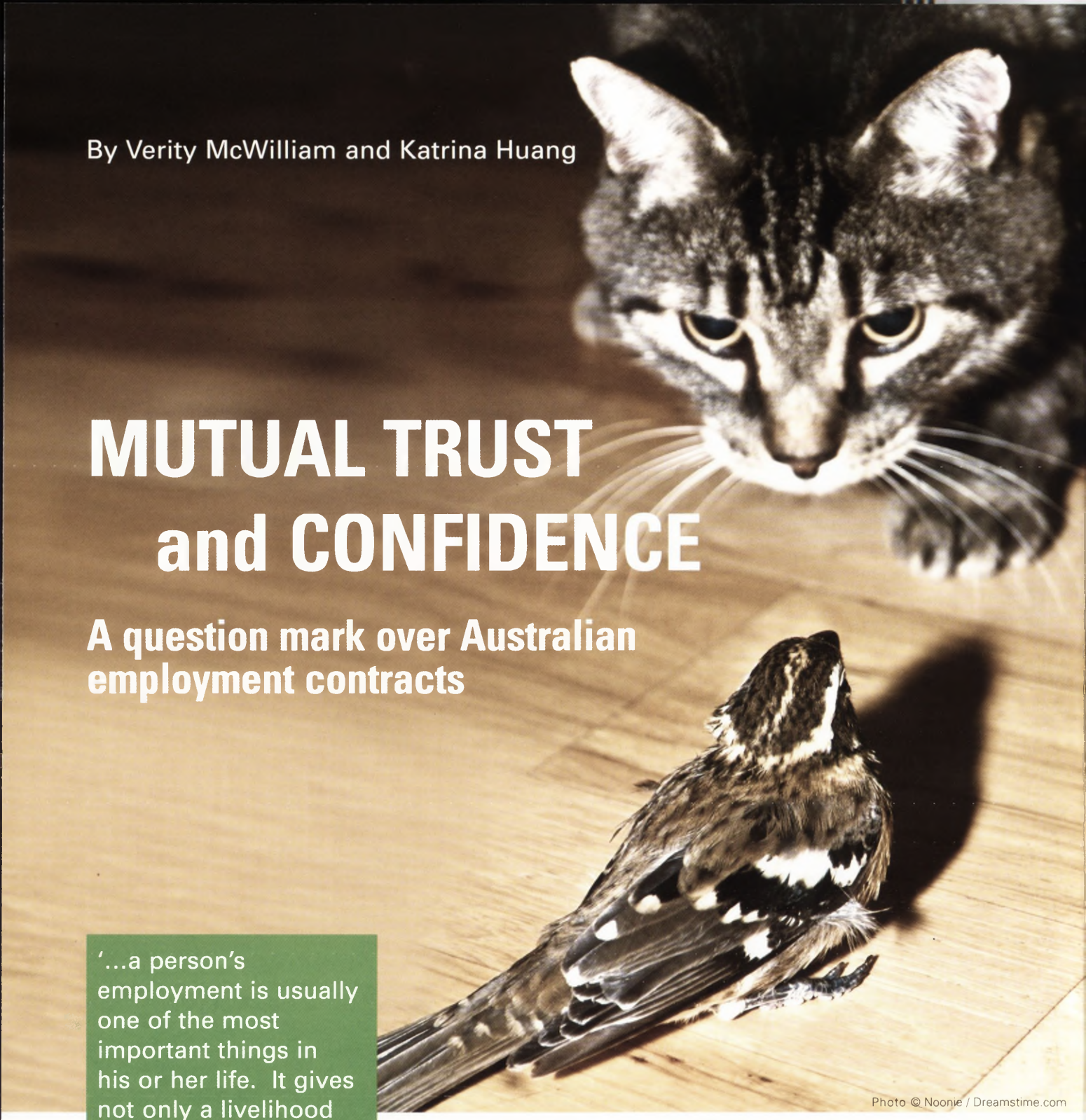
By Verity McWilliam and Katrina Huang

MUTUAL TRUST and CONFIDENCE

A question mark over Australian employment contracts



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'...a person's employment is usually one of the most important things in his or her life. It gives not only a livelihood but an occupation, an identity and a sense of self esteem. The law has changed to recognise this social reality.'

