

# SIBLINGS BUT NOT TWINS: MAKING SENSE OF ‘MUTUAL TRUST’ AND ‘GOOD FAITH’ IN EMPLOYMENT CONTRACTS

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*[Since the 1970s English employment law has recognised a duty not to destroy mutual trust and confidence in the employment relationship and has developed more general duties of good faith and fair dealing at work. Australian employment contract law, on the other hand, has been slow to articulate clear principles around these concepts. This article proposes a framework for understanding both concepts — mutual trust and confidence on the one hand, and good faith performance of contracts on the other — in the hope that the articulation of clear and bounded principles may encourage general judicial acceptance and greater certainty in employment contract law.]*

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## I INTRODUCTION

It has become common for employees claiming contractual damages following termination of their employment to plead that the employer has breached ‘an implied term of good faith, trust and confidence’ in the employment relationship.<sup>1</sup> Sometimes two separate implied terms are pleaded: ‘mutual

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<sup>1</sup> This is the expression used in the pleadings in *Yousif v Commonwealth Bank of Australia* (2010) 193 IR 212, 217 [20] (Kenny, Tracey and Jagot JJ). Such claims have become common-

trust and confidence' on the one hand, and 'good faith' on the other.<sup>2</sup> The circumstances in which these claims are made are as various as the causes of misery and grievance in human relationships at work. Sometimes they are pleaded hand in hand with allegations of bullying and harassment;<sup>3</sup> sometimes together with assertions of capricious denial of claimed entitlements (such as performance bonuses,<sup>4</sup> promotions,<sup>5</sup> or contract renewals).<sup>6</sup> Although 'mutual trust and confidence' and 'good faith' have become commonplace vocabulary in pleadings, there is still considerable confusion and disagreement about the content of these obligations. Some judicial decisions have been sceptical about whether they exist at all.<sup>7</sup>

The aim of this article is to propose a framework for understanding the role that mutual trust and confidence and good faith play in the resolution of employment contract disputes in Australia, in the hope that greater clarity around the concepts may convince the remaining sceptics that these are indeed legitimate employment obligations and they do not open floodgates to unpredictable damages awards. This framework may provide some guidance, and consequently alleviate some confusion, for the benefit not only of future litigants and their advisors, but also of the managers who determine workplace culture, and those who work within their influence.

place in recent years. For illustrations of cases in which such pleadings were made (although not necessarily successfully), see *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2007) 69 NSWLR 198, 201 [1] (Rothman J) ('*Russell (Trial)*'); *McDonald v Parnell Laboratories (Aust) Pty Ltd* (2007) 168 IR 375, 377–8 [7] (Buchanan J); *McDonald v South Australia* (2008) 172 IR 256, 261 [4] (Anderson J) ('*McDonald (Trial)*'); *Morton v Transport Appeal Board [No 1]* (2007) 168 IR 403, 429 [152] (Berman AJ); *Downe v Sydney West Area Health Service [No 2]* (2008) 71 NSWLR 633, 638 [5] (Rothman J) ('*Downe*'); *Quinn v Gray* (2009) 184 IR 279, 281 [8] (Byrne J); *Guthrie v News Ltd* (2010) 27 VR 196, 202 [15] (Kaye J); *Rogan-Gardiner v Woolworths Ltd [No 2]* [2010] WASC 290 (22 October 2010) [2] (Hall J) ('*Rogan-Gardiner*'); *Foggo v O'Sullivan Partners (Advisory) Pty Ltd* (2011) 206 IR 87, 95 [10] (Schmidt J); *Cameron v Asciano Services Pty Ltd* [2011] VSC 36 (21 February 2011) [3] (Beach J); *Eshuys v St Barbara Ltd* (2011) 205 IR 302, 311 [35] (Kaye J).

<sup>2</sup> See, eg, *McRae v Wyatt Australia Pty Ltd* [2008] FMCA 1568 (1 December 2008) [49] (Raphael FM). In *Rogan-Gardiner* [2010] WASC 290 (22 October 2010) [2] (Hall J), the plaintiff pleaded only a breach of an 'implied term requiring [the employer] to act in good faith'.

<sup>3</sup> See *South Australia v McDonald* (2009) 104 SASR 344, 349 [5] (Doyle CJ, White and Kelly JJ) ('*McDonald (Appeal)*').

<sup>4</sup> *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010).

<sup>5</sup> *Rogan-Gardiner* [2010] WASC 290 (22 October 2010) [14] (Hall J).

<sup>6</sup> *Guthrie v News Ltd* (2010) 27 VR 196, 202 [16] (Kaye J).

<sup>7</sup> See, eg, *Heptonstall v Gaskin [No 2]* (2005) 138 IR 103, 115 [22] (Hoeben J); *McDonald v Parnell Laboratories (Aust) Pty Ltd* (2007) 168 IR 375, 398–400 [83]–[94] (Buchanan J); *Van Efferen v CMA Corporation Ltd* (2009) 183 IR 319, 337–8 [80]–[86] (Tracey J).

This framework involves a number of propositions, each of which is expanded later in this article:

- 1 The two concepts — mutual trust and confidence on the one hand, and good faith on the other — describe closely related but nevertheless distinct obligations arising in an employment relationship, and perform different functions in resolving employment contract disputes.<sup>8</sup>
- 2 The notion that the employment relationship involves a duty on both employer and employee not to act in a manner calculated or likely to destroy the relationship of trust and confidence between employer and employee has been articulated clearly in the employment contract law of the United Kingdom,<sup>9</sup> and has been accepted or assumed in a sufficient number of cases in Australian jurisdictions to warrant its acceptance into the canon of Australian employment law.<sup>10</sup> This proposition, which I concede

<sup>8</sup> This position is supported by *Gillies v Downer EDI Ltd* [2011] NSWSC 1055 (9 September 2011) 78–9 [204] (Rothman J).

<sup>9</sup> Case law in the United Kingdom is extensive. The principal House of Lords decisions are *Malik v Bank of Credit and Commerce International SA (in liq)* [1998] AC 20 ('Malik'); *Johnson v Unisys Ltd* [2003] 1 AC 518; *Eastwood v Magnox Electric plc* [2005] 1 AC 503. For commentary, see generally Mark R Freedland, *The Personal Employment Contract* (Oxford University Press, 2003) 154–70. See also Douglas Brodie, 'The Heart of the Matter: Mutual Trust and Confidence' (1996) 25 *Industrial Law Journal* 121; Douglas Brodie, 'Beyond Exchange: The New Contract of Employment' (1998) 27 *Industrial Law Journal* 79; Douglas Brodie, 'A Fair Deal at Work' (1999) 19 *Oxford Journal of Legal Studies* 83; Douglas Brodie, 'Mutual Trust and the Values of the Employment Contract' (2001) 30 *Industrial Law Journal* 84; Douglas Brodie, *The Employment Contract: Legal Principles, Drafting and Interpretation* (Oxford University Press, 2005) 63–84; Douglas Brodie, 'Mutual Trust and Confidence: Catalysts, Constraints and Commonality' (2008) 37 *Industrial Law Journal* 329; Justice Lindsay, 'The Implied Term of Trust and Confidence' (2001) 30 *Industrial Law Journal* 1; Adrian Brooks, 'The Good and Considerate Employer: Developments in the Implied Duty of Mutual Trust and Confidence' (2001) 20 *University of Tasmania Law Review* 29; Mark Freedland, 'Constructing Fairness in Employment Contracts' (2007) 36 *Industrial Law Journal* 136; David Cabrelli, 'The Implied Duty of Mutual Trust and Confidence: An Emerging Overarching Principle?' (2005) 34 *Industrial Law Journal* 284.

<sup>10</sup> The authors of *Macken's Law of Employment*, 7<sup>th</sup> ed, prefer to state more conservatively that courts in Australia have 'largely been prepared to assume that the implied term is part of Australian law': Carolyn Sappideen et al, *Macken's Law of Employment* (Lawbook, 7<sup>th</sup> ed, 2011) 162 [5.230]. An even more tentative view is expressed in Breen Creighton and Andrew Stewart, *Labour Law* (Federation Press, 5<sup>th</sup> ed, 2010) 431–3 [14.43]–[14.44]. There are still those who reject the proposition: see, eg, Andrew Stewart, 'Good Faith: A Necessary Element in Australian Employment Law?' (2011) 32 *Comparative Labor Law & Policy Journal* 521, 543–4. Nevertheless, given the number of courts in most jurisdictions that have been prepared to concede the existence of the basic obligation on both employers and employees not to act in a manner calculated to destroy the mutual trust and confidence in the relationship, this article is confident in asserting that the obligation exists: see also Rosemary Owens,

is not yet universally accepted by Australian employment law advocates or judges, is explained more fully in Part II. Breach of this obligation (by either employer or employee) constitutes a repudiation of an employment contract justifying an election by the innocent party to terminate the contract. In Australian law, breach of this obligation has not yet sounded in any damages claim independently of any damages flowing from the termination of the employment.<sup>11</sup>

- 3 Employment contracts, like other contracts which describe long-term (or at least, indefinite) relationships for the mutual benefit of the parties, are to

Joellen Riley and Jill Murray, *The Law of Work* (Oxford University Press, 2<sup>nd</sup> ed, 2011) 288 [6.5.4]. For example, the High Court of Australia has alluded to the existence of this obligation: *Koehler v Cerebos (Australia) Ltd* (2005) 222 CLR 44, 54–5 [24] (McHugh, Gummow, Hayne and Heydon JJ); *Concut Pty Ltd v Worrell* (2000) 176 ALR 693, 706 [51] (Kirby J). See also *Aldersea v Public Transport Corporation* (2001) 3 VR 499, 511–12 [67] (Ashley J); *Jager v Australian National Hotels Pty Ltd* (1998) 7 Tas R 437, 457–8 (Slicer J); *Thomson v Broadley* [2002] QSC 255 (20 June 2002) [32]–[39] (Jones J); *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186, 224–5 [141]–[142], [147]–[148] (Allsop J); *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2008) 72 NSWLR 559, 573 [73] ('*Russell Appeal*'), where Campbell JA assumed to be correct the view adopted by Rothman J in *Russell (Trial)* (2007) 69 NSWLR 198; *Morton v Transport Appeal Board [No 1]* (2007) 168 IR 403, 430 [154]–[155] (Berman AJ); *Rogers v Millennium Inorganic Chemicals Ltd* (2009) 229 IR 198, 222 [119] (Lucev FM). See also the history of the term documented in *McDonald (Appeal)* (2009) 104 SASR 344, 385–8 [215]–[226] (Doyle CJ, White and Kelly JJ). For academic commentary accepting the existence of the obligation (although not necessarily its power to generate independent damages awards) see Brooks, above n 9, 38–43; Joellen Riley, 'Mutual Trust and Good Faith: Can Private Contract Law Guarantee Fair Dealing in the Workplace?' (2003) 16 *Australian Journal of Labour Law* 28; Kelly Godfrey, 'Contracts of Employment: Renaissance of the Implied Term of Trust and Confidence' (2003) 77 *Australian Law Journal* 764; Joellen Riley, *Employee Protection at Common Law* (Federation Press, 2005) 73–6; Andrew Stewart, 'Good Faith and Fair Dealing at Work' in Christopher Arup et al (eds), *Labour Law and Labour Market Regulation: Essays on the Construction, Constitution and Regulation of Labour Markets and Work Relationships* (Federation Press, 2006) 579, 583–4; Joellen Riley, 'The Boundaries of Mutual Trust and Good Faith' (2009) 22 *Australian Journal of Labour Law* 73.

