Good Faith, Mutual Trust and Confidence: How far have we come; and where are we heading?

The topic raises a number of fundamental issues relating to the contract of employment and the employment relationship. Indeed, a proper treatment of the question could not be adequately performed within the limits imposed by the nature of a paper. In order to deal with the question one must firstly examine the history of employment; and the movement (if there be movement) from status to contract.

The History of Employment

Roman Law forms the basis of the right to control as a means of discerning an employee from other work relationships. Under Roman Law, the degree of freedom and control determined the status of any particular person and the degree of control ranged from total control, in the case of slaves, to the total absence of control in the case of Patricians and, later, the members of the Senate. Within that range was the citizen who, subject to the laws, had total freedom.

In pre-Industrial Revolution feudal England, the nobility had total control over all service and, before Artisan's and the middle-class developed, total control over those persons holding land under the villeinage of the lord. As the feudal system disintegrated, replaced by the embryonic capitalist system, there was a need for workers, other than slaves and serfs, and an economic necessity for the emerging middle class to have the capacity to hire and fire. It is that economic necessity for mobility of labour, as required by the middle classes, which gave rise to modern employment. In accordance with its history, "modern employment" was, for an employee, a status, higher than slave or serf but lower than the entrepreneur who required the labour, and certainly lower than the nobility. Thus, employment was predominantly status based, over which was imposed the law of contract as it developed.

It should be remembered that the law of contract, in itself, was developing at that time to meet commercial arrangements in the middle-class and artisan group. It developed out of the law relating to covenant, the writ of praecipe, the writ of debt, and *indebitatus assumpsit:* *Slade v Morley* (1597-1602) B & M 420; *Anonymous* (1458) B. & M 236; *Lickbarrow v Mason* (1787) 2 Term Rep 63 at 73, per Buller J. The last mentioned judgment refers to the process undertaken by Lord Chief Justice Mansfield in the development of commercial law and the principles of contract in a series of cases and through consultation with the merchants of the time.

It was in that context that Holt CJ remarked, in relation to the right to control:

> "If a master gives correction to his servant, it ought to be with the proper instrument, as cudgel ... And then if by accident a blow gives death, this would be but manslaughter. The same law of a schoolmaster. But a sword is not a proper instrument for correction, and the cruelty of the cut will make a malice implied": cited in *Russell v Trustees of Roman Catholic Church for the Archdiocese of Sydney* (2007) 69 NSWLR 198 at 220 ('*Russell*').

While cudgels may be frowned upon today for: the correction of an employee; as punishment for a breach of the contract of employment; or a refusal to obey a lawful direction (as it is for a schoolmaster on a pupil), the contract of employment, even as it has developed to this point in time, involves the employee contracting away such freedom, as may otherwise be available, to the control of the employer. To paraphrase Sir Otto Khan-Freund, on entering the contract of employment, the employee submits to the employer, at least within the terms of that contract, and in performing work under the contract of employment, employees subordinate their will to the employer, at least to the extent of the terms of their contract.

The Notions of Contract

> "The law of contract is part of the law of obligations. The English law of obligations is about their sources and the remedies which the court can grant to the obligee for a failure by the obligor to perform his obligation voluntarily. ...
>
> English law is thus concerned with contracts as a source of obligations. The basic principle which the law of contract seeks to enforce is that a person who makes a promise to another ought to keep his promise. This basic principle is subject to an historical exception that English law does not give the promisee a remedy for the failure by a promisor to perform his promise unless either the promise was made in a particular form, e.g., under seal, or the promisee in return promises to do something for the promisor which he would not otherwise be obliged to do, i.e., gives consideration for the promise": *Moschi v Lep Air Services Ltd* [1973] AC 331 at 346-347, per Lord Diplock.

There can be no doubt, whether or not it is the discrimen by which employment is determined, that an employee is obliged (and has always been obliged) to obey the reasonable and lawful directions of the employer. Of late, the law, according to some, has imposed an obligation on employers to exercise their rights under contract in good faith and conduct themselves in a manner that will not destroy the relationship of trust and confidence that is necessarily involved in the relationship between employer and employee.

Nevertheless, it is still the duty of an employee to obey reasonable and lawful directions and, in so doing, subject himself/herself to the wishes of the employer. While ever such a duty exists, coupled with the capacity of an employer to dismiss without cause, the employee will always suffer the status of "servant", and the employer will always enjoy the status of "master".

