BEYOND CONTRACT:
RECONCEPTUALISING THE FUNDAMENTALS OF THE LAW OF WORK

Joellen Riley

Dean and Professor of Labour Law, Sydney Law School

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Joellen Riley, Dean and Professor of Labour Law, Sydney Law School
Email: joellen.riley@sydney.edu.au.

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Abstract:

In the common law world, the notion that employment relationships are essentially contractual in nature has become entrenched (although only since the beginning of the 20th century). The consequences of assuming the application of contract law principles (and particularly commercial contract law principles) to these relationships is that certain ideologically based precepts – such as 'sanctity of contract' – are frequently invoked to resolve disputes about the obligations of parties to such relationships. 'Sanctity of contract' invariably favours the stronger party to contract negotiations. This paper questions whether contract reasoning is at all useful in an age of increasing statutory regulation. Courts concerned with 'coherence' in the law have curtailed a principled and consistent application of contract reasoning whenever a statutory scheme has captured a field. (The House of Lords decision in Edwards v Chesterfield Royal Hospital NHS Foundation Trust *[2011] UKSC 58 provides an illustration of the way in which contract principles are made to surrender to assumptions drawn from statutory schemes.) This being so, it is time to review whether contract reasoning is at all useful as an analytical tool in the regulation of work relationships, and whether alternative concepts might better reflect and explain the way in which contemporary society perceives the mutual obligations of parties to working relationships. Consumer law has moved well beyond concepts of 'freedom of contract'. So – in reality – has employment law. It is time to expunge the last inconsistencies in the way this field of law is explained and applied.*

Death of the employment contract?

The decision of the House of Lords in *Edwards v Chesterfield Royal Hospital NHS Foundation Trust; Botham (FC) v Ministry of Defence*[1] has to be the last straw for the notion that employment is a species of commercial contract, regulated by ordinary contract law principles. In that case, it was held (by some of the bench at least[2]) that express provisions in an employment contract which promised compliance with certain disciplinary procedures before any summary dismissal, ought not to be treated in the same way as any other contract term. Breach of the promised procedures ought not to sound in common law damages, because it must be assumed that the parties included these terms only to comply with a statutory unfair dismissal scheme, and so the employer's liability for breach should be limited to any sanction imposed by the statute. Before such express contract terms should be given full contractual force under the common law, parties would need also to 'expressly agree'[3] that breach would give rise to contract-based damages.

This paper argues that this finding in *Edwards* demonstrates that contract law principles are now so overshadowed by the intervention of statutory regulation into employment law, that there is little point in continuing to adopt and adapt the common law of contract to resolve employment disputes. It is time to accept what Sir Otto Kahn-Freund noted long ago: the contract of employment is a figment of the legal imagination.[4] It is an artifact of a persistent, but (I would argue) now largely failed attempt to describe the relationship between employer and employee as one conforming to commercial ideals. At heart, those ideals assume that parties to commercial bargains are able and ought to take responsibility for their own bargains,

[1] [2011] UKSC 58 (14 December 2011).
[2] Lords Dyson, Walker and Mance.
[3] At [39].
[4] See Paul Davies and Mark Freedland (eds) *Otto Kahn Freund Labour and the Law*, 3rd ed, Stevens, London, 1983, at pp 1-17; Simon Deakin, 'The Many Futures of the Contract of Employment' in Joanne Conaghan, R M Fischl and Karl Klare (eds) *Labour Law in an Era of Globalisation*, OUP, Oxford, 2002.

and that commercial certainty is best served by holding parties to the terms of their original agreement.

Contemporary western industrial societies, however, have implicitly recognized that the employment relationship is not uniformly a relationship between autonomous actors with equal freedom to choose their contract partner and bargain for terms. This is evidenced in the extensive regulation in many jurisdictions of maximum working hours, minimum wages and conditions of work. Job security legislation, imposing obligations upon employers to refrain from unfair (or 'harsh, unjust and unreasonable'[5]) dismissal has been most influential in recent decades in eroding any similarity between employment and other commercial contracts under which work is performed. Australian unfair dismissal legislation[6] permits an arbitral tribunal to order reinstatement of an unfairly dismissed employee, much to the annoyance of employer lobby groups who lament the loss of a freedom to hire and fire at will. So in many jurisdictions, there is no unfettered freedom to contract when the kind of contract contemplated describes an employment relationship. This being so, it is time to abandon the vocabulary and inapt assumptions of contract law, and to recognise that employment relationships depend in reality upon other principles. The new challenge is to articulate those principles more precisely, and without distraction from an habitual reliance on contract law terminology.

This paper suggests that the contemporary employment relationship assumes a highly flexible and open-textured set of mutual obligations, sometimes described by organizational behaviour theorists as a 'psychological contract'.[7] Classical contract law principles, however, do not appropriately describe the reality of such a relationship, and do not always do justice when those relationships break down and parties bring a dispute to court. Attempts to persuade Australian courts to use implied terms (particularly the implied duty not to act in a manner calculated or likely to destroy mutual trust and confidence in the relationship[8]) to do

