

**GOOD FAITH PERFORMANCE IN EMPLOYMENT  
CONTRACTS: A “COMPARATIVE CONVERSATION”  
BETWEEN THE US AND ENGLAND**

**Katherine M. Apps**

The author is currently a supervisor in Law at New Hall College, University of Cambridge, UK. This paper was written whilst she was an LL.M candidate at Harvard Law School in 2004-5.

## Contents

### Abstract

### 1. Introduction

- 1.1 The common factual dilemma
- 1.2 Two questions
- 1.3 Tensions within adjudication: Atiyah and Llewellyn

### 2. Variation of handbooks: the US approach

- 2.1 No consideration required: *Govier v. North Sound Bank*
- 2.2 Consideration is required: *Demasse v. ITT Corp.*
- 2.3 Unilateral variation with reasonable notice: *Asmus v. Pacific Bell*
  - 2.3.1 Substantive fairness and good faith – a slightly different approach
  - 2.3.2 What is reasonable notice?
- 2.4 Policy arguments
- 2.5 Summary of the US arguments

### 3. Handbooks in England

- 3.1 The question of incorporation
- 3.2 The operation of the handbook provisions: background norms
- 3.3 Variation of incorporated terms
- 3.4 Other uses of the implied term of mutual trust and confidence
- 3.5 Unfair Contract Terms Act 1977
- 3.6 Summary of the English approach

### 4. Cross fertilization: the “comparative conversation”

- 4.1 How can the implied term of mutual trust and confidence have survived the test for implication of terms into the contract?
  - 4.1.1 Adding principled coherence
  - 4.1.2 The English reluctance to embrace principle
- 4.2 Where does the reasonable notice obligation come from?
  - 4.2.1 The case for explicit recognition of a doctrine of good faith variation in employment contracts
  - 4.2.2 Good faith interpretation
  - 4.2.3 Alternatives
- 4.3 If both can be explained by good faith, what does good faith mean?
  - 4.3.1 Good faith in US law
  - 4.3.2 Academic debate over good faith
  - 4.3.3 The several faces of good faith; a return to Llewellyn

### 5. Interrelations of at-will: a route through the tensions

- 5.1 Fire and rehire

- 5.1.1 The US story
- 5.1.2 The English story
- 5.2 Hortatory principles and rule application
- 5.3 The ramifications of conflict
- 5.4 The rationalisation
  - 5.4.1 The argument from “situation sense”
  - 5.4.2 The argument from autonomy
  - 5.4.3 The argument from cross fertilization

## **6. Conclusions**

### ABSTRACT:

This paper asks two questions connected by the fact that they both stem from the inherent incompleteness of employment contracts: in American law, how can the terms in employment handbooks be variable, but sometimes only within reasonable procedurally fair circumstances; and in English law, why doesn't the implied term of mutual trust and confidence in employment contracts fall foul of the strict test for implication of terms into contract? This paper finds the answer to both questions in the doctrine of good faith. An analysis of good faith as a “comparative conversation” between academic and judicial debates in the US and England against the backdrop of the tension recognized by Atiyah and Summers between the rule application and hortatory roles of the law in a common law system leads to the conclusion that the doctrine of good faith acts to legitimate reasonable expectations of contracting parties. This conclusion is linked back to Karl Llewellyn's vision of the common law as “situation sense.” It also forms the heart of the argument for common law reform of both English and US employment law to recognize explicitly the coherence creating function of good faith, and is used

to defend a rule of good faith variation against being subsumed by the at-will presumption.

## **1. Introduction**

Voltaire's *Candide* is famous for the many instances in which the main character encounters situations, which initially seem to be familiar and promising. Despite his eternal optimism, within a fairly short space of time first appearances often deceive him and catapult him once again into more calamities. All too easily can a comparative approach to contract law between common law systems suffer the same fate. The language of offer, acceptance, consideration, repudiation, implied terms and so on sound so like old friends to the common lawyer far from home. However, this familiarity can also be crushingly deceptive. Nevertheless, with a little more worldliness than *Candide*, and a carefully comparative approach, disasters can be avoided; there is a wealth of interesting lines of inquiry.

The contract law of both England<sup>1</sup> and the US share mutual roots<sup>2</sup> in the common law. Although the US began to forge its own distinctive path in developing its own style of common law, most of the tools of contractual analysis remained facially similar to those in England. These familiar-sounding doctrines are not all false friends, however, and some straight comparison can be possible.<sup>3</sup> What is particularly striking is how some of these tools have been used in very different ways to achieve substantively different results. This paper traces one such difference in the context of the evolution of the employment relationship to changed circumstances.

It is best to clarify one matter before we progress any further. Much of the discussion in the academic literature about employment market flexibility concerns the at-will presumption.<sup>4</sup> This paper will take a different course. This paper will not debate the question of whether the at-will presumption is

---

\* Harvard Law School. Many thanks to Yael Aridor Bar Ilan, Professor Christine Jolls, Professor Duncan Kennedy, Roni Mann, Professor John Manning, Professor Todd Rakoff, and Ramsi Woodcock for their help in discussing ideas for this paper; however all of the errors are entirely my own.

<sup>1</sup> For the purposes of this paper England is used to refer predominantly to the law of England and Wales. Occasional references to the interpretation of the Scottish Law of Session and Employment Tribunals in relation to the development of the implied covenant of mutual trust and confidence. However, no further mention of the Scottish law of contract will be included.

<sup>2</sup> For example Blackstone's commentaries were highly influential. *See further* Duncan Kennedy, *The Structure of Blackstone's Commentaries*, 28 Buffalo L. Rev. 205 (1979)

<sup>3</sup> Although as P.S Atiyah and Robert S. Summers note that in general "English legal system is highly 'formal' and the American highly 'substantive,'" in the area of variation of employee handbooks that distinction is turned on its head. For a very interesting study of English and American Law see P.S. Atiyah & Robert S. Summers, *Form and Substance in Anglo-American Law* (1987) [hereinafter Atiyah & Summers, *Form and Substance*].

<sup>4</sup> This is the presumption that the employment relationship may be terminated at the 'will' of either party to the contract without notice and without cause. See H.G. Wood, *A Treatise on the Law of Master and Servant* § 134, at 272 (William S. Hein & Co. 1981) (1877).

desirable,<sup>5</sup> instead, the focus will be on variation within employment relationship itself. Although many of the issues of employee handbook variation will concern variation of handbook terms relating to termination, the focus of this paper will be on the contractual mechanisms surrounding this variation, whilst the relationship is kept alive.

### **1.1 The common factual dilemma**

The tension between the twin poles of flexibility and concrete specificity in the contract will form another theme running through this paper. Both the courts and the parties are caught between the desire to ensure certainty of the specific obligations from the moment of formation, and to maintain sufficient flexibility in the relationship once created. This tension is present across all areas of contract law, especially where the contract is to last for any significant length of time, therefore it unsurprising that it is often particularly clear in the enforcement of contracts of employment. This tension manifests itself in incompleteness of the bargain.

---

<sup>5</sup> Epstein, *In Defence of Contract at Will*, 51 U. Chi. L.R. 947; Lawrence E. Blades, *Employment-at-will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 Colum L.Rev. 11414 (1967), Cornelius J. Peck, *Unjust Discharges from Employment: a Necessary Change in the Law*, 40 Ohio St. L.J. 1 (1979), Note, *Protecting At Will Employees Against Wrongful Discharge: the Duty to Terminate*, 93 Harv. L. Rev. 1816; Janice R. Bellace, *A Right of Fair Dismissal: Enforcing a Statutory Guarantee*, 16 U. Mich. J. L. Reform 207 (1983); William B.Gould IV, *The Idea of the Job as Property in Contemporary America: The Legal and Collective Bargaining Framework*, 1986 B.Y.U. L. Rev. 885; Clyde W. Summers, *Individual Protection Against Unjust Dismissal; Time for a Statute*, 62 Va. L. Rev 481 (1976); Peter Stone Partee, Note, *Reversing the Presumption of Employment At Will*, 44 Vand. L. Rev 689 (1991). Model Employment Termination Act, Nationals Conference of Commissions on Uniform State Laws (1991).

Contracts are left deliberately incomplete for various reasons. The first is that the transaction costs of bargaining for more precise provisions are often higher than the expected benefits.<sup>6</sup> Secondly, and relatedly, language will not actually permit them to be completely exhaustive. The longer the relationship is to last for, the more situations it must cover. It is not only costly but it is impossible, given the inherent limits of language for an employer to specify, *ex ante*, every conceivable duty and obligation of an employee and of every benefit which will accrue.<sup>7</sup> Also, "...as economists have long recognized, however, [such] complete contracts are vanishingly rare. In practice, contractual [language]...tends to be marred by gaps and flaws, forcing a choice between intensity and extensiveness."<sup>8</sup>

Thirdly, as Ayres and Gertner have noted, one party may sometimes have strategic reasons for leaving a provision underspecified. Where one party is more informed than the other, if they attempt to contract around a certain problem, they risk alerting the less informed party to the existence of

---

<sup>6</sup> Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L. J. 87 (1989), at 92 [hereinafter Ayres and Gertner, *Incomplete Contracts*]. "These transaction costs may include legal fees, negotiation costs, drafting and printing costs, the costs of researching the effects and probability of a contingency, and the costs to the parties and the courts of verifying whether a contingency occurred. Rational parties will weigh these costs against the benefits of contractually addressing a particular contingency. If either the magnitude or the probability of a contingency is sufficiently low, a contract may be insensitive to that contingency even if transaction costs are quite low." See also their footnote 30; O. Williamson, *The Economic Institutions of Capitalism* 70 (1985); MacNeil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 N.W.U.L. Rev. 854, 871-73 (1978); Steven Shavell, *Damage Measures for Breach of Contract*, 11 Bell. J. Econ. 466, 468 (1980)

<sup>7</sup> cf. H.L.A. Hart, *The Concept of Law* (2d ed.1994), Chapter 7; Ronald Dworkin, *Law's Empire* (1986), at 311.

<sup>8</sup> John Donahue and Joseph Nye, *Market Based Governance: Supply side, Demand side, Upside and Downside*, (2002), 9

the problem.<sup>9</sup> They propose that “the possibility of strategic incompleteness leads us to suggest that efficiency-minded lawmakers should sometimes choose penalty defaults that induce knowledgeable parties to reveal information by contracting around the default.”<sup>10</sup>

However, in employment contracts there is a fourth reason for incompleteness not always encountered in other types of contract. As Hugh Collins notes, “contracts of employment illustrate a type of contract which is incomplete by design,”<sup>11</sup> for a reason other than expected transaction costs. Even if every conceivable duty could be specified, both parties may not necessarily wish to set it “in stone” *ex ante*. Over-specificity runs the risk of ossifying the deal. This would run against the interests of employer and employee; both parties often “recognize that adjustments to their obligations have to be made to respond to changing market conditions.”<sup>12</sup> Flexibility is desired by both parties. This is not a situation of informational asymmetry alone; even if all the information which could have been known *ex ante* was complete on both sides, and transaction costs were removed, neither party would necessarily wish to set it in stone *ex ante*.

It is a common feature of long term contracts on both sides of the Atlantic that they “must often be phrased in broad, flexible terms to enable the parties to adjust their bargain to meet changed circumstances.”<sup>13</sup> In employment contracts, in order to mitigate this inherent tension between the

---

<sup>9</sup> Ayres and Gertner, *Incomplete Contracts*, *supra* note 6 at 94.

<sup>10</sup> Ayres and Gertner, *Incomplete Contracts*, *supra* note 6 at 94

<sup>11</sup> Hugh Collins, *The Law of Contract* (4d ed. 2003), at 331

<sup>12</sup> Hugh Collins, *The Law of Contract* (4d ed. 2003), at 331.

<sup>13</sup> Ewan McKendrick, *The Regulation of Long term Contracts in English Law in Good Faith and Fault in Contract Law* 305 (Beatson & Friedmann eds.,1995).

need for specificity of the obligations, and the need to retain flexibility within the bargain, employers often either retain broad contractual discretions or issue employee handbooks.<sup>14</sup> These set out company rules and policies on employee obligations, benefits, sick and pregnancy leave, dismissal process, harassment complaint mechanisms and so forth.

## 1.2 Two questions

US and English law therefore face a common dilemma in how to control variation of these employment handbooks and how to conceive of the employment relationship more generally. In both jurisdictions some handbooks terms have been held to have contractual effect. However, in order to maintain flexibility the law also regulates the degree to which such specifying documents are subject to change. Some provision for variation of the rules and policies contained within such handbooks must be provided for in order to prevent the contract pinning the parties into an inefficient deal.

This paper will be concerned with two specific questions against this background. Firstly, in England the courts' approach is highly influenced by the implied term of mutual trust and confidence. However, this term is stated in such broad terms that it appears, on first glance, not to pass the test for implication of terms into contracts used in the rest of English contract law. Also, it appears to affect the interpretation of the other terms of the contract

---

<sup>14</sup> Pauline Kim, found that in 1996 51% employees said that they had been issued handbooks before the accepted their job offer. Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105 (1997), 146.

into which it is implied to a greater degree than traditional contract scholars would expect.<sup>15</sup>

The second issue relates to the treatment of employee handbooks by some of the US states. The basis for permitting variation to these handbook provisions is in conceptual disarray with three main approaches being applied across different states. Some states do not allow any variation without additional consideration,<sup>16</sup> some permit any variation, provided actual notice is given<sup>17</sup> and some permit variation, but only with reasonable notice. This third approach, although the most attractive intuitively, currently lies on a very uncertain contractual doctrinal framework.

The search for a solution to these two questions will take the form of a “comparative conversation” between the two legal systems. This will bring together the cases, principles, academic commentary and a few statutory provisions from both sides of the Atlantic in order to tease out these difficult questions. A large amount of the difference can be accounted for in the difference between the terms implied “default rules.”<sup>18</sup> Implied terms play such a large part in employment contracts as the parties rarely specify many terms expressly, if at all. As Mark Freedland notes, “compared to that of many other types of contract, the content of personal work or employment

---

<sup>15</sup> See Andrew Phang, *Implied Terms in English Law - Some Recent Developments* [1993] J.B.L. 242 and *Johnstone v. Bloomsbury Area Health Authority* [1991] 2 W.L.R. 1362 *per* Leggatt L.J.

<sup>16</sup> *Demasse v. ITT Corp.* 984 P. 2d. 1138 (1999) [hereinafter *Demasse*].

<sup>17</sup> *Govier v. North Sound Bank*, 91 Wash. App. 493, 957 P.2d 811 (1998).

<sup>18</sup> Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, (1992) 78 Va. L.R. 821, 823-5.

contracts is to a very large extent dependent on implied terms.”<sup>19</sup> However, the cases also betray a difference in the way the other formal doctrines are applied; for example, bilateral offer and acceptance and the doctrine of consideration is applied differently to variation of the terms of employment across the states of the US as well as across the Atlantic. The ways these formal and substantive doctrines interact have important consequences for the legal presumptions used by the courts in both applying and interpreting contracts of employment.

This paper will take the doctrine of good faith as a focus for unraveling some of these dilemmas and argue that it has been underutilised by courts on both sides of the Atlantic. The coherence forming function of good faith has often been overlooked. However, in order to argue for theoretical coherence, as well as “justice” case-by-case, it will become essential to analyze the nature of “good faith” and its operation as a legal mechanism in common law adjudication.

### **1.3 Tensions within adjudication: Atiyah and Llewellyn**

Not only is there a tension inherent in the factual pattern of the employment relationship but the courts in both the US and England also face a common dilemma within the process of common law adjudication itself. This tension is recognized by Patrick Atiyah as the discord between the court’s function as an arbiter of individual disputes and its role as setting out legal principle for the settlement of future disputes, which he terms the

---

<sup>19</sup> Mark Freedland, *The Personal Employment Contract* (2003), at 119.

hortatory function.<sup>20</sup> Good faith is an abstract concept; if it is to have any utility it must both serve a useful hortatory function and the function of individual dispute settlement in the case at hand. It will be argued that part of the Court's reluctance to use this concept within the employment relationship on both sides of the Atlantic can be traced to this tension. Courts are either worried that it will be too hortatory and infect other doctrines with its overbreadth, or are skeptical of its ability to determine concrete cases.

Some of the predominant commentators on good faith have criticized the founding father of the Uniform Commercial Code, for misunderstanding the project of conceptualization, for incorporating concept of good faith,<sup>21</sup> which was insufficiently coherent.<sup>22</sup> However, it will be argued that Karl Llewellyn's methodology of deciding cases by situation sense has greater appeal than many have given it.<sup>23</sup> "Situation sense" is the method of dispute resolution

---

<sup>20</sup> P.S. Atiyah, *Pragmatism and Theory in English Law* (1987) especially at 125 [hereinafter *Pragmatism and Theory*]; P.S. Atiyah, *From Principles to Pragmatism: Changes in the Function of the Judicial Process and the Law*, 65 *Iowa L Rev* 1202 (1980), [hereinafter *Atiyah, Principles to Pragmatism*]. Also in M.A. Eisenberg, *The Nature of the Common Law* (1988) pp4-7 it is noted that the courts have two businesses, that of deciding individual disputes, and of enriching our body of legal norms. *See also* Elizabeth Peden, *Policy Concerns Behind Implication of Terms in Law*, 30 *L.Q.R.* 459 (2001). Peden noticed that the strictness of the necessity test can lead to seeming incoherence; "when the courts focus too intensely on whether a term is "necessary," rather than relying on broad principles, the results can be unfortunate."

<sup>21</sup> UCC § 1-203

<sup>22</sup> Robert S. Summers, *The General Duty of Good Faith – its Recognition and Conceptualisation* 67 *Cornell L. Rev.* 810, 825 (1982).