– Lord Hoffmann, *Johnson v Unisys Ltd*[1]

Of the many and various relationships that a person might have, one that most of us enter into at some time is that of employer and employee. Expressions such as 'married to the job' and a desire to 'work to live, rather than live to work' testify to the significance of that relationship in everyday life.

The employment contract takes many forms, but some features underline the very essence of the relationship, such as personal service whereby payment is received for work done. A corollary of this *personal* service relationship should be mutual trust and confidence between the employer and employee. Indeed, the High Court has described the relationship of employer and employee as one 'importing implied duties of loyalty, honesty, confidentiality and mutual trust'.[2]

However, there is now a question mark over the existence of an obligation of mutual trust and confidence as a standard implied term in Australian employment contracts.

STATE OF SOUTH AUSTRALIA v MCDONALD

The catalyst is *SA v McDonald*,[3] a recent decision of the Full Court of the Supreme Court of South Australia. A detailed summary of this case is provided later in this edition of Precedent, so it will not be repeated here.[4] A former school teacher claimed, among other things, that the state of South Australia had breached an implied term of mutual trust and confidence in his employment contract by failing to provide a safe system of work, which amounted to a repudiation of the contract and an entitlement to terminate his employment for constructive dismissal.[5]

The Court faced two issues: whether such a term existed generally in employment contracts in Australia, and whether such a term existed in the particular contract between Mr McDonald and the state. These may be said to represent the two 'methods' by which a term is implied into a contract: (1) by operation of law, and (2) on an *ad hoc* or factual basis.[6] It has been said that terms implied by law and by fact should be treated as 'shade[s] on a continuous spectrum'.[7] However, it is important to distinguish between a term that is implied of necessity (in the sense that it is fundamental to the type of contract), and a term that is implied because it is necessary for the business efficacy of the contract.

In light of the fact that Mr McDonald was self-represented, the Court declined to answer the first question.[8] As to the second, the Court found it unnecessary to imply such a term (in a business efficacy sense), given the statutory and regulatory context in which the contract operated.[9]

While the Court's approach is understandable, it is respectfully submitted that as part of its chain of reasoning, it could address only the second question once it had decided the first. This is because if there is an implied term of mutual trust and confidence in employment contracts generally, then the second question of whether that term formed part of Mr McDonald's particular employment contract would be answered in the affirmative, subject to any express terms or regulatory framework limiting its effect.

The Court focused on the regulatory framework overlaying the specific contract, referring[10] to the observation that 'legislation and the common law are not separate and independent sources of law…[t]hey exist in a symbiotic relationship'.[11] Given that reference, it seems odd that the Court did not first examine the common law overlaying the contract, which necessarily includes the terms applicable to all contracts of employment. The body of law has a heart with two cavities: legislation and common law. They are separate, but they draw from one another. In declining to answer the first question, the Court effectively eschewed the common law cavity.

Ultimately, this issue did not affect the outcome of the case. Even if there was such a term in the contract between Mr McDonald and the state, the Court found that it had not been breached.[12] The correctness of that finding is not considered here. Nevertheless, the decision ignites the debate on whether the implied term of mutual trust and confidence forms part of Australian law.

