Section 106: Calls for Legislative Reform Should be Silenced

SALLY GIBSON*

1. Introduction

The unfair contracts jurisdiction of the Industrial Relations Commission of New South Wales (hereinafter 'the Commission') is an increasingly popular avenue for employees, and former employees, to claim that elements of their employment relationships have been unfair or unconscionable. Section 106 of the *Industrial Relations Act* 1996 (NSW) (hereinafter 'the Act') establishes the Commission's power to intervene in and vary employment arrangements both prospectively and retrospectively.

In order to apply to the Commission for a review of a contract pursuant to s106, a claim can be based on the fact that the contract or arrangement is harsh, unjust or unreasonable; was against the public interest; or was designed to avoid the obligations of an industrial instrument.[1] The Commission's discretion extends firstly to the issue of whether to hear the claim, then to a determination of whether elements of unfairness are present in the employment relationship, and finally to the type of remedy which would most appropriately correct the injustice.

Given the Commission's broad scope to use the subjective notion of 'fairness' as the qualifying criterion on which to judge the operation of employment contracts and collateral arrangements, it is not surprising that the jurisprudential path which has been trodden is often criticised. The fact that this legislative power has been bestowed on the Commission and exercised, at times, creatively over a period of more than 40 years means that calls for statutory reform to limit the operation of s106 have not been uncommon.

The Department of Industrial Relations recently released an exposure bill entitled *Industrial Relations Amendment (Unfair Contracts) Bill* 2001 (hereinafter 'the Bill'), for public comment. This Bill sets out eight objects, the totality of which seeks to undermine the Commission's jurisdiction on a number of substantive grounds. While the Bill is only in draft form and subject to amendment, its content serves to emphasise the disquiet surrounding the scope and operation of the Commission's powers in dealing with unfair contracts.

Recent decisions of the Commission dealing with employee share option plans have provided ammunition for employer groups and practitioners alike, to vilify the operation of s106. The fact that employees who fall within the categories of middle management or executive status are increasingly being offered share

* BEc/LLB (Hons). I would like to thank Joellen Riley for her assistance and patience in helping me with this paper.

1 Section 105 of the *Industrial Relations Act* 1996 (NSW).

options as an 'inviting' form of supplementary remuneration means that successful claims which challenge the fairness of these schemes often lead to substantial awards of compensation. Those who simply cite these monetary figures as justification for their criticisms concerning the scope of s106 fail to appreciate the unfair conduct which actually prompted the Commission's intervention. While employees who seek review of option schemes are generally well-paid, this should not be a basis for a rejection of their claims of unconscionability or unfairness against a more powerful employer.

This paper begins by placing the operation of the unfair contracts provisions within a historical context. The way in which s106 has actually been utilised by employees is analysed with regard to the meaning of specific phrases within the provisions and the scope of the jurisdiction in its entirety. Finally, the different criticisms which have been levied at the operation of s106 will be reviewed, with specific reference to both the Bill and recent decisions about the 'fairness' of share option schemes.

2. *Historical Overview*

The original unfair contracts provision was introduced into the *Industrial Arbitration Act* 1940 (NSW) in 1959 in the form of s88F. In his Second Reading speech presenting the provision to Parliament, Mr Landa described the section as a counter to

> the growth of the abuse of the contract system [which] would lower the standards of wages and working conditions built up over many years of intense union organisation and industrial action. In the event of a recession, rival contractors are likely to indulge in cut-throat competition which might be expected to quickly lower existing standards.[2]

The intention behind the enactment of s88F appears to have been based on the desire to prevent employers from using their superior bargaining power to procure work arrangements which undermined entrenched employment relationships.[3] In particular, this provision aimed to ensure that the conduct of employers who categorised workers as non-employees in order to place themselves outside award coverage could be regulated.

It was not until 1965 that the first application was brought under s88F. In *Agius v Arrow Freightways Pty Ltd*,[4] an applicant had purchased a parcel-carrying business and a truck to undertake its operations. When making the purchase, the applicant had been assured that the truck was in good mechanical order and that

2 As extracted from Ron Baragry, 'Certain Injustice or Uncertain Justice: Developments in Unfair Work Contract Law' in Andrew Frazer, Ron McCallum & Paul Ronfeldt (eds), *Individual Contracts and Workplace Relations* (ACIRRT: Working Paper No. 50, 1997).