<sup>23</sup> *See* Karl N. Llewellyn, *Remarks on Theory of Appellate Decisions*, 3 *Vand. L. Rev.* 395, (1950) 398. A notable use of "Situation Sense" praised and utilized constructively is in Todd D. Rakoff, *The Implied Terms of Contracts: Of 'Default Rules' and 'Situation Sense,' in Good Faith and Fault in Contract Law* (Jack Beatson and David Friedmann eds., 1995) [hereinafter *Rakoff, Situation Sense*]

put forward by Llewellyn in his later work, of reasoning by “type facts in their context.”<sup>24</sup> He saw this as best captured by Levin Goldschmidt:

*“every fact pattern of common life, so far as the legal order can take it in, carried within itself its appropriate, natural rules, its right law. This is a natural law which is real, not imaginary; it is not a creature of mere reason, but rest on the solid foundation of what reason can recognize in the nature of man and of the life conditions of the time and place.”*<sup>25</sup>

However, as Todd Rakoff has convincingly argued, this passage can make situation sense sound rather too “mystical.”<sup>26</sup> In fact Llewellyn’s methodology does not fall into being mere intuitionism; it is “meant to be both a practical and creative human activity, and not mere divination.”<sup>27</sup>

This methodology captures much of the essence of the dispute settlement function of judges. In a system operating the situation sense method the judge is applying the type fact specific application of the rule. This explains why good faith can be described by Summers as excluding multifarious different facets of “bad faith” conduct.<sup>28</sup> Use of a situation sense method does not preclude the judge from recognizing general unifying principles. It should be remembered that finding the appropriate solution to

---

<sup>24</sup> Karl N. Llewellyn, *The Common Law Tradition: Deciding Appeals* (1960), at 60. and 121-154 [hereinafter Karl Llewellyn, *The Common Law Tradition*].

<sup>25</sup> Leon Goldschmidt, Preface to *Kritik des Entwurfs eines Handelsgesetzbuchs*, *Krit. Zeitschr. F.d.ges. Rechtswissenschaft*, Vol 4, No. 4. Cited in *supra* Karl N. Llewellyn, *The Common Law Tradition*, note 24 at 122

<sup>26</sup> *supra* Rakoff, *Situation Sense* note 23, at 202.

<sup>27</sup> Rakoff, *Situation Sense*, *supra* note 23 at 203

<sup>28</sup> Robert R. Summers, “Good Faith” in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 *Va.L.Rev.* 195, 201 (1968)

“type facts in their context”<sup>29</sup> is itself an important principle. It is important for the central thesis that Llewellyn’s methodology does not preclude the possibility of principles of substantive law aiding in the process, of a situation sense judgment.<sup>30</sup>

The tension between general hortatory function and tightness to the individual dispute is clearly visible in English law in relation to the implied term of mutual trust and confidence. The courts purport to be constrained by a strict test which permits the implication of terms only in very narrowly defined circumstances, which pushes the courts away from the more general into a term tailored as closely as possible to the fact pattern of the case. This deliberately down-plays any hortatory effect of an implication. The reason behind this is always cited as being the fiction that courts role is only as in filling small gaps in contracts, rather than dealing more generally at the level of default standards. In employment contracts, which are naturally incomplete, this is a fiction.

An implication of a good faith term, therefore poses large problems for the way English courts view their own role. Until they are comfortable with their hortatory role they will not be comfortable with the concept of principles. However, there is a paradox: by playing down their hortatory role, the English courts are forced into considerations of policy to decide individual cases. General assertions of the parties which go beyond the fact pattern of the case are tested against a general “floodgates” argument of “public policy.” This conception of “public policy” is often ill informed and

---

<sup>29</sup> Llewellyn, *The Common Law Tradition*, *supra* note 24.

<sup>30</sup> This is noted by P.S. Atiyah, *Pragmatism and Theory*, *supra* note 20, at 89-143

undertheorised.<sup>31</sup> This paper will argue for an approach which appeals to good faith as a principle, and not just as a policy.

One of the problems faced by courts in both the US and the UK is that broad hortatory principles often conflict. Recognition of conflict at the level of principle is not new within contract law,<sup>32</sup> however it is one which is in need of careful treatment when a solution is proposed in practice. In US law there is a potential for conflict between the hortatory effect of good faith and the hortatory effect of the at-will presumption. However in this particular situation, this can be resolved without necessarily requiring the demise of the at-will rule by separating out the content of the individual dispute settlement norm from the hortatory function of the principle. Specific applications of the good faith, or at will principles, can be used on the lowest level of abstraction as rules, without annihilating either principle. The hortatory function of the at-will presumption will be reduced by the recognition of the good faith principle in variation, where previously it had affected the rhetoric of the more pro-variation cases and dissents.<sup>33</sup> Although issues concerning variation and termination may, in some senses be similar, they are importantly different. The requirements of good faith have a stronger claim on the regulation of variation of the contract than termination as the

---

<sup>31</sup> See further section 4.1.2.

<sup>32</sup> Particularly in the US, for example, it is a common theme within the work of the American Legal Realists and Critical Legal Studies Movement. See further: F. Cohen, *The Ethical Basis of Legal Criticism*, 41 Yale L.J. 201 (1931); F. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 Colum. L. Rev. 809 (1935); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 Harv. L. Rev. 1685 (1976); Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 Yale, L.J. 997 (1985); Ronald Dworkin recognizes that conflict of principles is also a problem which his hypothetical ideal judge, Hercules, must contend with, *Law's Empire*, (1986), 177.

<sup>33</sup> E.g. the dissent of Jones V.C.J. in *Demasse*, *supra* note 16.

relationship is purported to be continuing. This separation of variation and termination can be supported by arguments from autonomy and efficiency.

Therefore, bearing all of these tensions in mind, we will start with an analysis framed from situation sense. First of all the “handbook variation” situation will be considered from the US approach, and then from the English approach. The English approach will introduce the broader issues of the conceptualization of the relationship between the parties. This will set the scene for the comparative conversation and analysis of the potential role of good faith. Once the role of good faith has been introduced the paper will consider the ramifications for this at the level of principle and rule application on the at-will presumption.

## 2. Variation of handbooks: the US approaches

Handbooks provide a crucial mechanism for employers to specify employee obligations, policies and benefits. Historically the US state courts have been hesitant to accept any contractual effect of employee handbooks, for example in *Johnson v. National Beef Packing Co.* the Kansas Supreme Court held that a handbook was “only an expression of company policy and procedures. Its terms were not bargained for by the parties and any benefits conferred by it were mere gratuities.”<sup>34</sup> However from the early 1980s the courts showed increased willingness to consider the effects of handbooks in contract or promissory estoppel.<sup>35</sup> This paper will not attempt to set out the development of the employee handbook jurisprudence as this is set out admirably in articles by Kohn and by Pratt,<sup>36</sup> but instead to sketch out by way of case example three of the predominant modern approaches. This will be followed by a consideration of the policy arguments surrounding the area.

The states are divided over the contractual basis for enforcement of terms within employee handbooks. Some states consider the handbook to

---

<sup>34</sup> 551 P.2d 779, 782 (Kansas 1976). See further Brian T. Kohn, *Contracts of Convenience: Preventing Employers from Unilaterally Modifying Promises Made in Employee Handbooks*, 24 *Cardozo L.Rev.* 799, 812 (2003)

<sup>35</sup> *Toussaint v. Blue Cross & Blue Shield of Mich.*, 292 N.W.2d 880 (Mich. 1980) (legitimate expectations analysis); *Pine River State Bank v. Mettille*, 333 N.W.2d 622, (Minn. 1983); *Woolley v. Hoffmann La Roche*, 491 A.2d 1257 (New Jersey 1985) (unilateral contract analysis), *Hammond v. N.D. State Pers. Bd.*, 345 N.W.2d 359, 361 (N.D. 1984) (promissory estoppel).

<sup>36</sup> Kohn, *supra* note 34; Richard J. Pratt, *Comment, Unilateral Modification of Employment Handbooks: Further Encroachments on the Employment At-Will Doctrine*, 139 *U. Pa. L. Rev.* 197 (1990). See also Stephen Carey Sullivan, *Comment, Unilateral Modification of Employee Handbooks: A Contractual Analysis*, 5 *Regent U. L. Rev.* 261 (1995)

constitute a unilateral contract, whereas others treat it as an independent bilateral contract. This has large implications for whether the courts consider consideration to be necessary for variation.

## 2.1 No consideration required: *Govier v. North Sound Bank*<sup>37</sup>

Ms. Govier, on the first day of her employment was given a copy of the personnel handbook. Although she had not been told at the time that her employment was for any specific length of time, the handbook provided that “a probationary period lasting the first ninety days of your new job applies to all new employees....If you reach the end of this probationary period successfully, you will have your first formal performance appraisal interview with your supervisor prior to the end of your first ninety days, and you will be considered a *permanent employee, assuming continued satisfactory performance (italics added).*” It additionally provided that once the probationary period was over “*you would not be dismissed for poor performance without first being counseled...and given an opportunity to improve your performance.*”

During Govier’s employment, the bank varied the handbook unilaterally at least eight times. The distribution of a memo to all employees was deemed to be the moment of modification.

In 1993 the Bank’s presented new agreements to Govier and her loan originator colleagues and told them that they must sign the contracts by 17<sup>th</sup> December or be terminated. The new terms were less favorable in that they

---

<sup>37</sup> 91 Wash. App. 493, 957 P.2d 811 (1998) [hereinafter *Govier*]

eliminated sick leave, holiday and vacation pay and allowed either party to terminate on 20 days notice.

Seinfeld J for the court held that “an employer may unilaterally amend or revoke policies and procedures established in an employee handbook” regardless of whether this power is reserved expressly.”<sup>38</sup> The court held that bilateral contract analysis was not appropriate as the bank had, without her consent, varied the handbook at least eight times. Seinfeld J held that “the law should not tie employers to anachronistic policies in perpetuity merely because they failed to expressly reserve at the outset the right to make policy changes.”<sup>39</sup> The court held that the only requirement was that the employer must notify the employee of the change.

This approach has drastic results for Ms. Govier as, by refusing to accept the new terms, she is caught ‘between a rock and a hard place.’ She can neither rely on her previous contractual terms, as they had been validly unilaterally varied, nor may she rely on the new terms as she had refused to sign the new agreements.<sup>40</sup> In effect, her contract therefore practically “evaporates.”

## 2.2 Consideration is required: *Demasse v. ITT Corp.*<sup>41</sup>

---

<sup>38</sup> *Id.* at 816

<sup>39</sup> *Id.* at 816

<sup>40</sup> Govier, *supra* note 37, at 817

<sup>41</sup> *supra* note 16. Arizona law applied by the US Court of appeals for the 9<sup>th</sup> circuit on diversity jurisdiction. Similar cases in other jurisdictions include *Torosayan v. Boehringer Ingleheim Pharm.* (1995) 234 Conn. 1, 662 A.2d 89; *Brodie v. General Chemical Corp* (Wyo, 1997) 934 P.2d 1263, 1268; *Robinson v. Ada S. McKinley Community Services* (7<sup>th</sup> Cir 1994) 19 F.3d 359, 364)

This case involved a change to the mechanism of deciding which employees would be dismissed in the situation of a need for collective redundancy. The employment handbooks originally provided that layoffs would be carried out in reverse order of seniority (commonly referred to as “last in, first out,” or “LIFO” in English cases). It expressly provided that “ITT Cannon reserves the right to amend, modify or cancel this handbook as well as any or all of the various policies, rules, procedures and programs outlined in it.” In 1993 ITT changed its layoff guidelines such that layoffs would not be performed under LIFO, but on each employee’s “abilities and documentation of performance.”<sup>42</sup> All of the plaintiffs were laid off before less senior employees and attempted to rely on their pre 1989 contract provisions.

Feldman J held, under Arizona law, that “when employment circumstances offer a term of job security to an employee who might otherwise be dischargeable at will and the employee acts in response to that promise, the employment relationship is no longer at will but is instead governed by the terms of the contract.”<sup>43</sup> In a unilateral contract, once the offer is accepted by performance, the terms cannot be changed. The court held that as there is no difference in law between express and implied contracts, an implied contract cannot be varied without offer, acceptance and consideration<sup>44</sup>. Crucially, in addition, the court added that “continued

---

<sup>42</sup> *Demasse, supra* note 16, para. 7.

<sup>43</sup> *Id.* para. 14. The court considers that a handbook is typically made up from promissory and non promissory terms. See *Sodelun v. Public Service co 944 P.2d616, 621 (Colo.App.1997)*. The court cites *Pratt, supra* note 34.

<sup>44</sup> *Demasse, supra* note 16, para. 19

employment after issuance of a new handbook does not constitute acceptance.”<sup>45</sup>

In defiant strain Feldman J took the opposite policy approach to that taken in *Govier*. He recognized that “if a contractual job security provision can be eliminated by unilateral modification, an employer can essentially terminate the employee at any time, thus abrogating any protection provided the employee. For example, an employer could terminate an employee who has a job security provision simply by saying, “I revoke that term and, as of today, you’re dismissed.”<sup>46</sup>

Jones, VCJ, concurring in part and dissenting in part, argued that it was necessary, as a matter of employment law, that “once an employer takes action, for whatever reasons, an employee must either accept those changes, quit, or be discharged. Because the employer retains this control over the employment relationship, unilateral acts of the employer are binding on its employees and both parties should understand this rule.”<sup>47</sup>

In reply to Justice Jones’ dissent, the court argued, “to those who believe our conclusion will destroy an employer’s ability to update and modernize its handbook, we can only reply that the great majority of handbook terms are certainly non-contractual and can be revised...permission to modify can always be obtained by mutual agreement and for consideration.”

---

<sup>45</sup> *Id.* para. 23, citing 1 s. Williston, A Treatise on the Law of Contracts § 91 (W. Jaeger 3d ed. 1957)

<sup>46</sup> *Demasse, supra* note 16, para. 28.

<sup>47</sup> *Id.* para 58

### 2.3 Unilateral variation with reasonable notice: *Asmus v. Pacific Bell*<sup>48</sup>

The benefit at issue in *Asmus* was a “Management Employment Security Policy” (MESP), which Pacific Bell had previously offered management level employees. This provided that, “it will be Pacific Bell’s policy to offer all management employees who continue to meet our changing business expectations employment security through reassignment to and retraining for other management positions, even if their present jobs are eliminated. This policy will be maintained so long as there is no change that will materially affect Pacific Bell’s business plan achievement.” In 1990 Pacific Bell notified its employees that it might need to discontinue the MESP “given the reality of the marketplace, changing demographics of the workforce and the continued need for cost reduction.” In October 1991 Pacific Bell notified its employees that it would discontinue the policy as of 1<sup>st</sup> April 1992.

The court held that for unilateral contract that “once the promisor determines after a reasonable time that it will terminate or modify the contract, and provides employees with reasonable notice of the change, additional consideration is not required.” Approving Justice Jones’ dissent in *Demasse* they held that “the mutuality of obligation principle requiring new consideration for contract termination applied to bilateral contracts only.” They also held that a rule holding that continued performance of employment did constitute consideration and to hold otherwise “would contradict the general principle that the law will not concern itself with the adequacy of consideration.”

---

<sup>48</sup> 96 Cal.Rptr 2d 179

George CJ dissented, arguing that the majority had misinterpreted ordinary contract law, as had the majority in *Demasse*. He also argued that the economic incentives of the majority's holding "condones and encouraged manipulative, oppressive and unfair treatment of employees" as it permits an employer to rescind a promise "simply because the promise later becomes inconvenient or financially disadvantageous to the employer during an economic downturn, a time when the employee would most expect to be able to rely upon and benefit from the employer's promise."<sup>49</sup> Such contractual promises, he asserts, if they could be altered so easily "would only be as good as the employer's desire to keep the promise at some unspecified point in the future." He sees the key as being the employer's ability to contract out of the obligation *ex ante* with regard to new employees.

Although George CJ in *Asmus* argues that, if the employer is concerned about flexibility of handbooks, she should expressly forbear from incurring obligations in the first place, this is not necessarily desirable for either party. As discussed in the first chapter, there is always a tension between the needs of specificity and flexibility; to dismiss this tension in this offhand manner is not likely to lead to coherence. The law should not be encouraging employers not to provide any degree of specificity at all. Specificity is not only useful for the employer, but the employee too, as they gain notice of their rights and obligations.

### **2.3.1 Substantive fairness and good faith – a slightly different approach**

---

<sup>49</sup> *Id.*, at 20.

It is arguable that the approach in *Bankey v. Storer Broad. Co.*,<sup>50</sup> is a different approach from that adopted in *Asmus*.<sup>51</sup> Twelve years before the Supreme Court of Michigan had held in *Toussaint v. Blue Cross Blue Shield*<sup>52</sup> that an employee may “legitimately expect” that his employer will uniformly apply personnel policies “in force at any time.” However, in *Bankey* the Supreme Court of Michigan reduced the scope of this ruling by holding that an employer may amend the handbook “from time to time” even if no discretion to amend was included within the handbook. The Court nevertheless cautioned, “against an assumption that our answer would condone changes made in bad faith.” Poetically, the Court argued that “fairness suggests that a discharge-for-cause policy announced with flourishes and fanfare at noonday should not be revoked by a pennywhistle trill at midnight” therefore reasonable notice must be required.