THE MEANING OF 'MUTUAL TRUST AND CONFIDENCE'

Deriving initially from English authorities[13] in the context of constructive dismissal laws, the term is concerned with preserving the continuing relationship between employer and employee.[14] Both parties owe a duty to conduct themselves in a way that will enable the contract to be performed.[15] The general formulation is: each party to the contract of employment must not, without reasonable and proper cause, conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee.[16]

In short, it has been said that the trust and confidence implied term means that an employer must treat his employees fairly,[17] a description apparently accepted at appellate level in Australia.[18] At first instance in the decision of *Russell*,[19] Rothman J described the relationship as follows: an employee must have confidence in the employer and trust the latter's capacity to provide a safe workplace. Conversely, the employer reposes trust and confidence in the employee and must trust the latter's judgement in the carrying out of his work. Hence, the obligations not to destroy or damage the relationship are mutual. On appeal, the Court of Appeal was prepared to assume the implied term existed, without deciding the issue.[20]

THE UNITED KINGDOM POSITION

Courts in the UK have long accepted the implied term of mutual trust and confidence on a variety of bases, as the Court in *SA v McDonald* pointed out,[21] including: the close personal relationship between an employer and an employee; the vulnerability of employees to the exercise of power by employers, such as 'squeezing out' an employee whose services are no longer desired;[22] and as an incident of the general duty of co-operation between contracting parties. Succinctly put, the term is 'a necessary incident of a definable category of contractual relationship'.[23]

These bases all concern the inherent nature of the relationship between employer and employee, and reflect the term's origin in the case of *Courtaulds*:[24]

> 'The test must be … that one implies into a contract **of this sort** such additional terms as are necessary to give it commercial and industrial validity.' (Emphasis added.)

The Court there referred to the general formulation of the implied term and said:

> '…in order to decide that the conduct is sufficiently repudiatory to justify a conclusion of constructive dismissal one has to consider whether the conduct complained of constitutes either a fundamental breach of the contract or a breach of a fundamental term of the contract: two somewhat elusive conceptions which figure in our modern contract… law. But there is not much room, as we think, for that inquiry in a case in which the test, within the terms of the contractual obligation, is one which involves considering whether the consequences, >>

The decision ignites the debate about whether the implied term of mutual trust and confidence forms part of Australian law.

or the likely consequences, **are to destroy or seriously damage the relationship of confidence and trust between employer and employee; because it does seem to us that any conduct which is likely to destroy or seriously to damage that relationship must be something which goes to the root of the contract, which is really fundamental in its effect upon the contractual relationship**.' (Emphasis added.)

Thus, the term that is firmly established in the UK was originally implied by operation of law because it was considered to be fundamental to the type of contract (hence 'of this sort') and the contractual relationship as a whole.

THE NEW ZEALAND POSITION

The term has also been recognised in NZ, again by virtue of the relationship between employer and employee.[25] In addition, one of the objects of NZ's employment legislation is:

'to build productive employment relationships through the promotion of good faith in all aspects of the employment environment and of the employment relationship –

(i) by recognising that employment relationships must be built not only on the implied mutual obligations of trust and confidence, but also on a legislative requirement for good faith behaviour…'.[26]

This passage demonstrates that the NZ legislature considered the term to be inherent in the employment relationship.

THE AUSTRALIAN POSITION

The existence of the implied term in contracts of employment in Australia has been endorsed or acknowledged on numerous occasions.[27] Cases such as *Shepherd v Felt and Textiles of Australia Ltd*,[28] *Blythe Chemicals Ltd v Bushnell*,[29] *Burazin v Blacktown City Guardian Pty Ltd*[30] and *Perkins v Grace Worldwide (Aust) Pty Ltd*[31] all include references, albeit variously expressed, to a general obligation of mutual trust and confidence in the employment relationship.