> "Here then is an ancient tension in the system. For the common law assumes it is dealing with a contract made between equals, but in reality, save in exceptional circumstances, the individual worker brings no equality of bargaining power to the labour market and to this transaction central to his life whereby the employer buys his labour power. This **individual** relationship, in its inception, 'is an act of submission, in its operation it is a condition of subordination, however much the submission and the subordination may be concealed by that indispensable figment of the legal mind known as the contract of employment'": Professor Joellen Riley, *Employee Protection at Common Law* (2005) Federation Press at 49, quoting Lord Wedderburn, *The Worker and the Law* (1986) 3rd Ed, Penguin, citing in turn Sir Otto Khan-Freund, *Blackstone's Neglected Child: the Contract of Employment* (1977) 93 Law Quarterly Review 508.

While it may be the case that, as the law gives greater significance to the contractual relationship between employer and employee and less to the aspects of status, the contractual subservience of an employee diminishes, there is, however, no lessening of the disparity in bargaining power between the different parties. In the words of the song: *"what force on earth is weaker than the feeble force of one".*

While ever there is the "submission" and " subordination" of which Sir Otto Khan-Freund wrote, there will continue to be a "master" and a "servant". But it is not only radicals that remark as to the inequality of bargaining power in the labour market.

Henry Bourne Higgins, a Justice of the High Court of Australia, the second President of the Commonwealth Court of Conciliation and Arbitration, and a relatively conservative equity lawyer, wrote:

> "In orderly pursuance of the agreement, the Institute gave the proper notice on the 24th November 1896, with a view to getting more satisfactory terms. The shipowners' reply was a menacing letter, sent - not to the Institute, but to each individual employee - asking him whether he was or was not satisfied with existing conditions, for if not he was 'jeopardising his position'. The attitude taken by the shipowners at this date is another illustration, if one were needed, of the general helplessness of individual employees as against employers. Virtually, the shipowner said to the engineer, 'If you are not satisfied, go.' This power of giving or refusing employment - of giving or refusing bread - is a tremendous factor in the bargain, an unfair weight thrown into the scale, like the sword of Brennus; and no one who fails to recognise this position can appreciate properly the forces which have impelled Australian parliaments to interfere, by wages boards or Arbitration Courts, with contracts between individual employers and employees. The contracting parties are not standing on the same level. The contract is not free": *Australasian Institute of Marine Engineers v Commonwealth Steamship Owners' Association*(1912) 6 CAR 95 at 100-101.

Nevertheless, the developing mutuality of conditions imposed upon employer and employee, together with the possible imposition of restrictions on termination of employment, may significantly ameliorate the inequality in contractual rights and in status. It is necessary, in that regard, to discuss mutual trust and confidence (a term, in this paper, used to describe the implied term that parties to a contract of employment will not so conduct themselves as to destroy or seriously damage the relationship of mutual trust and confidence between them) and good faith.

Mutual Trust and Confidence

Like all judicial officers, if not all lawyers, we often summarise concepts with a shorthand phrase. While such a course is convenient and useful, it is also often misleading. There may be some misleading aspects of the expression "breach of mutual trust and confidence" and "the duty of mutual trust and confidence".

It is necessary to analyse the concepts. As I have tried to explain (see in particular, *Gillies v Downer EDI Limited* [2011] NSWSC 1055), there is a difference between the "duty of good faith" and "mutual trust and confidence". One (the former) is an implied duty that relates to the terms of the contract and the relationship defined thereby; the other is an incident of the employment relationship (like the right to control).

Dealing with the incident, there can be little doubt that there exists a relationship of trust and confidence (see below). This arises from the nature of employment. If, as I suggest, there be such a relationship and if employment were intended to continue, then the existence of the relationship requires maintenance. In that situation, there must be a duty to maintain (i.e. not to damage seriously or not to destroy) that relationship while ever there is a continuing employment relationship.

There is little doubt that there has existed, and continues to exist, a necessary relationship of trust and confidence between employer and employee. That this is so has been recognised in so many judgments of so many courts that it is probably unnecessary to recite them. Nevertheless, of late, there has been some question raised as to the existence of such a relationship.