[5] This is the formulation of words used in Australian legislation: see the *Fair Work Act 2009* (Cth) s 385.
[6] See the *Fair Work Act 2009* (Cth) Pt 3-2.
[7] See Christeen George, *The Psychological Contract: Managing and Developing Professional Groups*, Open University Press McGraw-Hill, UK, 2009.
[8] The duty was affirmed by the House of Lords in *Mahmud v Bank of Credit and Commerce International SA* [1998] AC 20 (also known as *Malik's* case). For commentary on this implied duty, see Mark Freedland, *The Personal Employment Contract* (2003), 154 -170; Douglas Brodie 'The Heart of the Matter: Mutual Trust and Confidence' (1996) 25 *Industrial Law Journal* 121; 'Beyond Exchange: the New Contract of Employment' (1998) 27 *Industrial*

better justice in employment disputes have been largely unsuccessful,[9] and have faced a new obstacle in the reluctance of courts to develop common law principles in the face of significant statutory intervention into the field.[10] It is time to recognise that when employment relationships break down, recourse to the supposed contractual rights enshrined in some original bargain will not satisfy the mutual expectations of the parties to the relationship. A better approach would be to conceive employment separation disputes not as disputes over the recognition of existing legal rights (derived from contract), but as interest disputes, suitable for arbitration taking into account a reasonable balance of the interests of the worker, the

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Law Journal 79; (1999) ' A Fair Deal at Work' (1999) 19 *Oxford Journal of Legal Studies* 83; 'Mutual Trust and the Values of the Employment Contract' (2001) 30 *Industrial Law Journal* 84; The Employment Contract: legal Principles, Drafting and Interpretation (2005) 78-79; 'Mutual Trust and Confidence: Catalysts, Constraints and Commonality' (2008) 37 *Industrial Law Journal* 329; Hon Mr 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* 26; 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. For Australian scholarship on this development see: 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: the Renaissance of the Implied Term of Trust and Confidence' (2003) 77 *Australian Law Journal* 764; Joellen Riley, *Employee Protection at Common Law* (2005) 73-6; Andrew Stewart, 'Good Faith and Fair Dealing at Work' in Christopher Arup et al *Labour Law and Labour Market Regulation: Essays on the Construction, Constitution and Regulation of Labour Markets and Work Relationships* (2006), 579, 583-4; Joellen Riley, 'The Boundaries of Mutual Trust and Good Faith' (2009) 22(1) *Australian Journal of Labour Law* 73; Joellen Riley, 'Siblings but not Twins: Making Sense of 'Mutual Trust' and 'Good Faith' in Employment Contracts', (2012) 36 *Melbourne University Law Review* 521.

[9] See for example *Heptonstall v Gaskin and Ors (No 2)* [2005] NSWSC 30, [22]; *McDonald v Parnell Laboratories (Aust)* [2007] FCA 1903, [96]; *Van Efferen v CMA Corporation Limited* [2009] FCA 597, [79]-[86]; *Yousif v Commonwealth Bank of Australia* [2010] FCAFC 8. On the other hand, a number of Australian cases have been prepared to concede the existence of the mutual trust term. See for example *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186; *Russell v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2008) 72 NSWLR 559; (2008) 176 IR 82, (and particularly the statements of Campbell JA, [73]) conceding the point accepted by Rothman J in (2007) 69 NSWLR 198; [2007] NSWSC 104; *Morton* v *Transport Appeal Board* [2007] NSWSC 1454 (Berman AJ); *Rogers v Millenium Inorganic Chemicals* [2009] FMCA 1, [119] (Lucev FM); *Rogan-Gardiner v Woolworths Ltd [No 2]* [2010] WASC 290, [222] (upheld on appeal: see [2012] WASCA 31); *Gillies v Downer EDI Ltd* [2011] NSWSC 1055, [204]; *Foggo v O'Sullivan Partners (Advisory) Pty Limited* [2011] NSWSC 501, [99] (Schmidt J); *Barker v Commonwealth Bank of Australia* [2012] FCA 942 (Besanko J) (on appeal).

[10] Even in cases which have conceded the existence of a 'mutual trust and confidence' and/or good faith obligation, plaintiff employees' claims have been defeated by the existence of some statutory scheme covering the field: see for example *Russell v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2007) 69 NSWLR 198; [2007] NSWSC 104 and *State of South Australia v McDonald* [2009] SASC 219.

employer, and any other party whose interests would also be affected by the resolution of the dispute.[11]

In order to make good these assertions, this paper will first explain (by recounting the story of a typical employment dispute) why the 'psychological employment contract' rarely conforms to the assumptions upon which commercial contract law has developed. We are accustomed to thinking of the relationship between an employer and employee as contractual, because the relationship arises from a voluntarily entered arrangement, supported by some mutual promises, which the parties intend to be legally binding. According to basic principles, that essentially describes a contract. Look into the detail of the kinds of arrangements now typical between employer and employee, however, and you see a relationship governed by more flexible principles than would ever be tolerated by most commercial parties. Most, if not all, of that flexibility is demanded by and favours the interests of the employer. The paper goes on to argue that in this age of statutes, where a concern with coherence between the common law and statutory schemes is already curtailing the principled development of the common law in any event, it is time to abandon appeals to 'sanctity of contract' in resolving employment disputes. Better justice would be served by a specialist tribunal empowered to review the terms of separation of employment relationships, in order to impose fair and reasonable terms on the parties, determined in the light not only of the 'original' bargain between the parties, but also of any subsequent understandings arising between them, and any circumstances influencing their separation.

The 'psychological' contract

In the human resources management and organizational behaviour fields, the concept of the 'psychological contract' has gained some purchase.[12] It refers to the notion that parties to an

[11] In Australia unfair dismissal matters are arbitrated, however the jurisdiction is not open to 'high income' employees, and the range of remedies available is limited. The principal objective of the legislation is to permit reinstatement, not to assess appropriate terms of severance of the relationship.