Brian Kohn and Jason Walters consider this to be a different approach altogether.<sup>53</sup> Kohn sees the court as having “eschewed the contractual analysis altogether.” This is a very strong reading of *Bankey*. Griffen J did not entirely dispense with contractual analysis before delving in to the policies to be weighed. After an exhaustive analysis of the case law, he held, instead that “the principles on which *Toussaint* is based would be undermined if an employer could benefit from the good will generated by a discharge-for –

---

<sup>50</sup> 432 Mich. 438, 443 N.W.2d 112, 113 (Mich. 1989) [hereinafter *Bankey*].

<sup>51</sup> See Kohn, *supra* note 34.

<sup>52</sup> *Toussaint v. Blue Cross & Blue Shield of Mich.*, *supra* note 35

<sup>53</sup> Kohn, *supra* note 34. Jason A. Walters, *The Brooklyn Bridge is Falling Down: Unilateral Contract Modification and the Sole Requirement of the Offeree's Assent*, 32 Cumb. L. Rev. 375.

cause policy while unfairly manipulating the way in which it is revoked.”<sup>54</sup> Although traditional contract analysis does not reach a decisive result in this case, this does not necessarily mean that the courts’ reasoning was set loose ungrounded into the realm of policy balancing. This is not a decision made entirely on “policy” but from an important “hortatory principle.”<sup>55</sup> Griffen J also cautioned “against an assumption that our answer would condone changes made in bad faith.”<sup>56</sup> The use of the language of “bad faith” intimates that the true rationale behind Toussaint appeals to the principle of good faith. As will be argued further below, arguments from principle appeal to a more persuasive level of coherence and depth than mere assertions of “policy.”<sup>57</sup>

### 2.3.2 What is reasonable notice?

Before the comparison may continue to analysis of the basis for this requirement it is necessary to take a short side step and consider briefly what is regarded as reasonable notice in the states which have adopted and recognize this condition. For example in *Asmus*, the two year period from 1990 was held to be “ample.” In *At Safin v. Circuit City Stores, Inc.*,<sup>58</sup> the Court of Appeals for the Ninth Circuit applying Washington law held that posting change to arbitration policy in stores and in applicant packets did not

---

<sup>54</sup> *Bankey, supra note 50*, at 457

<sup>55</sup> For this distinction in more detail see Ronald Dworkin, *Taking Rights Seriously* (1978) Ch. 4. Although Dworkin is, himself inconsistent with the terminology, the distinction is important as principles appeal to coherence at a system wide level, whereas “public policy” is an often pejorative term for unsophisticated balancing of individuals interests in a case.

<sup>56</sup> *Bankey supra note 50*, at 456

<sup>57</sup> *At* section 4.2.1.

<sup>58</sup> 2005 U.S. App. LEXIS 747

constitute reasonable notice to former employees. However in *Mannix v. County of Monroe*,<sup>59</sup> the Court of Appeals for the Sixth Circuit, applying Michigan law, held that “Distribution of a new employee handbook constitutes reasonable notice, regardless of whether the affected employee actually reads it. In *Highstone v. Westin Engineering*,<sup>60</sup> the Court of Appeal for the Sixth Circuit applying Michigan law held that publishing the handbook online and sending 2 emails one month in advance, were sufficient to show reasonable notice. The method used to distribute amendment, they held, must be uniform and reasonable.<sup>61</sup> Therefore we can see that, although the case law is not entirely consistent the court tends to look to whether the employer went through reasonable efforts to notify the employees; the standard appears to be constructive, rather than actual, notice.

## 2.4 Policy arguments

The following chapters will advocate an approach which takes the same policy direction as *Asmus, Bankey* and some of the sentiments from *Demasse*. This is for five reasons.

Firstly, the *Govier* rule is in neither the interests of the employee nor the employer. The tension between flexibility and certainty, mentioned in the previous chapter, does not map on exactly to the interests of the employer as opposed to the interests of the employee. This tension plays itself out within the interests of both of the parties to the contract. It is too simple to say that

---

<sup>59</sup> 348 F.3d 526 (2003)

<sup>60</sup> 187 F.3d 548, 552-53 (6th Cir. 1999),

<sup>61</sup> *Grow v. General Products Inc.*, 184 Mich. App. 379, 457 N.W.2d 167 (1990), appeal denied, 439 Mich. 871, 478 N.W.2d 92 (1991).

the employer has an interest in maintaining her own flexibility as complete flexibility for the employer may be harmful to her employer's interests. For example, Slawson argues<sup>62</sup> that a rule which allows the employer to vary its express promises without notice "deprives employers of a valuable bargaining chip with their employees, and of a valuable means of attracting and keeping desirable employees, and of increasing its employees' job satisfaction and loyalty." This is because a well-informed employee knows that any promise will be revoked.

Secondly, as the employee will have no incentive to bargain for such an unenforceable promise, this will have the effect of mandating at-will employment, as any promises of job security will be, themselves, revocable at-will. This is an inefficient outcome, as those employees who would value these extra safeguards will be practically precluded from securing them.<sup>63</sup>

In addition, "the employer's inability to make enforceable promises of employment security will also put both employees who do not want to join unions and their employers who do not want them to join at an unfair disadvantage. . . . Union organizers in the states where the courts [permit unilateral modification] can now tell employees that no matter what their employers may promise them, the only way they can obtain rights—rather than just unenforceable promises—of employment security is to join a union."

---

<sup>62</sup> W. David Slawson, *Unilateral Contracts of Employment: Does Contract Law Conflict with Public Policy?* 10 Tex. Wesleyan L. Rev. 9, 30-31 (2003).

<sup>63</sup> Robert Cooter and Thomas Ulen, *Law and Economics* (2d ed 1997) ch4. Easterbrook & Fischel, *Contractual Freedom in Corporate Law; the Corporate Contract*, 89 Colum. L. Rev. 1416 (1989); Posner, *Economic Analysis of Law* 81 (3d ed. 1986), cited in Ayres and Gertner, *supra* note 6, at 91.

As Professor Hugh Collins has noted, “although the willingness to adapt is an essential ingredient in a co-operative and productive working relation...a fear that this discretionary power will be operated unfairly by an employer is likely to subvert the cooperation.”<sup>64</sup>

Fourthly, as noted above, neither the employer nor the employee is well served by a complete lack of specificity in the terms. As was noted in the discussion of George CJ’s dissent in *Asmus*, some degree of specificity is in the interests of the employer, as this helps them to direct the employees.<sup>65</sup> Employees are also benefited by increased specificity as this allows them to be more certain what duties they owe and what benefits they can expect in return. In the United Kingdom, the obligation to provide a written statement of particulars of employment,<sup>66</sup> is considered to be one of the first modern employment rights to have been enacted.<sup>67</sup>

Fifthly, the situation of handbook variation will always have an inherent asymmetry, as the variation will be solely at the instigation of the employer. The employer knows what the new variation will be in advance of its effect, but if the variation is deemed to take effect immediately, the employee does not. Professors Ayres and Gertner have proposed a theory of how to decide when default rules in contract should be penalty defaults. Penalty defaults are used to remedy certain informational asymmetries inherent in a relationship. A rule, which provided for reasonable notice,

---

<sup>64</sup> Hugh Collins, *Employment Law* (2003), at 106.

<sup>65</sup> Discussed at section 2.3.

<sup>66</sup> First enacted in the Contracts of Employment Act 1963 (now repealed); now contained within Employment Rights Act 1996 s. 1

<sup>67</sup> Simon Deakin & Gillian Morris, *Labour Law* (3d ed 2001), at 249.

would not be a traditional type of penalty default, as information is not elicited when the stronger party contracts round it, but later in the contract performance itself. In this situation, the penalty is in the information about the content of the new terms the employer must provide the employees with in reasonable time for a lawful variation to take place. This added time to consider the new terms will allow the employees opportunity to decide whether to remain in this employment or seek other opportunities elsewhere.

Such a penalty default rule could avoid another informational asymmetry in the case of variation of handbooks within a contract which is already at-will (although this situation was not covered on the facts of the cases cited above). In this situation an employer can terminate the employment without notice at any time. This paper will argue that such contracts should not be simply variable at-will in the same way as they are terminable. In altering the terms of employment in an at-will contract, the employer is, in effect, terminating the relationship. It is possible that this might not be self evident to an employee, who is still receiving instructions from the employer. A terminated employee considering re-engagement on different terms, if unaware of the nature of at-will employment, may consider themselves to be under less control and with "less to lose" than the employee who is purportedly retained, but under different conditions.

The question of employee expectations in this situation is clearly an empirical one. An employee may or may not have more expectations of what they are due under the contract, depending on how aware they are of the background default rules. Some employees, it seems have a large degree of

faith in legal default rules, over explicit statements in contracts. For example, Pauline Kim has conducted an empirical study into employee expectations relating to dismissal. She found that even where a handbook provided that the “Company reserves the right to discharge employees at any time, for any reason, with or without cause” 62.6% of employees nevertheless believed that discharge without cause is unlawful.<sup>68</sup> A similar method to the one used by Professor Kim could be used to test the hypothesis that at-will employees consider variation in their employment terms as different to their termination. If employees have such a degree of faith in legal default rules to protect them from the employer terminating them at-will, it would be interesting to discover whether there was also a high level of ignorance of the employee’s right to unilaterally walk away from the contract at any time. If a significant degree of ignorance would be found a penalty default requiring reasonable notice of variation, could ensure that this informational asymmetry would be corrected.

## 2.5 Summary of the US arguments

The different states seem to be in conceptual confusion over the appropriate policy and legal basis for handbook variation, oscillating between requiring no notice and conceptualizing the relation as unilateral, and between requiring consideration or reasonable notice and considering the relation to be bilateral. None of the approaches described are without their various

---

<sup>68</sup> Pauline T. Kim, *supra* note 14, A study of unemployment claimants was carried out during August, September and October of 1996 in St Louis City and County, Missouri. Claimants with different levels of education, between no high school diploma and graduate degree were assessed.

problems. Unilateral or bilateral analysis here is used little more than as a label for the policy approach recognized by the courts. In this confusion it is unsurprising that the Courts in *Bankey* and *Asmus*, plumped for an “in between approach.” The strands assembled in this Chapter will be reanalyzed and a proposal for coherence suggested as part of the comparative conversation of Chapter 4. However, before this is possible, the English position must be first put on the table.

### **3. Handbooks in England**

The existence of an employment handbook is not sufficient to give it contractual effect. English Law requires an employer to give every employee on employment a written statement of particulars of employment under section 1 of the Employment Rights Act 1996. English law treats the important issue is instead one of whether it is incorporated into the employment contract itself. As in most states in the US, as far as a handbook contains a codification of policy instructions to employees, these do not have contractual effect and are the subject of managerial prerogative, and therefore may be varied unilaterally without notice.<sup>69</sup>

#### **3.1 The question of incorporation**

The main practitioners guide, Harvey on Industrial Relations and Employment Law states that the test for whether handbook terms are incorporated into the contract of employment is “whether it is reasonably to be inferred from the circumstances that the parties must have intended them

---

<sup>69</sup> Secretary of State for Employment v. ASLEF (No 2) [1972] 2 Q.B. 455, Simon Deakin & Gillian Morris, Labour Law (3d 2001), at 268.

to have contractual force.”<sup>70</sup> For example in *Petrie v. Mac Fisheries Ltd*<sup>71</sup> the court held that displaying a notice about sick pay entitlements on the factory noticeboard was insufficient.

The terms must also be suitable for incorporation in to the contract. The courts and Employment Tribunals divide terms in a handbook between terms and policies. Policies tend to be treated as mere instances of managerial prerogative. Policies must nevertheless be “introduced for a legitimate purpose” and must be consistent with the implied term of mutual trust and confidence discussed below.<sup>72</sup>

The test for whether provisions in a handbook are incorporated is always a difficult matter of construction, for which the Courts and Employment tribunals use a variety of tests. In *Quinn v. Calder Industrial Materials Ltd*<sup>73</sup> Browne-Wilkinson J held that regard should be had to whether the document has been drawn to the attention of employees by the employer or whether it has been followed without exception for a substantial period.

Another option open to the court is to imply into the contract of employment under the “officious bystander test,” for implication of terms, although this approach is not often used for handbook terms and works rules. The “officious bystander” test was first set out in 1926 in the Court of Appeal’s judgment in *Shirlaw v. Southern Foundries*.

---

<sup>70</sup> Harvey on Industrial Relations and Employment Law (last updated February 2005) at [371-375], [hereinafter Harvey].

<sup>71</sup> [1940] 1 K.B. 258

<sup>72</sup> e.g. in *Dryden v. Greater Glasgow Health Board* [1992] I.R.L.R. 469 (EAT), introducing a no smoking policy. See also *Wandsworth Borough Council v. D’Silva* [1998] I.R.L.R. 193 (CA); *Grant v. South West Trains Ltd* [1998] I.R.L.R. 188 (QBD) – broadly stated equal opportunities policy did not have contractual effect.

<sup>73</sup> [1996] I.R.L.R. 126

*“Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying, so that if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement they would testily suppress him with a common ‘oh, of course.’”<sup>74</sup>*

The English cases on variation of handbook terms often involve situations where the handbook has been collectively bargained by a union. The general rule is that an employer cannot alter the contract by unilateral denunciation of the collective agreement where the relevant terms have become part of the contract of employment.<sup>75</sup> Likewise, the employee cannot unilaterally resile from the terms by mere disagreement with the union,<sup>76</sup> although two cases suggest that, if the employee leaves the union membership, they may cease to be bound by the collectively bargained terms.<sup>77</sup>

### **3.2 The operation of the handbook provisions: background norms**

The role of handbooks in the English cases are always analysed in the light of the employment relationship as a whole, rather than as extraneous contracts.

---

<sup>74</sup> *Shirlaw v. Southern Foundries (1926) Ltd* [1939] 2 K.B. 206 *per* McKinnon L.J. The term must also be sufficiently precise, *Lister v. Romford Ice and Cold Storage co Ltd* [1957] A.C. 555 *per* Viscount Simonds. The cry of “oh, of course,” must come from both parties and not just one of them: *Deeley v. British Rail Engineering Ltd* [1980] I.R.L.R. 147.

<sup>75</sup> *Cadoux v. Central Regional Council and National Coal board v. National Union of Mineworkers*, [1986] I.C.R. 736. *See also* Harvey at A[336].

<sup>76</sup> *Tocher v. General Motors Scotland, Ltd* [1981] I.R.L.R. 55 (EAT)

<sup>77</sup> *Singh v. British Steel Corporation* [1974] I.R.L.R. 131; *Land v. West Yorkshire Metropolitan County Council* [1981] I.C.R. 334 (CA), although the editors of Harvey consider these cases to be incorrectly decided and that the approach of Tocher is to be preferred (at A[339]).

They must therefore be read in light of the rest of the doctrinal considerations of the contractual relation. In England, courts are unlikely to hold that the provisions of the handbook are exhaustive of either party's obligations under the contract.

In *Secretary of State for Employment v. ASLEF (No 2)*<sup>78</sup> the employees of British Rail, in protest, instigated a policy of "work to rule" under union direction in which they performed only the duties specified in the employment handbook to the bare minimum the wording would allow. The Court of Appeal for a variety of reasons held unanimously that employees who had initiated a "work to rule" were in breach of their employment contracts. The reasoning of the three judges in the Court of Appeal is particularly interesting as they all have different conceptions of the scope and nature of the contract of employment.

Lord Denning M.R. argued that the work rules did not constitute terms in the employment contract. Nevertheless, he held that there is "clearly a breach of contract first to construe the rules unreasonably, and then to put that unreasonable construction into practice."<sup>79</sup> The lack of a good faith motive rendered the employees in breach.<sup>80</sup> Roskill L.J, disagreed with Lord Denning's use of subjective motivation in construing the contract and held that "questions of intent are usually irrelevant in determining whether or not there has been a breach of contract."<sup>81</sup> He held instead that employees may

---

<sup>78</sup> *Supra* note 69

<sup>79</sup> *Id.* at 490E-F

<sup>80</sup> *Id.* at 492

<sup>81</sup> *Id.* at 506

not rely on an interpretation of the rule which is “wholly unreasonable.”<sup>82</sup> As an alternative ground he found that there was an implied term that the employee would not seek to interpret the rules such as to disrupt the railway system;<sup>83</sup> he appears to have used the test of an officious bystander, for terms implied in fact rather than in law. Thirdly, Buckley L.J. held that there was an implied term “that within the term of the contract the employee must serve the employer faithfully with a view to promoting those commercial interests for which he is employed.”<sup>84</sup> Buckley L.J.’s interpretation, which imports the strongest background norm into the contract, is the one which has been generally followed by the courts.<sup>85</sup> As we will see in the next section, the openness of the courts to recognizing that the express terms of the employment contract rest on a large residue of legal defaults and principles has been a major factor in the development of the implied term of mutual trust and confidence.

### **3.3 Variation of incorporated terms**

In the context of a favorable variation of the employee handbook the courts have held that the employees continuation of work is sufficient consideration for the variation “thereby abandoning any argument that the increase should have been even greater, and removing a potential area of dispute between the employer and employee. The employer has both secured

---

<sup>82</sup> *Id.* at 507G

<sup>83</sup> *Id.* at 508H

<sup>84</sup> *Id.* at 498G

<sup>85</sup> See *Ticehurst v. British Telecommunications Plc* [1992] I.R.L.R. 219; *Cresswell v. Board of Inland Revenue* [1984] I.R.L.R. 190.

a benefit and avoided a detriment.”<sup>86</sup> Attempts to challenge only variation of policies “have not met with great success.”<sup>87</sup>

Attempts to diminish rights under an employee’s contract are dealt with under the “portmanteau” implied term of mutual trust and confidence.<sup>88</sup> English law recognizes a number of terms implied by law into the employment relationship.<sup>89</sup> However, the most important of these is the implied term of mutual trust and confidence.