<sup>11</sup> See *Rogan-Gardiner* [2010] WASC 290 (22 October 2010) [222] (Hall J), affd *Rogan-Gardiner v Woolworths Ltd* [2012] WASCA 31 (21 February 2012); *Gillies v Downer EDI Ltd* [2011] NSWSC 1055 (9 September 2011) [204] (Rothman J). See *Shaw v New South Wales* [2012] NSWCA 102 (19 April 2012) for a view from Barrett JA (with whom Beazley, McColl and Macfarlan JJA and McClellan CJ at CL agreed) that 'there is no authority of the High Court or an intermediate appeal court in Australia that will unquestionably compel dismissal of the claim for damages for breach of contract advanced [on the basis of an implied term of mutual trust and confidence]': at [119]. This case was a successful appeal from the decision of Elkaim DCJ to strike out of a statement of claim a number of paragraphs asserting a claim to damages based on alleged breach of the implied term of mutual trust and confidence: at [20].

be construed<sup>12</sup> according to the principle that parties to the relationship are committed to perform their obligations in good faith.<sup>13</sup> In this context, good faith is to be understood in the same way as good faith in the performance of other kinds of commercial contract.<sup>14</sup> This proposition — also considered dangerously novel by some judges — is explained in Part III.

- 4 Both obligations are contractual in nature, meaning that they depend upon an assumption that parties have willingly committed to these obligations in entering into the employment relationship. If the parties to the relationship have expressly limited their obligations to each other, the agreement between the parties prevails over any implied obligation.

These propositions are best explained first by tracing the development of each of these obligations in employment contract law, and then by practical illustrations from decided cases.

## II MUTUAL TRUST AND CONFIDENCE

The subsistence of mutual trust and confidence is essential to an employment relationship. Central among the indicia that distinguish an employment relationship from other commercial relationships under which work is performed is the expectation that the employer may exercise the prerogative

<sup>12</sup> There has been a debate over whether good faith is properly understood as an implied term, or as a principle of construction: see Marcel Gordon, 'Discreet Digression: The Recent Evolution of the Implied Duty of Good Faith' (2007) 19(2) *Bond Law Review* 26. This article prefers the view espoused by Elisabeth Peden in Elisabeth Peden, *Good Faith in the Performance of Contracts* (LexisNexis Butterworths, 2003) that good faith is a principle of contract construction. See also Riley, *Employee Protection at Common Law*, above n 10, 67.

<sup>13</sup> This proposition is more contentious in Australia than the proposition that parties will breach an employment contract by acting in a manner calculated or likely to destroy mutual trust and confidence. Only a small number of cases have articulated the concept clearly: see *Russell (Trial)* (2007) 69 NSWLR 198, 227 [117]–[119] (Rothman J). See also *Gillies v Downer EDI Ltd* [2011] NSWSC 1055 (9 September 2011) [204] (Rothman J); *Foggo v O'Sullivan Partners (Advisory) Pty Ltd* (2011) 206 IR 87, 115–16 [99] (Schmidt J).

<sup>14</sup> See J W Carter, Elisabeth Peden and G J Tolhurst, *Contract Law in Australia* (LexisNexis Butterworths, 5<sup>th</sup> ed, 2007) ch 2; J W Carter and Elisabeth Peden, 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155; Peden, *Good Faith in the Performance of Contracts*, above n 12; Elisabeth Peden, 'When Common Law Trumps Equity: The Rise of Good Faith and Reasonableness and the Demise of Unconscionability' (2005) 21 *Journal of Contract Law* 226; Elisabeth Peden, 'Implicit Good Faith — Or Do We Still Need an Implied Term of Good Faith?' (2009) 25 *Journal of Contract Law* 50; Chief Justice Marilyn Warren, 'Good Faith: Where Are We at?' (2010) 34 *Melbourne University Law Review* 344.

of control<sup>15</sup> (and should also bear the corresponding responsibilities of command),<sup>16</sup> and the employee must render loyal and obedient service.<sup>17</sup> These reciprocal obligations are at the heart of the employment relationship, and they depend upon a degree of trust and confidence between the parties. Just as an employer cannot be expected to continue to accept the service of a disloyal employee who has acted to undermine the employer's business interests,<sup>18</sup> so the employee should not be required to remain in employment with an employer who has engaged in conduct that has destroyed the employee's trust and confidence in the working relationship.

Destruction of the employee's trust may be evidenced by various kinds of conduct, depending on the circumstances of the employment. The following are examples of the kind of conduct which may be found to destroy trust and confidence: unwarranted carping criticism;<sup>19</sup> demotion;<sup>20</sup> capricious withdrawal of employment benefits;<sup>21</sup> pointed disregard of policy-based entitlements;<sup>22</sup> precipitate or unreasonable discipline without prudent and careful investigation of complaints.<sup>23</sup>

The development of the employer's obligation 'not without reasonable and proper cause [to] conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer

<sup>15</sup> Although the 'control' test has been supplemented by many other indicia in recent times, the existence of a legal right to control the performance of work remains a central distinction between employment and other forms of worker engagement: see Sappideen et al, above n 10, 31–3 [2.160]; Creighton and Stewart, above n 10, 181 [7.44]; Owens, Riley and Murray, above n 10, 156–8 [4.2.1.1]. See also *Hollis v Vabu Pty Ltd* (2001) 207 CLR 21.

<sup>16</sup> See *Patrick Stevedores (No 1) Pty Ltd v Vaughan* [2002] NSWCA 275 (2 September 2002) [16] (Davies AJA).

<sup>17</sup> See Ronald McCallum and Andrew Stewart, 'The Duty of Loyalty: Employee Loyalty in Australia' (1999) 20 *Comparative Labor Law & Policy Journal* 155.

<sup>18</sup> See *Concut Pty Ltd v Worrell* (2000) 176 ALR 693.

<sup>19</sup> *Lewis v Motorworld Garages Ltd* [1986] ICR 157.

<sup>20</sup> *Russian v Woolworths (SA) Pty Ltd* (1995) 64 IR 169.

<sup>21</sup> *Clark v Nomura International plc* [2000] IRLR 766; *Horkulak v Cantor Fitzgerald International* [2004] ICR 697, 722 [86] (Newman J); *Horkulak v Cantor Fitzgerald International* [2005] ICR 402, 419–20 [48] (Potter LJ for Potter and Carnwath LJ and Bodey J). Note: these are English decisions.

<sup>22</sup> *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186; *Dare v Hurley* [2005] FMCA 844 (12 August 2005); *Rispoli v Merck Sharpe & Dohme (Australia) Pty Ltd* [2003] FMCA 160 (3 October 2003).

<sup>23</sup> *Russell (Trial)* (2007) 69 NSWLR 198; *Downe* (2008) 71 NSWLR 633; *Morton v Transport Appeal Board [No 1]* (2007) 168 IR 403.

and employee' has been chronicled in many earlier books and articles.<sup>24</sup> It has also been traced in a number of Australian judicial decisions.<sup>25</sup> Here, it is sufficient to summarise the main steps in this development. The duty was articulated first in a series of cases in the United Kingdom, in which employees sought to cast the blame for the termination of their employment at the feet of employers, notwithstanding that the employers did not expressly dismiss these employees.<sup>26</sup> In each of these cases it was held that, if an employee was able to establish that the employer's conduct was so destructive of the mutual trust and confidence that properly binds parties to an employment relationship, the employee should be entitled to treat the employer's conduct as a constructive dismissal. In contract law terms, the employee will be permitted to treat the employer's conduct as a repudiation of the employment contract, and elect to terminate the contract and claim damages for wrongful dismissal. In many cases argued on this basis, the employee was seeking to claim statutory compensation for termination under the *Employment Rights Act 1996* (UK) c 18.<sup>27</sup>

The duty was cemented into English employment law by the House of Lords decision in *Malik v Bank of Credit and Commerce International SA (in liq)* ('*Malik*').<sup>28</sup> This was essentially a test case to determine whether a breach of the duty not to destroy mutual trust and confidence could sound in damages. It was held that a breach of mutual trust could sound in damages so long as loss could be shown to have arisen during employment as a consequence of the employer's breach.<sup>29</sup> Following this decision, the obligation not to destroy mutual trust has been engaged to address a wide variety of claims. For example, in *Clark v Nomura International plc*<sup>30</sup> and *Clark v BET plc*,<sup>31</sup> the

<sup>24</sup> See *Malik* [1998] AC 20, 44 (Lord Steyn) and the academic work noted above nn 9–10.

<sup>25</sup> See, eg, *McDonald (Appeal)* (2009) 104 SASR 344, 383–8 [206]–[226] (Doyle CJ, White and Kelly JJ); *Rogan-Gardiner* [2010] WASC 290 (22 October 2010) [112]–[126] (Hall J).

<sup>26</sup> See, eg, *Courtaulds Northern Textiles Ltd v Andrew* [1979] IRLR 84; *Woods v W M Car Services (Peterborough) Ltd* [1982] ICR 693; *Lewis v Motorworld Garages Ltd* [1986] IRC 157; *Bliss v South East Thames Regional Health Authority* [1987] ICR 700.

<sup>27</sup> See, eg, *Lewis v Motorworld Garages Ltd* [1986] ICR 157; *Woods v W M Car Services (Peterborough) Ltd* [1981] ICR 666.

<sup>28</sup> [1998] AC 20.

<sup>29</sup> *Malik* concerned an allegation that some middle management employees had suffered loss by being unable to secure future employment as a consequence of the stigma from association with a corrupt employer. The employer's corrupt business practices were said to constitute a breach of mutual trust. Although the House of Lords found in favour of the applicants on this theoretical point, the applicants failed to succeed on the facts when the case was re-heard: see *Bank of Credit and Commerce International SA v Ali [No 2]* [2002] ICR 1258.