[12] See Christeen George, *The Psychological Contract: Managing and Developing Professional Groups*, Open University Press McGraw-Hill, UK, 2009. See also Katherine van Wezel Stone, *From Widgets to Digits: Employment Regulation for the Changing Workplace*, Cambridge University Press, UK, 2004, at pp 88-92.

employment relationship are engaged in a cooperative endeavour, based on certain explicit and implicit expectations of how they will mutually benefit from the relationship. The use of the word 'contract' however, can be a misleading one for a hard-headed commercial lawyer, because the nature of the relationship loosely described by the 'psychological contract' does not conform to the precepts of classical contract law. And when parties to this 'psychological contract' experience a relationship breakdown, and their dispute ends up in a courtroom, the application of the hard principles of commercial contract law can produce results which defeat the expectations engendered by the 'psychological' contract.

This is well illustrated by a case decided by the Employment Court in Auckland, *Cuttriss v Carter Holt Harvey Limited*.[13] *Cuttriss* is typical of the kind of employment disputes that arise when an employee's expectations are disappointed by the employer's decision to exercise a discretion to change working conditions and entitlements unilaterally. And it is a good illustration of why commercial contract law principles are not well-suited to describing the reality of employment relationships, nor to resolving employment disputes.

Cuttriss v Carter Holt Harvey Ltd and the phantom employment contract

Mr Cuttriss was a long–serving employee of Carter Holt Harvey and its various precedessors when he challenged the company's unilateral decision to alter the terms of its retirement plan in a way that would reduce his retirement benefit by some $NZ54,000.[14] At the time of the hearing of this matter, Mr Cuttriss was 60 years old, still in employment, and anticipating normal retirement at 65. The information in the report of the case suggests that Mr Cuttriss was born in 1946 and started working in the business at the age of 24 in 1970. His earliest letter of appointment made no reference to any entitlement to retirement benefits. Likewise, letters issued to him on subsequent promotions in 1986 and 1987 also made no mention of a retirement benefit as a condition of employment,[15] but there was a well-known practice in the firm of providing such benefits.

[13] AK AC 19/07 27 April 2007 (B S Travis J) ('*Cuttriss*').
[14] *Cuttriss*, paragraph [1].
[15] *Cuttriss*, paragraph [5].

Any first year law student will tell you that these letters of appointment were evidence of an employment 'contract', the terms of which could be derived from a combination of the written and orally expressed commitments mutually agreed by the parties, and supplemented by any implied terms, made necessary by factual circumstances, or as a matter of law. By 1992, Mr Cuttriss already had an 'employment contract' with Carter Holt Harvey. Nevertheless, the case report records that 'the plaintiff signed an employment contract in 1992'.[16] It has become common practice in the human resources management context to use the word 'contract' to refer to a particular document, rather than the entirety of the agreement between the parties. This practice has facilitated a new notion that other aspects the agreed working arrangements might be contained in some other, non-legally binding document, such as a human resources policy manual.

Carter Holt Harvey's 1992 'employment contract' document, like the earlier letters of appointment, did not refer to a retiring benefit entitlement, but it did refer to a 'Company Policy Manual' which 'may be amended from time to time as a consequence of any change in Company policy'.[17] In 1998, the plaintiff was offered a further 'employment contract' (another document purporting to describe the current terms and conditions of his employment relationship) which also referred to Company policies. This document contained a clause which I imagine would be considered peculiar by a general commercial contract lawyer:

> Some of your employment conditions are based on specific Company policies and this offer is framed in accordance with those policies as they exist at present; however Company policies may be changed from time to time to meet operational or changing circumstances as is customary in employment generally. Should any change be necessary which affects your own conditions of employment you will be notified in advance.[18]

I imagine that a commercial contract lawyer would be concerned about recommending that a client should agree to such a contract. On its face it acknowledges that *conditions* of the agreement – important terms of the agreement, breach of which may entitle a party to a right

[16] *Cuttriss*, paragraph [6].
[17] *Cuttriss*, paragraph [6].
[18] *Cuttriss*, parapraph [7].

to terminate and claim expectation-based damages – are subject to modification unilaterally, to serve the operational needs of *one* of the parties. There is no promise that these changes will be negotiated, only that the party subject to a unilateral variation in important conditions of the agreement will be given notice of those changes.

As this clause itself asserts, this kind of arrangement is indeed commonplace in employment relations. Employers need to be able to manage their businesses flexibly, and it is in the interests of workers who want a long term stable career with an employer to agree to accept those flexible terms. That flexibility is, generally, part of the contemporary 'psychological contract'. It is entirely proper that this kind of flexible regulation of a relationship ought to receive legal recognition and support. Nevertheless, it is misleading (at least to a trained lawyer) to describe this kind of arrangement as a 'contract', and to attempt to impose upon it (usually at its breaking point) other hard principles of contract law.[19] This kind of arrangement does not conform to the principles of classical contract law[20] because those principles begin with a requirement of certainty of terms at the time of entering into the contract. Those principles also permit no recognition of any renegotiation of terms without consent and fresh consideration. These classical contract law principles support a theory of contract law that holds that the law should enforce contracts in the interests of economic efficiency. Commercial parties use contracts as risk management tools for allocating and pricing the risks of doing business in an uncertain world.[21] Contracts will not perform that function if one party can change the deal to accommodate their own reassessment of risk, without the agreement of the other party.