The Honourable Mr Justice Lindsay, a former President of the Employment Appeal Tribunal, writing extra judicially,<sup>90</sup> notes that one of the first recognizable formulations of the implied term of mutual trust and confidence was seen in *Courtaulds Northern Textiles v. Andrew*.<sup>91</sup> In this case Arnold J approved a formulation of the term proposed by the claimant’s lawyers,

---

<sup>86</sup> Lee v. GEC Plessey Telecommunications [1993] I.R.L.R. 383 (QBD)

<sup>87</sup> Harvey *supra* note 70 at [376] See Dryden v. Greater Glasgow Health Board [1992] I.R.L.R. 469 (EAT), Wandsworth London Borough Council v. d’Silva [1998] I.R.L.R. 193 (CA), Grant v. South West Trains Ltd [1998] I.R.L.R. 188 (QBD) *Codes of practice; Contract of employment. Uncertain rules: the contractual status of workplace policies*. Emp. L. Brief. 1998, 5(9), 107-108.

<sup>88</sup> *Per* Lord Nicholls in Malik v. BCCI [1998] A.C. 20. For example in Woods v. W.M car Services (Peterborough Ltd) [1981] I.R.L.R. 347, an employer’s persistent attempts to vary an employee’s contract were held to violate this obligation.

<sup>89</sup> At common law the UK courts have implied: a duty of the employee of cooperation. See R v. Secretary of State for Employment, ex parte ASLEF (No 2) *supra* note 69, Cresswell v. Inland Revenue [1984] I.R.L.R. 190); employee’s duty of obedience (Laws v. London Chronicle [1958] 1 W.L.R. 698); employee’s duty of confidence and fidelity (Hivac v. Park Royal Scientific Instruments Ltd [1946] Ch. 169); the employer’s duty of cooperation (Woods v. WM Car Services Ltd *supra* note 85). More recently this has been called the implied term of mutual trust and confidence (Malik v. BCCI *supra* note 88).

<sup>90</sup> The Honourable Mr Justice Lindsay, The Implied Term of Mutual Trust and Confidence, (2001) 30 I.L.J. 1.

<sup>91</sup> [1979] IRLR 84, although several “primitive life forms” (Lindsay, *id.*) are also visible in Associated Tyre Specialists v. Waterhouse, [1976] I.R.L.R. 386, and Fyfe v. Byrne, [1977] I.R.L.R. 29. See further Douglas Brodie, Beyond Exchange, the New Contract of Employment (1988) 27 I.L.J. 79.

*“that the employers would not, without reasonable and proper cause, conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between the parties.”*<sup>92</sup>

In *Woods v. W.M Car Ltd*<sup>93</sup> Browne-Wilkinson J in the EAT approved *Courtaulds*. He added, “we regard this implied term as one of great importance in good industrial relations.”<sup>94</sup>

Briefly to sum up before we go on, the key in the English cases is whether the term in the handbook is incorporated. *D’Silva* provides that this will be so if the provision, properly so regarded, confers a rights on employees rather than doing no more than setting out guidelines as to what is expected or required. Interpretation of a right conferring provision will be subject to interpretation in the light of the implied term of mutual trust and confidence and will require consideration to flow for variation.

### **3.4 Other uses of the implied term of mutual trust and confidence**

This term implied at law is not just important for the specific duties it imparts, but has also been influential in the way in which contracts of employment are interpreted. For example in *United Bank v. Akhtar*<sup>95</sup> the EAT were confronted with a term providing that, “the Bank may from time to time require an employee to be transferred temporarily or permanently to any place of business which the Bank may have in the UK for which a relocation or other allowance may be payable at the discretion of the Bank.” Using the implied

---

<sup>92</sup> At para 10. *Courtaulds*, *supra* note 91.

<sup>93</sup> [1981] I.C.R. 666, 670

<sup>94</sup> *Id.*, at 671

<sup>95</sup> [1988] I.R.L.R. 507

term of mutual trust and confidence, they held that this could only be lawfully exercised if reasonable notice were given and if the discretion as to allowances was exercised reasonably.

The question of the strength of the implied obligation of trust and confidence was directly considered in *Johnstone v. Bloomsbury Area Health Authority*.<sup>96</sup> Although Stuart Smith L.J. held that the implied term of mutual trust and confidence superceded the express wording of the contract, the other two members of the Court of Appeal held otherwise. Leggatt L.J. held, formalistically, that the implied term cannot have any effect over the express terms of the contract.

Browne-Wilkinson V-C's solution is the more elegant. He held that where the express term includes a contractual discretion this must be read as being bounded by the implied term of mutual trust and confidence. Although traditional contract scholars consider this to be unconventional,<sup>97</sup> it is far from so. This is precisely the approach that the courts take to the interpretation of many statutes, presuming them not to violate rule of law principles unless clear wording is used.<sup>98</sup> As we will consider below,<sup>99</sup> given the openness of text, the impossibility of an uncontroversial reading purely from the language, and the speculativity of deriving true legislative intent, a

---

<sup>96</sup> [1992] Q.B. 333

<sup>97</sup> this suggestion was criticized by Legatt LJ and subsequently by Phang *supra* note 15.

<sup>98</sup> For an example of this principle in action *see* *Anisminic Ltd. v. Foreign Compensation Commission* [1969] 2 A.C. 147; *R. v. Secretary of State for the Home Department, ex p. Pierson* [1998] A.C.539; *R v. A. (Sexual Offence: Complainant's Sexual History)* [2001] UKHL 25, [2002] 1 A.C. 45. *See also* the discussion of these cases in T.R.S. Allan, *Legislative Supremacy and Legislative Intention: Interpretation, Meaning and Authority*, (2004) 63 C.L.J. 685.

<sup>99</sup> At section 4.2.2.

presumptive approach is all the court is left with.<sup>100</sup> What commentators, such as Phang, and Legatt L.J. miss, is that court's adjudication of contracts involves far more than following the intention of the parties. By entering even into presumed intention, they are going beyond the simple autonomous will of the two parties. This will be considered in greater detail in the next Chapter against the backdrop of the US case of *Tymshare v. Covell* and the English case of *Mallone v. BPP Industries*.<sup>101</sup>

### 3.5 Unfair Contract Terms Act 1977

In addition, it is worth noting, in a brief detour, that express terms may be avoided under the Unfair Contract Terms Act 1977. Under section 3, a party is prevented from unreasonably excluding or restricting liability for rendering substantially different, or no performance. Under the test in *Brigden*, a court will make a distinction between exclusion clauses, to which the test of reasonableness will then be applied, and provisions "setting out the entitlement and limits of his rights."<sup>102</sup>

### 3.6 Summary of the English position

The English approach is therefore very different to that of the majority of the US states. The relationship is considered as distinctly bilateral. This does not,

---

<sup>100</sup> See for example, Max Radin, *Statutory Interpretation*, 43 Harv. L. Rev 863 (1930); Ronald Dworkin, *Law's Empire* (1986), 313-354, David L. Shapiro, *Continuity and Change in Statutory Interpretation*, 67 N.Y. U. L. Rev. 921 (1992) accepts this assumption; Richard A. Posner, *Statutory Interpretation in the Classroom and in the Courtroom*, 50 U. Chi. L. Rev 800 (1983); Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 Harv. L. Rev. 405 (1989)

<sup>101</sup> See section 4.2.2.

<sup>102</sup> *Brigden v. American Express Bank Ltd*, [2000] IRLR 94 (QBD)

however, conclude the analysis. Given the dominant effect of the implied term of mutual trust and confidence on the contract of employment itself the most important two questions in the English cases have become: firstly, whether the particular term or condition has been “incorporated” into the contract of employment; and secondly what the effect of the implied term of mutual trust and confidence will have on the recognition and flexibility of that term with regard to all of the others in the relationship as a whole.

#### **4. Cross fertilization: the comparative conversation**

There are several unexplained issues on both sides of the Atlantic. One is the search for the doctrinal source of the obligation of reasonable notice from *Asmus*. Another relates to the English implied term of mutual trust and confidence and how such a broad obligation can satisfy the, usually stringent, test for implying terms into contracts. The analysis in this chapter will aim to demonstrate that tools for answering both of these dilemmas can be derived from the opposite side of the ocean. As Atiyah and Summers, writing together, note, the English and American systems do have important methodological differences in legal reasoning. This means that any proposal for a “legal transplant” must be treated carefully and sensitively.<sup>103</sup> However, with appropriate sensitivity and care to these factors there are interesting lessons to be learned from both systems, which can bring clarity to these two confused issues.

---

<sup>103</sup> P.S. Atiyah & Robert S. Summers, Form and Substance, *supra* note 3, 428-432

#### **4.1 How can the implied term of mutual trust and confidence have survived the test for implication of terms into the contract?**

In English Law terms may be implied into contracts in three ways: by statute;<sup>104</sup> by custom;<sup>105</sup> and by operation of law. Terms implied at common law fall into two categories, those “implied in fact” and those “implied in law.” We have already considered the officious bystander test of McKinnon L.J. in *Shirlaw v. Southern Foundries*, when considering incorporation of handbooks into the contract of employment.<sup>106</sup> Another formulation of the test is that implication must be “necessary to give the transaction such business efficacy as the parties must have intended.”<sup>107</sup> If the contract can be operative without it, it is not implied into the bargain. Terms implied in law may be implied into contracts of a certain type. The test for implication clearly cannot be the business efficacy/officious bystander test, as this would make the implication of the implied term of mutual trust and confidence impossible.

However the distinction between terms implied in fact and those implied in law has not been without its critics, for example Andrew Phang argues that only the narrow officious bystander test is capable of providing

---

<sup>104</sup> for example s12-15 of the Sale of Goods Act 1979, s1 of the Equal Pay Act 1970.

<sup>105</sup> A custom will be generally implied into a contract if it was generally accepted by those doing business in the particular trade, at that place and time and a reasonable observer would be able to discover it. *Hutton v. Warren*, (1836) 1 M & W 466; *Palgrave, Brown and Sons v. SS Turid (Owners)* [1922] 1 A.C. 397. This is an objective test and it is clear it will apply whether or not the parties actually knew of the custom or not: *Kum v. Wah Tat Bank Ltd* [1971] 1 Lloyds Rep 439.

<sup>106</sup> See section 3.1

<sup>107</sup> *The Moorcock* (1889) 14 P.D. 64. This test was approved by Cardozo J in *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917), although Professor Melvin Eisenberg doubts that this test was applied at this full strength in this case; M. A. Eisenberg, *The Principles of Consideration* 67 Cornell L. Rev. 640, 649-51 (1982).

for the necessary degree of certainty. He argues that the distinction between fact and law, between “the search for an implied term necessary to give business efficacy to a particular contract and the search, based on wider considerations, for a term which the law will imply as a necessary incident of a definable category of contractual relationship”<sup>108</sup> is futile. In *Scally v. Southern Health and Social Services Board*, Lord Bridge, however concluded that, “the criterion to justify an implication of this kind is necessity, not reasonableness.”<sup>109</sup>

The implied term of mutual trust and confidence would not easily have survived the officious bystander test as it is both specified very broadly, and it is recognized in a much broader class of contracts than previous implication at law cases had held<sup>110</sup>

Like Leggatt L.J.’s approach to the interpretation of contractual terms in *Johnstone*, the test for the implication of terms in English law is aggressively formalistic. It shows the same symptoms of skepticism of abstract principles, or what P.S. Atiyah termed, “explicit theory.” This brings us to a particular peculiarity of English legal reasoning, which will have large ramifications for the rest of the analysis. Atiyah is correct when he observes:

*“...the truth is that the inclination towards pragmatism, and the aversion to theory which I have suggested are the characteristics of the English legal system, turn out to be an aversion to explicit theory rather than an aversion to all theory. Implicit theories exist all around us in the law and the legal system,*

---

<sup>108</sup> *Scally v. Southern Health and Social Services Board* [1991] 3 W.L.R. 778, 787 *per* Lord Bridge of Harwich [hereinafter *Scally*]

<sup>109</sup> *Id.* at 779

<sup>110</sup> For example in *Liverpool City Council v. Irwin* [1977] A.C. 239

*sometimes half acknowledged, sometimes understood but not thought suitable for discussion, and sometimes probably not appreciated at all. I need hardly point out that this reliance on implicit theory does not adequately substitute for an avowed willingness to discuss explicit theory. Experience is, in truth, no substitute for logic in the appropriate place, a pragmatic emphasis on remedies is no adequate substitute for an understanding of the rights which those remedies are invoked to protect, the use of precedent without principle would render the law a meaningless jumble, and the wholly practical lawyer without the assistance of the academic would probably do much the same. And implicit theory is no substitute for explicit theory for the obvious reason that it is not available for discussion and refutation.”<sup>111</sup>*

This caution towards explicit theory can be seen in the test formulated by the courts to imply terms. Where terms cannot be imputed to the parties intentions, as in the business efficacy test, the test permits the courts only to imply in what is “necessary” rather than what would be reasonable. This encourages the courts to look for the narrowest language, rather than the best justification for the term. This discourages coherence and theoretical soundness.

Patrick Atiyah argued that “the judicial process serves...two main functions,”<sup>112</sup> that of individual “dispute settlement,” and what he termed the

---

<sup>111</sup> Atiyah, Pragmatism and Theory, *supra* note 20, at 148.

<sup>112</sup> Atiyah, *Principles to Pragmatism: Changes in the Function of the Judicial Process and the Law*, 65 Iowa L Rev 1202 (1980). Also in M.A. Eisenberg, *The Nature of the Common Law* (1988) pp4-7 it is noted that the courts have two businesses, that of deciding individual disputes, and of enriching our body of legal norms.

“hortatory function,” the process by which the law produces incentives and disincentives for various types of behavior. These two functions, he posits, produces a tension between principles and pragmatism. English lawyers, he posits, have a tendency towards embracing pragmatism at the expense of theoretical and principled coherence. This produces “serious weaknesses in the common law pragmatic tradition, because of the tendency, sometimes more and sometimes less pronounced, to concentrate on precedent rather than principle.”<sup>113</sup>

The difference between the hortatory effect of broadly stated principles, and precise rules can be seen in the recent case of *Crossley v. Faithful and Gould Holdings*.<sup>114</sup> In this case Dyson L.J. acknowledged that the test for implication of terms in law is not one of strict “necessity,” but “it is better to recognize that, to some extent at least, the existence and scope of standardized implied terms raise questions of reasonableness, fairness and the balancing of competing policy considerations,”<sup>115</sup> although what test he does propose is unclear. This test is better suited to the implication of terms such as the implied term of mutual trust and confidence, as it shows a willingness by the courts to consider interest balancing, and a move towards the embracing of an approach which welcomes more expansive theoretical justifications and principles openly into the adjudicative process. Under the former test of necessity, the courts were in denial about the degree to which

---

<sup>113</sup> Atiyah, Pragmatism and Theory, *supra* note 20, 125 See also Elizabeth Peden, *supra* note 25, noticed that the strictness of the necessity test can lead to seeming incoherence; “when the courts focus too intensely on whether a term is “necessary,” rather than relying on broad principles, the results can be unfortunate.”

<sup>114</sup> [2004] EWCA Civ 293, [2004] ICR 1615

<sup>115</sup> *Id.*, at para. 36.

default rules, prescribed by law, were necessary for the operation of a contract. It belonged to a time of fiction of the agreement as a complete “meeting of the minds” of the parties. The necessity test had also been allied to conservative incrementalism<sup>116</sup>

#### 4.1.1 Adding principled coherence

However, relaxing the strictness of the “necessity” test for implication into one which considers “reasonableness and fairness” is not, by itself, sufficient to bring principled coherence to English contract law. As Atiyah noted in the passage reproduced above, English courts reluctance to embrace explicit theory leads them, instead to rely on implicit theory. In order for the law in this area to be properly understood, however, what is needed is a justification for the implication of the implied term of mutual trust and confidence which is not married exclusively to the subjective agreement of the parties, or a strict incrementalist approach to the court’s role in private law adjudication. What is needed is not just, as Dyson L.J. suggested, an approach which appeals to “policy,” but one which also appeals to “principle.”

One credible solution lies in the doctrine of good faith, which has been developed to a much greater degree over the last century in American contract jurisprudence than by the English courts. This is unsurprising, as Professor Atiyah observed that “American legal theory is profoundly

---

<sup>116</sup> Atiyah, *Principles to Pragmatism*, *supra* 112. For an interesting parallel analysis of the development of American legal thought *see* Duncan Kennedy, *The Rise and Fall of Classical Legal Thought* (1998).

different to ours,"<sup>117</sup> in its openness to principle and theorizing. In England, in *Malik v. BCCI*, Lord Nicholls recognized that the implied term of mutual trust and confidence is a "portmanteau obligation."<sup>118</sup> Although this description is clearly true on one level, as the term does operate on the level of individual dispute settlement as a generalized suitcase full of specific rights, it is misleading in the sense that it does not appeal to the justifying principles which drive it. These implicit moral principles are those of reciprocity and good faith.

Given the breadth of the implied term of mutual trust and confidence, it is not surprising that the courts have begun to flirt with the rhetoric of good faith in this area. This is an exciting development as although in 1766 in *Carter v. Boehm*, an insurance case, Lord Mansfield famously referred to good faith as "the governing principle...applicable to all contracts and dealings;"<sup>119</sup> from the perspective of the end of the twentieth century Farnsworth notes, in England "the course of the doctrine of good faith performance has been downhill"<sup>120</sup> since then.