<sup>30</sup> [2000] IRLR 766.

obligation was relied upon to claim that an employer must exercise discretions relating to performance pay and salary increases in a reasonable manner.<sup>32</sup> In *Gogay v Hertfordshire County Council*,<sup>33</sup> it was relied on as the basis for an employer's obligation to act fairly and reasonably in conducting an investigation into alleged misconduct. It was engaged in *Spring v Guardian Assurance plc* ('*Spring*')<sup>34</sup> to articulate a duty to exercise care when giving references. In *BG plc v O'Brien*, it assisted an employee to obtain a redundancy payment that was not expressly provided in his contract of employment (although it had been paid to others), on the basis that the employer bore an obligation to 'treat employees in a fair and even-handed manner'.<sup>35</sup> Lord Steyn has described the duty more generally as a duty of 'fair dealing' in English employment law.<sup>36</sup>

The one hiccough in the development of this duty in English law came in the decision of a majority of the House of Lords in *Johnson v Unisys Ltd*,<sup>37</sup> affirmed in *Eastwood v Magnox Electric plc*<sup>38</sup> and more recently (by the Supreme Court) in *Edwards v Chesterfield Royal Hospital NHS Foundation Trust* ('*Edwards*'),<sup>39</sup> that breach of the common law duty of mutual trust, good faith and fair dealing would not sound in damages, if the damages flowed only from the fact of termination of the employment relationship. This is what has become colloquially known as the '*Johnson* exclusion zone'.<sup>40</sup> The House of Lords held that the common law should not be developed so as to overreach limitations already determined by statute.<sup>41</sup> Since legislation in the United Kingdom already imposed a cap on damages for termination of employment,

<sup>31</sup> [1997] IRLR 348.

<sup>32</sup> See also *Horkulak v Cantor Fitzgerald International* [2005] ICR 402.

<sup>33</sup> [2000] IRLR 703.

<sup>34</sup> [1995] 2 AC 296.

<sup>35</sup> [2001] IRLR 496, 497 [7] (Recorder Langstaff). This decision was affirmed on appeal in *Transco plc v O'Brien* [2002] ICR 721.

<sup>36</sup> *Johnson v Unisys Ltd* [2003] 1 AC 518, 536 [24]. For commentary on this development see Brodie, 'A Fair Deal at Work', above n 9; Brodie, 'Mutual Trust and the Values of the Employment Contract', above n 9; Brodie, *The Employment Contract*, above n 9, 63–84; Brodie, 'Mutual Trust and Confidence: Catalysts, Constraints and Commonality', above n 9; Freedland, 'Constructing Fairness in Employment Contracts', above n 9.

<sup>37</sup> [2003] 1 AC 518, 541–4 [45]–[58] (Lord Hoffmann).

<sup>38</sup> [2005] 1 AC 503.

<sup>39</sup> [2012] 2 AC 22, 49 [67] (Lord Dyson for Lords Dyson and Walker).

<sup>40</sup> See Sappideen et al, above n 10, 167–70 for a more detailed account of the '*Johnson* exclusion zone'.

<sup>41</sup> *Johnson v Unisys Ltd* [2003] 1 AC 518, 544 [56]–[58] (Lord Hoffmann).



courts exercising common law jurisdiction should not award damages for termination that exceeded the statutory limits. Damages might be awarded to compensate for any loss incurred by the employee as a consequence of breach of the employment contract during employment, but not for any loss suffered as a consequence of losing the job.<sup>42</sup>

In *Edwards*, three of the bench (Lords Dyson, Walker and Mance) held that this 'Johnson exclusion zone' also extended to any claim for breach of an express provision in an employment contract promising that particular disciplinary processes must be followed prior to a decision to dismiss.<sup>43</sup> This was because employers must be taken to have included those express clauses in their employment contracts to meet their statutory obligations under unfair dismissal laws. Such clauses therefore were intended 'to operate within the scope of the law of unfair dismissal'<sup>44</sup> only, and did not give rise to an entitlement to claim common law damages for breach of contract. Lord Phillips reached the same conclusion, but on the basis that the damages claimed by the dismissed employees in this pair of cases were too remote.<sup>45</sup> Stigma damages (that is, compensation for reputational harm resulting in an inability to find other employment) cannot be claimed as a result of any breach of the implied duty not to destroy mutual trust and confidence that led to dismissal, nor any breach of an express term dealing with statutory obligations to the same effect. The 'Johnson exclusion zone', extended as it has been by *Edwards*, means that damages cannot be claimed for any alleged breach of the obligation not to destroy mutual trust and confidence if the damage arises from the fact of dismissal.

In summary, English jurisprudence has allowed damages for breach of the obligation not to destroy trust and confidence, but not when the damage flowed from the fact or manner of dismissal. Importantly, in English law '[t]he

<sup>42</sup> See, eg, *Gogay v Hertfordshire County Council* [2000] IRLR 703, where an employee who suffered damage as a consequence of suspension from duties but whose employment was not terminated was able to make a claim for breach of mutual trust and confidence. *Gogay* is not a useful authority in Australia, because the damages claimed were for losses consequent upon suffering mental distress. Australian judges would consider a claim of this nature as a matter of breach of a duty of care, not a duty of mutual trust and confidence. See, eg, *Sneddon v Speaker of the Legislative Assembly* (2011) 208 IR 255, in which an electoral office worker who suffered serious mental-distress-related illness as a consequence of bullying was awarded \$438 613.75 in damages.

<sup>43</sup> [2012] 2 AC 22, 41 [40] (Lord Dyson for Lords Dyson and Walker), 54 [94] (Lord Mance).

<sup>44</sup> *Ibid* [37] (Lord Dyson for Lords Dyson and Walker), citing *Johnson v Unisys Ltd* [2003] 1 AC 518, 545 [63] (Lord Hoffmann).

<sup>45</sup> *Edwards* [2012] 2 AC 22, 52–3 [85]–[88].

giving of lawful notice cannot of itself constitute a breach of the implied term.<sup>46</sup>

Australian case law has generally assumed or conceded the existence of a duty not to act in a manner calculated or likely to destroy the mutual trust and confidence in the employment relationship,<sup>47</sup> even though no appellate court decision has depended upon such a finding.<sup>48</sup> The employee's duty not to destroy trust and confidence has a long pedigree.<sup>49</sup> It has frequently been raised in cases in which the employer has sought to justify summary dismissal,<sup>50</sup> or (in the context of statutory claims under unfair dismissal laws) when an employer has sought to resist an argument that the employee should be reinstated. A breakdown in trust and confidence is a ground upon which a tribunal might refuse to reinstate, and order compensation instead.<sup>51</sup>

It has only been in more recent times that (some) Australian courts have conceded (or assumed) that both parties to an employment relationship bear the duty not to destroy mutual trust and confidence. It is not surprising that this development should have been so slow. Until Australian law also provided statutory remedies for unfair dismissal, it was unusual for employees to bring actions for termination of employment, principally because the remedies available under the common law would rarely justify the costs of litigation for any employee other than a very high income earner. The usual remedy for wrongful dismissal at common law is payment of wages for a relatively short period of notice. As was the case in the United Kingdom, it was the advent of statutory unfair dismissal protection that led to a rise in arguments that employees had been 'constructively dismissed', and so became entitled to

<sup>46</sup> *Kerry Foods Ltd v Lynch* [2005] IRLR 680, 682 [16] (Clark J).

<sup>47</sup> See Sappideen et al, above n 10, 162 [5.230] and the cases cited there.

<sup>48</sup> For some examples of first instance cases deciding that a duty of mutual trust and confidence existed (whether or not it had been breached in the circumstances), see *Aldersea v Public Transport Corporation* (2001) 3 VR 499, 511–12 [67] (Ashley J); *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186; *Dare v Hurley* [2005] FMCA 844 (12 August 2005); *Rispoli v Merck Sharpe & Dohme (Australia) Pty Ltd* [2003] FMCA 160; *Russell (Trial)* (2007) 69 NSWLR 198; *Downe* (2008) 71 NSWLR 633; *Morton v Transport Appeal Board [No 1]* (2007) 168 IR 403; *Rogan-Gardiner* [2010] WASC 290 (22 October 2010).

<sup>49</sup> See, eg, *Blyth Chemicals Ltd v Bushnell* (1933) 49 CLR 66, 81 (Dixon and McTiernan JJ); *Concut Pty Ltd v Worrell* (2000) 176 ALR 693, 695 [8] (Gleeson CJ, Gaudron and Gummow JJ).

<sup>50</sup> See, eg, *Concut Pty Ltd v Worrell* (2000) 176 ALR 693.

<sup>51</sup> See, eg, *Perkins v Grace Worldwide (Aust) Pty Ltd* (1997) 72 IR 186, 191–2 (Wilcox CJ, Marshall and North JJ), cited with approval in *Hollingsworth v Commissioner of Police [No 2]* (1999) 47 NSWLR 151, 213 (Wright and Hungerford JJ). See also the discussion in *Blackadder v Ramsey Butchering Services Pty Ltd* (2002) 118 FCR 395, 405–6 [47] (Madgwick J).

statutory compensation for unfair dismissal.<sup>52</sup> And so the burgeoning case law based on statutory claims began to develop a recognition that the employer also bore a duty not to act in a manner calculated to destroy trust and confidence. Many of the cases in which courts and tribunals in Australia have recognised the mutual obligation not to destroy trust and confidence have been brought in the context of statutory claims.<sup>53</sup> The well-known case of *Burazin v Blacktown City Guardian Pty Ltd*,<sup>54</sup> which is often cited as a decision in which a court awarded damages for hurt and humiliation because of the egregious way in which the employer treated an employee upon dismissal, was in fact a case brought under the statutory unfair dismissal provisions, and not a case based on common law principles.<sup>55</sup>

While it is still difficult to identify a body of common law cases deciding that an employer owes this duty, there are cases conceding or assuming its existence as a matter of contract law. For example, when considering the employer's duty of care under an employment contract, the High Court of Australia in *Koehler v Cerebos Australia Ltd* stated: 'It is only when the contractual position between the parties (including the implied duty of trust and confidence between them) is explored ... that it would be possible to give appropriate content to the duty of reasonable care'.<sup>56</sup>

In *Thomson v Orica Australia Pty Ltd*,<sup>57</sup> Allsop J referred to the duty as the basis for finding that an employer had breached the employment contract by refusing to honour its own human resources policy. This act was calculated or

<sup>52</sup> The *Fair Work Act 2009* (Cth) s 386(2) does not leave as much room for arguments based on constructive dismissal as the initial unfair dismissal laws introduced in 1993 into the *Industrial Relations Act 1988* (Cth). Now, an employee who has resigned must show that he or she was 'forced to do so because of conduct, or a course of conduct engaged in by his or her employer': at s 386(1)(b).