As early as the 1930s, the High Court of Australia reiterated the law in this respect. In *Blyth Chemicals Ltd v Bushnell* [1933] HCA 8; (1933) 49 CLR 66, Dixon and McTiernan JJ said, at 81:

> "Conduct which in respect of important matters is incompatible with the fulfilment of an employee's duty, or involves an

> opposition, or conflict between his interest and his duty to his employer, or impedes the faithful performance of his obligations, or is **destructive of the necessary confidence between employer and employee,** is a ground of dismissal" [emphasis added].

Likewise, in *Concut Pty Ltd v Worrell* [2000] HCA 64; (2000) 75 ALJR 312 at 317-8, the High Court said:

> "[17] The issues which must be determined are to be understood in the context of the law respecting employment relationships. It would be unusual for this to be purely contractual. Statute may impose obligations to observe industrial awards and agreements, and in some instances the relevant terms of the employment relationship may be found in the industrial award which binds the parties at the relevant time. Further, as Mason J. pointed out in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, the relationship between employee and employer is one of the accepted fiduciary relationships; their critical feature is that the fiduciary undertakes or agrees to act for or on behalf of, or in the interests of, another person in the exercise of the power or discretion that will affect the interests of that other person in a legal or practical sense. ...
>
> [26] Contractual obligations and fiduciary duties have different conceptual origins, 'the former', in the words of McClelland J, 'representing express or implied common intentions manifested by the mutual assents of contracting parties, and the latter being descriptive of circumstances in which equity will regard conduct of a particular kind as unconscionable and consequently attracting equitable remedies'. Formulations of the obligations of an employee in terms such as those in *Pearce* and *Blyth Chemicals* may be understood, Professor Finn has pointed out, as the re-expression of equitable obligations in terms of implied

> contracts. If so, the importation is well established and beneficial, and nothing turns upon it for present purposes."

Further, Kirby J in *Concut* remarked that the relationship of employer and employee is one "importing implied duties of loyalty, honesty, confidentiality and mutual trust": at [51](3), citing *Blyth Chemicals.*

As earlier stated, that there is a relationship of trust and confidence is well established: see *Hern v Nichols* (1701) 1 Salk 289. The question that has arisen in recent times is whether there is a duty to maintain that relationship and, if so, whether the duty to maintain that relationship is imposed on the employer, as well as the employee. It is only the mutuality of the obligation that has been "controversial".

No controversy exists in the UK or Canada, or any of New Zealand, Fiji, India and Malaysia. It seems, at least at one level, that it is a matter of some controversy in Australia. If one were to believe newspaper and journal reports, the first acceptance of a duty, on both employer and employee, not to destroy the relationship of trust and confidence, was by the Supreme Court of New South Wales in *Russell.* It had been accepted as an arguable proposition in a number of cases to which reference is made in *Russell.* Since the judgement in *Russell,* the matter came before the Court of Appeal *(Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* [2008] NSWCA 217; (2008) 72 NSWLR 559, hereinafter *'Russell* (2008)') in which the New South Wales Court of Appeal accepted, without finally determining, the existence of such an implied duty on employers, but found no breach of that duty.

Intermediate appellate courts have, both before and after *Russell,* accepted and applied the duty in the same terms as it has applied in the United Kingdom: see *Burazin v Blacktown City Guardian Pty Ltd* (1996) 142 ALR 144; *Perkins v Grace Worldwide (Australia) Pty Ltd* (1997) 72 IR 186. Further, Allsop J adopted and applied those

judgments in *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186 at 224. See also, *Rogan-Gardiner v Woolworths Ltd (No 2)* [2010] WASC 290 at [125]; *Lennon v State of South Australia* [2010] SASC 272 at [177]; *Foggo v O'Sullivan Partners (Advisory) Pty Ltd* [2011] NSWSC 501; *Taske v Occupational and Medical Innovations Ltd* [2007] QSC 118; (2007) 167 IR 298; *McDonald v State of South Australia* [2008] SASC 134; (2008) 172 IR 256; *State of South Australia v McDonald* [2009] SASC 219; (2009) 104 SASR 344. I will deal with the latest two judgments on this issue in the conclusion to this paper.