A few of the UK courts have suggested that the mutual obligation of trust and confidence and good faith are in fact synonymous. The first example was in *Imperial Group Pension v. Imperial Tobacco*,<sup>121</sup> where Sir Nicolas Browne-Wilkinson V-C in the Chancery Division held that employee

---

<sup>117</sup> Atiyah, *Pragmatism and Theory*, *supra* note 20. At 167

<sup>118</sup> *Malik v. BCCI*, *supra* note 88, para. 13

<sup>119</sup> *Carter v. Boehm* (1766) 3 Burr 1905, at 1910; 97 ER 1162 at 1164

<sup>120</sup> E. Allen Farnsworth, *Good Faith in Contract Performance in Good Faith and Fault in Contract Law* (Beatson & Freidmann eds., 1995) 154, 155 [hereinafter Farnsworth in Beatson & Friedman]

<sup>121</sup> [1991] 2 All ER 597

beneficiaries of a company pension scheme were entitled to the protection of the implied term of mutual trust and confidence. Crucially, he equates this with “the implied obligation of good faith.”<sup>122</sup> Later in the same paragraph the Vice Chancellor gives the hypothetical example of where “the company were to say, capriciously, that it would consent to an increase in the pension benefits of members of union A but not of union B.” Good faith, in Sir Nicolas Browne-Wilkinson’s view, is not a test of “whether the company is acting reasonably.”<sup>123</sup> The duty of good faith is interpreted to require “that the company should not exercise its rights for the purpose of coercing that class (the closed class of employees) to give up its rights under the existing trust.”<sup>124</sup> This terminology was also more recently approved of by Lord Steyn in *Eastwood v. Magnox*<sup>125</sup> and has also been spoken of favorably by some academic commentators.<sup>126</sup>

However the UK courts rarely use the terms interchangeably. This seems to be due to several misconceptions about the principle of good faith. Firstly, Lindsay J, a former President of the EAT, suggests that judicial reluctance is due to the ease of confusing “good faith” with contracts “*uberrimae fidei*,”<sup>127</sup> however, it would be a shame if lawyers’ inability to distinguish utmost-good-faith, from good faith, was sufficient to prevent conceptual coherence within the law. Secondly, and perhaps more clearly in the courts’ mind, there is a deep seated suspicion that good faith is merely a

---

<sup>122</sup> *Id.* at 606b

<sup>123</sup> *Id.* at 607b

<sup>124</sup> *Id.* at 607g

<sup>125</sup> [2004] 1 W.L.R. 322

<sup>126</sup> See further: Hugh Collins, *Regulating the Employment Relationship*, [2001] ILJ 17, 37

<sup>127</sup> The Honourable Mr Justice Lindsay, *supra* note 90, at 6

subjective test which would lead to unadministrable uncertainty.<sup>128</sup> Douglas Brodie, for example claims that “the practical difference between the obligation of good faith and that of mutual trust and confidence would appear to lie in that the former is subjective,” whereas the implied term of mutual trust and confidence is subjective.<sup>129</sup>

However, this is a misperception of the essence of good faith both in application in individual cases and as a guiding principle. In the US the Courts and commentators, although they are often divided on the true meaning of good faith, are almost unanimous in considering that good faith is not a purely subjective test.<sup>130</sup> However, the US commentators are divided on how subjective the test for good faith is. This does raise grave issues of administrability across contract law in general. However, it will be argued later in this chapter that these concerns can be overcome at the level of rule application in these fact patterns with the aid of “Situation Sense.”

#### 4.1.2 The English reluctance to embrace principle

---

<sup>128</sup> In *Walford v. Miles*, [1992] 2 AC 128, the House of Lords energetically denied that there existed a doctrine of good faith in English Law.

<sup>129</sup> Douglas Brodie, *The Heart of the matter: Mutual Trust and Confidence*, 25 ILJ 121, 128 (1996) . In *Malik v. BCCI*, *supra* note 88, Lord Nicholls held that “the conduct required of a breach must...impinge on the relationship in the sense that, *looked at objectively*, it is likely to destroy or seriously damage the degree of trust and confidence the employee is reasonably entitled to have in his employer” at para [14], *my italics*.

<sup>130</sup> for example, Holdsworth notes that the concept of good faith in the English law of merchant “put into legal form the religious and moral ideas which, at this period coloured the economic thought of all the nations of Europe ...[therefore]...contributed to enforce those high standard of good faith and fair dealing which are the very life of the trade.” 5 Holdsworth, *A history of English Law* 79-81 (2d ed.1937). See section 4.3.2.

Additionally, the reluctance to recognize good faith may also be due to the English court's occasional reluctance to differentiate between principle and policy. This links up with Atiyah's observations that English practising lawyers are averse to "explicit theory."<sup>131</sup> Ronald Dworkin famously described the distinction as turning on the fact that "arguments of policy justify a political decision by showing that the decision advances or protects some collective goal of the community as a whole," whereas arguments from principle "secures some individual or group right."<sup>132</sup> This captures one aspect of the distinction, but it is also important to notice where this leads. Substantially, arguments from policy tend towards the role of the court as a settler of individual disputes and are unstructured considerations, arguments from principle have a higher aim from the hortatory function. However, as Atiyah notes, the court can never safely ignore the hortatory function entirely as it exists forever in tension with their role as arbiters of individual disputes. Hostility to "explicit theory" becomes blindness to "implicit theory" and lack of coherence in policy arguments.

This can be seen in the way some of the English courts have dealt with the typical consequentialist policy argument of "floodgates." This particular argument, typically raised to combat a newly proposed legal test or an implied term, alleges that the new formulation would "open the floodgates" to interminable litigation, radical uncertainty and practical chaos.<sup>133</sup> It is

---

<sup>131</sup> See footnote 111.

<sup>132</sup> Ronald Dworkin, *Taking Rights Seriously* (1978), at 82

<sup>133</sup> This is the reason why the third limb of the test for whether there is a duty of care in English tort law is whether recognition of such a duty contravenes public policy. *Caparo Industries Plc. v. Dickman* [1990] 2 AC 605

treated, on the surface, as an argument that the rule falls foul of overbreadth. Arguments from “floodgates” tend to involve a combination of empirical assertions and predictions, and general worries. One thing this argument does not generally appeal to is “principle.” In the “rag bag” of prudential factors mentioned, arguments about hortatory coherence of the law or principled methods of analysis are left out. As some of the English House of Lords are increasingly recognizing, arguments from principle appeal to something higher than prudential balancing; a counter argument alleging that the principle is overbroad misses the importance of the hortatory effect of the principle.<sup>134</sup> This is not to say that prudential concerns, such as are often expressed under the heading of “floodgates” are not valid concerns, as they clearly are, however, no coherent method is used for assessing their relevance or weight.<sup>135</sup> Duncan Kennedy notes, at the hortatory level, there is a value in showing “orderliness” to the debates which are often framed in terms of policy.<sup>136</sup> The general reluctance of the English courts to consider the value in considering this higher level of ordering, explains a large amount of their reluctance to recognize the principle of good faith. In mistaking it for a “rule” they hurl floodgates policy arguments at it. As will be considered later in this chapter, this criticism fundamentally misunderstands the nature of good

---

<sup>134</sup> *See per* Lords Steyn and Walker in *Chester v Ashfar* [2004] UKHL 41

<sup>135</sup> An example of the failure of floodgates arguments in practice is in *Pepper (Inspector of Taxes) v. Hart*, [1993] A.C. 593, in which the House of Lords recognized that legislative history could be relevant in the interpretation of statutes. Unlike the principled debate in the US, the judgments of the House of Lords seem mostly concerned with the prudential policy concern of whether such a holding would cause litigation to become more long-winded.

<sup>136</sup> Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 Harv. L. Rev 1685, 1724 [hereinafter Kennedy, *Form and Substance*].

faith's operation as a hortatory principle as well as acting in different fact patterns as a specific rule.

Before we delve into these questions about the nature of good faith, however, we must first consider the other question raised in this analysis.

#### **4.2 Where does the "reasonable notice" obligation in variation cases come from?**

Richard Pratt has argued that "it is grossly unjust to tell an employee who has been working for years under such a provision that the handbook has suddenly changed."<sup>137</sup> As it was suggested at the end of the second chapter, this appeal to fairness seems to be intuitively correct. Policy reasons against the *Govier- esque* analysis were clearly felt, by the courts in *Bankey* and *Asmus*, as they require reasonable notice of a unilateral variation. However, the legal basis of this obligation is somewhat unclear. On the analysis in *Asmus*, the right to vary a separate unilateral contract without the need for consideration to flow is an automatic consequence of its nature as unilateral. However, if this is the case, there seems to be little basis for requiring any notice, reasonable or not. In at-will contracts, for instance, the essence is that they are terminable without reasonable notice. Although the majority of employment handbook variation cases are not at-will contracts, at least prior

---

<sup>137</sup> Richard J. Pratt, *supra* note 34, at 224. Stephen Carey Sullivan also advocates use of the bilateral analysis in, *Unilateral Modification of Employee Handbooks: A Contractual Analysis*, 5 Regent U. L. Rev. 261 (1995)

to the variation, the reasonable notice requirement cannot be part and parcel of the fact that the contracts are unilateral.

In *Bankey*, the court put a large degree of emphasis on the “legitimate expectations” of the employer. However, invocation of legitimate expectations on their own can reduce to a circular appeal to policy as an expectation of reasonable notice will only be legitimate if the law regards it as subject to entitlement.<sup>138</sup> The “legitimate expectations” analysis does, however, appeal to a recognition of the employment relationship as an ongoing one. However this reasoning has mainly been eschewed by courts, who seem to prefer instead the “traditional”<sup>139</sup> contractual analysis.<sup>140</sup>

Although *Toussaint* was not a variation case, its characterization of the relationship as one resting on legitimate expectations does appeal to the relationship of the parties as a foundation for the obligation. This inquiry is on more fertile ground than the arid search for whether the handbook is a unilateral or bilateral contract separate from the contract of employment. It is important because it notices a counter current to the strongly employer favoring rhetoric of the at-will presumption. Recognition of certain expectations as legitimate is therefore a rhetorical tool for referring to deeper justifications for the ruling.

---

<sup>138</sup> This is central to the reasoning of cases in the European Court of Justice under the doctrine of legitimate expectations. See Joined Cases 205/82 to 215/82 *Deutsche Milchkontor* [1983] ECR 2633; and Joined Cases T-116/01 and T-118/01 *P & O European Ferries (Vizcaya) and Diputación Foral de Vizcaya v. Commission* [2003] ECR II-2957. This is also a precondition of an action for legitimate expectations in England too; see further Simon P. Atrill, *The End of Estoppel in Public Law?* C.L.J. 2003, 62(1), 3

<sup>139</sup> See Kohn *supra* note 34.

<sup>140</sup> E.g. in *Hoffman-La Roche, Inc. v. Campbell*, 512 So.2d 725, 730 (Ala. 1987) the Alabama Supreme Court, although holding the *Toussaint* approach to be “well reasoned and logical” used the unilateral contractual analysis, in preference.

Once the invocation of “legitimate expectations” is viewed at the level of justificatory rhetoric it begins to sound similar to the courts’ invocation of “good faith.” The need to avoid bad faith is also referred to by the courts in both *Govier* and *Bankey*. The language of good faith is a familiar doctrinal tool of the US courts in contract cases, contained within the Restatement (Second) of Contracts and regularly applied in commercial contracts as it is included within the UCC.

#### **4.2.1 The case for explicit recognition of a doctrine of good faith variation in employment contracts.**

The policy justifications for recognizing a rule requiring at least reasonable notice have already been considered at the end of the second chapter. There are also several compelling reasons why the doctrine of good faith should be invoked more freely by the courts as the underlying rationale for imposing these obligations on the employer.

Not only does good faith give a doctrinal basis for regulating the variation of employee handbooks, its explicit recognition also adds coherence to the area of law as a whole. It appeals to the relationship as one of mutuality, where the employer’s ongoing control over the employee is tempered by an obligation to exercise that control in good faith. As we have seen, in England the implied term of mutual trust and confidence grew up as a term of symmetry with the employees duties of loyalty and cooperation to the employer. In return for faithful service, the employer exercises control over the employee, which must be exercised in a manner,

which does not destroy the relationship of mutual trust and confidence between the parties. US law clearly recognizes one half of the obligations in this relationship, that of the employer's control; for example, this used as the central test for distinguishing between employees and independent contractors.<sup>141</sup>

#### 4.2.2 Good faith interpretation

Secondly, recognition of the principle of good faith in one area of the regulation of the employment contract, it can also unify it with another. As we saw in *Johnstone*, good faith can play an important role in the interpretation of contracts. This can be seen on the facts of the US case of *Tymshare v. Covell*, where an employer attempted to make use of a broad discretionary power in bad faith to deprive an employee commission sales representative of a benefit.<sup>142</sup> In 1980 Covell's sale quota was set at \$1.2million in the expectation that it would be a successful year. However, problems ensued and Tymshare reduced Covell's quota to \$815,000 in Spring 1980. Covell's projected earnings, were therefore approximately \$31,000. In the fall, however, business boomed and Covell's commissions bloomed. In December, before Covell had been paid his newly earned commission,

---

<sup>141</sup> See *Mitzner v. State*, 891 P.2d 435 (Kan.1995), *Vizcaino v. Microsoft Corp.* 120 F.3d 1006 (9<sup>th</sup> cir.1997), cert denied, 522 U.S. 1098 (1998). Although courts consider various factors to be relevant to the issue, *Mortgage Consultants v. Mahoney*, 655 N. E. 2d 493, 496 (Ind. 1995) existence of employer control is seen as one of the most important criteria, *Hunte v. Blumenthal*, 680 A. 2d. 1231 (Conn, 1996), *Kristianson Flying J Oil & Gas, Inc.*, 553 N.W. 2d 186 (N.D. 1996); *Dewater v. State*, 921 P.2d 1059 (Wash, 1996).

<sup>142</sup> 727 F 2d 1145 (1984) [hereinafter *Tymshare*]. Also see *Locke v. Warner Bros., Inc.*, 57 Cal. App. 4<sup>th</sup> 354, 66 call. Rptr.2d 921 (1997)

Tymshare produced a revised quota plan in order to eliminate the increase. Covell's employment was terminated on December 20<sup>th</sup>. Covell claimed that the discretion under the plan had not been exercised in good faith, contrary to Virginia law. As his accounts included contracts with the United States Postal Service the Court of Appeals for the Second Circuit held that they had jurisdiction under the District of Columbia to hear the case. This quirk of factual circumstances permitted Circuit Judge Scalia, as he then was, to write an academically dense judgment.<sup>143</sup>

He agrees explicitly both with Professor Summers and Farnsworth's accounts of good faith, (which will be discussed further below). Taking these two together he argues that "when these two insights are combined, it becomes clear that the doctrine of good faith performance is a means of finding within a contract an implied obligation not to engage in the particular form of conduct which, in the case at hand constitutes "bad faith." He sees this as consistent with the principle of "honoring the reasonable expectations created by the autonomous expressions of the contracting parties" although "the new formulation may have more appeal to modern taste since it purports to rely directly upon considerations of morality and public policy."

Interestingly, he uses the principle of good faith as a technique of contractual interpretation. Tymshare had argued that their contractual

---

<sup>143</sup> Scalia J. cites Steven Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv L Rev 369 (1980) [hereinafter *Common Law Duty*], Robert R. Summers, *Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, *supra*, note 28, E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code*, 30 U. Chi. L. Rev. 666 (1963) [hereinafter Farnsworth, *Good Faith Performance*] in the main text of the judgment, rather than in footnotes.

discretion permitted them to alter the benefit scheme in this way. However Circuit Judge Scalia held that this interpretation would “require such a degree of folly on the part of these sales representatives we are not inclined to posit where another plausible interpretation of the language is available.”<sup>144</sup> The contract cannot be interpreted such as to take away the benefits which the employee has bargained for. This is similar to the formulation of good faith set out in the old case of *Kirke La Shelle v. Paul Armstrong Co* that:

*“in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.”*<sup>145</sup>

Not only is the formulation of good faith in *Kirke la Shelle* very similar to the formulation of the EAT in *Courtaulds Northern Textiles v. Andrew*,<sup>146</sup> that an employer must not act so as to destroy the relationship of mutual trust and confidence, but Circuit Judge Scalia’s application of these principles to the case is very similar to that taken recently in the English case of *Mallone v. BPP Industries*.<sup>147</sup>

Mallone was an executive of BPP’s Italian subsidiary until 1995. His contract contained an executive share option scheme. However, when he was

---

<sup>144</sup> *Tymshare supra note 142*, 1154

<sup>145</sup> 188 N.E. 163, 167 (NY 1933). Although this case was not cited directly by Scalia J in the judgment. He chooses instead to prefer that parties reasonable expectations are honoured (at 1152). See also *Uproar Co. v. National Broadcasting Co.*, 81 F.2d 373, 377 (1st Cir.), cert. denied, 298 U.S. 670 (1936), *Druker v. Roland Wm. Jutras Assocs.*, 370 Mass. 383, 385 (1976). Restatement (Second) of Contracts § 231 (Tent. Drafts Nos. 1-7 (1973). 5 S. Williston, Contracts § 670 (3d ed. 1961).

<sup>146</sup> *Supra note 91*.