In *Koehler v Cerebros (Australia) Ltd*, the High Court expressly referred to 'the implied duty of trust and confidence' as part of the contractual position in the context of employment.[32]

The Court in *SA v McDonald* acknowledged those authorities but was reluctant to accept any of them as properly deciding the question[33] – including *Burazin* and *Perkins*, where the term was expressly discussed – because the issue was not essential to the decision in those cases.[34] The Court stated that, with two exceptions, 'none of the Australian authorities has addressed in any detail the basis for the implication of the implied term'.[35]

The two exceptions were *Heptonstall*, discussed below, and *Russell*. The Court dismissed the significant attention Rothman J gave to the issue in *Russell*, apparently because his Honour drew heavily on the implied obligation of good faith.[36]

The Court later stated that, apart from *Downe*,[37] none of the Australian authorities had addressed the implied term in circumstances like *SA v McDonald*. It was said of *Downe* that Rothman J regarded himself bound to find that the term was implied.[38] However, that does not capture Rothman J's reasoning in *Downe*. His Honour stated that he did not consider the implication of the term to be plainly wrong and relied not only on the Full Court judgment of *Burazin* but also on his Honour's own reasons 'adumbrated at length' in *Russell*.[39]

Respectfully, the Court's approach was unduly dismissive of these numerous prior judicial statements accepting or assuming the implied term as part of Australian employment law. Given the application of Rothman J's detailed reasoning in *Russell* to the particular circumstances in *Downe*, a case that was similar to *SA v McDonald*, greater attention to that reasoning was warranted.

The point to be drawn from these cases may not be (as apparently concluded in *SA v McDonald*) that the question of the implied term remains open because it has not received specific judicial consideration at an appellate level. Rather, the point emerging from the numerous statements of judicial officers in diverse factual contexts is that the term is so entrenched that it can simply be assumed rather than decided.

Thus, the Australian position may well be the same as that in the UK and NZ, aptly described in *Malik* as:

'a standardised term implied by law, that is… a term which is said to be an incident of all contracts of employment'… Such implied terms operate as default rules. The parties are free to exclude or modify them.'[40]

'NECESSITY' AS AN INAPPROPRIATE FOCUS

The focus for the Court in *SA v McDonald* was whether it was necessary to imply the term into Mr McDonald's individual employment contract, rather than whether the express terms of the contract itself or the regulatory context meant that the term was necessarily limited or excluded.

Hoeben J, in the decision of *Heptonstall*,[41] took a similar approach when considering the same question, stating that the background to the implied term in the UK is important and 'contrasts with the situation in Australia'. In that case, Hoeben J was considering proposed amendments to a statement of claim. His Honour discussed the way in which the law of negligence had developed in the UK as opposed to Australia, before stating:

'Accordingly there has been no need in Australia to rely upon a "trust and confidence" implied term in the contract of employment to enable employees to succeed in claims against employers for purely psychiatric injury suffered in the course of employment.'

This argument also concerned whether it was 'necessary' for the term to be implied in the business efficacy sense, as opposed to necessity by operation of law. Although Hoeben J's statement as to a contrasting position between Australia and the UK may be true in the context of negligence, it is entirely beside the point when considering the 'background' to why the term was originally implied in the UK. As can be seen from the history set out above, the development of tort law in a different direction and/or the absence of a remedy in certain circumstances were not foundations for the original implication of the term. Rather, it was the inherent nature of the employment relationship. Thus, to the extent that this type of reasoning informed the Court's approach in *SA v McDonald*, it is a red herring.

The different (and preferable) approach can be seen in the House of Lords decision of *Johnson v Unisys*,[42] referred to in *SA v McDonald*. In that case, an employee sought to extend the implied term to situations where unfair dismissal was claimed. Lord Hoffman found that the implied term could not be so extended for two reasons. The first was that the express terms of the contract were contradictory.[43] The second reason was the uncontroversial proposition that in developing the law, judges must have regard to the policies expressed by Parliament in legislation. The UK Parliament had specifically and expressly dealt with the issue, allowing a remedy but imposing a limit on the amount that could be recovered. To construct a general unlimited common law remedy for unfair circumstances attending dismissal would have been contrary to Parliament's evident intention that the remedy should be limited in application and extent.[44]

Returning to *SA v McDonald*, in finding that the legislative protection to employees restrained the exercise of power and provided a means of redress, thus rendering any common law obligation of mutual trust and confidence unnecessary, the Court gave no consideration to the 'mutual' element of the obligation, and whether the legislation was adequate to cover the reverse part of the obligation. The answer might lie in other implied terms in relation to employees, but that question was simply not addressed. This highlights the narrowness of the finding. A wide range of factual situations might be covered by a mutual obligation of trust and confidence,[45] even if only Mr McDonald's specific contract is being considered. The availability of a remedy in legislation in response to a specific factual situation cannot be the sole basis for excluding (or not implying) a term that has such wide application and importance.