Is it really fair to describe the long term arrangement between Carter Holt Harvey and Mr Cuttriss as a contract, when Mr Cuttriss was obliged to accept the risk of changes to his

[19] In other writing, I have explained my concern about cases in which employees have been held to a principle of 'sanctity of contract', notwithstanding how flexible these arrangements are for employers. See for example, Joellen Riley, 'Sterilising Talent: A Critical Assessment of Injunctions Enforcing Negative Covenants' (2012) 34 *Sydney Law Review* 617, at 628.

[20] I am relying on the concept of classical contract law described by Professor Patrick Atiyah as those principles of modern contract law developed by the English courts in the 18th and 19th centuries: see Patrick S Atiyah, *An Introduction to the Law of Contract*, 5th ed (1995), at p 7. See also Rosemary Owens, Joellen Riley and Jill Murray, *The Law of Work*, 2nd ed (2011) at pp 214-222, for a fuller articulation of the reasons that employment relationships do not really conform to classical contractual principles, notwithstanding the custom of describing them as contracts.

[21] See generally Stephen Waddams, 'The Price of Excessive Damages Awards' (2005) 27 *Sydney Law Review* 543.

conditions of employment whenever those changes benefited his employer? As it happens, Mr Cuttriss was not willing to accept that term and refused to sign the 1998 contract document, no doubt because he recognized the risk of losing important employment benefits. Nevertheless, the relationship between the parties appears to have continued amicably until 2003, when the company advised employees that it intended to change the Employee Benefits Programme that applied to Mr Cuttriss' employment. One can imagine that a long-serving employee, who has remained with a company for more than two decades and is now within five years of retirement, might object to a withdrawal of significant retirement benefits. Few people would be happy to lose the prospect of $NZ54,000 overnight.[22] The judge accepted Mr Cuttriss' evidence that the retirement benefits policy 'was a material factor which influenced him' and 'was an important consideration in his decision to retain long term employment with the defendant'.[23] This is not surprising. Employers do not devise retirement plans out of pure altruism and concern for the well-being of the old and infirm. They devise these schemes as attractions to recruit and retain the best staff. Certain kinds of retirement benefits (like the policy in issue in this case) are 'golden handcuffs': deferred remuneration intended to hold experienced and senior staff until a minimum retirement age, so as to protect the employer from defection of their most experienced team members to competitors.

Mr Cuttriss was so concerned about this issue that he brought these proceedings with a view to obtaining either an order that the policy be reinstated as part of his own employment conditions, or that he should receive a compensatory payment to recognize his inchoate entitlements under the policy up until the time it was removed. He lost his case, because he was not able to establish a contractual entitlement to keep the retirement benefit. This is where the injustice of treating an arrangement such as this as a contract, subject to other principles of classical contract law, becomes apparent. Even though his arrangement with the employer was flexible, so that the employer could change it unilaterally at any time, when it came to deciding whether he had a contractual right to the retirement benefits that had been

[22] To give this figure some context, according to Statistics New Zealand, median weekly earnings from wages and salary in New Zealand for the year to June 2012 was $NZ806. Available on-line at: http://www.stats.govt.nz/browse_for_stats/income-and-work/Income/NZIncomeSurvey_HOTPJun12qtr.aspx, last accessed 23 May 2013.

[23] *Cuttriss*, paragraph [20].

part of his conditions of employment for many years, it was the initial letter of appointment from 1970 that was most crucial to his claim. His original terms of employment did not include a mention of a retirement plan, so it was held that there was no express contract term entitling him to the benefit. It did not form part of his original offer of employment.[24] The benefit arose as a matter of company policy, and while he might have a right to enjoy the benefit of a policy while it remained in force, it was within the discretion of the company to remove benefits by changing policies.[25] Justice Travis was not impressed by an argument that any policy that provided important financial benefits was 'fundamental' to the conditions of employment and should therefore be exempt from any asserted discretion to make unilateral variations.[26]

Mr Cuttriss' counsel also tried all of the usual arguments in the contract lawyer's armoury when one cannot point to an express term in the initial contract between the parties, but these arguments based on implied terms also failed. The trouble with making arguments that a mutable policy should be treated as a term implied 'in fact' into an employment contract, is that courts generally refer to the five requirements stated in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings.*[27] A term implied in fact must be reasonable and equitable; necessary to give business efficacy to the contract; so obvious that it 'goes without saying'; capable of clear expression; and – here's the rub – must not contradict any express term of the contract. In this case, Travis J cited the New Zealand case of *Attorney-General v NZ Post Primary Teachers' Association*[28] for these principles, and found (predictably) that an implied term requiring that the employer could not vary the retirement benefit was inconsistent with the express term in the contract permitting unilateral deletion of policies.[29] The only real solution for Mr Cuttriss would be a finding that Travis J should be permitted to read down or excise the contractual clause asserting the right to vary policies. Those kinds of powers can be granted by statute (and

[24] At *Cuttriss*, paragraph [43], his Honour distinguishes policies that offer benefits as 'part of the offer of employment', from others that can be withdrawn unilaterally.
[25] *Cuttriss*, paragraph [42].
[26] *Cuttriss*, paragraph [43].
[27] (1977) 180 CLR 266 at 282-3.
[28] [1992] 1 ERNZ 1163.
[29] *Cuttriss*, paragraphs [47]-[48].

have been in a number of Australian statutes[30]), but are generally anathema to the common law, clinging as it does to the notion that the judge's role is to give effect to the legal rights already enshrined in a contract reflecting the intentions of the parties themselves at the time they first entered into their bargain. A power to vary contracts is most appropriately treated as an exercise of administrative power, and left in the hands of an expert tribunal, charged with responsibility to take into account a range of relevant factors.