<sup>53</sup> See, eg, *Linkstaff International Pty Ltd v Roberts* (1996) 67 IR 381, 388–92 (Jennings P, Cawthorne DP and Commissioner Huxter); *Russian v Woolworths (SA) Pty Ltd* (1995) 64 IR 169 (both unfair dismissal decisions of industrial relations tribunals in South Australia). See also *Gambotto v John Fairfax Publications Pty Ltd* (2001) 104 IR 303, 309–11 [24]–[29] (Peterson J); *Sea Acres Rainforest Centre Pty Ltd v New South Wales* (2001) 109 IR 56, 66 [39] (Haylen J) (both brought under the statutory unfair contracts jurisdiction of the New South Wales Industrial Relations Commission).

<sup>54</sup> (1996) 142 ALR 144.

<sup>55</sup> Note that since the enactment of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) in March 2006, it has not been possible for a compensation award made under federal unfair dismissal laws to include any amount in respect of 'shock, distress or humiliation': see also *Fair Work Act 2009* (Cth) s 392(4).

<sup>56</sup> (2005) 222 CLR 44, 55 [24] (McHugh, Gummow, Hayne and Heydon JJ).

<sup>57</sup> (2002) 116 IR 186, 224–5 [141], 225 [147]–[148].

likely to destroy trust and confidence in the relationship, and so entitled Ms Thomson to treat herself as constructively dismissed.

While a number of cases have assumed the duty not to destroy mutual trust and confidence, they have not all conceded that this duty goes so far as a duty of 'good faith'. The limited number of cases that have done so (such as *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* ('*Russell (Trial)*'))<sup>58</sup> are discussed in Part III. Here, the discussion is limited to a discussion of the role of the 'mutual trust and confidence' obligation in Australian law.

As in English law, destruction of mutual trust signifies a repudiatory breach of an employment contract and identifies who is to blame if termination of the contract ensues. In Australian law, destruction of mutual trust and confidence has not been found to sound in any damages on its own. Damages, if any, flow from the fact that destruction of trust undermined the basis of the employment relationship, and so entitled the wronged party to terminate the employment contract. Australian case law of the highest authority articulates a distinction between the employment relationship and the employment contract.<sup>59</sup> The employment relationship describes the actual dealings between the employer and employee, and will be regulated by various forms of law, including the common law of contract, and also statutes (such as the *Fair Work Act 2009* (Cth) ('*FW Act*')) that impose mandatory obligations on the parties.<sup>60</sup> The relationship may be destroyed (and parties may cease to engage with each other) but the contract may still remain on foot until the wronged party takes steps to terminate the contract. In Australian law, an employment contract is not automatically terminated by destruction of the relationship of trust, but by the election of the innocent party.<sup>61</sup> The employee who elects to terminate in such circumstances is entitled to be paid any remuneration or other benefits he or she has lost on account of premature termination of the employment contract.<sup>62</sup> Generally this will mean payment

<sup>58</sup> (2007) NSWLR 198.

<sup>59</sup> See *Visscher v Giudice* (2009) 239 CLR 361. See also *Automatic Fire Sprinklers v Watson* (1946) 72 CLR 435.

<sup>60</sup> For the separate operation of the common law of contract and statute, see *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 421 (Brennan CJ, Dawson and Toohey JJ). For a fuller explanation, see Sappideen et al, above n 10, 264 [6.270].

<sup>61</sup> In *Visscher v Giudice* (2009) 239 CLR 361, 379–81 [53]–[55] (Heydon, Crennan, Kiefel and Bell JJ), the High Court affirmed that breach of an employment contract does not automatically cause termination. Termination of the contract depends upon the election of the innocent party.

<sup>62</sup> See, eg, *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186.

of remuneration and other benefits that would have been received during a proper notice period.

Most importantly, the obligation not to destroy mutual trust does not constrain an employer from taking a decision to terminate the employment. So long as the employer complies with the terms of the contract, follows any stipulated procedures and provides the required notice, the employer will not be liable for breaching the employment contract simply by deciding to terminate.<sup>63</sup> Employees who wish to claim an entitlement to keep their jobs (unless the employer can demonstrate a valid reason for dismissal) must look to the statutory unfair dismissal protections in the *FW Act*,<sup>64</sup> or (in the case of public servants and others covered by state laws) in relevant state industrial relations legislation.<sup>65</sup> Australian courts have adopted the attitude of the House of Lords in *Johnson v Unisys Ltd*<sup>66</sup> in refusing to allow a common law development that would be 'incoherent' with statutory law.<sup>67</sup> This principle of preserving coherence in the law has also been called upon to justify a refusal to recognise an employer's duty not to destroy mutual trust and confidence, if such a claim relates to the employer's obligations under some other statute or statutory instrument which governs disciplinary and grievance procedures. This obstacle prevented the employee from succeeding following the employ-

<sup>63</sup> *Russell (Trial)* (2007) 69 NSWLR 198; *Rogan-Gardiner* [2010] WASC 290 (22 October 2010). See also *Intico (Vic) Pty Ltd v Walmsley* [2004] VSCA 90 (21 May 2004). In those cases in which employees were held to have a common law entitlement to fair procedures (such as warnings) prior to a decision to dismiss, the employees could point to contract terms promising the application of fair procedures. For example, in *Murray Irrigation Ltd v Balsdon* (2006) 67 NSWLR 73, the employee was held to have the benefit of a contractual entitlement not to be dismissed without reasons, because of a term in his employment contract incorporated from an enterprise agreement. In *Dare v Hurley* [2005] FMCA 844 (12 August 2005), the employee was held to have the benefit of a promise of certain fair disciplinary procedures as a consequence of the incorporation of a human resources policy manual into her employment contract. See also *Rispoli v Merck Sharpe & Dohme (Australia) Pty Ltd* [2003] FMCA 160 (3 October 2003).

<sup>64</sup> *FW Act* pt 3-2.

<sup>65</sup> See Andrew Lynch, 'The Fair Work Act and the Referrals Power — Keeping the States in the Game' (2011) 24 *Australian Journal of Labour Law* 1 for an explanation of the relationship between federal and state labour laws.

<sup>66</sup> [2003] 1 AC 518.

<sup>67</sup> See *New South Wales v Paige* (2002) 60 NSWLR 371, 395 [132] (Spigelman CJ). See also the statement of Hoeben J in *Heptonstall v Gaskin [No 2]* [2005] 138 IR 103, 116 [29], that the coherence of the law of 'tort, wrongful dismissal and administrative law as it presently stands could be significantly undermined by the operation of an implied "trust and confidence" term in the contract of employment.' See also *Russell (Appeal)* (2008) 72 NSWLR 559, 574–5 [63]–[64] (Basten JA).

er's appeal in *South Australia v McDonald* ('*McDonald (Appeal)*').<sup>68</sup> In that case, it was held that a schoolteacher's claim (successful at first instance)<sup>69</sup> that the employer had breached the duty of mutual trust and confidence in the way it managed a grievance procedure could not succeed, because the grievance procedures were governed by public sector employment regulation.<sup>70</sup>

Since Parliament has framed important limits on unfair dismissal protection (by restricting it to employees whose employment is governed by an industrial instrument, or those who earn less than a stipulated income threshold),<sup>71</sup> this commitment to coherence also means that the common law will not develop in such a way as to usurp those limits. This does not mean that common law claims based on contractual rights cannot be brought for sums in excess of the statutory cap on unfair dismissal compensation. Clearly they can, as is shown by the many cases in which contractual damages have been awarded to employees who would not be entitled to complain of a 'harsh, unjust or unreasonable' dismissal under statute.<sup>72</sup> The statutory provisions protect a different interest — not the interest in the proper performance of a contract, but an interest in procedurally fair treatment, similar to the rights to procedural fairness in administrative law.<sup>73</sup> The common law maintains its role in supporting the reasonable expectations of parties to contractual bargains, but it will not now develop an implied right to procedural fairness in contracts between private parties, because such a development would compete with identical rights already enacted in legislation and made subject to restrictions. To do so would create incoherence in the law.

There is perhaps one somewhat anomalous case which ought to be mentioned here, because on its face it appears to allow that a claim for breach of the obligation of mutual trust and confidence can sound in damages for distress and humiliation consequent upon a procedurally unfair termination

<sup>68</sup> (2009) 104 SASR 344.

<sup>69</sup> See *McDonald (Trial)* (2008) 172 IR 256.

<sup>70</sup> *McDonald (Appeal)* (2009) 104 SASR 344, 398 [270] (Doyle CJ, White and Kelly JJ). See Rachael White 'A Setback for Mutual Trust and Confidence?' (2010) 23 *Australian Journal of Labour Law* 220 for a note explaining the McDonald decisions.

<sup>71</sup> See *FW Act* s 382.

<sup>72</sup> See, eg, *Walker v Citigroup Global Markets Australia Pty Ltd* (2006) 233 ALR 687; *Whittaker v Unisys Australia Pty Ltd* (2010) 26 VR 668; *Earney v Australian Property Investment Strategic Pty Ltd* [2010] VSC 621 (22 December 2010).

<sup>73</sup> See Jonathan Greenacre, 'The Continuing Rise of the Implied Term of Mutual Trust and Confidence' (2007) 13 *Employment Law Bulletin* 28 for an argument that the obligation not to destroy mutual trust does seek to import administrative law concepts of procedural fairness into private employment law.

of employment. *Quinn v Gray*<sup>74</sup> concerned the dismissal of a school principal without allowing her to serve out the term of her notice period. According to a term in her employment contract, her complaint was determined by an arbitrator who found that there was an implied term of mutual trust and confidence in her employment contract and it had been breached by the employer (the Association of Canonical Administrators of the Catholic Archdiocese of Melbourne — the 'ACA') when it summarily dismissed her.<sup>75</sup> Her dismissal followed some complaints brought by the Independent Education Union on behalf of some teachers.<sup>76</sup> The arbitrator held that the ACA failed to afford her procedural fairness in dealing with this complaint. Justice Byrne of the Supreme Court of Victoria upheld the arbitrator's award on the basis that he could find no 'manifest error' in the decision.<sup>77</sup> In particular, Byrne J said: 'I am mindful that, in a contract of employment these damages might rarely arise as a matter of fact, but I am not concerned with this because the arbitrator has made the findings of fact.'<sup>78</sup> The case is promising for those who would wish to see an unqualified acceptance of the duty of mutual trust and confidence, not least because Byrne J stated that there was 'abundant authority to support' the implication of such a term in an employment contract.<sup>79</sup> Nevertheless, it would be unwise to place too much store on a case decided as a matter of judicial review (on administrative law principles) of a private arbitration.

On the whole, the most that can confidently be said about the duty of mutual trust and confidence in the Australian common law of employment is that it underpins the continuation of an employment relationship. Its calculated destruction grounds a claim for constructive dismissal, on the basis that the aggrieved employee should be entitled to terminate the employment contract for the employer's breach.