Further, suppose the Court had determined the first question (or indeed a later court has occasion to address it), to the effect that there is a general implied obligation of mutual trust and confidence in Australian employment contracts. The result would be incoherence – the term could not be included as inherently necessary but simultaneously excluded because it was not necessary on the particular facts of the case. >>

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An approach to the second question that assessed the issue by reference to inconsistency or limitation rather than necessity would be more in line with the principle that clear words are necessary before the legislation in question may be said to operate to exclude the common law.[46] In particular, there must be a manifestation or indication that the legislature has directed its intention to the question of abrogation, and has consciously determined that the privilege is to be excluded.[47]

This caselaw shows that the implied term is so entrenched that it can simply be assumed, rather than decided.

In any event, in the recent decision of *Attorney-General of Belize v Belize Telecom Ltd,*[48] Lord Hoffman cautioned against the 'necessity' test in the context of implied terms in contract. There is only one question: 'is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?'[49]

In particular, Lord Hoffman referred to the five conditions outlined in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings,*[50] which were set out in *Byrne v Australian Airlines Ltd;*[51] namely, that the implication is:

(1) reasonable and equitable;
(2) necessary to give business efficacy to the contract;
(3) so obvious that it goes without saying;
(4) capable of clear expression; and
(5) not inconsistent with any express term of the contract.

(Buchanan J also relied on these conditions in *McDonald v Parnell* as the basis for 'disquiet'.[52])

Lord Hoffman said that this list is best regarded, not as a 'series of independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means', and that the conditions were merely 'all good reasons for saying that a reasonable man would not have understood that to be what the instrument meant'.[53]

Accordingly, even if the Court's approach in *SA v McDonald* is accepted, whether the term was necessary in light of the present legislation was not the question to ask. The question that should have been asked is whether Mr McDonald or the state, reading the contract as a whole against the relevant regulatory framework, would reasonably understand that an obligation of trust and confidence was owed?

THE INDIVIDUAL AUSTRALIAN EMPLOYEE OR EMPLOYER

Australian employment law is in a continual state of development, with sweeping changes made by the government of the day,[54] workplace agreements and office policies being revised, and legislative intervention affecting some workplaces but not others. This is the 'relevant background' against which to assess what the average employee and employer in Australia would understand his or her contract of employment to include.

In small business, it is not hard to imagine offers of employment being constituted by a letter to the effect of, 'Congratulations, you've got the job. You start Monday on a salary of $x.' If the existence of legislation regulating some employers removes any common law implied obligation of mutual trust and confidence in their contracts, then do employees without the benefit of such legislation but with more detailed contracts as to how an employee may raise a grievance stand in the same or a different position as (a) those who are fortunate to work for employers who are regulated and (b) those whose contracts are in the nature of brief, two-line letters or oral agreements? What if procedures purporting to protect the employee are, in fact, inadequate? Where is the line as to when the term will and will not be implied to be drawn? The approach adopted by the Full Court in *SA v McDonald* gives rise to uncertainty – a feature which the very signing of a contract is meant to remove.