3 Breen Creighton & Andrew Stewart, *Labour Law: An Introduction* (3rd ed, 2000) at 271.

4 [1965] AR (NSW) 77 (hereinafter *Arrow Freightways*). Facts extracted from Malcolm Holmes, 'An Historical Analysis of the Jurisdiction Conferred on the Industrial Court by s275 of the Industrial Relations Act 1991 (NSW)' (1995) 69 *ALJ* 49 at 52.

the business's net return was 35 pounds per week. In reality, the receipts were far less than was indicated and the truck had a substantial number of defects. After 12 weeks the applicant was informed by the vendor company that his services would no longer be required because he could not process the quantity of orders they required. Ultimately, he was left with no work and a defective truck.

The initial issue to be determined was whether the Industrial Commission had the requisite jurisdiction to deal with the matter. After confirming its jurisdiction, the Commission adopted an expansive approach to the case and did not confine itself simply to the written contract between the parties. The approach taken in determining whether the contract was harsh, unfair or unconscionable is one which is still utilised today. The Commission held that

> Parliament was content to leave it to the Commission ... to decide in each particular case by the application of the tribunal's common sense and sense of justice whether a particular transaction is unfair, harsh and unconscionable.[5]

Arrow Freightways exemplifies the breadth of the power available to the Commission under the unfair contract provisions. The jurisdiction conferred is not confined by notions of contract law or the form of documentation involved.[6]

When the *Industrial Relations Act* 1991 (NSW) was introduced, s275 replaced s88F. The Explanatory Note to this Bill stipulated that this

> continues the provision of the 1940 Act which will enable the Industrial Court to declare void, or vary, a contract or arrangement for the performance of work if the contract is unfair, harsh or unconscionable or against the public interest.[7]

With the enactment of the *Industrial Relations Act* 1996 (NSW) the unfair contracts provisions were inserted in Part 9 of Chapter 2, and are currently comprised of sections 105, 106, 107, 108, 109 and 109A. The powers originally conferred by s88F were expanded to invest the Commission with the ability, pursuant to s106(5), to make orders for the payment of moneys against non-contracting parties.[8]

3. *The Meaning of Specific Terms Within s106*

There are a number of prerequisites which must be fulfilled before the Commission has the jurisdiction to entertain a s106 claim:

a) there must be a contract or arrangement, or a related condition or collateral agreement;
b) the contract or arrangement must be one 'whereby a person performs work in any industry'; and

5 *Arrow Freightways*, above n4 at 88–89.
6 Holmes, above n4 at 53.
7 Explanatory Note accompanying the *Industrial Relations Act* 1991 (NSW).
8 This is discussed further in Part 4 below.

c) the contract or arrangement must be 'unfair' in terms of being harsh, unjust or unreasonable; against the public interest; or designed to avoid an industrial instrument.

The operation of s106 is not limited to contracts entered into in New South Wales. The jurisdiction has been utilised in relation to contracts or arrangements made outside the state of New South Wales, and whose proper law was not the law of New South Wales.[9] The only jurisdictional threshold in this regard is that the contract at issue lead to the performance of work in a New South Wales industry.

Once a contract or arrangement falls within the parameters of the unfair contracts jurisdiction, both the substantive and procedural aspects of the contract are reviewable. 'Indeed the scope offered by the jurisdiction is so extensive that it has turned the Commission, and now the court, into a forum for considering almost every conceivable issue raised by the making, substance or performance of "work" contracts.'[10]

A. Contract/Arrangement

Section 105 defines 'contract' to include any contract or arrangement, or any related condition or collateral arrangement. 'Arrangement' and 'collateral arrangement' have been broadly defined by the Commission and can include share option plans, superannuation and other benefits, agency and partnership agreements, mortgages and deeds of release.

The Commission will look at the substance of the agreement over its form, and as such, representations made by the parties and any relevant oral evidence which deals with the relationship between the parties will be considered.[11]

B. 'Whereby a Person Performs Work in an Industry'

The phrase 'performs work in any industry' has also been expansively interpreted by both the Commission and the courts. While there must be a direct connection between the contract and the performance of work in an industry, a broad definition has been given to the term 'industry'. It is not restricted to blue collar employment and extends to professional and white collar employment.[12] Section 7 of the Act defines 'industry' to include:

a) any trade, manufacture, business, project or occupation in which persons work; or

b) a part of an industry or number of industries.

---

9 *Ex parte Richardson; Re Hildred* [1972] 2 NSWLR 423; *Maloney v Hoffman* [1980] AR 318; *Chevron Breeders and Producers of Australia Pty Ltd v Fast Food Service Development Pty Ltd* [1984] AR 54; *Australian Entre Business Centre v Smith* (1989) 29 IR 172.