Unlike English law, Australian case law has not gone so far as to conflate the obligation not to destroy mutual trust and confidence with a general duty of good faith and fair dealing in employment contracts, breach of which might sound in damages. Although there are some suggestions in Australian cases that the two obligations of mutual trust and confidence on one hand,

<sup>74</sup> (2009) 184 IR 279.

<sup>75</sup> *Ibid* 281 [4], 282 [9] (Byrne J).

<sup>76</sup> *Ibid* 283 [17].

<sup>77</sup> *Ibid* 282 [12], 286 [31].

<sup>78</sup> *Ibid* 286 [30].

<sup>79</sup> *Ibid* 282–3 [13].

and good faith on the other, are synonymous, these statements tend to be made by courts who have found themselves relieved of any obligation to decide upon the matter.<sup>80</sup> The better view is that these are separate if related obligations.<sup>81</sup> Like siblings, they derive from the same source, ie the existence of a relationship of employment, but they are best understood as separate concepts, performing different functions. This is really a matter of choosing and clarifying a vocabulary to assist in the clear articulation of separate concepts. It is useful to reserve the terminology of ‘mutual trust and confidence’ to describe a particular characteristic of an employment contract that distinguishes it from, say, a contract of sale or other transient contractual arrangement. The terminology of ‘good faith’ is best engaged to describe a governing principle in the construction and interpretation of relational contracts such as employment.

### III GOOD FAITH

To summarise, ‘mutual trust and confidence’ is an indicative feature of an employment relationship. It describes a necessary element in a relationship characterised by an expectation of mutual cooperation to achieve business objectives. Destruction of trust and confidence in the relationship signals the end of that kind of relationship. Since the employment contract is the legal tool that regulates the voluntary relationship between the parties, an act calculated or likely to destroy the underlying trust and confidence in the relationship also constitutes a breach of the employment contract, and allows the innocent party to elect to terminate for breach, and to claim whatever remedies flow from termination of the contract.

‘Good faith’, on the other hand, is a principle of construction in certain kinds of contracts.<sup>82</sup> The principle of good faith performance assumes that parties intend to perform their contractual obligations in a manner which permits each party to enjoy the mutually intended benefits of the contract.<sup>83</sup> Good faith performance means ‘not acting arbitrarily or capriciously; not

<sup>80</sup> See, eg, *Russell (Appeal)* (2008) 72 NSWLR 559, 567 [32], where Basten JA stated: ‘Although there were said to be two implied terms, it is probably sufficient to identify them as a single obligation.’

<sup>81</sup> *Gillies v Downer EDI Ltd* [2011] NSWSC 1055 (9 September 2011) [204]–[207] (Rothman J).

<sup>82</sup> See above n 14 and the authorities cited there.

<sup>83</sup> This principle has a long pedigree: see *Mackay v Dick* (1881) 6 App Cas 251, 263 (Lord Blackburn); *Butt v M'Donald* (1896) 7 *Queensland Law Journal* 68, 70–1 (Griffith CJ, with whom Cooper and Power JJ agreed).



acting with an intention to cause harm; and acting with due respect for the intent of [the] bargain as a matter of substance not form'.<sup>84</sup>

This conception of good faith has been affirmed by those judges who have been prepared to find a duty of good faith performance in employment contracts. The first case to clearly decide that this duty exists in Australian employment law was *Russell (Trial)*.<sup>85</sup> Mr Russell's was a peculiar case, because it was brought by a person who had already succeeded in obtaining reinstatement and continuity of salary in an unfair dismissal application before the NSW Industrial Relations Commission. Mr Russell's common law claim was for damages in respect of his legal expenses in pursuing the unfair dismissal case, and the costs of hiring a public relations consultant to manage publicity in the matter. (He was originally dismissed upon allegations that he had been passively involved in an incident of child abuse.) In the end, a finding that the church owed Mr Russell a duty of good faith did Mr Russell no good, because his legal and other expenses were held not to be recoverable.<sup>86</sup> Nevertheless, the case is important for the clear statement (by Rothman J) about the existence and scope of a duty of good faith in employment:

In the context of an employment relationship, if there exists a duty to act in good faith it 'imports a requirement that the person doing the act exercise prudence, caution and diligence', which would mean due care to avoid or minimise adverse consequences to the other party.<sup>87</sup>

Although the matter went to the NSW Court of Appeal, the appeal bench was able to decide the matter without deciding whether Rothman J's statement of the duty of good faith was sound.<sup>88</sup>

A similar expression of a duty of good faith appears in *Morton v Transport Appeal Board [No 1]*, where Berman AJ said: 'what is required is a balancing, in good faith, of the interests of the employer against adverse effects it may have on the employee'.<sup>89</sup> Justice Schmidt came closer to articulating a general

<sup>84</sup> Carter, Peden and Tolhurst, above n 14, 26–27 [2–12].

<sup>85</sup> (2007) 69 NSWLR 198, 227–8 [117]–[119] (Rothman J). See Riley, 'The Boundaries of Mutual Trust and Good Faith', above n 10 for more detailed analysis of the Russell litigation and its contribution to the present state of Australian law.

<sup>86</sup> *Russell (Trial)* (2007) 69 NSWLR 198, 237 [166]–[181] (Rothman J).

<sup>87</sup> *Ibid* 227 [117].

<sup>88</sup> *Russell (Appeal)* (2008) 72 NSWLR 559.

<sup>89</sup> (2007) 168 IR 403, 435 [201].

obligation to act fairly in *Foggo v O'Sullivan Partners (Advisory) Pty Ltd*.<sup>90</sup> Justice Schmidt described the employer's obligation in these terms:

Compliance with the implied terms does not require an employer to act contrary to its own interests. Rather, what is required is an approach which has regard to matters such as the honest and reasonable exercise of the employer's rights; with prudence, caution and diligence, and with care taken to avoid or minimise adverse consequences to the employee, that are inconsistent with the agreed common purpose and expectations of the parties to the contract. Essentially, employers must treat employees fairly in the conduct of their business, and must act responsibly and in good faith in the treatment of their employees.<sup>91</sup>

While good faith is sometimes treated sceptically in employment law cases, it is rarely dismissed out of hand. Even in *Intico (Vic) Pty Ltd v Walmsley*,<sup>92</sup> a case noted for the Court's refusal to accede to an argument based on good faith, Buchanan JA stated: 'The duty of good faith does not qualify an employer's right to summarily dismiss an employee for misconduct.'<sup>93</sup> This statement does not deny the existence of an obligation of good faith; it merely limits its operation and denies that it qualifies the employer's common law right to dismiss with notice.

It is nevertheless true that the third proposition stated above has not yet received universal endorsement, so it is worth elaborating an argument as to why it ought to be accepted.

The debate about 'good faith' often stalls at the point of deciding whether a good faith obligation exists at all in contract law. Behind much of the resistance to its acceptance is a fear that good faith is too indeterminate a principle and if adopted would introduce chaos into the common law. Gunther Teubner has described good faith as an 'irritant' in English law, because this infection from European civil law does not accord with the inherent culture of the common law.<sup>94</sup> A similar sentiment was expressed by Mason P in *CGU Workers Compensation (NSW) Ltd v Garcia*,<sup>95</sup> where the Court was asked by a plaintiff to find that an insurer had a duty of good faith towards claimants when it was dealing with compensation claims. This duty

<sup>90</sup> (2011) 206 IR 87.

<sup>91</sup> *Ibid* 115–16 [99].

<sup>92</sup> [2004] VSCA 90 (21 May 2004).

<sup>93</sup> *Ibid* [23].

<sup>94</sup> See Gunther Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences' (1998) 61 *Modern Law Review* 11.

<sup>95</sup> (2007) 69 NSWLR 680.

was argued to arise as a general tortious duty, which the insurer was alleged to have breached by withholding compensation payments from an injured worker for capricious reasons.

In refusing the claim, Mason P observed that the 'adversary paradigm' adopted by the scheme of the workers' compensation legislation, whereby parties were required to test claims in court, was not a conducive framework for the recognition of good faith obligations.<sup>96</sup> The common law's adversarial system of justice has traditionally focused on contest, not cooperation. Those who have been trained in courtroom practice and procedure perhaps understandably harbour a suspicion that 'good faith' means surrendering some power to the other side. An adversarial system is antagonistic to the notion that one party is obliged to 'temper the deliberate pursuit of self-interest' and to regard the interests of the other.<sup>97</sup> This may be why some legal scholars have been so reluctant to recognise let alone advocate principles of good faith in contractual relationships.<sup>98</sup> Nevertheless, there is good authority for the proposition that an obligation of good faith does arise in certain kinds of contracts — those which describe long-term or at least indefinite relationships in which parties expect to cooperate for their mutual benefit.<sup>99</sup> A number of judicial decisions have been prepared to find and apply such an obligation in cases of commercial distributorships, franchises and other ongoing business relationships.<sup>100</sup> Employment is also such a relationship.<sup>101</sup>

<sup>96</sup> Ibid 697 [87].

<sup>97</sup> See Jane Stapleton, 'Good Faith in Private Law' (1999) 52 *Current Legal Problems* 1, 7 for the proposition that the core principle of good faith is to 'temper the deliberate pursuit of self-interest'.

<sup>98</sup> See, eg, Tyrone M Carlin, 'The Rise (and Fall?) of Implied Duties of Good Faith in Contractual Performance in Australia' (2002) 25 *University of New South Wales Law Journal* 99; Andrew Terry and Cary Di Lernia, 'Franchising and the Quest for the Holy Grail: Good Faith or Good Intentions?' (2009) 33 *Melbourne University Law Review* 542.

<sup>99</sup> See P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989) 1, 11; A F Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66.

<sup>100</sup> See, eg, *Hungry Jack's Pty Ltd v Burger King Corp* (1999) 30 ACSR 551, affd *Burger King Corporation v Hungry Jack's Pty Ltd* (2011) 69 NSWLR 558; *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* [1999] ATPR ¶41-703; *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 (18 August 2000); *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1; *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 (20 February 2004); *J F Keir Pty Ltd v Priority Management Systems Pty Ltd (admin apptd)* [2007] NSWSC 789 (24 July 2007) [27] (Rein AJ); *Mangrove Mountain Quarries Pty Ltd v Barlow* [2007] NSWSC 492 (17 May 2007) [27] (Windeyer J).