Whether the question is one of operation of law or of fact, the following passage from the judgment of Rothman J in *Russell* is relevant:[55]

> '126 ... In everything the employee does, in the course of employment, the employer must trust the employee's [judgement], honesty, care and the like because it will bind the employer. Trust and confidence, reposed by each of the employer and employee in the other, is a necessary concomitant of the right to control. **It is essential to the contract of employment.**
>
> 127 In that regard, the second of the implications may be quite different from the first. If one destroys trust and confidence, and trust and confidence is a necessary and essential ingredient of a contract of employment, then the contract of employment is destroyed. Similarly, if one sought to exclude, expressly, the relationship of trust and confidence, if it were a necessary and essential ingredient of employment, one may still have a contract, but it is unlikely to be a contract of employment. Without trust and confidence there is no submission and subordination and no right of control. **Without trust and confidence there is no contract of employment.**
>
> 128 Such an analysis renders the duty not to act in a manner calculated or likely to destroy the relationship of trust and confidence **in a fundamentally different position. Unlike most other implied duties, it cannot be excluded unless one does not want to have a contract of employment.** If an employee destroys the trust of the employer necessary for the carrying out of the work, the employer would be unable to allow the employee to work and bind the employer. Similarly,

if the employer destroyed the trust of the employee necessary for the giving of directions, the whole basis of the employment relationship ceases.' (Emphasis added.)

CONCLUSION

Although the Full Court in *SA v McDonald* may have benefited from more detailed submissions on the point, the issue was nevertheless squarely before it and required resolution before the Court embarked on the specific facts of the case. Moreover, the Court's detailed discussion of the Australian authorities suggests that it was in truth in a position to determine the question.

Respectfully, the above reasoning of Rothman J in *Russell* is compelling on the point, and provides a basis for incorporating the term into Australian law that is the same as the basis in the UK and in NZ. There is nothing to suggest that, as a general proposition, Australian employees have relationships with their employers that are any different to those in NZ and the UK. There may be different limits imposed by the legislature and cases where the term is found to be excluded, but the presence of trust and confidence in employment as the foundation or the starting point of the relationship, and therefore of the employment contract, is as true for the factory worker as it is for the boss. It is taken for granted, until it is lost. ■