The Court of Appeal of the Supreme Court of Western Australia has applied the authority to the relationship of student and teacher: *Delooze v Healey* [2007] WASCA 157. In that judgment, Wheeler JA (with whom Steytler P agreed) said:

> "[32] ... So far as employees are concerned, there is implied in a contract of employment a term to the effect that the employee will render faithful service, and will not 'do anything inconsistent with the continuance of confidence' between employer and employee. So far as employers are concerned, there is implied in contracts of employment, a term that employers will not (without reasonable and proper cause), conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee *(Easting v Mahoney Insurance Brokers* (2001) 78 SASR 489 at 514 per Olsson J; *Thomson v Orica Australia Pty Ltd* per Allsop J)."

On current authority *(Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89 at 151), until considered by the High Court of Australia, the reasons for judgment of the WA Court of Appeal are binding on all other intermediate appellate courts and all trial judges, unless they take the view that *Delooze* is plainly wrong.

Notwithstanding the binding nature of the judgement in *Delooze,* supra, there have been judgments of the Federal Court of Australia that have doubted the existence of the implied duty: see *McDonald v Parnell Laboratories (Aust) Pty Ltd* [2007] FCA 1903; *Van Efferen v CMA Corporation Ltd* [2009] FCA 597; *Poniatowska v Hickinbotham* [2009] FCA 680. In each case the judge or judges of the Federal Court have expressed doubt as to the existence of the duty because of the operation of the principles for the importing of an implied duty into a contract: see *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* [1977] HCA 40; (1977) 180 CLR 266 *(BP Westernport).* However, trust and confidence has been a feature of the contract of employment since the 1700s, and it is only a question as to whether each party to the contract is under an obligation not to destroy that relationship.

Relevantly for later discussion, it is necessary to refer to the judgment of the House of Lords in *Johnson v Unisys Ltd* [2001] UKHL 13; [2003] 1 AC 518. First, Lord Steyn's speech deals with the question of implication of fact as it, allegedly, conflicted with the express terms of the contract then before the House of Lords. Referring to Treitel, *The Law of Contract* (1962) Steyn LJ refers to the obligation of mutual trust and confidence as not a term implied in fact but an overarching obligation implied by law as an incident of the contract of employment *(Johnson,* supra, at 536) and therefore requires at least express words or a necessary implication to displace it or to cut down its scope.

In *Johnson,* Lord Hoffmann comments, most relevantly for the question currently being discussed, in the following terms:

> "[35] ... At common law the contract of employment was regarded by the courts as a contract like any other. The parties were free to negotiate whatever terms they liked and no terms would be implied unless they satisfied the strict test of necessity applied to a commercial contract. Freedom of contract meant that the stronger party, usually the employer, was free to impose

> his terms upon the weaker. But over the last 30 years or so, the nature of the contract of employment has been transformed. It has been recognized that a person's employment is usually one of the most important things in his or her life. It gives not only our livelihood but an occupation, and identity and a sense of self-esteem. ...
>
> [36) The contribution of the common law to the employment revolution has been by the evolution of implied terms in the contract of employment. The most far reaching is the implied term of trust and confidence. ...
>
> [37] ... Implied terms may supplement the express terms of the contract but cannot contradict them. Only Parliament may actually override what the parties have agreed. The second reason is that judges, in developing the law, must have regard to the policies expressed by Parliament in legislation. Employment law requires balancing of the interests of employers and employees, with proper regard not only to the individual dignity and worth of the employees but also to the general economic interest. Subject to observance of fundamental human rights, the point at which this balance should be struck is a matter for democratic decision. The development of the common law by the judges plays a subsidiary role. Their traditional function is to adapt and modernise the common law."

One of the difficulties, in applying the House of Lords authority, in both *Johnson* and *Mahmud v Bank of Credit and Commerce International SA* [1998] AC 20, is that the speeches of their Lordships seem to conflate the duty to conduct oneself in a manner that would not destroy the relationship of trust and confidence with the duty of good faith. While Lord Hoffmann refers to the Canadian decisions relating to the applicability of the duty of good faith to the act of termination, and expressly disavows its applicability and extension by the common law,

the descriptions of the duty of trust and confidence seem, expressly or implicitly, to involve the doctrine of good faith. The difference between "good faith" and "mutual trust and confidence" is significant.

Good Faith

The reluctance of the House of Lords to apply a duty of good faith to the act of termination is partly the result of the doctrine of cohesion with the legislative schemes in place in the UK and partly due to the reluctance of judges to develop the law overtly, in circumstances where the legislature has turned its mind to the question. It is, however, important to reiterate that the development of the law of employment has witnessed the application of general contractual principles to the previously status-defined employment relationship and greater cohesion of principle between the principles that apply to other contracts and the contract that defines the employment relationship.

