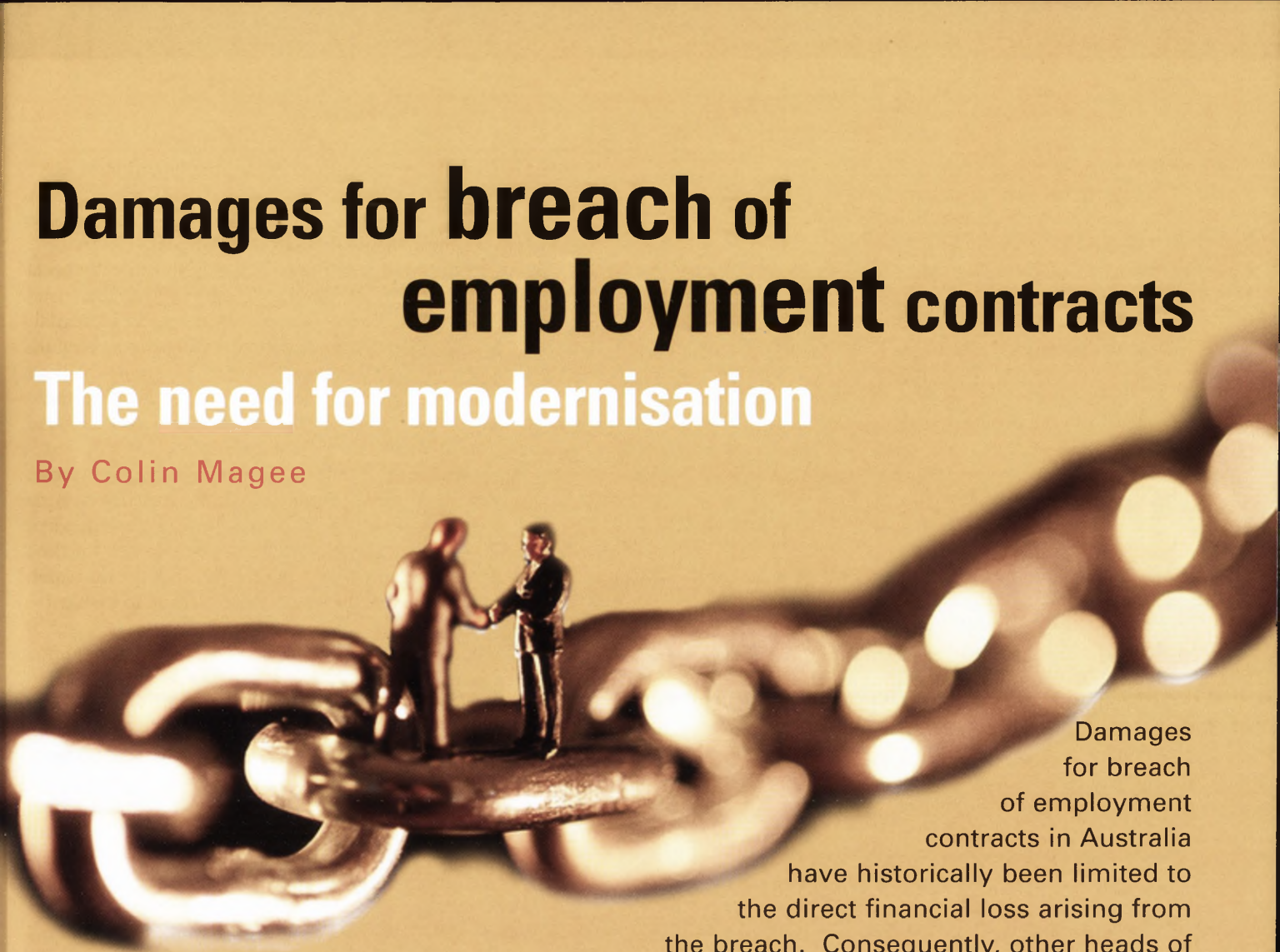


Damages for breach of employment contracts

The need for modernisation

By Colin Magee



Damages for breach of employment contracts in Australia have historically been limited to the direct financial loss arising from the breach. Consequently, other heads of damage – such as for the manner of the dismissal, personal distress and psychological injury – have been excluded.