Employment relationships are often very fluid. In preparing a contract to describe and regulate that relationship, employers often reserve to themselves considerable discretions over important aspects of the relationship, such as what duties are to be performed, when and how.<sup>102</sup> They rely on the employee's obligation to cooperate in pursuing the employer's business interests rather than spelling out duties in intricate detail in a written document.<sup>103</sup>

The risk of such open-ended contracts is that disputes may arise over the way in which the employer chooses to exercise such discretions. This is where a good faith obligation can play a valuable role. Good faith comes into play when parties to an employment contract that contains imprecise commitments and discretions discover a need to determine the precise contours of their obligations and entitlements. For example, a contract might make open-ended promises to review salaries regularly, or pay performance-based bonuses. If an argument arises over a salary review or bonus calculation, a court may be called upon to assess whether the relevant contractual term has been adequately observed. This role for good faith has received some judicial endorsement:

Ascertaining the meaning of an expression in an employment contract must rest on the premise that the contract was made in good faith with the object of at least potential mutual benefit by due performance.<sup>104</sup>

On this view, good faith is an umbrella or 'portmanteau' principle,<sup>105</sup> which assists in the interpretation of other obligations in the employment contract, especially those obligations which involve the exercise of some discretion. Good faith requires that discretions be exercised for the purposes intended by the mutual agreement of the parties, and not opportunistically or arbitrarily. While the relationship survives, the good faith obligation requires each to permit the other party to derive the intended benefits from the

<sup>101</sup> See *CGU Workers Compensation (NSW) Ltd v Garcia* (2007) 69 NSWLR 680, 710 [168] (Santow JA): 'while the duty to act in good faith may be implied in certain contractual contexts, such as employment' (emphasis added).

<sup>102</sup> See, eg, *Cameron v Asciano Services Pty Ltd* [2011] VSC 36 (21 February 2011) [6] (Beach J), where a change of duties clause was held to allow an employer to make substantial changes to an executive's role.

<sup>103</sup> The employee's duty to cooperate is well-established: see *Secretary of State for Employment v Associated Society of Locomotive Engineers and Firemen [No 2]* [1972] 2 QB 455, 498 (Buckley LJ), discussed in Lizzie Barmes, 'The Continuing Conceptual Crisis in the Common Law of the Contract of Employment' (2004) 67 *Modern Law Review* 435, 441.

<sup>104</sup> *Whittaker v Unisys Australia Pty Ltd* (2010) 26 VR 668, 689 [114] (Ross J).

<sup>105</sup> See Freedland, *The Personal Employment Contract*, above n 9, 159.

relationship.<sup>106</sup> In other words, the obligation to perform in good faith precludes contradictory and capricious conduct which undermines the spirit of the agreement.

Good faith requires a 'reasonable' exercise of discretion, but only if 'reasonable' means in accordance with the spirit and intent of parties' own agreement. The express terms of the parties' own agreement determine what is 'reasonable'. Most importantly, the good faith obligation does not import any excuse for judicial imposition of an external standard of reasonableness upon the parties' conduct. External standards of reasonableness may be imposed by statute. For example, the obligation imposed by the *FW Act* s 387 that an employer must notify an employee of a 'valid reason' before dismissal, requires employers to meet a standard of objective reasonableness in their decision-making, or else face the prospect of a successful application from the employee for reinstatement or compensation under the statute.<sup>107</sup>

The common law of contract does not impose such obligations. Contract law is a form of regulation entirely dependent upon the consent of the parties, so if parties have contracted on the basis that either of them may decide to bring the relationship to an end without providing reasons, then the agreement of the parties will prevail — whether or not other people might believe such an agreement to be an unreasonable one. The common law implies no obligation to provide reasons for termination.<sup>108</sup> Those common law cases in which courts have found that an employer was constrained to afford the employee procedural fairness in dismissal generally depend upon a finding that an obligation to follow fair disciplinary procedures was incorporated into the employment contract,<sup>109</sup> perhaps from a workplace policy document, or from the terms of an industrial instrument incorporated by implication,<sup>110</sup> or by reference into the contract.<sup>111</sup>

<sup>106</sup> See above n 83.

<sup>107</sup> *FW Act* ss 390–2.

<sup>108</sup> *Intico (Vic) Pty Ltd v Walmsley* [2004] VSCA 90 (21 May 2004) [17] (Buchanan JA).

<sup>109</sup> See *Dare v Hurley* [2005] FMCA 844 (12 August 2005). Note that under English law, incorporation of an express term will still attract the operation of the 'Johnson exclusion zone', explained above, if a court takes the view that the express term providing disciplinary or grievance procedures was incorporated only to serve the employer's compliance with statutory unfair dismissal laws: see *Edwards* [2012] 2 AC 22, 41 [40] (Lord Dyson for Lords Dyson and Walker), 54 [94] (Lord Mance).

<sup>110</sup> See *Gregory v Phillip Morris Ltd* (1988) 80 ALR 455; *Bostik (Australia) Pty Ltd v Gorgevski [No 1]* (1992) 36 FCR 20. These cases have since been overturned on this point: see *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410.

<sup>111</sup> *Murray Irrigation Ltd v Balsdon* (2006) 67 NSWLR 73.

In *Balsdon v Murray Irrigation Ltd*,<sup>112</sup> for example, Ashford DCJ in the District Court of New South Wales held that Mr Balsdon's dismissal was in breach of the employer's obligation not to dismiss on 'harsh, unjust and unreasonable' grounds. This obligation had been incorporated into his employment contract by reference to an enterprise bargain. This finding was confirmed on appeal by Bryson JA (with whom Handley and Ipp JJA agreed).<sup>113</sup> Sometimes, an obligation not to dismiss without conducting a proper enquiry and establishing a good reason will be incorporated into the employment contract from a human resources policy.<sup>114</sup> It is still the case, however, that absent such a contractual term, employers enjoy a common law right to terminate employment contracts for any reason or no reason at all, so long as they observe the terms of those contracts.<sup>115</sup>

This is one of the main concerns of employers, and one of the frequent obstacles to acceptance of an obligation of good faith in employment: the fear that a good faith obligation will lock employers in to keeping staff whose services they no longer require. This fear has not been realised in any of the case law. So long as the employer is careful to agree an express notice period for termination, and is careful not to include any terms which signal that the employee has a right to remain in employment until dismissed for a just cause, then employers can rely on the notice periods in their employment contracts.<sup>116</sup> An employer will not, however, be permitted to speak in a forked tongue. This was essentially the problem in the case of *Walker v Citigroup Global Markets Australia Pty Ltd* ('Walker').<sup>117</sup>

In *Walker*, the Court had to make sense of some conflicting evidence as to the terms of Mr Walker's engagement. On the one hand the employer's counsel produced a set of standard term 'conditions of employment' which had been attached to his letter of offer and which stipulated that the engagement could be terminated with one month's notice. On the other hand,

<sup>112</sup> (Unreported, District Court of New South Wales, Ashford DCJ, 9 December 2005).

<sup>113</sup> *Murray Irrigation Ltd v Balsdon* (2006) 67 NSWLR 73, 81 [25].

<sup>114</sup> See, eg, *Rispoli v Merck Sharpe & Dohme (Australia) Pty Ltd* [2003] FMCA 160 (3 October 2003).

<sup>115</sup> See *Intico (Vic) Pty Ltd v Walmsley* [2004] VSCA 90 (21 May 2004) [17] (Buchanan JA).

<sup>116</sup> There is a statutory minimum notice period for national system employers in *FW Act* s 117. Also, employees aggrieved that their dismissal was motivated by an impermissibly discriminatory reason may pursue an adverse action claim under 'general protections' in the *FW Act* pt 3-1. For an explanation of this cause of action, see Joellen Riley, 'Adverse Action Claims under the *Fair Work Act 2009* (Cth): Some Lessons from the Early Cases' (2011) 25(3) *Commercial Law Quarterly* 12.

<sup>117</sup> (2006) 233 ALR 687.

however, was proof of some correspondence leading up to his appointment which indicated that both the employer and employee expected the engagement to last for at least a year. This correspondence showed that the parties had agreed that Mr Walker would receive a guaranteed bonus for his first year of service, and that he would be given a more illustrious title after the end of that first year.

At first instance, Kenny J held that the standard term conditions prevailed.<sup>118</sup> The other promises about longer term employment were held to be misleading and deceptive representations, entitling Mr Walker to compensation for breach of s 52 of the *Trade Practices Act 1974* (Cth).<sup>119</sup> On appeal, however, a full bench held that the commitments evidenced in the correspondence between the parties during negotiations were contractual. The Court was guided by the general principle of contract construction that '[w]here there are clauses of a contract specially framed with the individual circumstances in mind, together with standard form clauses, it will normally be appropriate to give greater weight to the specially negotiated clauses'.<sup>120</sup> The circumstances of the recruitment assisted the court to this conclusion. It was held that 'the purpose and object of the transaction, namely, the recruiting of a high level and high profile employee then in other employment' made it a 'practical absurdity' that the parties would have agreed to a clause allowing termination on only one month's notice, and a consequent avoidance of any obligation to pay the promised guaranteed bonus.<sup>121</sup> So Mr Walker was held to have the benefit of a contract with a minimum one-year term.

This reasoning evidences an approach to contract construction that assumes good faith and fair dealing between the parties. The Court looked to the 'purpose and object'<sup>122</sup> of the contract, and the expectations of 'business people active in the financial world',<sup>123</sup> and assumed that each was committed to cooperating to allow the other the benefit of their agreement. The employer was not permitted to rely opportunistically on the standard terms attached to a contract document, in the face of clear evidence of a contrary intention in the real agreement between the parties.

<sup>118</sup> *Walker v Citigroup Global Markets Australia Pty Ltd* (2005) 226 ALR 114.

<sup>119</sup> This would now be a claim under s 18 of the *Australian Consumer Law*, contained in sch 2 of the *Competition and Consumer Act 2010* (Cth).

<sup>120</sup> (2006) 233 ALR 687, 706 [77] (Gyles, Edmonds and Greenwood JJ).

<sup>121</sup> *Ibid* 705–6 [76].

<sup>122</sup> *Ibid* 705 [76].

<sup>123</sup> *Ibid* 705–6 [76].