Mr Cuttriss' counsel also made an argument based on the disappointment of his 'legitimate expectation' of the continuation of the policy (an appeal to principles more recognizable as belonging to administrative law than contract law) , but this was also defeated by reference to the primacy of the contract. His initial contract, and the contract document signed in 1992, did not refer to the policy. Subsequent communications from the employer asserted an entitlement to vary policies, so Mr Cuttriss could not 'establish a legitimate expectation that the benefit would be retained'.[31] Mr Cuttriss' problem was that he hoped and trusted that the policy would be retained, but he did that in the face of clear assertions in the written documentation provided by the employer that it could not be held to existing policies.

Governance by policy not contract

A case such as this one demonstrates that the typical arrangements between employers and employees today are not really contractual arrangements, because many important employment benefits are contained in company policies, and these policies are generally mutable at the discretion of the employer. This means that many of the important incentives that motivate employees to choose one job or career over another – performance pay, retirement benefits, job security – are susceptible to withdrawal at the will of the employer. This suggests an 'at will' relationship rather than a fully contractual one. As more and more matters pertaining to employment conditions are included in mutable policies rather than in

[30] See for example the powers to vary contracts under which non-employed work is performed in *the Independent Contractors Act 2006* (Cth), s 12, and the power to make 'other orders' including contract variation in the *Competition and Consumer Act 2010* (Cth) s 87(2)(b).
[31] *Cuttriss*, paragraph [51].

letters of offer or service 'contract' documents, the contractual aspects of the employment relationship are surely diminishing.

Australian cases grappling with the legal status of company policies have generally held that if a company states clearly in its offer of employment that policies can be varied from time to time, then the employer has effectively reserved a discretion to vary those policies. In Australia, terms in a policy document which are of a promissory nature about matters directly affecting the relationship between the parties (such as remuneration, performance review, termination for redundancy) are likely to be held to be contractual in nature, notwithstanding that they are included in a policy document rather than in a letter of offer.[32] However, according to *McCormick v Riverwood International (Australia) Pty Ltd*,[33] such policy-based terms can be varied by an employer who has reserved a contractual right to vary them, subject to an implied term that the employer gives notice of the variation and does not act capriciously. Mansfield J stated that the employer's power to vary policies from time to time would be 'constrained by an implied term that it would act with due regard to the purposes of the contract of employment . . . so it could not act capriciously and arguably could not act unfairly'.[34]

This constraint on the use of variable policies relies on judicial willingness to imply terms when the parties themselves have not made any explicit agreement. The history of acceptance of any implied term requiring an employer not to act capriciously or unfairly has been somewhat chequered in Australian law, where arguments continue over whether there is, or should be, any implied 'good faith' obligation in employment contracts.[35] It is difficult to be optimistic that the common law can develop the necessary implied obligation of good faith to ensure that discretions exercised by employers under these highly open-textured, so-called 'contracts' are not exercised capriciously and opportunistically. One reason for pessimism is

[32] See *Goldman Sachs JB Were Services Pty Limited v Nikolich* (2007) 13 FCR 62. For a note on this case see Louise Keats, 'Workplace Policy as Contract: the Full Federal Court Hands Down its Decision in the Nikolich Appeal' (2008) 21(1) *Australian Journal of Labour Law* 43-58.
[33] (1999) 167 ALR 689.
[34] Ibid at paragraph [150].
[35] See Joellen Riley, 'Siblings but not Twins: Making Sense of 'Mutual Trust' and 'Good Faith' in Employment Contracts', (2012) 36 *Melbourne University Law Review* 521, for an analysis of the acceptance of 'mutual trust and confidence' and 'good faith' in Australian employment law.

the curtailment of common law development as a consequence of judicial concern with 'coherence' in the law.

Coherence between common law and statute?

Employment law has evolved rapidly in recent decades as a consequence of important statutory developments. Although a creature of judicial reasoning, the contentious implied term forbidding calculated destruction of 'mutual trust and confidence' largely arose in response to the enactment of employment protection legislation allowing unfairly dismissed employees to seek statutory compensation for dismissal.[36] The notion of conduct 'likely to destroy mutual trust' arose in cases where employers sought to avoid the application of the statute by harassing employees into resigning in order to avoid taking responsibility for initiating a dismissal.[37] This strategy was defeated in cases where it was found that such harassing conduct constituted breach of the mutual trust term implied into the employment contract, and hence a repudiation of the employment contract entitling the employee to terminate for breach and access statutory dismissal rights.