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This situation has arisen because of a reliance on English authorities due, in part, to the insufficient development of Australian common law, which itself has arisen from the availability of alternative statutory remedies relating to termination of employment.

The willingness of Australian courts to reconsider the earlier authorities, and more recent limitations placed upon access to statutory remedies, particularly for senior executives, have led to significant developments in claims for damages arising from the breach of employment contracts.

The availability of additional damages for breach of employment contracts has arisen primarily from:

1. the acceptance in Australian law of the existence in contracts of employment of an implied term as to 'mutual trust and confidence';
2. the broadening of the circumstances in which damages will be awarded for 'personal distress' caused by the manner in which the employment contract was terminated;
3. the increased preparedness of judicial officers to have regard to terms negotiated between parties that do not

form part of the standard written terms of the contract of employment;

4. the recognition of 'loss of chance' as a head of damage arising from a breach of an employment contract; and
5. the use of the provisions of the *Trade Practices Act 1974* (Cth);

While an action for breach of damages of contract is available to both the employer and employee, this paper addresses only actions for damages by employees for their employer's breach of contract.

ACTIONS FOR DAMAGES BY EMPLOYEES

Proceedings for damages are available to employees for any breach of the contract by their employer.

The most common circumstance in which a claim for damages for breach of employment contract arises is a wrongful termination of the contract by the employer.

Damages actions can also be brought in relation to breaches of other terms of the contract by an employer, such as a failure to pay the remuneration due under the terms of the contract.

A wrongful termination of the contract by an employer >>

will arise where the employer has:

- (a) terminated the contract but failed to give to the employee the period of notice required by the contract to lawfully terminate the contract;
- (b) terminated the contract summarily for misconduct, where the circumstances of the conduct do not warrant summary dismissal;
- (c) terminated a fixed-term contract prior to the expiration of its term, in circumstances that are not otherwise permitted by the terms of the contract.

An action for damages for wrongful termination of the contract allows the recovery of damages for the remuneration that the employee would have earned but for the wrongful termination.

Generally speaking, the damages that can be recovered in such circumstances are the direct financial losses resulting from the failure to terminate the contract in accordance with its terms.

The underlying rationale for damages being so limited is that employers are entitled to perform the contract in the manner least disadvantageous to them.¹

The quantum of the damages depends on whether the contract is one terminable on notice, or is a fixed-term contract.

A fixed-term contract is not subject to termination by notice, but ends when its term expires.

In contracts subject to termination by notice, the quantum of damages is an amount equivalent to the remuneration that the employee would have received had the proper contractual notice been given.

If the contract contains an express term as to notice, then the damages will be what the employee would have earned had that express period of notice been given.

Where the contract does not have an express term as to the period of notice required, then a court is required to imply a term as to 'reasonable notice'.

Calculating damages for breach of the implied term to provide 'reasonable notice' is approached in the same way as for a contract with an express term. However, the court must determine what was 'reasonable notice' in all the circumstances at the date of the termination.

In both situations, the employees must seek to mitigate their loss. The quantum of damages awarded may be reduced by an actual mitigation of loss, or by an unreasonable failure on the part of employees to attempt to mitigate their loss.

Where a fixed-term contract is terminated by the employer prior to the expiration of its term, in circumstances that are not otherwise permitted by the contract, the employee will have a right to claim damages equivalent to the remuneration payable over the remainder of the period of the contract.²

However, in determining the quantum of damages payable for breach of a fixed-term contract, courts have generally taken into account the likelihood of re-employment within the remaining contractual period and the possibility that the contract may have been terminated before the expiry of its term without fault on the part of the employer. These factors

have been taken into account to reduce the quantum of damages awarded.

DAMAGES FOR MANNER OF DISMISSAL

Damages for the manner of the dismissal have generally been unavailable in wrongful termination claims in Australia.

As a result, damages for losses such as in respect of mental distress, anguish, frustration or injured feelings for wrongful dismissal have not been awarded.