The Full Court did not expressly refer to this principle of construction as a 'good faith' obligation. In fact, Kenny J at first instance held that the Court should *not* imply a duty of good faith in employment contracts,<sup>124</sup> and the Full Bench opined that it was not necessary to consider such an obligation to resolve the appeal.<sup>125</sup> Arguably, the process of construing a contract on the basis that the parties must be assumed to be committed to performing the contract according to the reasonable expectations of prudent business people negotiating such transactions is to apply a good faith standard. This is all that good faith implies. Good faith does not oblige a contracting party to volunteer new benefits to a counterparty. It requires only faithful observance of the agreement made. It requires respect for the spirit of the agreement, and disallows opportunistic manipulation of some technical flaw in its form.<sup>126</sup>

*Silverbrook Research Pty Ltd v Lindley*<sup>127</sup> provides another example of a case determined on principles of construction that implicitly assumed good faith performance. In that case, the employer had solemnly promised the employee a quarterly performance bonus based on achievement of certain key performance indicators. The contract document explicitly stated that the determination of bonuses was 'entirely within the discretion of Silverbrook'.<sup>128</sup> Nevertheless, when the employer failed to pay any bonuses because it had failed to set any performance benchmarks, it was held to be in breach of its contractual obligations. The employee (who had resigned by the time the matter came for hearing) was nevertheless held to be entitled to receive a measure of damages based on the loss of a chance to receive bonuses.<sup>129</sup> President Allsop's reasoning is illuminating:

The discretion [whether to pay a bonus] is to be exercised honestly and conformably with the purposes of the contract. There may be many circumstances in which it would be legitimate, and conformable with the purposes of the con-

<sup>124</sup> *Walker v Citigroup Global Markets Australia Pty Ltd* (2005) 226 ALR 114, 156–7 [203]–[207].

<sup>125</sup> *Walker v Citigroup Global Markets Australia Pty Ltd* (2006) 233 ALR 687, 708 [86] (Gyles, Edmonds and Greenwood JJ).

<sup>126</sup> See Carter, Peden and Tolhurst, above n 14, 27 [2–12] for an authoritative view that good faith means 'not acting arbitrarily or capriciously; not acting with an intention to cause harm; and acting with due respect for the intent of bargain as a matter of substance not form.'

<sup>127</sup> [2010] NSWCA 357 (17 December 2010).

<sup>128</sup> *Ibid* [22] (Hammerschlag J).

<sup>129</sup> For employment cases allowing loss of chance claims, see *Manubens v Leon* [1919] 1 KB 208 (concerning a hairdresser's claim for lost tips); *Herbert Clayton and Jack Waller Ltd v Oliver* [1930] AC 209 (a performing artist's claim for damages in respect of the lost chance to derive fame and reputation). See *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64 for the principles upon which a loss of chance claim may succeed in contract.



tract, not to pay the bonus. There may be financial stringency or misbehaviour by the respondent or some other consideration. ... What, however, would not be permitted is an unreasoned, unreasonable, arbitrary refusal to pay anything, come what may. This would be a denial of the very clause that had been agreed. If these parties wished to make payment under the clause entirely gratuitous and voluntary such that payment could be withheld capriciously, notwithstanding the compliance with solemnly set objectives they needed to say so clearly.<sup>130</sup>

Notwithstanding the absence of any express mention of 'good faith', this is a precise articulation of the good faith obligation.

The *Silverbrook* case also provides a useful illustration of the way in which breach of good faith may sound in some award of damages. Where a breach of good faith effectively robs the employee of some benefit that he or she would otherwise have received as a consequence of the proper, good faith performance of the contract, the employee may claim expectation damages in respect of that loss, on the ordinary principles of contract law.<sup>131</sup> Damages may include compensation for the loss of a chance.<sup>132</sup>

Another illustration of good faith working invisibly as a tool of contract construction is the case of *McRae v Watson Wyatt Australia Pty Ltd*,<sup>133</sup> where it was found that early negotiations and 'industry practices'<sup>134</sup> entitled a manager to a redundancy payment when terminated, notwithstanding that no express redundancy clause existed in her contract.<sup>135</sup>

The discussion above illustrates that mutual trust and confidence and good faith are related concepts, because behaviour that offends the good faith principle may also be sufficiently contemptuous to destroy mutual trust and confidence and permit the employee to claim compensation for a constructive dismissal. Both concepts arise because the relationship described by the contract between the parties is an employment relationship. Nevertheless they do different work. Mutual trust describes a necessary characteristic of an

<sup>130</sup> *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010) [6]. See also *Eshuys v St Barbara Ltd* (2011) 205 IR 302, 327–9 [105]–[108], where Kaye J also applied a principle that a discretion to award bonuses must be exercised 'bona fide' (Latin for 'in good faith') and rationally, and not perversely nor capriciously.

<sup>131</sup> See Carter, Peden and Tolhurst, above n 14, 811–12 [35–10].

<sup>132</sup> *Ibid* 856–7 [36–19]. See also *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010) [2] (Allsop P); *Guthrie v News Ltd* (2010) 27 VR 196, 210–14 [46]–[57] (Kaye J).

<sup>133</sup> [2008] FMCA 1568 (1 December 2008).

<sup>134</sup> *Ibid* [32] (Raphael FM).

<sup>135</sup> *Ibid* [7].

employment relationship. Destruction of trust and confidence justifies the innocent party in bringing the employment contract to an end, but it will not sound in any damages additional to the compensation that would otherwise flow from a wrongful termination of the employment contract. Breach of good faith may, however, assist an employee to a damages claim based on the loss of some benefit that she would have enjoyed if the contract had been performed in good faith. In appropriate circumstances this may exceed payment of salary for a stipulated or 'reasonable' period of notice. It may, for example, give her an entitlement to the calculation of performance-based remuneration, the allocation of other promised rewards, or the benefits she would have received if granted a promotion.

It falls now to consider some of the particular kinds of claims which have commonly been made by employees, but which have produced difficulty in the case law. Often, employees who have lost their jobs after an arduous period of conflict at work will claim that they were bullied and harassed, and that this constituted a breach of mutual trust and confidence or good faith giving rise to damages. Mr McDonald's claim against the State of South Australia's education department included such allegations.<sup>136</sup> So did the investment advisor's claim in *Nikolich v Goldman Sachs J B Were Services Pty Ltd*.<sup>137</sup> In both these cases an element of the damages claim was for mental suffering. Another common claim is that the employee has suffered reputational harm as a consequence of a dismissal, and now has difficulty securing further employment.<sup>138</sup> What role do mutual trust and confidence and good faith play in these kinds of claims?

#### IV BULLYING AND HARASSMENT CLAIMS

If an employer can be shown to have engaged in, or tolerated, bullying or harassment of an employee, the employee is very likely to be able to demonstrate that the employer has acted in a manner calculated to destroy mutual trust and confidence in the relationship, so that the bullied employee can succeed in demonstrating constructive dismissal. It is not so clear, however, that a bullied employee will be able to establish any entitlement to damages

<sup>136</sup> *McDonald (Trial)* (2008) 172 IR 256; *McDonald (Appeal)* (2009) 104 SASR 344. See White, above n 70, for a note explaining the McDonald decisions.

<sup>137</sup> [2006] FCA 784 (23 June 2006); *Goldman Sachs JBWere Services Pty Ltd v Nikolich* (2007) 163 FCR 62.

<sup>138</sup> See, eg, *Quinn v Gray* (2009) 184 IR 279.

for breach of the employment contract,<sup>139</sup> beyond an amount sufficient to compensate for the premature termination of the employment contract.

It is becoming increasingly common for employees who are aggrieved by the fact or manner of the termination of their employment to claim some kind of general damages based on hurt, distress or mental suffering.<sup>140</sup> To the extent that these claims are based on an alleged breach of mutual trust and confidence or good faith, they are misconceived, at least according to the present state of Australian law. As far as Australian law is concerned, no contractual damages flow simply from the disappointment and distress felt as a consequence of the fact that an employment contract is terminated, even if the reason for termination is that the employer has destroyed the employee's trust and confidence in the relationship.<sup>141</sup> Australian case law continues to cite the old case of *Addis v Gramophone Co Ltd*<sup>142</sup> for the proposition that no damages are recoverable for distress or disappointment resulting from the fact of termination of an employment relationship.<sup>143</sup>

A number of English cases have been prepared to allow recovery of damages under contract for breach of the mutual trust and confidence obligation when the damage sounds in some kind of medically-treated mental illness, but only if the mental suffering was caused during employment, and did not arise only as a consequence of the fact of early termination.<sup>144</sup> Australian cases have tended to treat these kinds of claims as damages flowing not from a breach of good faith, but from breach of a duty to provide a safe workplace (a duty which arises concurrently in tort and contract).<sup>145</sup> So bullying and

<sup>139</sup> This article is confined to a discussion of an employee's rights under the common law of contract. Bullying and harassment may also constitute a breach of occupational health and safety laws, and may permit an employee to bring a workers' compensation claim. Examining those statutory regimes protecting workplace safety are outside the parameters of this article. The aim here is to analyse only the mutual trust and good faith obligations, to assess the role that they play in employment contract disputes.

<sup>140</sup> See, eg, *Goldman Sachs JBWere Services Pty Ltd v Nikolich* (2007) 163 FCR 62.

<sup>141</sup> General damages of \$100 000 were awarded by a full bench of the Federal Court in *Walker v Citigroup Global Markets Australia Pty Ltd* (2006) 233 ALR 687, but for the claim based on breach of the *Trade Practices Act 1974* (Cth), not for the breach of contract claim: at 709 [91] (Gyles, Edmonds and Greenwood JJ).

<sup>142</sup> [1909] AC 488.

<sup>143</sup> See, eg, *Reynolds v Southcorp Wines Pty Ltd* (2002) 122 FCR 301, 321 [121] (Hely J). See Sappideen et al, above n 10, 418–26 [11-230]–[11-270] for a complete discussion of the *Addis* case and its reception in Australian, New Zealand and Canadian law.

<sup>144</sup> See *Gogay v Hertfordshire County Council* [2000] IRLR 703; *Eastwood v Magnox Electric plc* [2005] 1 AC 503.

<sup>145</sup> See, eg, *Goldman Sachs JBWere Services Pty Ltd v Nikolich* (2007) 163 FCR 62.

harassment can be actionable as a breach of an employment contract in Australia and give rise to a damages award, but as a breach of the employer's duty of care to the employee, and not as a consequence simply of the destruction of trust in the relationship. This means that an employee bringing such a claim needs to be able to demonstrate that the bullying caused some illness and consequent loss.<sup>146</sup>

For example, in *Sneddon v Speaker of the Legislative Assembly*,<sup>147</sup> an electoral office worker established that she had suffered serious mental-distress-related illness as a consequence of bullying by the Member of Parliament whom she served,<sup>148</sup> and by others in his office. Ms Sneddon was awarded \$438 000, calculated as lost income during a proper notice period, and future loss of earnings. Future earnings were compensated because it was held she was unable to find other employment while suffering from the illness induced by the bullying.<sup>149</sup> Only a relatively small proportion of her claim (\$7500) was awarded as general damages for pain and suffering.<sup>150</sup>

One of the most commonly cited bullying cases in New South Wales is *Naidu v Group 4 Securitas*<sup>151</sup> which concerned a security guard working under a labour hire agreement between Group 4 Securitas and News Ltd. Mr Naidu was bullied mercilessly for about six years, in the most shocking of circumstances. He suffered debilitating depression and became unable to work. His marriage broke down as a consequence of his declining psychiatric health. He was awarded damages amounting to about \$1.9 million, most of which represented lost earnings and medical expenses.<sup>152</sup> He was however awarded general damages of \$350 000 (shared between the labour hire and host employers) and News Ltd was also held to be liable for a further \$150 000 in exemplary damages, on the basis that it was vicariously liable for its manager's conduct.<sup>153</sup>

In these and cases like them, employees have been able to establish an entitlement to some damages as a consequence of being bullied, but on the

<sup>146</sup> See, eg, *Bailey v Peakhurst Bowling & Recreation Club Ltd* [2009] NSWDC 284 (3 November 2009).