<sup>147</sup> [2002] EWCA Civ 126, [2002] I.C.R. 1045

dismissed in 1995, BPP informed him that his share option was zero. At trial Christopher Symons Q.C., sitting as a deputy High Court Judge, held that the contractual discretion under the employment contract did not entitle them to cancel the option scheme once it had been held for three years. In the Court of Appeal Mr Mallone's counsel argued that the directors' discretion was not exercised in "good faith." Rix L.J. held for the court that the contractual language could "in theory embrace an exercise of the directors' discretion in relation to mature as well as immature options." However, he then went on to consider whether the exercise of the discretion was "irrational." In *Clark v. Nomura*,<sup>148</sup> Burton J. had held that employer's discretions are "not unfettered...a simple discretion whether to award a bonus must not be exercised capriciously." This, he equated, with a test of "irrationality or perversity" borrowed from the Administrative law context, "whether any reasonable employer could have come to that conclusion." As in this case, "there is no sign any regard was had to the fact the options were clearly granted at a time when Mr Mallone's performance was clearly regarded as excellent....I have no difficulty in saying that the judge was entitled to find that the committee's decision was one which no reasonable employer could have reached."

Although Rix L.J. never sounds entirely comfortable with the term "good faith," using it only twice in his judgment; preferring to consider specific types of dishonesty, improper purpose or arbitrariness, they are clearly talking of virtually indistinguishable tests.

---

<sup>148</sup> [2000] I.R.L.R. 766 at para. 40

Neither of these is an instance of the use of *contra proferentum* construction.

In 1994 Professor, now the Honourable Mr Justice, Jack Beatson wrote that “Contract law...has not been influenced by public law principles or by the rules of statutory regulatory regimes.”<sup>149</sup> However, were he to write the same article now, after *Mallone*, he could no longer claim this to be the case.

The analogy to administrative law is interesting, and one which links up well with the approach of Scalia J in *Tymshare*. In *Tymshare* some of Scalia C.J.’s language could be mistaken for that of an administrative law judgment. For example he states that , “the language need not...be read to confer discretion to reduce the quota for any reason.”<sup>150</sup> The contract is treated as an autonomous document, which has “purpose implicitly envisioned” in it.<sup>151</sup>

However, we must consider whether it is wise for a theory of the interpretation of contracts to borrow a theory of statutory interpretation? Attempts to borrow theories in the opposite direction have rarely been uncontroversial.<sup>152</sup> Statutory interpretation involves more problematic questions of divining legislative intention than contractual interpretation, as a statute is the product of the entire legislative process, and the work of many minds. Ronald Dworkin persuasively argues that a theory of statutory interpretation cannot be “conversational;” a search for the subjective state of mind of the legislature is both doomed to failure and inconclusive. He points

---

<sup>149</sup> Jack Beatson, *Public Law Influences in Contract Law in Good Faith and Fault in Contract Law* (Beatson & Friedmann eds, 1995), 265, 288.

<sup>150</sup> *Tymshare supra note 142*, at 1145

<sup>151</sup> *Tymshare supra note 142* at 1155

<sup>152</sup> See further Mark L. Movsesian, Are Statutes Really “Legislative Bargains”? The Failure of the Contract Analogy in Statutory Interpretation, 76 N.C.L. Rev. 1145.

to the problems facing an intentionalist judge in determining who the true authors of a statute are, how they combine together, and whether their mental state is relevant beyond their expressions in the wording of the statutes.<sup>153</sup> He echoes Max Radin's pessimism that "the intention of the legislature is undiscoverable."<sup>154</sup>

Contracts, on the other hand have far fewer of these particular problems. They tend not to be the product of so many minds. The law repeatedly asserts that freedom of contract means freedom for the parties to contract for whatever they subjectively intend. However, even though the law grants this freedom, this does not necessarily mean that parties have exhaustively exercised it. If, as in the case of a discretion, the limits to which the parties have bound themselves are unclear, we are not dealing with a question of limiting "freedom of contract," as the parties have not committed themselves either way. Although it may initially seem that Dworkin's conception of "conversational interpretation" is of most relevance to the interpretation of contracts, the similarities between contract and statutes become clearer and it appears that constructive interpretation is more suitable as a technique, given the creation of the "contract" as a separate entity to the "conversational" negotiations. The language of administrative statutory interpretation, therefore, seems to be particularly apt in this case. Its congruence with the principle of good faith is clear.<sup>155</sup>

---

<sup>153</sup> Ronald Dworkin, *Law's Empire*, (1986) 313-355.

<sup>154</sup> Max Radin, *supra* note 100, at 870.

<sup>155</sup> For a very interesting article arguing in the opposite direction, that the relaxed approach to the parol evidence rule should be used to support the argument in favor of using legislative history in interpreting statutes see: Stephen F. Ross & Daniel

### 4.2.3 Alternatives

After considering the case for evaluating good faith as a doctrinal basis for the reasonable notice criterion we must consider some of the other options which have already been suggested. A note, by Brian T. Kohn, argues for an ingenious solution. He suggests that “courts should imply into all unilaterally adopted employee policies a subsidiary promise by the employer not to modify that policy.”<sup>156</sup> He refers to a term implied in law recognized by the Californian Supreme Court in *Drennan v. Star Paving Co.*,<sup>157</sup> in the context of a contractor relying on a subcontractor’s bid in preparing its own. He notes that this has been used once in the employment pension context by the Oregon Supreme Court to imply a subsidiary contract not to revoke a unilateral offer of a retirement plan.<sup>158</sup> He argues that, as the courts have had no reluctance in implying terms in to the contract favoring the employer,<sup>159</sup> there is no legal impediment to them implying a subsidiary promise not to vary into the contract too.

Kohn is on promising ground by looking to implied terms to solve this problem. However, this proposal runs into several potential pitfalls by relying on cross fertilization between areas of law, without deriving it from an overarching principle. To use the terminology of Karl Llewellyn, Kohn’s

---

Tranen, *The Modern Parol Evidence Rule and Its Implications for New Textualist Statutory Interpretation*, 87 Geo. L.J. 195.

<sup>156</sup> Kohn, *supra* note 34, at 843.

<sup>157</sup> 333 P.2d 757 (Cal. 1958)

<sup>158</sup> *Taylor v. Multnomah County Deputy Sheriff’s Retirement Board* 510 P.2d. 339 (Or 1973)

<sup>159</sup> For example, the Colorado Court of Appeals, in *Ferrara v. Nielson* 799 P.2d 458 (Colo. Ct. App. 1990).

proposal is open to attack from situation sense. Kohn attempts to borrow a term across different fact patterns only by analogy. Analogous references are most successful across fact patterns which are as similar as possible. This type of reasoning is open to the attack that another term is instead more suitable from a nearer fact pattern. As in *Ferrara* a court could instead import an alternative formulation of the at-will presumption. This is a condition transported from a closer fact pattern than Kohn's analogies to bids and the early pension case.

However Kohn's suggestion gains weight if we counter that argument with one which goes one step deeper, and appeal to a principled theoretical basis for implying such options in to the contract. This is where the principle of good faith can play its role.

A similar suggestion is offered by Jason Walters.<sup>160</sup> He argues that handbooks in at-will contracts can be modified at any time as the offer by the employer of employment may be terminated at any time. As unilateral offers cannot be revoked when performance is continuing he argues that in at-will contracts the employer may determine at any time that performance is complete. Where a handbook term, however, gives assurances to job security, however, the situation is different. He argues that, in this situation, performance cannot be deemed complete simply at the whim of either party, therefore the terms of the offer of employment may not be revoked or altered while the employee is still performing the contract.

---

<sup>160</sup> Jason A. Walters, *The Brooklyn Bridge is Falling Down: Unilateral Contract Modification and the Sole Requirement of the Offeree's Assent*, 32 *Cumb. L. Rev.* 375

There are several problems with this analysis. Firstly it is premised on the idea that contracts of employment must be unilateral contracts. The necessity for this is far from clear. As there is clearly an exchange of promises when the contract is formed, it could just as easily be analysed as a bilateral contract. Given the mutuality of obligations on both parties in the contract it is more appealing to analyse the contract of employment on bilateral principles. Only where a bilateral exchange of promises does not take place should unilateral contract analysis be applied.<sup>161</sup>

However, even assuming that unilateral contract analysis is appropriate in these situations, Walters' conclusions do not flow as simply from his premises as he suggests. His claim that, in an at-will contract, an employer may deem performance complete at any time, therefore may extinguish the obligations at any time is undoubtably true. However, it is too formalistic to assume that an attempted variation is functionally the same as a termination. Although the end result of a successful variation will be a variation in the terms of the initial offer, it is too rigid to maintain that a termination has taken place at the moment of variation. For example, time accrued under the Family and Medical Leave Act 1993 (which requires a worker to have been employed for at least twelve months and have at least 1,250 hours of service in the twelve month period preceding leave) would be

---

<sup>161</sup> See further on the case for bilateral analysis of employee handbook cases: Richard J. Pratt, *Comment, Unilateral Modification of Employment Handbooks: Further Encroachments on the Employment At-Will Doctrine*, 139 U. Pa. L. Rev. 197 (1990).

most unlikely to be held to be interrupted by a variation of the other terms of employment during that time.<sup>162</sup>

There are clear differences between variation and termination, which have been suggested in Chapter 2 and will be analysed further in Chapter 4 of this paper. Because of this, Walters' contention that the employer may deem performance to be adequate is not of itself sufficient to demonstrate that the employer should be permitted to vary the contract unilaterally, at any time and without notice.

#### **4.3 If both are explainable by good faith, what does good faith mean?**

We have repeatedly been colliding with the question of the meaning of good faith means in the various fact patterns of the preceding analysis. However, before progressing any further, the time has come to consider the broader question of what good faith, may mean in general. However, although the question sounds as though it is simple, the answer is likely not to be. As Professor Farnsworth has noted, "if, as Professor Goode suggests, the English have difficulty in attaching any meaning to good faith, the difficulty in my country is quite the opposite: the Americans have, or so it might seem, too many meanings of good faith."<sup>163</sup> Before turning to the issue of how best to conceptualise good faith, however, it is helpful to consider a brief general overview of how "good faith" fits into US law.

##### **4.3.1 Good faith in US law**

---

<sup>162</sup> Family and Medical Leave Act 1993 29 U.S.C.A. § 2611 (2).

<sup>163</sup> Farnsworth in Beatson & Friedman *supra* note 120, at 161

Lawyers in the US are no strangers to the invocation of “good faith.” The classic formulation of good faith is from the 1933 case of *Kirke La Shelle Co., v. Paul Armstrong Co.*, has already been considered. This provides that parties are precluded by the doctrine of doing anything “which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.”<sup>164</sup>

The U.C.C., which applies to commercial contracts, and not to contracts of service, a general duty such that:

*“Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” Section 1-203.*

There are two standards specifying the duty of good faith, which seem to offer slightly different conceptions of the provision. Section 1-201(19) defines good faith as “honesty in fact in the conduct or transaction concerned,” whereas Section 2-103 (1) (b), which applied only to contracts of sale, good faith is defined as “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” The second definition explicitly recognizes an objective element, in addition to a consideration of the subjective motivation of the parties.<sup>165</sup> The Restatement (Second) of Contracts recognizes that good faith “excludes a variety of types of conduct

---

<sup>164</sup> *Kirke La Shelle*, *supra* note 145.

<sup>165</sup> A theory as to why these two provisions differ is provided by Allen R. Kamp, *Downtown Code, A History of the Uniform Commercial Code: 1949-1954*, 49 *Buff. L. Rev.* 359 (2001); Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code: 1940-1949*, 51 *S.M.U.L. Rev.* 275 (1998)

characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness."<sup>166</sup>

#### 4.3.2 Academic debate over good faith

However, commentators in the US have been debating the meaning of "good faith" for over fifty years. As Robert S. Summers noted, "general definitions of good faith either spiral into the Charybdis of vacuous generality or collide with the Scylla of restrictive specificity."<sup>167</sup> In the search for a "meaning" for good faith, however, many of the commentators have strayed far from the reason for adopting the principle in the first place.

Professor Farnsworth has argued that, in good faith performance, "good faith has nothing to do with a state of mind – with innocence, suspicion or notice. Here the inquiry goes to decency, fairness or reasonableness." The "chief utility of the concept of good faith performance has always been as a rationale in a process ...that of implying terms."<sup>168</sup> The doctrine of good faith results in "an implied term of the contract requiring cooperation on the part of one party to the contract is that another party will not be deprived of his reasonable expectations."<sup>169</sup>

In 1968 Robert S. Summers published a highly influential article, which claimed that "good faith" must be defined negatively. He argued that "in contract law, taken as a whole, good faith is an "excluder;" "it is a phrase without general meaning (or meanings) of its own and serves to exclude a

---

<sup>166</sup> Restatement (Second) of Contracts §205, Cmts., A and D.

<sup>167</sup> Summers, *supra* note 28 at 202

<sup>168</sup> Farnsworth, *Good Faith Performance*, *supra* note 143, at 672

<sup>169</sup> Farnsworth, *Good Faith Performance*, *id.* at 669

wide range of heterogeneous forms of bad faith.”<sup>170</sup> A focus on defining the positive content of good faith from the case-law is therefore doomed to be more difficult as “the typical judge who uses this phrase is primarily concerned with ruling out specific conduct, and only secondarily, or not at all, with formulating the positive content of a standard.”<sup>171</sup>

Justice John Priestly JA in the Supreme Court of New South Wales in *Renard Constructions (ME) Pty Ltd v. Minister for Public Works*,<sup>172</sup> described Summers’ approach as having “the great merit of being workable, without involving the use of fictions often resorted to by the courts where the good faith obligation is not available, and reflects what actually happens in decision making. Just as Lord Nicholls described the obligation of mutual trust and confidence as a “portmanteau,” this is a very traditional English/Commonwealth Common law way of embracing good faith in that it stresses the pragmatic over the principled. It is not surprising that Judge Priestly finds that looking at the individual concrete instances of good faith can be a useful tool in deciding when to apply it to cases.

However, the interesting question, if Summers’ analysis is to be accepted, is whether anything in particular unites these separate instances under the principle of good faith at all.<sup>173</sup> Summers does offer a general conceptualization;

---

<sup>170</sup> Summers, *supra* note 28, at 201.

<sup>171</sup> *Id.* at 202

<sup>172</sup> (1992) 26 N.S.W.L.R. 234 at 266G

<sup>173</sup> Yael Aridor Bar Ilan, *The Good Faith Puzzle*, (May 2002) (unpublished manuscript, submitted as an LL.M paper, Harvard University) (On file at Harvard Law School Langdell Law Library) at 20.

*“In most cases the party acting in bad faith frustrates the justified expectations of another...the ways in which he may do this are numerous and radically diverse.”*<sup>174</sup>

This sounds similar to the Court’s invocation of legitimate expectations of the parties in *Toussaint* and *Bankey*. However, a crucial issue with a justification based on expectations is which particular expectations will be regarded as legitimate.

This is a particularly important factor to consider with regard Steven Burton’s analysis of good faith. He suggests that the doctrine of good faith is premised on the need to enforce the justifiable expectations of the parties when the contract was formed.<sup>175</sup> Burton’s theory has the advantage of explicitly resting on the recognition that contracts are incomplete *ex ante*.<sup>176</sup> Even contractual discretions are naturally incomplete. The obligation of good faith, therefore operates as a “gap filler.” A party ‘performs in bad faith by using discretion in performance for reasons outside the justified expectations of the parties arising from their agreement.’<sup>177</sup>

It might initially seem that there is little to tell between Burton and Summers, as both ultimately rely on the expectations of the parties. However Summers and Burton clearly considered themselves to be in disagreement.<sup>178</sup>

---

<sup>174</sup> Summers, *supra* note 28 at 262-3

<sup>175</sup> Steven Burton, *Common Law Duty supra* note 143

<sup>176</sup> *Id.*, 371

<sup>177</sup> Steven Burton, *Contractual Good Faith* (1995), p62

<sup>178</sup> See further Summers, *The General Duty of Good Faith and its Conceptualisation*, 67 *Cornell L. Rev.* 810 (1982) [hereinafter *Summers, Conceptualisation*], Burton & Anderson, *Contractual Good Faith* (1995) 406 et cetera.

One of the crucial aspects of disagreement is over the relevant timing of the expectations. Burton's stress is upon the moment of contracting. He argued that "bad faith performance occurs precisely when discretion is used to recapture opportunities forgone upon contracting."<sup>179</sup> Although Summers is not entirely clear on this point, his concept of good faith involves taking into account expectations and hopes formed after the initial moment of contract formation. One way of understanding this conception is that good faith **legitimizes expectations *ex post***, rather than recapturing those formed *ex ante*. Summer's reference to "justified expectations" is rather unfortunate in that it seems to suggest that the expectations are justified at the moment when they are formed rather than deemed to be so later in the life of the dispute.

Burton also characterizes Summers as advocating an approach which appeals to morality, rather than to the agreement of the parties. However, Burton rather overestimates the "agreement" between the parties. As in the interpretation of statutes which we considered above, the search for complete "intended meaning" is often as futile as resorting to palmistry. As with legislative intent "we have no means of knowing that content except by the external utterances or behaviour,"<sup>180</sup> but more often than not the exact issue in question has not had any direct thought put to it at all. As Ronald Dworkin notes, we can attempt to glean presumed intention by engaging in elaborate counterfactualising; what would X have thought had they thought about it. However, this kind of question also spirals off into wild speculation.<sup>181</sup>

---

<sup>179</sup> Steven Burton, *Contractual Good Faith* (1995) at 373

<sup>180</sup> *Id.*, 870-1

<sup>181</sup> Ronald Dworkin, *Law's Empire*, (1986), 325-7.