The major impediment to claims for losses other than the direct financial loss caused by the breach of contract has been the rule in *Addis v Gramophone Co Ltd*.³

In *Addis*, the House of Lords held that damages for breach of contract cannot include compensation for frustration, mental distress, injured feelings or annoyance occasioned by the breach. Further, damages would not be awarded for the loss suffered by the employee from the fact that the dismissal in itself makes it more difficult for the employee to obtain new employment.⁴

In *Baltic Shipping Company v Dillon*,⁵ the High Court of Australia considered the decision of the House of Lords in *Addis* and suggested that the restrictions on the award of damages for 'pain and suffering' under the law of contract rested on 'flimsy policy foundations' and was 'conceptually at odds with the fundamental principle governing the recovery of damages...'⁶ However, it concluded that it was bound by the decision in *Addis*.⁷

But, in *Baltic*, the High Court noted that there were exceptions to the general rule. These relate primarily to cases that fall within the class known as 'contracts for enjoyment': where there is an express or implied term whereby one party is promising 'enjoyment' or 'pleasure' or freedom from molestation to the other party.⁸

EXTENDING THE BOUNDARIES OF DAMAGES FOR BREACH OF EMPLOYMENT CONTRACTS

A number of recent authorities has potentially extended the scope of damages that can be recovered in wrongful termination-type cases.

In particular, these authorities have raised the possibility that damages can exceed the financial loss that equates to the amount an employee could have earned in the required notice period.

They have also given rise to potential means of circumventing the general rule regarding damages for the manner of dismissal established by *Addis*.

IMPLIED TERM AS TO MUTUAL TRUST AND CONFIDENCE

Over the past decade or so, an increasing acceptance of a number of implied terms has been incorporated into all contracts of employment, regardless of the intention of the parties, in employment jurisprudence in both the UK and Australia.

The acceptance of these implied terms has given rise to a number of potential new grounds for demonstrating a breach of contract and, consequently, potential avenues of redress and heads of damage.

One significant such development arises from the emergence of an implied term as to 'mutual trust and confidence' in contracts of employment.

Such an implied term was formally recognised by the House of Lords in *Malik v Bank of Credit and Commerce International SA (In Compulsory Liquidation)*.⁹

The implied term imposes an obligation that an employer shall not, without reasonable and proper cause, conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of confidence and trust between the employer and employee.¹⁰

In order to establish a breach of the implied term, the conduct of the employer must impinge on the relationship such that, when examined objectively, the conduct is likely to destroy or seriously damage the degree of trust and confidence the employee is reasonably entitled to have in the employer.¹¹

In *Malik*, the breach of the implied term was used to found a claim for 'reputational loss' or 'stigma compensation'.

The decision in *Malik* extended the damages for wrongful termination beyond the direct financial loss suffered, to include damages for 'premature termination' losses and 'continuing financial' losses.

In *Malik*, the damages were held to be available to employees for loss of reputation that resulted in their inability to obtain new employment.¹² This head of damages was said to be based on a breach of the implied term of 'trust and confidence' and was therefore separate from, and independent of, the termination of the contract of employment.

It was this separate and independent breach of the contract of employment that allowed for recovery of damages in *Malik*, and which enabled the House of Lords to distinguish their circumstances from those in *Addis*.

Drawing from the reasoning in *Malik*, if wrongful dismissal is the only cause of action, nothing can be recovered for mental distress or damage to reputation. If, however, the damage flows from breach of another implied term of the contract, the limitation on damages arising from *Addis* need not apply.

Under the head of damage referred to as 'premature termination' losses, an employee could recover lost salary, allowances and other benefits under the contract.¹³

The head of damage referred to as 'continuing financial' losses would conceivably include all those losses that arise directly from the prejudicial effect of the termination on the employee's future employment prospects.

While claims based upon a breach of the implied term of 'trust and confidence' may open up potential new avenues of redress, it is likely that questions of remoteness, causation and proof of damage will significantly limit the circumstances in which damages can be recovered.

There has been some debate as to whether an implied term of 'mutual trust and confidence' can be implied generally into employment contracts in Australia.

This issue has not as yet been definitively determined by the High Court. However, several Australian superior courts

have either expressly or implicitly recognised the implied term of mutual trust and confidence as part of Australian law in relation to contracts of employment, and should be implied into contracts of employment, unless expressly excluded by the parties.¹⁴

Implication of the terms of 'company policies' into employment contracts


A further development with respect to damages that can be awarded in wrongful termination cases is the rule that an employee may bring a breach of contract claim in respect of an employer's failure to abide by its own contractual promises in relation to the provision of a safe workplace and to its grievance-handling procedures.