There has, however, been a significant curb on the principled development of the common law in this field, as a consequence of the existence of statutory schemes. In the United Kingdom, the development of awards of damages for breach of the mutual trust obligation has been curtailed by what has been labeled the 'Johnson Exclusion Zone'. The finding in *Edwards v Chesterfield Royal Hospital NHS Foundation Trust; Botham (FC) v Ministry of Defence*[38] was made in the influential shadow of *Johnson v Unisys Ltd*,[39] the case which decided that the implied term of trust and confidence which is now 'well-established'[40] in employment contract law, ought not to be extended so that an employee might recover damages for loss arising from

[36] See *Edwards v Chesterfield Royal Hospital NHS Foundation Trust; Botham (FC) v Ministry of Defence* [2011] UKSC 58 (14 December 2011) at [19] for the history of the introduction of these protections in English law.
[37] See for example *Woods v W M Car Services (Peterborough) Ltd* [1982] ICR 666 and *Lewis v Motorworld Garages Ltd* [1986] ICR 157.
[38] [2011] UKSC 58 (14 December 2011).
[39] [2003] 1 AC 518 ('*Johnson*'). This principle from *Johnson* has been followed in Australia. See for example *State of New South Wales v Paige* (60) NSWLR 371 at 395-400 [132]-[155].
[40] At [1].

the manner of dismissal, because such a development would produce 'incoherence' between the common law and statutory regulation of unfair dismissals (under the *Employment Rights Act 1996*).

In *Johnson,* the plaintiff had already accessed his statutory rights for unfair dismissal and was seeking further common law damages for breach of the mutual trust obligation by his employer in the manner in which his dismissal was managed. He claimed that the duty not to act in a manner likely to destroy trust and confidence gave him an entitlement to fair procedures, and the employer's failure in this regards stigmatized him, and made it difficult for him to obtain future employment. The House of Lords rejected this argument, by holding that it was not permissible for judges to develop the common law in ways that would conflict with or overreach statutory laws. If Parliament has created new rights but has placed limits or conditions on access to those rights, then there is no room for judge-made law to intrude into that field.[41] In *Eastwood v Magnox Electric plc*,[42] it was made clear that this principle meant that a breach of the mutual trust obligation during employment might sound in common law damages, but a breach arising out of the fact or manner of the termination of employment would be confined to statutory remedies.

The significance of this demarcation between statutory and common law developments is particularly notable in *Edwards v Chesterfield Royal Hospital NHS Foundation Trust; Botham (FC) v Ministry of Defence.*[43] There were five different opinions in this case, including a vigorous dissent from Lady Hale, so I do not propose to untangle them all here, nor to deal with all the arguments in the case. I wish only to note that the opinions of Lord Dyson (with whom Lord Walker agreed) and Lord Mance included a finding that even breach of an express term in an employment contract guaranteeing fair procedures on dismissal would not sound in common law damages. A complainant would still be confined to statutory compensation, because the claim concerned the manner of dismissal, and Parliament had enacted a statute to deal with termination of employment complaints.

[41] *Johnson* per Lord Hoffman at 541-4, [45]-[58].
[42] [2005] 1 AC 503.
[43] [2011] UKSC 58 (14 December 2011).

This case involved two similar matters, both arising out of botched disciplinary proceedings which resulted in the termination of employment of a doctor (in *Edwards*) and a social worker (in *Botham*). Both employees had express clauses in their employment contracts entitling them to certain procedures before they could be dismissed on disciplinary grounds. Both suffered as a consequence of the employer's failure to follow its own procedures, and both sought compensation under statute for unfair dismissal, and also under the common law for breach of contract. Neither needed to rely upon the implication of mutual trust and confidence, because they had express provisions in their contracts which had been breached. Mr Botham's case seems particularly hard, because he appears to have been the victim of malicious allegations which were proven false in his unfair dismissal proceedings. Nevertheless, the fact that these employees could point to express contractual terms did not assist them. It was held by Lords Dyson and Mance that the employer had never intended that breach of these clauses should give rise to a right to common law damages. The clauses were included in their employment contracts only in order to signal an intention to comply with statutory obligations to provide fair procedures. Breach of these clauses would only entitle the employee to seek an injunction requiring the procedures to be followed prior to dismissal, or, if the employee moved too late for an injunction to be granted, to seek statutory compensation for dismissal.

Australian unfair dismissal statutes

The findings in *Edwards* are particularly interesting for an Australian employer. Our statutory unfair dismissal protections include provisions allowing a tribunal to take account of procedural matters in determining whether a dismissal was 'harsh, unjust or unreasonable'.[44] We know that since the first introduction of these laws, employers have developed human resources

[44] Presently these provisions are to be found in the *Fair Work Act* 2009 (Cth) Part 3-2, but similar provisions have existed in federal law since 1993 (in the *Industrial Relations Act* 1988 (Cth) as amended by the *Industrial Relations Reform Act* 1992 (Cth)) and in various State laws. The earliest enactment of such provisions was in South Australia in 1973 (in the *Industrial Relations Act* 1972 (SA) s 15. For an early history of Australian unfair dismissal regimes, see Andrew Stewart, 'And (Industrial) Justice for All? Protecting Workers against unfair Dismissal' (1995) 1 *Flinders Journal of Law Reform* 85.

manuals providing protocols for issuing warnings and permitting employees opportunities to respond to allegations of misconduct and underperformance. These protocols have generally been developed in large organisations to assist managers and supervisors in avoiding or defending unfair dismissal applications from aggrieved employees. Sometimes these disciplinary protocols are communicated to employees, either in policy documents, or in written contracts of employment. Hence they become part of the agreed obligations between the parties. But are they properly contractual? We might very well conclude that it has only been the existence of statutory rights that has prompted this development. Should we also conclude that the parties drafting these protocols intend only to be bound by the statutory consequences of breach, and do not expect them to have any effect on common law obligations?