Whether good faith is an implied term of the contract or simply a result of the construction of the contract and implicit in the exercise of rights under the contract is a question that is beyond the scope of this paper: see Elisabeth Peden, *'Implicit Good Faith'- Or Do We Still Need an Implied Term of Good Faith?* (2009) 25 Journal of Contract Law 50. For most practical purposes, whether the contract is construed so that particular rights must be exercised in good faith, on the one hand, or there is implied into the contract an obligation of good faith and reasonableness, makes little practical difference. Each can be excluded by express terms of the contract. It suffices, for present purposes, to remark that rights that are exercisable under a contract are not generally referred to as "powers", and have not hitherto been subjected to the restrictions imposed on the exercise of powers in administrative law.

Further, there may be a difference between "good faith" and "reasonableness". The difference, although not always obvious or

significant, may be the requirement to consider the interests of the other party. A right may be exercised reasonably, from the perspective of the person exercising the right, yet not take account of the interests of the other party to the contract.

If one were to apply to the contract of employment the principles that generally apply to contracts of an indefinite duration, or involving personal relations, there is ample authority for the imposition of a duty of good faith. I do not repeat the authority, but rather refer to the discussion in *Russell* and following, and of the cases cited therein.

For the purposes of the current discussion, it is important to draw the distinction between the duty or obligation of good faith, on the one hand, and mutual trust and confidence, on the other hand. As is clear from the judgment of the House of Lords in *Mahmud,* the obligation not to destroy the relationship of trust and confidence is an obligation that restricts the conduct of the parties to a contract of employment in a manner that goes well beyond the terms of that contract. In *Mahmud,* the conduct held to be in breach of the contract of employment, by destroying the requisite relationship, was corrupt conduct of the employer unrelated to any direction to the employee and not requiring the involvement of the employee. The corrupt conduct was held to be such as to destroy the employee's relationship with the employer, and seriously damaged the employee's capacity to obtain subsequent employment.

Good faith deals with either the construction of the rights otherwise contained within the contract of employment, or a separate implied duty to act in good faith in the exercise of those otherwise-conferred rights. The duty to act in good faith is limited to the exercise of rights under the contract of employment, and is not concerned with conduct independent of the contract of employment.

While the implied duty not to destroy the relationship of trust and confidence may involve, implicitly, a duty to act in good faith, it is not the main thrust of the implied duty. Good faith, in the context of an employment relationship, imports a requirement or obligation on the person doing the act to exercise prudence, caution and diligence, which, in that circumstance, would mean taking due care to avoid or minimise adverse consequences on the other party consistently with the agreed common purpose of the parties to the contract in making the contract and their expectations: *Russell* at [115]-[118], citing *Mid Density Developments Pty Limited v Rockdale Municipal Council* (1993) 44 FCR 290 at 298, per Gummow, Hill and Drummond JJ; *Bropho v Human Rights and Equal Opportunity Commission* (2004) 135 FCR 105 at [83] - [121] and [144], per French J and Lee J.

The Right to Dismiss without Cause

The contract of employment, being a contract of personal service, has, in accordance with authority, been held to include a right to terminate the contract, without cause, on reasonable notice. To the extent that the contract of employment necessarily includes such a right, it is peculiar to the employment relationship, and does not exist in other contracts.

Generally, i.e. not in relation to a contract of employment, the right to discharge a contract arises in two circumstances. It arises when the contract is frustrated, i.e. circumstances arising, otherwise than through the default of one party, whereby the contract becomes impossible to perform or impossible to perform in a matter for which the parties had originally contracted. Secondly, the right to discharge a contract arises where the promisor breaches a condition (or essential term) or breaches an intermediate term in a manner that it is sufficiently serious to allow the promisee to discharge the contract. A sufficiently serious breach of an intermediate term will, like the test for frustration, tend to be one that goes "to the root of the contract" and deprives the promisee

of "substantially the whole benefit of the promise" for which the parties had originally contracted: *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 6 at 65-66, 69 and 71-72; *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd* [2007] HCA 61; (2007) 233 CLR 115 at [47]-[49], [51]-[52], and [54].