The decision in *Goldman Sachs JBWere Services Pty Ltd v Nikolich*¹⁵ is authority for that proposition.

In *Nikolich*, the grounds of claim included that Mr Nikolich's employer had breached:

- (a) the implied term of good faith and confidence, specifically, to provide a workplace free from bullying and to deal with complaints in a timely manner; and
- (b) express terms contained in the employer's policies and procedures documents.

In the Federal Court, Justice Wilcox concluded that the contract incorporated the company policies as an express term. This was based on a finding that there was an obligation on employees to comply with the policies. >>



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It followed that the obligations were mutual, and the company was required to comply with its own policies.

Justice Wilcox found that the company had breached the terms of Mr Nikolich's employment contract by not properly handling his grievance and in not providing a workplace free from harassment.

Significantly, the decision in *Nikolich* appears to have opened a new means of claiming damages for humiliation and distress for breach of an employment contract.

Mr Nikolich was awarded damages of approximately \$500,000, including the sum of \$80,000 awarded as general damages in respect of psychological damage suffered by Mr Nikolich.

Justice Wilcox held that Mr Nikolich's contract came within one of the exceptions to the rule in *Addis*. This decision was based on a finding that one of the contracts objects was to provide comfort to Mr Nikolich about how he would be treated and to give him 'peace of mind'. As such, the claim for general damages came within the principles allowed in *Baltic*.

An appeal against Justice Wilcox's decision in respect to damages for breach of contract was dismissed by the Full court of the Federal Court,¹⁶ by majority.¹⁷

The full court held that the employer was contractually bound by the representations contained within its procedures manual, and was therefore liable in damages for the psychiatric injury suffered by Mr Nikolich as a result of

its breach of those obligations.

Based on the principle in *Nikolich*, if it can be shown that an object of the contract of employment included a requirement to provide enjoyment, relaxation or 'peace of mind', then it is a breach of contract to cause distress, and so the distress will enable an award of damages.

A similar approach was adopted in *Naidu v Group 4 Securitas Pty Ltd*.¹⁸ In *Naidu*, Justice Adams in the Supreme Court of NSW found that bullying conduct, to which Mr Naidu had been exposed in his employment, constituted a breach of his employer's contractual obligations to provide a safe place of work.

Justice Adams further held that a discrimination and harassment policy formed a condition of Mr Naidu's contract of employment.

Mr Naidu was awarded general damages of \$100,000 for psychiatric illness induced by breach of his employer's obligation under the employment contract 'that he would not be intimidated by physical or verbal abuse by persons with whom he was required to work nor was he to be subjected to personal or racial vilification'.¹⁹

Damages beyond the express term as to notice

Historically, courts have been reticent to look beyond the express terms of the notice clause contained in a contract in assessing damages for wrongful termination.

The decision of the full court of the Federal Court in *Walker v Citigroup Global Markets Pty Ltd*²⁰ has brought into focus the need to pay close attention to the construction of employment contracts where there is inconsistency between the wording of a notice clause contained in a written 'standard form' contract, and specific terms agreed during negotiations for the employment.

Mr Walker had signed a contract of employment that included:

- (a) a covering letter that made provision for Mr Walker to be promoted at the end of approximately 12 months, and for a guaranteed minimum bonus, which was expected to be paid in approximately 12 months; and
- (b) attached a standard conditions document, which included a provision for one month's notice for termination of employment.

Mr Walker alleged breach of contract and also misleading and deceptive conduct contrary to the *Trade Practices Act 1974*.

One of the key issues that had to be determined in *Walker* was whether the damages that could be awarded for breach of contract were limited to the one-month salary that would have been required to be paid under the express terms of the contract.

The full court of the Federal Court determined that, on its true construction, the contents of the express terms of the letter of offer were clearly inconsistent with the standard form conditions allowing for termination upon one month's notice.

The full court came to this conclusion based upon the principle that 'where there are clauses of the contract specifically framed with the individual circumstances in

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mind, together with standard form causes, it will normally be appropriate to give greater weight to the specifically negotiated causes'.²¹

The full court awarded damages of four years' pay, despite the express term providing for one month's notice of termination.

