty to the court and the administration of justice is paramount and prevails to the extent of inconsistency with any other duty."[17]

"Justice" is not defined in the Conduct Rules but is a word that has activated philosophers throughout history. A particularly helpful contribution is grounded in Plato's recognition that justice is essentially relational. In Plato's Greece, the word for justice *'dikaisyne'* was closely related to morality or righteousness. This view of justice has been described as *"right relationship"*[18], or *"creating a generative tension and balance between autonomy and relationality"*[19]. It is a potent idea for solicitors charged with creating the governing architecture of commercial relationships.

Other relevant ethical duties include those in rules 4.1, 7.1 and 8.1. Taken together, they promote testing and embedding the relational principles clients wish to underpin their agreements. The obligations to *"act in the best interests of a client"*, to *"deliver legal services ...diligently"* and *"to assist a client to understand relevant legal issues and to make informed choices"* comfortably incorporates the obligation to advise clients how different relational dynamics created by contractual choices are likely to play out in their business.

Inking the deal – final thoughts

Long-term relationships are notoriously challenging because of the intended duration of interdependence. A common temptation for lawyers is to draft ever-longer and more complicated documents. This is logical if the task is understood as anticipating the full range of theoretical risks and attaching contractual consequences to each to maintain a static risk and value allocation. The folly of this approach is revealed on the occurrence of the first unanticipated external shift.

The uncomfortable reality is that all contracts are somewhat incompetent to deal with the future. If the drafting assumption is that the parties will enforce their strict rights, unanticipated change

inevitably creates a perceived winner and loser which alters the relational balance.

Better options are available to offer clarity in the specific relational context.

The scope of the relationship between contracting parties extends beyond the promises contained in the contract. Real people administer them on behalf of their employers, and express both their personal and organisational values in that role. It is the behavioural outworking of those values that create the relational dynamics of trust, honesty, reciprocity and solidarity that determine the ongoing alignment of the parties.

Enshrining these governing principles in the contract assists to ensure the relational norms survive changes in personnel. It also has the benefit of relieving the perceived burden on lawyers and their clients of predicting and addressing every possible eventuality and its impact on the risk/reward framework.

The UK jurisprudence on relational contracts provides a helpful checklist for exploring clients' expectations when taking instructions. The elements of a relational contract were articulated in one of the judgments coming out of the ongoing Post Office scandal:[20]

1. The contract must be a *long-term* one, with the mutual intention of the parties being that there will be a long-term relationship.
2. The parties must intend that their respective roles be performed with *integrity and fidelity to the bargain*.
3. The parties will be committed to *collaborating* with one another in the performance of the contract.
4. The spirit and objectives of their venture may not be capable of being *expressed exhaustively* in a written contract.
5. They will each repose *trust and confidence* in one another, but of a different kind to that involved in fiduciary relationships.
6. The contract in question involves a *high degree of communication, cooperation* and predictable performance based on mutual trust and confidence and loyalty.
7. There may be a degree of *significant investment* by one party or both in the venture.
8. *Exclusivity* of the relationship may also be present.

If a number of these factors exist, the parties are likely to be well served by different relational architecture than they would be by a conventional transactional model. There is no need to debate whether terms of fair dealing, transparency, co-operation, trust and confidence need to be implied into the contract if the parties have made those expectations explicit and defined how 'reasonable' is to be understood in the specific relational context.

Solicitors need not assume that exploring shared purpose and guiding principles and implementing them into a contract demands an entirely unfamiliar framework.

"...[A] formal, well-structured relational contract includes many components of a traditional contract but also contains relationship-building elements such as a shared vision, guiding principles, and robust governance structures – designed to keep the parties' expectations and interests aligned... The contracting parties co-create a flexible contract framework purposefully designed to meet the dynamic nature of business. The driving purpose of the contract shifts from documenting the deal to guiding the parties toward continuous alignment over the life of the relationship."[21]

"The parties can mitigate misalignment by adopting interest-aligning relationship mechanisms to enhance communication, ensure clarity of expectations, and promote fairness".[22]

It is of course the privilege of the parties to compete rather than co-operate if they choose. But where they understand themselves as co-creators of a shared endeavour rather than combatants competing in a zero-sum game, it is the responsibility of their solicitors to capture that and reflect it in the architecture of the agreement. ■