Of course, a general contract may include a termination provision on reasonable notice and, in some circumstances, such a provision may be implied. Yet in a contract of employment, such a term is the default implication, excluded only by express terms. For those that suggest that mutual trust and confidence ought not be implied, one may ask how the right to terminate the contract of employment without cause could be said to be consistent with the principles established in *BP Westernport;* or, indeed, the right to control. What is it about the contract of employment that requires it, "for efficacy", to have implied as a term a right to terminate the contract on reasonable notice, but otherwise without cause? And why would such an implied right be available without the necessity to exercise it "in good faith"?

The Fair Work Act 2009 (Commonwealth)

The provisions of Part 3-2 of the *Fair Work Act* 2009 seem, at least in relation to employees of a trading or financial corporation, to render impermissible the dismissal of an employee without cause. The effect of s 387 of the *Fair Work Act* requires Fair Work Australia to take into account whether there was "a valid reason for the dismissal related to [the employee's] capacity or conduct". Dismissal without cause necessarily involves the absence of such a valid reason.

Nevertheless, there are a number of employees not covered by the provisions of the Commonwealth Act. Various State provisions will cover a number of those employees and will have the same effect. In the case of public servants the prohibition on termination of employment without cause is even more obvious.

On that basis, the courts may take the view that an implication, in the contract, of like kind, or an implied duty restricting the capacity to terminate employment, is unnecessary: see *Byrne and Frew v Australian Airlines Ltd* [1995] HCA 24; (1995) 185 CLR 410. But legislation alters. And, to the extent possible, it is important that there be cohesion between the various areas of law and consistency of approach in the principles to be applied to different kinds of contracts. In that sense, where differences occur between different kinds of contract, they should be based upon a rational determination of the differences in the contractual circumstances.

Conclusion and latest cases: where are we and where are we going?

I have quite deliberately declined to deal with the two latest judgments of note in this area. The first of them is the judgment of the five member Court of Appeal in *Shaw v State of New South Wales* [2012] NSWCA 102, delivered on 19 April 2012. The judgment was written by Barrett JA with whom Beazley, McColl and Macfarlan JJA and McClellan CJ at CL all agreed.

In truth the judgment in *Shaw* is not a development of great note and achieves little more than did *Russell* on appeal, and many other judgments to which reference has already been made. There are some matters that require noting. At [96], the judgment, in dealing with damages on termination, states that damages on termination have not before seemingly included the loss sustained from the greater difficulty in obtaining fresh employment: but see Irving, *The Contract of Employment* (2012) LexisNexis, at [11.59] and [11.62]; Macken, O'Grady, Sappideen and Warburton, *Law of Employment* (2002) LawBook Co, 5th Ed, at 171-2; and *Grout v Gunnedah Shire Council* (1994) 125 ALR 355; (1995) 1 IRCR 143 at 152; *Birrell v Australian National Airlines Commission* (1984) 5 FCR 447 at 457; *Quinn v Jack*

Chia (Australia) Ltd [1992] 1 VR 567; *Haley v Public Transport Corporation of Victoria* [1998] VSC 132 at [20]; *Australian Blue Metal Ltd v Hughes* [1963] AC 74 at 99, per Lord Devlin. Nevertheless Barrett JA questions, as did Basten JA in *Russell* (2008), whether breach of the implied duty not to damage or destroy may give rise to relief by way of damages. Otherwise the judgment does no more than did the judgment of Basten JA in *Russell* (2008), and determines only that the issue is arguable. It is, however, interesting in its treatment *of Addis v Gramophone Co Ltd* [1909] AC 488.

Further, the judgment in *Shaw* maintains the view that good faith and mutual trust and confidence are one and the same duty. As can be seen from the foregoing, my thesis is significantly different and, in my view, such a proposition misunderstands each of the duties. Nevertheless, the general view of immediate Courts of Appeal is that such a condition either applies or arguably applies and the likelihood is that that will be entrenched to an even greater degree, particularly in light of the West Australian judgment.

I then turn to the judgment of Besanko J in *Barker v Commonwealth Bank of Australia* [2012] FCA 942, delivered on 3 September 2012. This judgment is significant for two reasons. First, his Honour awarded damages for the breach of the implied term of mutual trust and confidence. The mere fact of the awarding of damages is significant. The other aspect of the judgment is that it continues the proposition that the duty not to destroy or damage the relationship of mutual trust and confidence is capable of being excluded by express terms in the contract.