10 Above n2 at 272.

11 Refer to Part 6C for a discussion of the changes which the Bill seeks to implement to limit the ability of the Commission to refer to the conduct of the parties in a consideration of the fairness of employment contracts.

12 Lawbook Company, 'Unfair Contracts' (Sydney, Lawbook Co., May 2001: *The Laws of Australia* CD ROM (2001).

In reality there would be very few areas of employment which would not fall within this definition — 'any craft, occupation or calling is included'.[13]

Ronfeldt emphasises the expansive approach which is routinely adopted by the Commission with regard to the meaning to be given to the phrase 'whereby a person performs work'.[14] This has been illustrated over the 40 years since the introduction of s88F in cases where independent contractors have succeeded in alleging the unfairness of arrangements and cases where commercial arrangements for the sale of machinery, leases, franchise agreements and loans have been demonstrated to amount to unfair dealings involving the performance of work.[15] It is sufficient that, as a direct consequence of the contract, a person performs work.

C. Unfairness

The key element of a s106 action is that the applicant must prove an element of unfairness either in their substantive employment contract or as a matter of procedure arising from the manner in which the parties conducted themselves. Fairness is to be determined by a common sense approach. The Commission will assess the conduct of the parties, the employee's ability to appreciate the contract they made and the parties' comparative bargaining positions when entering into the contract or arrangement.[16]

It is important to note that, pursuant to s106(2), the Commission may find that a contract was unfair at the time it was entered into or that it subsequently became an unfair contract because of the conduct of the parties.

'Unfairness' can arise because of a number of different and interacting factors. These factors are as diverse as:

a) Misrepresentations as to the effect of the contract.

b) Denial of certain benefits. Share schemes and superannuation arrangements have been found to be unfair because the employee loses the advantage of share options through redundancy.[17]

c) Inadequate notice. A contract that provided fair notice on its commencement may become unfair by the time of termination.[18]

d) Manner of termination. Increasingly, this has become a source of unfair contract claims particularly when an employee is summarily dismissed without being given adequate notice or an opportunity to respond to allegations made against them.

---

13 CCH Australia Limited, 'Special Category — Unfair Contracts' 2001: *Australian Employment Law Guide* CD Rom (Sydney: CCH, May 2001).

14 See Paul Ronfeldt, 'Unfair Dismissal in Disguise: Post-Employment Claims under s106 of the Industrial Relations Act 1996 (NSW)' (2000) 13(1) *AJLL* 99.

15 Id at 100. It should be noted that an outright sale of a business would not come within the unfair contracts jurisdiction because there would not be a sufficiently direct link between the sale and the performance of work: *Production Spray Painting & Panel Beating Pty Ltd v Newnham* (1991) 37 IR 46.

16 *AM Thompson Pty Ltd v Total Australia Ltd* [1980] 2 NSWLR 1 at 13.

17 See Section 5.

18 *Pullen v Reckitts and Coleman Products Pty Ltd* (1994) 60 IR 183.

e) Inadequate redundancy payments. In *Rothmans v Industrial Court of NSW*[19] unfairness was identified when a monthly non award employee was offered less redundancy in comparison to weekly employees.

The circumstances in which the Commission may exercise jurisdiction under s106 were considered by a five member Full Bench of the Commission in *Reich v Client Server Professionals of Australia Pty Ltd.*[20] Their Honours emphasised that the only jurisdictional threshold which must be passed is that there is a contract or arrangement or any related condition or collateral arrangement under which a person performs work in an industry.[21] Once this gate has been cleared the Commission will, subject to its discretion not to exercise jurisdiction, determine the 'fairness' of the employment relationship according to the 'common sense approach of a juryman by applying standards which appear to provide a proper balance or division of advantage and disadvantage between the parties who have made the contract or arrangement'.[22]

4. *Scope of the Unfair Contracts Jurisdiction*

The coverage of the NSW unfair contracts legislation was summarised by Sir Garfield Barwick, when he stated that the language of s88F was

> intractable and must be given effect according to its width and generality. The legislature has apparently left it to the good sense of the Industrial Commission not to use its extensive discretion to interfere with bargains freely made by a person who was under no constraint or inequality or whose labour was not being oppressively exploited.[23]

The court's approach to the breadth of these provisions has changed little since the above comments were made in 1976. In a 1994 judgment, President Kirby recognised that while

> the large jurisdiction afforded under s88F(2) to do what appears 'just in the circumstances of the case' is not without controlling limits ... those limits are cast very widely by the plain language of the statute.[24]

Section 106 gives the Commission the power to make orders against non-contracting parties who have influenced the making and performance of the contract at issue. In *Brown v Rezitis*,[25] the High Court confirmed that monetary orders could be made against persons other than parties to the contract. However, such an order cannot be made unless the non-contracting party had a 'real connexion with

19 (1994) 53 IR 157.