<sup>147</sup> (2011) 208 IR 255.

<sup>148</sup> Milton Orkopoulos.

<sup>149</sup> *Sneddon v Speaker of the Legislative Assembly* (2011) 208 IR 255, 312 [282] (Price J).

<sup>150</sup> *Ibid* 310 [270].

<sup>151</sup> [2005] NSWSC 618 (24 June 2005), *affd* *Nationwide News Pty Ltd v Naidu* (2007) 71 NSWLR 471.

<sup>152</sup> *Nationwide News Pty Ltd v Naidu* (2007) 71 NSWLR 471, 535 [426] (Basten JA).

<sup>153</sup> *Naidu v Group 4 Securitas Pty Ltd* [2005] NSWSC 618 (24 June 2005) [294]–[300] (Adams J).

basis of losses caused by the employer's breach of its duty of care. Absent a viable claim for breach of a duty of care, an employee will not be able to sustain a large damages award for grief or stress caused by the fact of dismissal. It is still the case in Australia that damages awards for breach of an employment contract are confined by the general refusal to grant exemplary or punitive damages, except where the employer has breached a duty of care.

Notwithstanding that some high profile cases involving allegations of bullying and harassment (such as those of Mr McDonald and Mr Nikolich) have conflated claims of breach of mutual trust and breach of a duty of care, the better view in Australian law is that this type of harm is compensable only when the employee can establish harm suffered as a consequence of a breach of the employer's duty of care.<sup>154</sup>

## V REPUTATIONAL HARM

Another common assertion in employee claims is that the employer should be liable to compensate the employee for losses flowing from the fact that the dismissed employee now faces difficulty in finding a new job, because the fact of dismissal has stigmatised the employee. Fear of the proliferation of such claims is unfounded, and ought not to discourage recognition of an obligation to perform employment contracts in good faith.

On one view, *Malik*<sup>155</sup> appeared to open the door to such claims in the United Kingdom. *Malik* is authority only for the narrow proposition that an employer who has conducted a corrupt business, and so stigmatised its employees by association, may be liable to compensate those employees for any loss arising from their inability to secure fresh employment. Even in the United Kingdom, reputational harm that flows from the mere fact of dismissal is not compensable in contract, because the employer is not contractually bound to ensure that employees remain employable in the future.

Generally, the appropriate cause of action where an employee or former employee alleges that the employer has damaged the employee's reputation is a suit in the tort of defamation. English cases have allowed employees to claim

<sup>154</sup> For a more detailed analysis of the Nikolich litigation, see Joellen Riley, 'Mental Health and Employment: Issues for Lawyers' (Paper presented at the Tristan Jepson Memorial Symposium: Mental Health and the Legal Profession, University of New South Wales, Sydney, 8 September 2006) <<http://ssrn.com/abstract=993296>>; Joellen Riley, 'Damages in Executive Employment Litigation' (Paper presented at New South Wales Young Lawyers Annual Employment & Industrial Relations One Day Seminar, Sydney, 24 February 2007) <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1003943](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003943)>.

<sup>155</sup> [1998] AC 20.

damages for reputational harm suffered as a consequence of the employer's negligence in giving a false or misleading reference about the employee.<sup>156</sup> This duty is said to arise as a consequence of the employer's duty to exercise reasonable care in preparing references in respect of employees. The measure of any damages an employee may claim is the value of any 'reasonable chance of employment' lost as a consequence of the negligent reference.<sup>157</sup> English authority was followed by Harper J in deciding *Wade v Victoria*,<sup>158</sup> a case concerning carelessly provided, false and damaging information passed on by a former employer (the Victoria Police) to a new employer. Mr Wade sued in defamation and also in negligence, on the basis that the former employer had breached its duty to be careful in providing the reference, and this had caused economic loss.<sup>159</sup>

It is by no means clear, following the High Court of Australia's decision in *Sullivan v Moody*,<sup>160</sup> that the decision in *Wade v Victoria* can stand. *Sullivan v Moody* raised the problem of 'coherence' in the law.<sup>161</sup> It was not an employment case. It concerned a claim brought in negligence by parents who had suffered reputational harm as a consequence of false allegations of child sexual abuse brought by social workers. Nevertheless, the case may hinder the development of any new principle that employees can be compensated for reputational harm (outside of a claim brought in defamation) as a consequence of breach of an employment contract. This is because the High Court clearly refused to develop the law of negligence in a way which would 'cut across other legal principles as to impair their proper application'.<sup>162</sup> In *Sullivan v Moody*, the other legal principles were those governing defamation claims. Arguably, there is also limited scope for developing any new principle

<sup>156</sup> See *Spring* [1995] 2 AC 296, 325–7 (Lord Lowry), 334–5 (Lord Slynn), 344, 351 (Lord Woolf); *McKie v Swindon College* [2011] IRLR 575.

<sup>157</sup> *Spring* [1995] 2 AC 296, 327 (Lord Lowry).

<sup>158</sup> [1999] 1 VR 121. *Spring* has not been followed in New Zealand: see *Bell-Booth Group Ltd v A-G* [1989] 3 NZLR 148; *Balfour v A-G* [1991] 1 NZLR 519.

<sup>159</sup> The defamation case in which he might have secured damages in respect of lost reputation was defended on the basis of qualified privilege: see *Wade v Victoria* [1999] 1 VR 121, 123–4 [10] (Harper J).

<sup>160</sup> (2001) 207 CLR 562. See also *New South Wales v Paige* (2002) 60 NSWLR 371, 395 [132] (Spigelman CJ). For a discussion of *Sullivan v Moody* and its impact on the decision in *Wade v Victoria*, and the acceptance of *Spring* in other common law jurisdictions, see David Rolph, Matt Vitins and Judith Bannister, *Media Law: Cases, Materials and Commentary* (Oxford University Press, 2010) 362–85.

<sup>161</sup> (2001) 207 CLR 562, 580–1 [54]–[55] (Gleeson CJ, Gaudron, McHugh, Hayne and Callinan JJ).

<sup>162</sup> *Ibid* 580 [53].

that the employer's breach of a duty not to destroy trust and confidence can justify a claim for damages based on a loss of reputation, because the employee has been unable to secure fresh employment. This means that claims for large damages based on loss of reputation are still properly to be brought as defamation claims, and are subject to the limitations and defences appropriate to those claims. Recognising the obligations not to destroy mutual trust, and to perform employment contracts in good faith, will not disturb the proper application of the law of defamation.

## VI CONCLUSIONS

On the basis of the analysis above, it is difficult to understand why there has been such judicial reluctance to accept unconditionally the following two propositions:

- 1 Employers and employees who have acted in a manner calculated or likely to destroy trust and confidence in an employment relationship are to blame for termination of the employment contract if the innocent party elects to terminate.
- 2 Employment contracts are to be construed on the basis that parties are obliged, and expect, to perform those contracts in good faith.

The first proposition works simply to allow a victimised employee to escape from an intolerable job with the same benefits they would have received if the employer decided to dismiss them. The second simply requires parties to respect the obligations mutually undertaken at the time they entered into their relationship. It does not preclude parties from limiting those obligations by express provision, though it does prevent one party from relying opportunistically on a written document to defeat the terms of the real agreement between the parties. Neither proposition opens any gates to floods of claims alleging rights to perpetual employment, or damages for hurt feelings.

The very fact that counsel representing employers sometimes vigorously argue the absence of any such obligations, even in the face of the most compelling evidence of appalling behaviour and serious harm, is testimony to the unsatisfactory state of the common law in this field. Fortright and unconditional judicial acceptance of these propositions, as limited as they are, may go some way to communicating a message to Australian employers that they do bear a responsibility to promote decent, respectful behaviour in their workplaces. Such responsibilities are not so terribly onerous. A prudent,

diligent and cautious<sup>163</sup> employer who paid heed to these principles would ensure that supervisors did not abuse their staff (as occurred in the *Naidu* case).<sup>164</sup> They would institute fair and reasonable performance review systems (and so avoid the problems arising in *Silverbrook Research Pty Ltd v Lindley*<sup>165</sup> and *McDonald (Trial)*);<sup>166</sup> they would prudently investigate any allegations of impropriety against employees before acting precipitately, and they would respectfully follow up repeated complaints from employees (as arose for *Nikolich*<sup>167</sup> and in *McDonald (Trial)*).<sup>168</sup> They would certainly not trump up malicious complaints against their staff (as in *Eastwood v Magnox Electric plc*).<sup>169</sup> They would also ensure that their contract documentation properly reflected the real agreement between the parties.<sup>170</sup> A great deal of personal grief, and an enormous amount of business time, finances and resources, may be saved by the encouragement of a corporate culture that respected obligations of mutual trust, confidence and of good faith.<sup>171</sup> Over time, we might witness a general improvement in Australian workplace culture, to the benefit of employees and employers alike. This is not an appeal for a great leaping legal development. It is nothing more than a plea for a consistent, principled message from case law in this field of law that is so important to the wellbeing of working citizens.

<sup>163</sup> *Russell (Trial)* (2007) 69 NSWLR 198, 227 [117] (Rothman J).

<sup>164</sup> *Naidu v Group 4 Securitas Pty Ltd* [2005] NSWSC 618 (24 June 2005).

<sup>165</sup> [2010] NSWCA 357 (17 December 2010).

<sup>166</sup> *McDonald (Trial)* (2008) 172 IR 256.

<sup>167</sup> *Goldman Sachs JBWere Services Pty Ltd v Nikolich* (2007) 163 FCR 62.

<sup>168</sup> *McDonald (Trial)* (2008) 172 IR 256.

<sup>169</sup> [2005] 1 AC 503.

<sup>170</sup> *Walker v Citigroup Global Markets Australia Pty Ltd* (2006) 233 ALR 687.

<sup>171</sup> For commentary on Australia's dubious workplace culture, see Fiona Smith 'The Two-Faced World of Human Resources', *Australian Financial Review* (Melbourne), 19 July 2011, 58; Michael Harmer, 'Employment Rights Leader Calls a Stop to Political To-and-Fro on Workplace Relations System' (Media Release, 17 May 2010).