A common answer to this problem in the area of statutory interpretation is to invoke a presumption of rationality and good faith of the legislature.<sup>182</sup> If we resolve questions about the interpretation of contracts by presuming good faith, we are appealing to a long standing tradition. However, the courts on both sides of the Atlantic are still wedded to the conception of the contract as the “meeting of minds.” Both in the interpretation of contracts and the implication of terms this is not the case. Mark Freedland explains the reluctance of the courts in implying terms which also goes for interpretation:

*“when the process of ascertainment of implied terms actually involves creative law making, the real difficulty presents itself that the courts and tribunals are reluctant to evolve positive rationales for that creative law making because they are committed to disclaiming the creative law-making role.”*<sup>183</sup>

Burton is therefore mistaken in referring to the subjective expectations of the parties before the formation of the contract. As Todd Rakoff has noted, the language of “intention” and “intended meaning” in contract is a “ceremonial bow” to private autonomy “answering the needs of ideological justification rather than a realistic description.”<sup>184</sup> A system which requires such obsequious devotion to a fiction, at the expense of principled coherence, is storing up trouble for any future developments.

---

<sup>182</sup> See note 98. For example of this approach in the U.S. see H. Hart & A. Sachs, *The Legal Process Materials* (W. Eskridge, Jr & P. Frickey eds. 1994), a similar suggestion, although one which is arguably stronger has recently been made in the UK by T.R.S. Allan, *supra* note 98.

<sup>183</sup> Mark Freedland, *The Personal Employment Contract* (2003), 124.

<sup>184</sup> Todd D. Rakoff, *The Implied Terms of Contracts: Of ‘Default Rules’ and ‘Situation Sense,’ supra* note 23 at 192.

### 4.3.3. The several faces of good faith: a return to Llewellyn

It is helpful to go back, for a moment, to the founding father of the UCC, Karl Llewellyn. Llewellyn's influential work in the 1930s, like Max Radin's, had been distinctly within the legal realist movement.<sup>185</sup> One of the tenets of this movement, he recognized as "the distrust of verbally simple rules."<sup>186</sup> In his early work he advocated "the worthwhileness of grouping cases and legal situations into narrower categories than has been the practice in the past," as deductive reasoning from abstract general legal concepts was doomed to indeterminacy and failure. This approach seems to be distinctly at the "dispute settlement" end of Atiyah's tension. Even in his later work, where he eschews the realist "dirges" in favour of "situation sense,"<sup>187</sup> he remains wedded to a pragmatic commitment to "type-facts in their context." What is someone who distrusts "verbally simple rules" and ascribes to such fact dependent pragmatism doing advocating a principle as abstract as that of "good faith and fair dealing" within the UCC? The key to this question appears to be what he considered to be the purpose good rule making:

*"The way to write good law is to indicate what you want to do, and you assume within reason that the persons the law deals with will try to be decent; then after that, you lay down the edges to take care of the dirty guys and try to hold them in, which means that every statute ought to have two essential*

---

<sup>185</sup> For example Karl N. Llewellyn, *Some Realism About Realism*, 44 Harv. L. Rev. 1222 (1931); Karl Llewellyn, *A Realistic Jurisprudence – The Next Step*, 30 Colum. L. Rev. 431 (1930).

<sup>186</sup> Karl N. Llewellyn, *Some Realism About Realism*, *supra* note 185.

<sup>187</sup> Karl N. Llewellyn, *The Common Law Tradition: Deciding Appeals* (1960).

*bases, one to show where the law wants you to go, and one to show where we will put you if you don't.*"<sup>188</sup>

He criticizes lawyers for focusing only on the second sense of rule making. As these two facets of the law are inevitable, we should celebrate the functions of good faith in the first sense of Llewellyn's distinction. We can see this function in practice, in its usage as an interpretative tool in the construction of contracts. Llewellyn's second sense is more consonant with Summers' excluder analysis; the doctrine of good faith can also be used to prescribe "dirty" conduct, for example in this situation, the immediate variation and depriving of rights in employee handbooks. Read in this manner good faith is fully consistent with requirements of situation sense.

In an interesting comparative work on legal reasoning in the US and UK, Summers<sup>189</sup> and Atiyah writing in tandem conclude that the formulation of good faith is a "principle."<sup>190</sup> Such principles "generate highly substantive reasons...upon which private persons may act in the conduct of their ordinary affairs."<sup>191</sup> They concede that such principles conflict. It is in instances of conflict that the legal system comes to recognize such principles as law. On recognition as such it becomes, not only a substantive reason, but a formal reason, but only in that fact pattern. They note that "there can be little doubt that lawmakers, judges and other officials in the American system resort far more often to such principles directly and indirectly, as *forms of valid*

---

<sup>188</sup> Karl Llewellyn, *Why a Commercial Code* (1953) 22 *Tenn L. Rev.* 779, 782.

<sup>189</sup> This is the same Summers as proposed the excluder analysis.

<sup>190</sup> P.S. Atiyah & Robert S. Summers, *Form and Substance* **supra note 3**.

<sup>191</sup> Atiyah and Summers, *Form and Substance*, **supra note 3** at 94.

*law*, than is true in the English system.”<sup>192</sup> Although he is often thought of as a pragmatist, there is ample space for principle in Llewellyn’s theory. This is demonstrated by one of his most elegant passages on statutory interpretation

*“a court must strive to make sense as a whole out of our law as a whole. It must...take the music of any statute as written by the legislature...but there are many ways to play that music, and a court’s duty is to play it well and in harmony with the other music of the legal system.”*<sup>193</sup>

This another moment where we can see that the English court’s treatment of “floodgates” arguments against good faith miss the point of principle. As principles are able to generate and justify substantive reasons for certain substantive or procedural outcomes, rather than just prudential considerations and narrow defining terms they are not just operating simply at the level of rule application. Although, in the individual dispute the parties will have arguments mainly of policy concerning their fact pattern, arguments of principle cannot be ignored for hortatory purposes of the common law method.

A situation sense reading can also allay some of the fears of unadministrability of so broad a standard as good faith. If Summers is correct, and at the level of rule application good faith does operate as an excluder to prevent various specific types of bad faith conduct, there may be

---

<sup>192</sup> Atiyah and Summers, *Form and Substance*, *supra* note 3, at 94.

<sup>193</sup> Karl N. Llewellyn, *Remarks on the Theory of Appellate Decisions and the Rules of Canons About How Statutes are to be Construed*, 3 Vand. L. Rev 395 (1950), 399.

certainty about the operation of good faith in that particular fact pattern. This paper is considering two particular fact patterns, that of variation of handbook terms, and that of interpretation of the express terms of the contract of employment. In these fact patterns the implied term of mutual trust and confidence has not proved to be excessively unadministrable and has been mostly well received.<sup>194</sup>

This situation sensitive analysis will be crucial to the argument in the next chapter that at-will and good faith variation can survive side by side.

---

<sup>194</sup> See further, The Honourable Mr Justice Lindsay, *The Implied Term of Mutual Trust and Confidence*, *supra* note 90.

## **5. Interrelations with at-will: a route through the tensions**

The argument in this Chapter will suggest that, although at the level of principles at-will appears to be moving along a different vector from that of good faith performance, the proposed development, need not substantively change the scope of the at-will rule. It will only limit the “at-will principle.”

The at-will rule in the US has come under a barrage of criticism for decades.<sup>195</sup> In the 1980s, one state, Montana, enacted legislation providing for a statutory remedy to unfair dismissal.<sup>196</sup> Some states also have developed an exception to at-will based on good faith.<sup>197</sup> However, since then, no other state has followed suit, and the courts have increasingly become less willing to develop common law exceptions to the rule. It would therefore be reasonable to assume that the courts are committed to the survival of this rule for the foreseeable future; therefore if recognition of a good faith restriction on variation would practically eliminate it, the courts would be much less inclined to recognize reasonable notice in variation as an instance of this doctrine. This chapter argues that good faith in variation does not eliminate the rule of at-will presumption in employment contracts. To do this, however, it must proceed first set out why this might be a problem.

---

<sup>195</sup> For example see note 5; in particular Clyde W. Summers, *Individual Protection Against Unjust Dismissal; time for a Statute*, 62 Va. L. Rev 481 (1976)

<sup>196</sup> Mont. Code Ann. §21-7-221 (2003).

<sup>197</sup> for example, *Somers v. Somers*, 613 A.2d 1211 (Pa. Super. Ct. 1992); *Trent Partners and Assoc., Inc. v. Digital Equipment Corp.*, 120 f. Supp. 2d 84 (D. Mass. 1999); *Fortune v. National Cash Register Co.*, 364 N.E. 2d 1251 (Mass, 177); *E. I. Dupont de Nemours & co. v. Pressman*, 679 A. 2d 436 (Del. 1996). For a more comprehensive summary of the current state of the law see Bennett, Polden and Rubin, *Employment Relationships, Law and Practice*, Looseleaf (updated 2004).

## 5.1. Fire and rehire

There is a dominant shadow behind the question of variation of the employment contract; to what extent does regulation of the variation within the contract become practically meaningless if the employer is free to fire and then rehire employees on substantially different (and less favorable) terms. The interest in flexibility in US employment law is often seen as, to a large extent, protected by the presumption that a contract is “at-will,” thus permitting either the employer or employee to terminate the contract with no notice. An employer, under an at-will contract, is therefore afforded flexibility by the ability to fire and then rehire employees on new terms. In England, there is no at-will presumption, but the *Catamaran Cruises*<sup>198</sup> case demonstrates that similar considerations also arise within English law.

### 5.1.1 The US story

In the majority of US states, an employer is free to terminate an employment relationship without notice and then offer reemployment on different terms. An employer is also free to threaten an employee with total termination without reengagement if the new terms are not agreed to. The classic formulation of the rule was stated by Horace G. Wood:

*“With us the rule is inflexible that a general or indefinite hiring is prima facie a hiring at-will, and if the servant seeks to make it out a yearly hiring, the burden*

---

<sup>198</sup> *Catamaran Cruises v. Williams* [1994] IRLR 386 [hereinafter *Catameran Cruises*]

*is upon him to establish it by proof. A hiring at so much a day, week, month or year, no time being specified, is an indefinite hiring, and no presumption attaches that it was for a day even, but only at the rate fixed for whatever time the party may serve. It is competent for either party to show what the mutual understanding of the parties was in reference to the matter; but unless their understanding was mutual that the service was to extend for a certain fixed and definite period, it is an indefinite hiring and is determinable at the will of either party...*"<sup>199</sup>

### 5.1.2 The English story

In order to see how this tension also appears with English law it is necessary to give a summary of the rather complex law in this area.<sup>200</sup> English law has both common law and statutory mechanisms of dealing with the end of the employment relationship. The common law action of *wrongful dismissal* stems from the presumption that servants in agriculture were hired for a fixed term of one year<sup>201</sup>. If an employer fires an employee without notice she is liable for the wages for the notice period. These damages are subject to the duty to mitigate.<sup>202</sup> An employer may only terminate without notice

---

<sup>199</sup> See H.G. Wood, A Treatise on the Law of Master and Servant § 134, at 272, *supra* **note 4**.

<sup>200</sup> For further details see Simon Deakin and Gillian S. Morris, Labour Law (3d ed 2001) Ch5; Harvey *supra* **note 70**.

<sup>201</sup> Deakin and Morris, Labour Law, (3d ed 2001) 393. This rule has its origins in the Statute of Artificers of 1563 and the poor laws of the seventeenth century

<sup>202</sup> *Gunton v. Richmond-upon-Thames London Borough Council* [1980] I.C.R. 755, 722 (Buckley LJ).

(summary dismissal) where the employee is guilty of gross misconduct.<sup>203</sup> To confuse matters, these notice periods are calculated by statute.<sup>204</sup> Like the “at-will” rule, this notice requirement also purports to be symmetrical. An employee must therefore give notice before resigning, as the employer can give notice of dismissal. Reason for termination has no role to play in an action for wrongful dismissal, except in the case where the employer is claiming that they have summarily dismissed the employee in response to known gross misconduct. This, however, is a simple application of the principles of repudiatory breach. If the employee has “disregarded the essential conditions of the contract of service”<sup>205</sup> the employer is entitled to accept this repudiation as termination of the contract.

The statutory concept of *unfair dismissal* has been present on UK law since the Industrial Relations Act in 1971. This action permits an evaluation of the reasons for dismissal if an employee has been continuously employed for more than one year<sup>206</sup>. This is now governed by Part X of the Employment Rights Act 1996. An employer is under a duty to show that the dismissal of an employee is due to a reason which:

- (a) Is related to the capability or qualifications of the employee for performing work of the kind which he was employed by the employer to do (s98(2)(a)),
- (b) relates to the conduct of the employee (s98(2)(b)),

---

<sup>203</sup> And, after the Employment Act 2002, after the employer has operated a shortened disciplinary procedure as set out in the regulations to the Employment Act 2002, Sched 3.

<sup>204</sup> S. 86 *et seq.* of the Employment Rights Act 1996

<sup>205</sup> *Laws v. London Chronicle*, *supra* note **WHICH 700** (*per* Lord Evershed M.R.).

<sup>206</sup> s 108 Employment Rights Act 1996

- (c) is that the employee was redundant (s 98(2)(c), this is dealt with under Part XI of the Employment Rights Act 1996)
- (d) is that the employee could not continue to work in the position which he held without contravention (either on his part or that of his employer) of a duty or restriction imposed by or under an enactment. (s98(2)(d))
- (e) or some other substantial reason of a kind such as to justify the dismissal of an employee holding the position which the employee held. (s98(1)(b))

In addition the statute provides for various protected grounds which are automatically unfair.<sup>207</sup>

Returning to *Catamaran Cruises*; in that case the employer had fired his employees and then offered them much less favorable contracts as a result of financial difficulties. The Employment Appeal Tribunal held that the dismissal was not unfair as it was within the “band of reasonable responses” for “some other substantial reason” (s98(1)(b)). The EAT held that the employees had been unreasonable not to have accepted the new terms. The test, post *Catamaran Cruises*, is essentially one of balancing the interests. What

---

<sup>207</sup> A list of automatically unfair reasons for dismissal: procedures under Schedule 2 to the Employment Act 2002 has not been completed (s98A); pregnancy, childbirth or maternity, maternity leave, parental leave, paternity leave, adoption leave (s99); actions as a health and safety representative (s100); shop workers refusal to work on a Sunday (s101); complaint under the working time regulations (s101A); actions as the trustee of an occupational pension scheme (s102); being an employee representative under Chapter II of Part IV of the Trade Union and Labour Relations (Consolidation) Act (TULRCA) 1992); making a protected disclosure (s103A); assertion of a statutory right under s86 ERA, S68, 86, 146, 168, 168A, 169 and 170 of TULRCA (s 104); action taken with a view to enforcing the national minimum wage (s104A); action taken with a view to enforcing s25 Tax Credits Act 2002 (s104B); requesting flexible working (s104C).

is clear, however, is that an employer is relatively safe to attempt to fire and then rehire, if it is rationally connected with a business reason and is not motivated by sharp practice. Since *Catamaran Cruises*, the Employment Act 2002 requires in addition that the minimal standard disciplinary and dismissal procedure set out in Part 1 of Schedule 2 is carried out in addition to the appropriate notice period, however these guarantees are only procedural rather than substantive.<sup>208</sup>

The shadow that both of these situations spread across any regulation of the conduct of the parties within the relationship, is whether any such regulation can be destroyed by the ease by which the parties can terminate the relationship. Also, if regulation of terminations are governed by a principle which moves in one direction, how successful can a principle of good faith which moves along quite a different vector fare where the factual circumstances are closely interrelated? Any regulation of the modes of variation must inevitably take into account how it will fit with any provision for the regulation of termination.

## 5.2 Hortatory principles and rule-application

---

<sup>208</sup> This is a 3 step procedure requiring a statement of grounds for action and invitation to meeting, meeting and opportunity for appeal meeting. Failure to comply with these procedures makes any resulting dismissal automatically unfair and subject to either reduction or inflation of the award by between 10-50% (depending on which party is at fault in causing this failure), S. 31 Employment Act 2002. See also Bob Hepple Q.C. and Gillian S. Morris, *The Employment Act 2002 and the Crisis of Individual Employment Rights* (2002) 31 I.L.J. 245

Although Justice Holmes cautioned, “general propositions do not decide concrete cases,”<sup>209</sup> questions of principle are unavoidable in adjudication. As Atiyah notes, “in the process of generalization, principles also attempt to give some overall structure, or rational shape to the law, not just in the interests of elegance but in the interests of consistency, of the desire to ensure that like is treated alike.”<sup>210</sup>

It is crucial that the principle of good faith be recognized and utilized as a principle, not only in interpretation of contracts, but in the interpretation of contract doctrine itself. The hortatory function of good faith is an important counter balance against the pervasive hortatory function of the presumption of at-will termination. Both rules can, nevertheless, coherently coexist at the level of pragmatic rules within bounded spheres for pragmatic application. For their role as principles, however, their conflict, far from being fatal, is important for the safeguarding of coherent balance between flexibility and certainty in course of employment. At least part of the success of the recognition of the implied term of mutual trust and confidence has been because of its hortatory function.

The hortatory effect of at-will is strong in US law. We can see its hortatory effect in the cases where the courts refuse to accept the possibility of a handbook exception to at-will. Although this hortatory fertilization has largely slipped in unnoticed in cases like *Govier* and in Jones V.C.J.’s dissent in *Demasse*, it has been resisted by some courts. They have noted that extension of the rationales applied to at-will do not extend naturally into the variation

---

<sup>209</sup> Justice Holmes dissent in *Lochner v New York* 198 U.S. 45, 25 S.Ct. 539,76 (1905)

<sup>210</sup> Atiyah, *Pragmatism and Theory*, *supra* note 20, at 27.

cases as, “the cases which reason that the at-will rule takes precedence over even explicit job termination restraints, simply because the contract is of indefinite duration, misapply the at-will rule of construction as a rule of substantive limitation on contract formation.”<sup>211</sup> However this formal argument seems to be but a frail twig against the tide of much of the courts’ strong rhetoric of laissez faire and individual autonomy. Nevertheless, instances of good faith are visible, and indeed unavoidable in the jurisprudence of employment contracts.