The issues associated with the implication of a duty will no doubt not be resolved finally or otherwise until it is considered by the High Court. In all probability, it is likely to find its way to that Court on appeal by a company in relation to a senior executive; and probably associated with

allegations of breach of Corporations Law by a senior executive, at the behest, or authorisation, of his Board.

There are two fundamental aspects that require consideration. With great respect to the Court of Appeal and the House of Lords (as it was then called), the first aspect must be whether good faith is subsumed within mutual trust and confidence. In my view, as I have no doubt inadequately expressed in some judgments, they are separate issues.

I give but one example. Assume an employee is paid a discretionary bonus and assume that the bonus is not awarded in a particular year in circumstances where there had been an expectation of its awarding and reliance upon that expectation. Leaving aside reasonableness and doctrines of unconscionability, estoppel and, possibly, loss of opportunity damages, the non-awarding of a discretionary bonus would not seem to be a matter that could possibly or arguably affect the relationship of trust and confidence, in the contractual sense. However, it could well be a matter that, if not otherwise excluded, breached the duty to exercise the rights under the contract in good faith.

The separation of the duties is important. Good faith is a duty implied, not confined to the contract of employment, in order to give business efficacy and meaning to a commercial contract that applies over a period of time. It affects the exercise of rights under that contract.

Trust and confidence is a necessary and essential incident of a contract of employment. It underpins, as explained, in a philosophical sense, vicarious liability, the prohibition on work to rule, and the like. Once it is accepted that the relationship of trust and confidence is a necessary element in a contract of employment, then, even under the *BP Westernport* principles, there must arise, as a matter of business efficacy and otherwise, a duty not to damage or destroy that relationship. The relationship of trust and confidence, like the duty to control, cannot be totally excluded while ever there exists a contract of

employment, because it is an incident of the employment relationship. As a consequence, the duty not to destroy that relationship is a duty that cannot be excluded contractually, without changing the relationship to something other than employment.

On the other hand, good faith, being a term that arises in the exercise of rights under contract, is a term that can be excluded by express provision.

As the courts move to the proposition of treating contracts of employment in the same way as all other contracts are treated, these issues will come to the fore. If good faith were not expressly excluded (and assuming it is a duty different from mutual trust and confidence), it is a duty that can and should apply at termination.

In other words, if an employer is required to downsize and makes redundant a number of employees, the selection of particular employees, or the identification of the employees to be made redundant, may well require the application of the principles and duty of good faith. Yet the process of dismissal could never, rationally, be affected by a duty not to destroy mutual trust and confidence, because the act of dismissal is itself a destruction of that relationship.

The history of the regulation of employment relationships by the common law has, as earlier discussed, arisen from the status of employees and the peculiar requirements necessary for personal service of butlers, cooks, gardeners and the like. It is difficult to explain rationally why a bricklayer engaged to construct a house and paid, say, $1000 per 1000 bricks, is entitled to be dismissed without any reason whatsoever, because the bricklayer is engaged under a contract of employment, while the same bricklayer, performing the same work for the same pay (based on the same rate), and engaged as an independent contractor, could not be dismissed without cause (absent express terms).

A rational approach to the contract of employment may require that discharge of the contract of employment can occur only on the same basis as the discharge of any other contract, namely, for frustration or for breach of an essential term or a sufficiently serious breach of an intermediate term (see above).

At the very least, the provisions of good faith that apply to the right of termination in commercial contracts should apply to contracts of employment. In commercial contracts, where the right to terminate is conferred expressly by contract (or implied), it will generally require the giving of notice (as is the case in employment contracts), and will usually require a warning of the kind that would allow the party allegedly in breach to rectify the breach: see *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235.

The power to terminate, in commercial contracts, is not required to be exercised reasonably, but, to the extent that it is in the nature of a contractual right, it is required to be exercised in good faith, namely, honestly or fairly: see *Daw v Herring* [1892] 1 Ch 284; the cases referred to in *Russell,* discussing good faith in commercial contracts; and *Carter On Contracts* (2002) Butterworths, at [29-070] and [37-060]. The High Court seemed to suggest that the exercise of the contractual rights must not be oppressive: see *Esanda Finance Corp Ltd v Plessnig* [1989] HCA 7; (1989) 166 CLR 131 at 148. Applying those principles to employment, even if, as is the case, mutual trust does not apply to termination (see *Johnson* and *Russell* above), good faith would.