20 (2000) NSWIRComm 143; (2000) 99 IR 69.

21 Id at para 21.

22 Ibid.

23 Above n14 at 106; *Stevenson v Barham* (1976) 12 ALR 175 at 177.

24 Above n14 at 106; *Walker v Industrial Relations Court of New South Wales* (1994) 53 IR 121 at 136.

25 (1970) 127 CLR 157.

the making, variation or avoidance of the contract or arrangement which has been varied or avoided'.[26] Chief Justice Barwick suggests that the only basis for an order of payment against a person not a party to the contract or arrangement could be if the person 'had received the proceeds of the contract or arrangement or were in some way culpably associated with its making or operation'.[27]

The scope of the Commission's jurisdiction to deal with unfair contracts is also evident from the variety of different orders that can be utilised to remedy the unfairness identified. The Commission has the power to declare a contract wholly or partially void from the commencement of the contract or from any other time after its commencement.[28] The Commission can also make any order as to the payment of money in connection with an unfair contract as it considers just in the circumstances. The purpose of making such an order is to restore the applicant to the position they would have been in had the contract not been unfair. Section 107 also allows the Commission to make orders for the prevention of further unfair contracts.

A. An Alternative to Unfair Dismissal Proceedings?

The breadth of the unfair contracts provisions has effectively expanded the ability of claimants to allege unfair dismissal outside the stringent requirements of Chapter 2 Part 6 (Unfair Dismissals) of the Act. Under section 83, only limited classes of employees can actually bring claims for unfair dismissal:

a) public sector employees; or
b) any employee, except an employee for whom conditions of employment are not set by an industrial instrument and whose annual remuneration is greater than $75200.[29]

As a consequence of these limitations, it is often claimed that employees on higher levels of income are pursuing s106 claims as an alternative mechanism to remedy their claims of unfair dismissal.[30] Criticisms have also been levied by the trade union movement at the amount of the Commission's time which has become devoted to hearing s106 claims brought by affluent individuals who do not fall within the unfair dismissal scheme.[31]

Section 106 also has another potential advantage to litigants in the fact that there is currently no cap on the monetary award which the Commission can grant.[32] In contrast, the unfair dismissal provisions place a limit of six months

26 Id at 162.

27 Id at 164. For an application of this principle see *Robert Edmond Coghill v Technicall Australia* [2000] NSWIRComm 141 (15 August 2000); *Ace Business Brokers Pty Ltd v Phillips-Treby* [2000] NSWIRComm 163 (25 August 2000); *Gallagher & Anor v Modern Garages Australia Pty Ltd* [2000] NSWIRComm 184 (8 September 2000).

28 Section 106(2).

29 Regulation 5A *Industrial Relations (General) Regulation* 1996 (NSW).

30 See Stephen Long, 'Jobless rich may lose de facto dismissal law' *The Australian Financial Review* (6 July 2001).

31 Above n14 at 101.

32 See Part 6A below.

remuneration on the amount of compensation which can be awarded. However, it is important to note the different remedies, aside from compensation, available under both the unfair dismissal and unfair contracts provisions. The primary remedy for the former is reinstatement, whereas the Commission does not have the jurisdiction to make such an order in a s106 claim.

On 1 December 1998,[33] section 109A was incorporated into the unfair contracts regime in an attempt to impose a limitation on post-employment claims under s106. Section 109A provided that a claim could not be made under s106 if an application could have been made by the employee under Chapter 2 Part 6 but for the exclusions relating to the monetary cap. However, the Full Bench of the Commission thwarted parliament's attempt to curb the explosion of s106 claims. In *Beahan v Bush Boake Allen Australia Ltd*[34] the Full Bench found that, irrespective of the introduction of s109A, a claim under s106 still remains open to dismissed employees.[35] Their Honours distinguished between a contract which on its terms was unfair — and lead to an unfair termination — and the unfair termination of an otherwise fair contract. The former is still capable of being addressed by a s106 claim, despite the enactment of s109A.