This is an important question because contract damages can be quite impressive. In Australia, a successful contract claim based on an entitlement to remain in employment until the employer has found a good reason warranting dismissal can be worth considerably more than the maximum six months compensation available under the statute. See for example the successful contract claim in *Walker v Citigroup Global Markets Australia Pty Ltd*.[45] Mr Walker persuaded a full bench of the Federal court that his contract entitled him to receive compensation amounting to about two and half years' worth of salary, when an employer changed its mind and purported to withdraw an offer of a senior position before he even began work with them.

I have a theory that it was a realization of the potential for huge contract damages claims that prompted the enactment of unfair dismissal provisions into federal legislation in Australia in 1993. Rights to complain of unfair dismissal had already crept into the law via 'termination, change and redundancy clauses' in federal industrial awards.[46] In some high profile cases, employees who had been dismissed in breach of award provisions entitling them to procedural fairness, succeeded in obtaining substantial damages awards, on an argument that these award provisions had become terms of their employment contracts.[47] *Bostik*

[45] (2006) 233 ALR 687 (Gyles, Edmonds and Greenwood JJ).
[46] See *Termination Change and Redundancy Case* (1984) 8 IR 34; 9 IR 115.
[47] The first of these was *Gregory v Phillip Morris Ltd* (1988) 80 ALR 455.

(Australia) Pty Limited v Gorgevski (No 1)[48] was a particularly frightening decision for employers, because it allowed an employee to claim damages based on an entitlement to receive wages for the remaining seven years till statutory retirement age when he was dismissed in breach of what was held to be a contractually enforceable award clause.

The argument that award provisions were contractually binding was ultimately put to the sword in the High Court decision of *Byrne v Australian Airlines Limited*,[49] but not before a federal enactment moved these provisions out of awards, and into statutory provisions which provided limits on the compensation available to employees. In *Byrne,* the High Court determined that award provisions had the effect given to them by statute, so that breach of an award clause would provoke a statutory remedy only, and would not sound in common law damages for breach of contract, unless it could be shown that the parties had mutually agreed to include the award provision as part of their contractual obligations.

Now that HR policy manuals have taken over much of the work once done by the old industrial awards in setting out work practices and procedures,[50] a similar problem has emerged. To what extent are the obligations set out in those policies contractual in nature? If they are not contractual (as a case such as *Cuttriss* suggests), then is there scope for employers to shift even matters concerning important elements of an employee's remuneration and benefits into policy documents, to avoid contractual liability for those obligations? And if we have sympathy with the employers' desire to achieve such a result, because we recognize that it is unreasonable in an uncertain universe to hold employers to immutable terms and conditions of employment, then ought we not abandon the notion that employment relationships should be regulated by ordinary commercial contract law, and develop a special branch of the law of obligations to deal with this kind of relationship?

This is not such a radical suggestion. The notion that the employment relationship is best regulated as a contract is relatively new, and already much criticized.[51] Statutory

[48] (1992) 36 FCR 20.
[49] (1995) 185 CLR 410.
[50] Old industrial awards, pre-1996, were not like modern awards made under the *Fair Work Act* 2009 (Cth), in that they were permitted to contain extensive provisions dealing with work practices. The *Workplace Relations Act* 1996 (Cth) s 89A first restricted the content of awards to certain allowable matters.
[51] See Simon Deakin, above n 4.

regulation in the field is, and always has been, extensive. It makes sense to cease with the pretense that these kinds of relationships are appropriately regulated by contract law principles, and to stop leaving the task of adjudicating separation disputes to ordinary courts according to the rules of commercial contract law. If these relationships are really governed, while they subsist, by mutable policies designed to serve the employing enterprise's evolving interests, then a better form of regulation is one which recognizes this flexibility. Separation disputes should be determined according to a fair balance of the interests of the parties at the time of separation, and this balance should be determined taking into account the whole relationship and the circumstances at separation, and not merely some historical document containing an incomplete record of the real bargain between the parties. Such a form of regulation would better recognise the investments that long serving employees make in an employing enterprise, and would better reflect the nature of long term employment relationships, as cooperative collaborations which evolve over time.

Insiders and outsiders

Many of the cases dealing with these kinds of employment disputes involve long serving managerial employees. (This is of course not surprising, given the income level one would need to litigate such a claim.) Typically, these kinds of employees have made a considerable personal investment in their jobs, in terms of developing a highly firm-specific skill set that may not travel to an alternative employer, in putting down extensive family and social roots in a particular location, and in making considerable long term financial commitments requiring maintenance of a certain level of income. It is not surprising that they are aggrieved if, after a long career as an 'insider' in an employing enterprise, they suddenly find themselves excluded from sharing in the benefits of the 'club'.

In my time as a consultant to a specialist law firm[52] working with executive employee clients, I witnessed a great deal of grief, anxiety and anger suffered by people who had been unceremoniously tipped out of senior positions. Even senior, commercially-trained and

[52] People+Culture Strategies, Sydney.

experienced people are often shocked to learn how little the principles of contract law can do to protect their expectations from their employment arrangements. The nature of these kinds of workers' engagement in a firm highlights the unreality of treating the employment relationship as a contract between two legal persons – the employing master and the employed servant.