Sir Otto Khan-Freund, cited above, has a more radical approach to the contract of employment than most. However, most have not given serious consideration to the degree to which the right to control involves submission and subordination. Employment, for it to operate effectively and appropriately, requires a right to control and requires mobility of labour.

It is unlikely, if not impossible, that the courts will seriously consider inhibiting an employer's right to direct an employee in the performance of the employee's work and in ancillary matters. Likewise, it is unlikely, if not impossible, that the courts will seriously consider qualifying the rules that allow for mobility of labour. But mobility of labour does not require termination without cause - operational requirements are a rational cause.

The introduction of greater mutuality in the responsibilities reposed in parties in the contract of employment has, it seems, achieved greater equality of the parties in the rights and obligations under the contract. Nevertheless, the continued inequality of bargaining power, together with the right reposed in an employer to direct an employee as to the manner of the performance of the employee's work and the right to terminate the contract of employment on reasonable notice and without cause, will necessarily mean that we have not come far at all "from the notion of a master and servant".

The fundamental difficulty with the analysis by courts is the failure to appreciate that which is expressed by Sir Otto Khan-Freund and Henry Bourne Higgins as to the essential inequality in bargaining power in the contract of employment. The contractual approach to employment is being implemented by great legal minds unfamiliar with the proposition, and the matching experience, that individual employees, in such an analysis, are unequal. It is the employer that has the right to control; it is, to paraphrase Higgins, "the employer that has the right to grant or deny employment", and it is the employer, generally, that determines the terms of the contract of employment.

In other areas of the law, statutes have ameliorated contractual disadvantage. We have a *Contracts Review Act* and provisions of the *Trade Practices Act* that deal with these issues. Yet, the provisions that

dealt with these issues in employment, e.g. s 106 of the *Industrial Relations Act,* have been denied effect, or significantly qualified.

In my view, there will be a continuing move to "equal justice" or, more accurately, cohesion: that is, treating contracts of employment in the same way as other contracts, other than in areas where they are rationally different. In so doing, insufficient regard will be paid to the inequality of bargaining power that exists in negotiating most contracts of employment. Nevertheless, that will mean the doctrine of good faith will apply in the same way that it applies in commercial contracts. Damages and injunctive relief will run for a breach thereof.

Mutual trust and confidence will probably be authoritatively determined as a part of the contract of employment. Most likely, if *Shaw* is any guide, it will be done in the context of an elision of the relationship of mutual trust and confidence with the duty of good faith and will be able to be excluded by express terms. In my view, such an elision would be wrong and an exclusion would be inconsistent with the proper analysis of the relationship and duty.

Nevertheless, notwithstanding the judgment of Besanko J, the occasions when damages will run for a breach of mutual trust and confidence will be rare. On the other hand, it may well be used far more broadly for injunctive relief and to ameliorate the harshest aspects of contractual dealings.

Most likely, the duty not to destroy or damage the relationship of mutual trust and confidence will be used against employees in any attempt to "work to rule" or engage in industrial activity that undermines the business operations of the employer.

Lastly, I refer to these issues as contractual rights and obligations and adopt, with respect, the analysis of Lord Diplock. However, the nature and functions of appellate courts, particularly the High Court, will

increasingly see a cross-fertilisation of concepts from different areas. Eventually, we may well see the notion of "contractual powers" and the introduction into contract law (and particularly the contract of employment) of administrative law concepts. Such an introduction will enhance the development of the kind of concepts discussed in this paper.

****

Bibliography

1. *Carter on Contract,* Butterworths, 2002;
2. J. W. Carter, *Breach of Contract,* second edition Law book Company, 1991;
3. Mark Freedland, *The Personal Employment Contract,* Oxford University Press, 2003;
4. Justice Robert McDougall, *The Implied Duty of Good Faith in Australian Contract Law,* paper delivered 21 February 2006, Website of the Supreme Court of New South Wales;
5. Professor Joellen Riley, *Employee Protection at Common Law,* The Federation Press, 2005;
6. Sappideen, O'Grady, Warburton *Macken's Law of Employment,* Fifth and Sixth Edition, Law Book Company, 2002 and 2009;
7. Professor Elisabeth Peden, *'Implicit Good Faith' - Or Do We Still Need an Implied Term of Good Faith?* (2009) 25 JCL 50;
8. Cases, articles and judgements to which reference has been made in the body of the paper.