### 5.3 The ramifications of conflict

Duncan Kennedy has recognized a tension in Private Law adjudication between individualism and altruism.<sup>212</sup> He notices that both contradictory visions which “emerge as biases or tendencies whose proponents have much in common and a large basis for adjustment through analysis of the particularizes of fact situations.”<sup>213</sup> He notes that “there is a connection in the rhetoric of private law between individualism and a preference for rules, and between altruism and a preference for standards.” This is not the same tension, as the one described above. In the Atiyah-esque tension between the hortatory power of a principle of good faith and the situation specific

---

<sup>211</sup> *Pine River State Bank v. Mettelle*, 333 N.W.2d 622, 626 (Minn. 1983)

<sup>212</sup> Duncan Kennedy, *Form and Substance in Private Law Adjudication* 89 Harv L Rev 1685 (1976). Another interesting discussion of tension in the context of implied terms is contained in, Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 Maryland. L. Rev. 563 (1982)

<sup>213</sup> Duncan Kennedy, *Form and Substance in Private Law Adjudication* 89 Harv L Rev 1685, 1776 (1976).

application of a rule applied at its lowest level of abstraction, the abstract does not correlate with a more altruistic vision. In current US employment law the principle of at will termination is pervasive at the abstract level through the rhetoric of flexibility. However, Kennedy's essay is helpful for this one in that he sees conflict at the level of hortatory principle as unavoidable. The process of law, therefore must be able to go forward in light of this interminable conflict. Claire Dalton notes that theoretical duality exist in tension throughout contract law.<sup>214</sup> However, despite this conflict she concludes that doctrinal talk is not "meaningless"<sup>215</sup>

Recognition of conflict between hortatory principles can be important for coherence at the level of rules. Although the modes of individualism and altruism, as described by Kennedy, do conflict at the highest level, this does not mean that appeal to one mode, automatically annihilates doctrines which have a shade of the other.

To see how lawyers can get through this, it should also be remembered that tension at the level of principle does not translate exactly into tension at the level of rule application. Judges and legislators are not aiming at creating a mirror of a just society in the rules; these rules must be practicable and be likely to produce these effects. Ramifications at the level of principle can take on a different shade at the level of rule application. Although it is relatively easy to state a rule which would solve the case, *ex post facto*, it is much more

---

<sup>214</sup> Claire Dalton, *Deconstructing Contract Doctrine* 994 Yale. L.J. 997 (1985) especially at 1007.

<sup>215</sup> Dalton, *Deconstructing Contract* at 1009. Ronald Dworkin also gives the argument, that conflict leads to insolvability, short shrift in *Law's Empire* (1986, 441-444 in footnote 20).

difficult to state one which would prevent it occurring *ex ante*. As Scott and Krauss note, there is a difference between a rule, which is consistent with legal and moral principle but which may nevertheless have perverse incentive effects. This, it is argued, is captured in the essence of situation sense methodology. Llewellyn's Delphic comment, that situation sense is a compound of "Isness and Oughtness and what have you more,"<sup>216</sup> can be understood as acknowledging this dimension to the deciding of cases.<sup>217</sup>

#### **5.4. The rationalisation**

To argue that the at-will rule in application is not impossible in a system which recognizes the principle of good faith, we must consider some of the differences between the situations of dismissal, fire and then rehire, and variation, as was attempted in *Govier, Asmus, Bankey and Demasse*. Returning again to "situation sense" the rule must be applied to "type facts in their context." We must now look at those contexts in detail to see how they can be distinguished from one another coherently.

##### **5.4.1 The argument from situation sense**

Although it is clearly moving along a different vector at the level of principle, at the level of rule application the recognition of an obligation of good faith in variation of employment contracts does not necessarily subsume

---

<sup>216</sup> Karl Llewellyn, *The Common Law Tradition: Deciding Appeals* (1960) at 61

<sup>217</sup> Although it should be acknowledged that this is a very different route from the one proposed by Kennedy. For an example of his response to this conflict in individual dispute resolution see, Duncan Kennedy, *Freedom & Constraint in Adjudication: A Critical Phenomenology*, 36 J. Leg. Ed. 518 (1986)

the presumption of at-will termination. Although the vast majority of employment cases which consider “good faith” do so in the context of termination, this does not mean that good faith in variation will naturally become a doctrine of good faith termination. These actions can be kept analytically distinct; they are different “type facts.”

A host of different considerations arise when we are considering issues of termination as opposed to variation. This will be particularly so when we are considering a contract which provides specific restrictions on termination; for these to be variable at-will would negate any reason for the employee to have bargained for those enhanced terms. These considerations have already been analysed in Chapter 2. Breach of terms providing for added constraints on termination do not automatically bring the contract to an end, without more; the employee can still legitimately expect performance of the other contract terms.<sup>218</sup>

There are many reasons why an employer may wish to do this, for example if they are needing to accrue the necessary length of service with that one employer to be eligible for FMLA leave.<sup>219</sup> The employer also may wish to vary the contract, but not to lose all of the benefits inherent in the relationship itself. As was considered above, the employer, in the course of employment has “control” over the employee (or it does not constitute a contract of employment at all, and is merely a contract for services). An employer in notifying employees of a variation is communicating an intention

---

<sup>218</sup> Provided that the employee does not elect to accept this fundamental breach as effecting repudiation.

<sup>219</sup> See footnote 162.

to maintain that control. It is true that an employee can legally bring the relationship to an end at any time, but from the point of view of employee perception, a manifest intention on the part of the employer to maintain control may seem to be very different from a manifest intention by them to terminate. To treat all variations as if they terminate the entire relationship would be to ignore these relevant considerations.

#### **5.4.2. The argument from autonomy**

Also the principle of at-will termination is often justified by reference to considerations of autonomy.<sup>220</sup> In the passage quoted from Horace Wood in the previous chapter it is clear that, if parties wish to vary the legal default of at-will, they are free to contract around it. In most of the cases cited in this paper the contractual term at issue was a variation of the default, to require for cause termination or LIFO. The principle of autonomy respects the liberty of the parties to contract out of any default they wish to provided there is agreement and consideration. The rule in *Govier*, which provided no protection for those autonomous bargains already entered into would violate the principle of autonomy. This is ironic, as the result in *Govier* is mostly buttressed by policy arguments usually seen in the context of proponents of at-will; in fact, the case runs counter to the guiding principle of autonomous dealing.

---

<sup>220</sup> Epstein, *In Defense of Contract at Will*, 51 U. Chi. L.R. 947. For an example of a prominent proponent of the autonomy principle in contract law see, Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981).

### 5.4.3. The argument from cross-fertilization

Proponents of the at-will presumption in termination should also be comforted by the approach of the English courts to the implied term of mutual trust and confidence. The House of Lords in *Eastwood v. Magnox*<sup>221</sup> has very recently held that this does not, in any way constrain the manner of dismissal of an employee. This is the exclusive domain of the statutory action for unfair dismissal. Although the House of Lords, partly relied on an argument that, as a matter of statutory interpretation, the provisions of the Industrial Relations Act 1971 (now contained within the Employment Rights Act 1996, Part X) preclude any common law development in this area,<sup>222</sup> the decision is founded on the rationale that dismissal is fundamentally different to the continuation of employment. Parliament has only “occupied the field” with regard to unfair dismissal.<sup>223</sup>

To frame the debate in *Eastwood* it is necessary to provide a little background. The year before, in *Johnson v. Unisys*<sup>224</sup> the House of Lords had closed the door on the development of an action for damages for psychological harm due to the manner of dismissal under the implied term of mutual trust and confidence. They rejected the broad proposition that the implied term of mutual trust and confidence implied a term “that the

---

<sup>221</sup> [2004] 1 W.L.R. 322 [hereinafter *Eastwood*]

<sup>222</sup> per Lord Nicholls at para [14]. This is a similar manner to the judgment of Justice in Rehnquist in the Supreme Court in *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council Inc* 435 U.S. 519 (1978), holding that the provisions of the Administrative Procedure Act 1946 precluded any supplementary development of the common law. This method of argument has been strongly criticized for example by Lord Steyn in *Eastwood* at para[44]; Collins, *Claim for Unfair Dismissal* [2003] I.L.J. 305, Lizzie Barmes, *The Continuing Conceptual Crisis in the Common Law of the Contract of Employment*, (2004) 67 (3) M.L.R. 435.

<sup>223</sup> *Eastwood supra note 221* at para 14 per Lord Nicholls

<sup>224</sup> [2003] 1 AC 518

employer must treat his employees fairly.” This was because the implied term of mutual trust and confidence did not extend to the conduct of termination.<sup>225</sup> This introduced a distinction into the law of employment contracts that called into question how termination was to be differentiated from issued concerning termination. Given that the quantum of damages which could be claimed under statute and under the common law term of mutual trust and confidence was potentially huge, the stakes for identifying a clear distinction were high.<sup>226</sup>

Although the facts of *Eastwood and McCabe* were difficult, Lord Nicholls held that “identifying the boundary of the ‘Johnson exclusion area’ as it has been called, is comparatively straightforward.”<sup>227</sup> Although a seemingly continuous course of conduct from disciplinary process to dismissal “may have to be chopped artificially into separate pieces”<sup>228</sup> the separation is held to nevertheless exist. Although it is clear that the distinction drawn in *Johnson* is not particularly popular, many of the concerns relate to the low cap on damages for unfair dismissal.<sup>229</sup>

Lord Hoffmann in *Johnson* had primarily argued that the term of mutual trust and confidence “in the way it has always been formulated, is concerned with preserving the continuing relationship which should subsist between employer and employee. So it does not seem altogether appropriate

---

<sup>225</sup> Eastwood *supra* note 221 at para 14 per Lord Nicholls

<sup>226</sup> There is a “statutory cap” on the amount of damages which can be claimed under the statutory cause of action of unfair dismissal (currently £55,000). However, actions under the implied term of mutual trust and confidence can run much higher.

<sup>227</sup> Eastwood, *supra* note 221, para. 27.

<sup>228</sup> Eastwood, *supra* note 221, para 31.

<sup>229</sup> Cf Lizzie Barmes, *The Continuing Conceptual Crisis in the Common Law of the Contract of Employment*, (2004) 67 (3) M.L.R. 435.

for use in connection with the way that relationship is terminated.”<sup>230</sup> He considered that, although it would be possible to imply a separate obligation to exercise the power of dismissal in good faith this was a different question, resting on different principles.<sup>231</sup>

Even Lord Steyn, in his dissent in *Johnson*, draws a distinction between hortatory principles, which can exist in conflict, and rules in application, which cannot. For example, when responding to an argument by counsel for the employers that recognition of the extension of the implied term of mutual trust and confidence would conflict with the express term providing that dismissal may be made on 4 weeks notice,<sup>232</sup> he was unsympathetic, claiming that “they can live together.”

Therefore, the necessity of destroying the at-will presumption, were good faith performance to be recognized, is far from a *fait accomplis*. There are considerations of both policy and principle for keeping them analytically distinct.

This discussion reaffirms the importance of recognizing the perpetual nature of Atiyah’s inherent common law tension between hortatory principles and rule application. It also, however, reaffirms the importance of the courts being aware that this tension is always in play. Only when this is recognized can factual patterns be distinguished from each other in a principled manner.

---

<sup>230</sup> *Johnson*, *supra* note 224, at para 46, per Lord Hoffmann

<sup>231</sup> *Johnson*, *id.*, at para 4, citing the judgment of Iacobucci J in *Wallace v. United Grain Growers Ltd* 152 D.L.R. 4<sup>th</sup> 1.

<sup>232</sup> *Id.*, At para. 24

## 6. Conclusions

It is now time to pull together all of the threads in this “comparative conversation” while avoiding falling into Candide-esque peril. The proposition at the heart of this paper was that good faith is more useful in the employment context in both the US and the UK than is currently recognized, particularly in the specific example of handbook variation. This seemingly simple proposition, however potentially ran into perils from many angles. Nevertheless, the paper has shown a plausible route through these.

In finding a useful route for good faith doctrinally courts are able to sidestep the vast abstract controversy over “what good faith means” by viewing it as a doctrinal tool, capable of permitting the courts **to legitimate expectations** of the contracting parties. Expectations are legitimated if they are within the reasonable band of interpretations and expectations, but not if they come outside this and are likely to destroy the relationship of mutual trust and confidence. This formulation of good faith is captured in Scalia J’s judgment in *Tymshare*, where he holds that the implied covenant of good faith provides that “reasonable expectations” of the parties are protected.<sup>233</sup> If the doctrine of good faith is seen to work *ex post* as a legitimator of expectations arising out of the employment relationship, this eliminates the necessity to form a definite view in the Summers/ Burton debate as to whether good faith is an excluder or whether it protects legitimate expectations.

---

<sup>233</sup> *Tymshare*, *supra* note 142, at 1152

This view of good faith also has important practical implications for courts on both sides of the Atlantic. It is necessary to set the minds of the courts free from any temptation of treating the entire content of the contract as if it derives only from the subjective mind states of the individual parties. As mentioned in the first section, a complete contract *ex ante* is at most “vanishingly rare.”<sup>234</sup> As subjective intent is unknowable, any content given to good faith will be that of “imputed intent” rather than actual hopes or expectations of the parties. “Conversational interpretation,”<sup>235</sup> in the sense of interpreting words to divining true subjective “meaning” of the parties, is impossible in both the interpretation of contracts and statutory interpretation, as the text is settled at the time of formation.

This aspect of good faith explains why the English implied term of mutual trust and confidence seems initially to fail the emphatically *laissez faire* imbued tests for the implication of terms into contracts. The courts, in developing the implied term of mutual trust and confidence have recognized that, as mentioned in the first section, both parties have a particularly strong interest in leaving the express terms incomplete in order to permit the employment relationship to evolve to changing circumstances. This situation naturally leads to the increased visibility of legal background norms. The invocation of “mutual trust and confidence” both conceptualizes the relationship as mutual, but also polices the edges of this relationship to exclude bad faith.

---

<sup>234</sup> *supra* fn 8.

<sup>235</sup> Ronald Dworkin, *Law's Empire*, (1986) Ch2.

Viewing the operation of the implied term of mutual trust and confidence as an incidence of good faith also explains why in *Mallone* the courts could use the implied term of mutual trust and confidence as a principle to delimit an express discretion granted to the employer. Under formalist contractual orthodoxy, this strong hortatory effect should not have been possible. In fact, a large amount of the success of the implied term of mutual trust and confidence can be traced to its hortatory effect, in that it appeals to the principle of good faith as a higher justification. Many of the problems English lawyers seem to see with importing such a general concept of good faith can be allayed to large extent by much of the US literature. Karl Llewellyn's tool of situation sensitive reasoning is particularly helpful here.

On this side of the Atlantic the English experience of, what we have now concluded is an instance of good faith, can be used to explain why and how the courts can justify regulating handbook variations in the US. When good faith is recognized as influencing the doctrinal framework it is possible to build a strong case for the implication of a term at law which constrains the employer's ability to vary immediately unilaterally without notice. As in *United Bank v Akhtar*,<sup>236</sup> the implied obligation not to read the mobility clause in the contract so as to allow it to deprive the employee substantially of the benefits of the rest of the contract; in the situation of handbook variation good faith can also provide the justifying rationale for implying a term into the contract limiting the manner in which the employer may vary a handbook provision.

---

<sup>236</sup> *Supra* note 95.

The potential problem posed by any conflict between the hortatory function of good faith and the at-will presumption were faced head on in the fifth section of this article. In order to combat this objection it was necessary to consider the nature of principles and policies directly and their function within the jurisprudence of the courts. This is not in itself problematic if the court's role is seen as one in itself in tension, between the need to decide the individual case and the need to ensure coherence in the law; and yet it is recognized that it is the courts continuing duty to make its way through this treacherously difficult territory with the aid of doctrinal constructs, such as the various doctrines of contract law, in order to demarcate the permissible from the impermissible.

One of the most powerful tools at the courts command, which is of particular importance when dealing with such a seemingly abstract doctrine as good faith, is that of *situation sense*. This forces us to see that it is necessary to look at disputes from both the more abstract side, and than from that of the individual dispute. By doing so, both a greater understanding and coherence can be achieved. This is not to deny the inherent tensions between the specificity of the implied term and the breadth of the principle if stated as a rule. However instead, it is to recognize that, as the hortatory function of the common law and the individual rule application function are always pulling in different directions, it is useful to look at these tensions from both sides of the lens. Atiyah's analysis recognizes that the one cannot live without the other. At the moment, in general, the US courts tend to be more content at the hortatory end of the spectrum than the English courts; although in the case of

handbook variation some of the US opinions lapse into more formal hidden implicit theorizing than some of the English cases.<sup>237</sup> However, if neither dimension is ignored we can therefore ensure that questions are considered both from the abstract, coherence seeking analysis at the level of principle, and at the level of individual situation. This brings us back to the very essence of the situation sense method. Without an appreciation of the principles behind a distinction between type facts, no rule classification can appropriately be made. Situation sense, read, in this way, is a methodology for linking the justifications for the rules whilst being attentive to the factual patterns to avoid over and underbreadth of them in application.

---

<sup>237</sup> For example contrast the reasoning of Jones VCJ in *Asmus* *supra* note 48, with *Browne Wilkinson V.C. in Imperial Tobacco*, *supra* note 121.