Significantly, in *Walker* the full court re-opened the debate about the availability of damages for loss of chance in employment contracts.

The High Court in *Commonwealth v Amann Aviation Pty Ltd*²² had allowed damages for loss of chance in a commercial contract. However, it was unclear whether the High Court's reasoning in *Amann* would be applicable to employment contracts.

The full court held that Mr Walker's damages should be assessed by taking into account his loss of chance to remain in employment for a longer period. A significant proportion of the figure awarded for damages arose from this head of damage.

In taking this approach, *Walker* departs from the proposition that, in assessing damages, a party should be taken to have terminated the contract in the most beneficial way available to them. The effect is that it can no longer be assumed that damages for breach of contract will be limited to the notice period.

In *Walker*, the full court also gave further consideration to awarding damages for personal distress arising out of the circumstances surrounding the termination of employment.

The full court awarded damages of \$100,000 in relation to the circumstances of the termination. These were said to be to compensate Mr Walker for the consequential effects of losing his job on his business reputation and personal life – including the breakdown of his marriage.

These damages were awarded under the *Trade Practices Act 1974* and, as such, were therefore not subject to the limitations on damages arising from the rule in *Addis*.

CONCLUSION

Developments in the area of damages for breach of employment contracts are still in their infancy. Many of the developments have occurred in circumstances where the factual background was unusual and fell outside the norm in relation to 'wrongful termination' cases.

It is yet to be seen whether the developments arising from *Malik*, *Nikolich* and *Walker* will affect more common breach of employment contract cases, particularly for those who are not senior executives or on substantial remuneration packages.

There is a concern that Australian common law courts will see the principles arising from *Malik*, *Nikolich* and *Walker* as being confined to their particular factual circumstances and will be reluctant to extend the principles to a broader range of employment contracts.

So it cannot be said with any certainty that damages for breach of contracts of employment have moved from the age of the gramophone into the digital age. ■

Notes: **1** *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64 at 92 per Mason CJ and Dawson J. **2** *Scharmman v APIA Club Ltd* (1983) 6 IR 157. **3** [1909] AC 488. **4** *Addis* at p488. **5** (1993) 176 CLR 344. **6** *Baltic* (supra) at p362. **7** The issue of the applicability of *Addis* to Australian law was also considered by the full court of Industrial Relations Court of Australia in *Burazin v Blacktown City Guardian Pty Ltd* (1996) 142 ALR 144 at 151. It, however, came to the conclusion that it was similarly confined by *Addis*. **8** *Baltic* (supra) per Mason CJ at 362-3. **9** [1997] 3 All ER 1. **10** *Malik* at 45 per Lord Steyn. **11** *Malik* at 35 per Lord Nicholls. **12** *Malik* at 40-41 per Lord Nicholls; 52 per Lord Steyn. **13** *Malik* at 36 per Lord Nicholls. **14** See *Russell v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2007) NSWLR 198; (2007) 167 IR 121; per *Rothman J*; *Russell v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* [2008] NSWCA 217; *Burazin v Blacktown City Guardian (Op. Cit)*; *Perkins v Grace Worldwide* (1997) 72 IR 186; *Easling v Mahoney Insurance Brokers* (2001) 78 SASR 489; *Thomson v Orica Australia Pty Ltd* (2002) 116 IR 186; [2002] FCA 939; *Morton v Transport Appeal Board (No. 1)* (2007) 168 IR 403 at 430 per Berman AJ; [2007] NSWSC 1454 at paras 154-5 per Berman AJ (expressly following *Russell*); *McDonald v State of South Australia* [2008] SASC 134 at paras 373-90 per Anderson J; *Downe v Sydney West Area Health Service & Ors (No. 2)* (2008) 218 FLR 268 at 335-6 and 352 per Rothman J; [2008] NSWSC 159 at paras 326-8 and 411 per Rothman J. **15** [2006] FCA 784. **16** [2007] FCAFC 120; (2007) 163 FCR 62. **17** Per Black CJ, Marshall J; Jessup J dissenting. **18** [2006] NSWSC 144. **19** *Ibid* at [18]. **20** [2006] FCAFC 101. **21** [2006] FCAFC 101 at [77]. **22** *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.

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