EndNotes

1. Mal Cooke is a director of Neometric, an incorporated legal practice specialising in organisational clarity and relational alignment. He thanks his fellow directors for their input, and Zoe Cooke for her assistance in researching and referencing this article.
2. Robert Greene, *Mastery* (Viking Press, 2012)
3. *Chevron (Tapl) Pty Ltd v Pilbara Iron Company (Services) Pty Ltd* [2021] WASCA 193, at [126]
4. Ibid, at [127]. See also Sui v Jiang [2021] NSWSC 435 per Leeming JA (with whom Gleeson JA agreed) at [49] citing *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104 at [47]
5. Michael Scott from The Office, https://www.youtube.com/watch?v=K-zE0nSyYNI
6. See for example: Colin Mayer, *The Future of the Corporation and the Economics of Purpose*, Journal of Management Studies, (2021) 58(3); Alex Edmans, *How great companies deliver both purpose and profit*, Journal of Chinese Economic and Business Studies, (2023) 21(3); Jessica Vredenburg et al, *Brands Taking a Stand: Authentic Brand Activism or Woke Washing?*, Journal of Public Policy and Marketing, (2020) 39(4)
7. See for example: Arash Azadegan and Kevin Dooley, *A Typology of Supply Network Resilience Strategies: Complex Collaborations in a Complex World*, Journal of Supply Chain Management, (2021) 57(1); Rosabeth Moss Kanter, *Collaborative Advantage: The Art of Alliances*, Harvard Business Review (1994)
8. See for example Bo Bernhard Nielsen, *The Role of Trust in Collaborative Relationships: A Multi-Dimensional Approach, M@n@gment* (2004) 7(3).
9. "[R]etaliatory behaviour in which one party stops cooperating, ceases to be proactive, or makes countermoves." David Fridlinger et al, *Contracting in the New Economy: Using Relational Contracts to Boost Trust and Collaboration in Strategic Business Relations* (Palgrave Macmillan, 2021), 49
10. "... [L]itigation imposes significant indirect costs. It causes higher borrowing costs, wasted management time, the deterioration of business relationships and organizational stress. These indirect costs are estimated to be at least several times the direct costs." Michael Bueler et al, *World Economic Forum* (20 December 2017) www.weforum.org/agenda/2017/12/commercial-disputes-conflicts-costs-trillions-dollars-alternative-dispute-resolution/
11. https://www.sbs.com.au/news/article/recalled-french-ambassador-says-next-steps-being-considered-after-australias-breach-of-trust/2ykx6mtda
12. (1992) 26 NSWLR 234
13. Ibid per Priestley JA at [257]
14. *Paciocco v ANZ Banking Group Ltd* [2015] FCAFC 50
15. While this category has not been recognised in Australian courts, the possibility was foreshadowed 20 years ago by Finn J in which he described a relational contract as a:

    "'contract that involves not merely an exchange, but also a relationship, between the contracting parties'. I should not be taken as suggesting that special rules apply to such contracts though I will indicate, as is well accepted, that particular rules of contract law have greater or less ease of application in relational contract settings. However, I would suggest that account should be taken of such contracts as we shape and develop contract law". GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd [2003] FCA 50; 128 FCR 1; referring to Goldwasser and Ciro, *"Standards of Behaviour in Commercial Contracting"* (2002) 30 Aust Bus Law Rev 369.
16. *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111
17. *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* (NSW) s 3.1 (applied in WA)
18. Humbach, John A., *Towards a Natural Justice of Right Relationships. Human Rights in Philosophy and Practice*, Burton M. Leiser and Tom D. Campbell, eds., Ashgate Publishing, Available at SSRN: https://ssrn.com/abstract=287485 or http://dx.doi.org/10.2139/ssrn.287485
19. Tyson Yunkaporta, *Right Story Wrong Story – Adventures in Indigenous Thinking* (The Text Publishing Company, 2023), p215
20. *Bates v Post Office (No 3: Common Issues)* [2019] EWHC 606 (QB), per Fraser J.
21. David Fridlinger et al, *op. cit.* p53
22. Ibid, p132