Notes: **1** [2001] 2 All ER 801; [2001] 2 WLR 1076 at [35]. **2** *Concut v Worrell* [2000] HCA 64; (2000) 75 ALJR 312 at [51.3] per Kirby J. **3** *State of South Australia v McDonald* [2009] SASC 219 (*SA v McDonald*). **4** Please see A Sibree, 'The implied duty of mutual trust and confidence in employment contracts: *State of SA v McDonald* [2009] SASC 219', p45 below. **5** *SA v McDonald* at [8]. **6** *Castlemaine Tooheys v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468 at 487 per Hope J; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at 448 per McHugh and Gummow JJ. **7** *Liverpool City Council v Irwin* [1976] UKHL 1; [1977] AC 239 at 254; *Parramatta Design & Developments Pty Ltd v Concrete Pty Ltd* [2005] FCAFC 138; 144 FCR 264 at [16] (overturned on appeal but not in respect of this point). **8** *SA v McDonald* at [235]-[236]. **9** *Ibid* at [270]. **10** *Ibid* at [239]. **11** *Brodie v Singleton Shire Council* (2001) 206 CLR 512 per Gleeson CJ. **12** *SA v McDonald* at [272]. **13** *Courtaulds Northern Textiles Ltd v Andrew* [1979] IRLR 84 at 86; *Woods v W M Car Services (Peterborough) Ltd* [1981] ICR 666, affirmed [1982] ICR 693; *Lewis v Motorworld Garages Ltd* [1986] ICR 157; *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589. **14** *Johnson v Unisys* [2003] 1 AC 518 at [46] per Lord Hoffman. **15** *Eastwood v Magnox Electric plc; McCabe v Cornwall County Council* [2004] UKHL 35; (2004) 3 WLR 322 (*Eastwood*) at [5] per Lord Nicholls. **16** *Malik v Bank of Credit and Commerce International SA* [1997] 3 WLR 95 (*Malik*) at 109 per Lord Steyn; *Eastwood* at [11] at [5] per Lord Nicholls; *Burazin v Blacktown City Guardian* (1996) 142 ALR 144; *Thomson Orica Australia* (2002) 116 IR 186; *Heptonstall v Gaskin (No 2)* [2005] NSWSC 30; (2005) 138 IR 103 (*Heptonstall*). **17** *Eastwood* at [11] per Lord Nicholls. **18** *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney & Anor* [2008] NSWCA 217 (*Russell (CA)*) at [32] per Basten JA. **19** *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney & Anor* [2007] NSWSC 104 (*Russell*). **20** *Russell (CA)* at [1], [73]. **21** As the Court in *SA v McDonald* pointed out at [228]. **22** *Woods v W M Car Services (Peterborough) Ltd* [1981] ICR 666 at 671. **23** *Scally v Southern Health and Social Sciences Board* [1991] 4 All ER 563 at 571. **24** *Courtaulds v Northern Textiles Ltd v Andrew* [1979] IRLR 84. **25** *Auckland Shop Employees Union v Woolworths (NZ) Ltd* [1985] 2 NZLR 372 at 375; *Auckland Electric Power Board v Auckland Provincial District Local Authorities Officers Industrial Union of Workers (Inc)* [1994] 2 NZLR 415 at 419. **26** *Employment Relations Act* 2000 (NZ), s3(a). **27** *SA v McDonald* at [215]-[223]. **28** (1931) 45 CLR 359. **29** (1933) 49 CLR 66. **30** (1996) 142 ALR 144. **31** (1997) 72 IR 186. **32** (2005) 222 CLR 44 at 55. **33** *SA v McDonald* at [215], [216]. **34** *Ibid* at [218], [220]. **35** *SA v McDonald at [227].* **36** *Ibid* at [227]. **37** [2008] NSWSC 159; 71 NSWLR 633. **38** *SA v McDonald* at [237]. **39** *Downe* at [326]-[328]. **40** *Malik* at 109. Lord Steyn went on to accept (at 110) the implied obligation of trust and confidence as established. **41** *Heptonstall* at [20]-[21]. **42** [2003] 1 AC 518 **43** *Johnson v Unisys* at [46]. **44** *Ibid* at [58]. **45** See K Godfrey, *Contracts of employment: Renaissance of the implied term of trust and confidence* (2003) 77 ALJ 764 at 769. **46** *Sorby v The Commonwealth* [1983] HCA 10; (1983) 152 CLR 281 at 289-90, 309, 311, 316; *Daniels Corporation International Pty Limited v Australian Competition and Consumer Commission* [2002] HCA 49; (2002) 213 CLR 543 at [11]; *A v Boulton* [2004] FCAFC 101; (2004) 136 FCR 420 at [54]; *Griffin v Pantzer* [2004] FCAFC 113; (2004) 137 FCR 209 at [46]. **47** *Coco v The Queen* (1994) 179 CLR 427 at 439-41. **48** [2009] UKPC 11 (*Belize*). **49** *Ibid* at [21]. **50** (1977) 180 CLR 266. **51** (1995) 185 CLR 410 at 422. **52** (2007) 168 IR 375 at [91]. **53** *Belize* at [27]. **54** Compare *Workplace Relations Amendment (Work Choices) Act* 2005 with the present *Fair Work Act* 2009. **55** *Russell* at [126]-[128].

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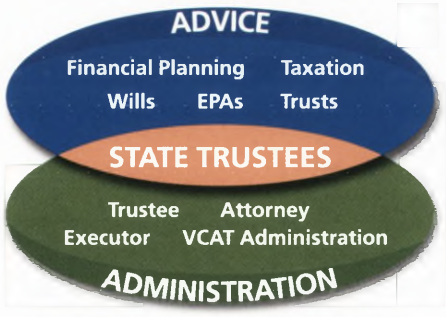

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