In reality, the employer is a collective entity, and generally the senior employees play important roles in forming the collective will of that corporate entity. The corporation is indeed a marvelous fiction. The capacity to create a single, artificial legal 'person' to own and control assets on behalf of a collective enables wealth-generating collaboration between people who contribute a variety of resources: not only those resources traditionally described as 'capital' (such as land and money), but also the 'human capital' of labour (including knowledge, skill and managerial capability as well as sheer muscle power). Legal doctrine enables this beneficial collaboration – the separate legal personality of the corporation (separate from its incorporators) creates a stable and efficient means for a collective to marshall, exploit and develop resources for mutual benefit.[53] Although there are respectable arguments that the working people who contribute much of the wealth of corporate enterprise are stakeholders with a legitimate claim to share in the wealth created from their collective endeavours,[54] Anglo American (and Australian) corporate law does not recognise any proprietary claim by these contributors. Orthodox corporate theory treats these individuals as outsiders who contract with the corporate entity. Even the chief executive officer who has been the guiding mind and will of a corporation is treated as an outsider should the corporate entity decide to dispense with her services.

If we were able to forget all of our legal training, and unlearn our assumptions about corporations, we might see that the employee who is excluded from the collective ought to be entitled to recoup some of the investment in the group endeavour upon departure. Why should those who remain be entitled to keep all of the wealth accumulated by the efforts of

[53] The *Salomon* doctrine (from *Salomon v Salomon & Co Ltd* [1897] AC 22) is firmly entrenched in Anglo-American corporate law, notwithstanding some strident criticism: see Otto Kahn-Freund, 'Some Reflections on Company Law Reform' (1944) 7 *Modern Law Review* 54.

[54] See generally the collection of essays in Margaret M Blair and Mark J Roe (eds) *Employees & Corporate Governance*, Brookings Institution Press, Washington DC, 1999.

others? The argument that each member has an opportunity to bargain for separation terms when they first join the collective is disingenuous in the new world of flexible, policy-based enterprise governance – as I hope the commentary on *Cuttriss* above has shown.

Given the real nature of the world of productive enterprise in the 21st century, it does seem unrealistic – and productive of potential injustice – to continue to treat employment as if it is a contractual bargain between an individual master and a servant. So what might the alternative be?

A proposal

The notion that labour relations disputes can be arbitrated as disputes over interests is by no means novel. Why not treat employment disputes in a similar manner? Upon separation, parties who are not able to settle their own severance terms should be entitled to consult an employment tribunal invested by statute with arbitral powers to determine a settlement between them, which takes into account a range of factors, including (for example):

- The original terms agreed between the parties, with greater weight given to more recent agreements which comprehensively address the terms of a genuinely negotiated agreement;
- Any policies adopted and relied upon during the currency of the engagement;
- The circumstances of the separation, including the benefits each has already received from the relationship.
- Any relevant interests of other parties (for example, the financial viability of the enterprise and its capacity to continue to employ others).

It should not be necessary for a court to identify an 'implied term', concocted from the assumed intention of contracting parties, to reach this settlement. An arbitral tribunal should be able, honestly and without artifice, to reach a fair and balanced settlement of the interests of the parties. Why should employment disputes be treated as if they concern legal rights, already established in the terms (express or implied) of a contract entered into by the parties at some time in the possibly distant past? Rarely will the parties have completely negotiated comprehensive terms to that arrangement, and even if they have, it would be an unusual

employment relationship that has not evolved over time to include new duties and expectations of reward. The common practice of large employers in using codes of conduct and policy manuals to manage the governance of enterprises in changing economic and technological circumstances demonstrates that employing enterprises see no virtue in locking their employees into the kinds of detailed contractual arrangements common to other commercial bargains. It makes sense to invent a form of regulation and dispute resolution that recognizes this reality. This approach may not, indeed, be too far removed from current unfair dismissal regimes in various jurisdictions – except that it would not be constrained by eligibility rules that preserved separate jurisdictions for different kinds of employees,[55] and it would not limit remedies to reinstatement or compensation fixed by reference to weeks of service.

The kind of proposal suggested here for employment relationships has already been adopted in some measure in Australian consumer protection laws. Even small business operators (and not merely individual consumers) have recourse to remedies which would vary contracts which prove to be unconscionable. Since 1993, Australian consumer protection legislation has empowered a court to make orders varying contractual arrangements that are 'unconscionable', within the terms of what is now the Australian Consumer Law.[56] Similar powers to vary contracts which are relevantly 'unfair' are available in the *Independent Contractors Act 2006* (Cth), which seeks to protect non-employed contract workers from exploitative bargains.

We no longer hold consumers to ancient 'caveat emptor' principles, because we know that they frequently enter into unequal bargains with inadequate knowledge of the potential consequences of those arrangements. We know that a system of regulation that imposes obligations to behave fairly and responsibly on the more powerful bargaining party promotes better justice and more efficient economic outcomes. If we care so much about the well-being of consumers in our society, how much more should we be concerned with the well-being of

[55] In Australia, access to statutory unfair dismissal protection is limited to employees engaged on awards, enterprise agreements, or to non-award employees with incomes below a certain 'high income threshold' presently set at $A123,300.

[56] See the *Competition and Consumer Act 2010* (Cth), Schedule 2, formerly the *Trade Practices Act 1974* (Cth). The current provisions are s 20 (prohibiting unconscionable conduct) and s 22 (relating specifically to small business transactions). Power to vary contracts is found in s 243.

those same citizens in their capacity as workers. Just as consumer protection law has moved away from strict adherence to notions of 'freedom of contract' and the 'sanctity of the bargain', so we need also to rethink reliance on the concepts and terminology of contract law when fashioning a form of regulation suitable to doing justice in employment disputes.