B. Mechanism for obtaining 'Reasonable Notice'

The term 'reasonable notice' refers to the period of notice 'which the employer should have reasonably given in all the circumstances. Such a period should reflect that which the hypothetical ordinary average standard employer acting reasonably should have given.'[36]

One of the most common applications of s106 is to claims by employees for notice periods which exceed those provided for in their contract of employment. However, this concept is only of recent invention and was endorsed by the Commission in *Walker v Hussmann Australia Pty Ltd.*[37] In that case Justice Maidment upheld a claim that a contract of employment was unfair, because of its failure to treat employees equally with regard to severance payments.[38] The decision was appealed to the Industrial Court, where the judges were divided over whether a broad or narrow approach should be taken to the interpretation of the provisions.

On appeal to the New South Wales Court of Appeal, President Kirby clarified the correct approach:

> [W]hatever doubts may have existed earlier, it is now beyond argument that the 'unfairness' referred to can arise not only from positive provisions of the contract or

33 The enactment of the *Industrial Relations Amendment (Unfair Contracts) Act* 1998 introduced s109A.

34 (1999) 39 IR 1.

35 Above n14 at 99.

36 *Moray v Merrill Lynch Australia Pty Ltd* [2000] NSWIRComm 160 (8 September 2000) at para 35.

37 (1992) 44 IR 404.

38 Jeff Shaw, 'The Industrial Relations Act 1996 (NSW): Some Legal Aspects' (1996) 9 *AJLL* 273 at 278.

> arrangement which offend fairness in the relevant sense, but also on the failure in the part of the contract or arrangement to provide in a way that such fairness requires.[39]

While there are numerous cases which relate to reasonable notice and associated issues, the recent decision of *Moray Vincent v Merrill Lynch Australia Pty Ltd*[40] is a useful example of the factors which contribute to create unfairness and the appropriate orders to remedy that unfairness.

In that case, the applicant joined the Merrill Lynch organisation in its New York office in 1994. He was initially involved in a rotational programme and after completing his training in New York, he moved to London for three months and then to Sydney for six months. At the completion of the programme he transferred to the Sydney office and commenced employment with the respondent.

The applicant's remuneration package consisted of a base salary and a bonus, which could be determined at the complete discretion of the employer. The applicant received a bonus of $20000 in 1995, $120000 in 1996 and $120000 in 1997. Until the termination of his employment in October 1998, the applicant had received two substantial base salary increases during his time with the respondent. However, while the applicant received bonus payments and salary increases, there was some suggestion that he needed to address weaknesses in his leadership skills.

On being informed of his redundancy, the applicant was offered one month's notice and five months' pay as a redundancy package. He was also offered a 1998 bonus of $36 000. The redundancy package and the bonus payment were conditional on the applicant signing a deed of release, which he refused to do. Consequently, Moray Vincent was paid only one month's notice.

The applicant brought a section 106 claim on the basis that:

- his contract of employment did not provide for reasonable notice on termination;
- an adequate redundancy package should be included in the employment contract; and
- the bonus scheme was unfair in its operation on termination.[41]

Justice Marks approached the issue of redundancy and notice from the perspective that the determination of one issue necessarily impacts on the determination of the other. Ultimately, Marks J found that six months was a reasonable period of notice. The factors that lead to this determination included the following:

- the middle management position occupied by the applicant;
- the volatile nature of the industry in which the respondent operated; and
- the period of the applicant's employment with both the respondent and the global Merrill Lynch organisation in the United States.[42]

---

39 Above n24 at 133.
40 Above n36.
41 Id at para 22.
42 Id at para 40.

While the period of notice ordered equalled the amount of payment in lieu originally offered by the respondent, His Honour held that their failure to honour this offer after the applicant refused to sign the deed of release was unfair.

Marks J also considered the bonus scheme to be unfair, particularly given the fact that if an employee is terminated part-way through a calendar year for reasons unassociated with performance, then there is no opportunity for the employee to participate in any bonus.[43] The applicant was only offered a bonus for 1998 which was equal to 30 per cent of the bonus he had received in 1997. The respondent argued that the bonus programme was purely discretionary and as such it was within its purview to offer only a proportion of the previous year's bonus. His Honour did not accept this interpretation and characterised the discretionary nature of such schemes as providing the framework from which 'claims of unfairness may foster and grow'.[44]

In order to rectify claims of unfairness, it is necessary for employers to develop criteria which can be applied in determining whether, and in what proportion, a bonus payment shall be made. The implementation of a settled assessment process leads to certainty for both employees and employers. As Marks J stipulates:

> Enlightened employers establish performance criteria by which the employer and employees alike can assess the work and contribution of employees and by which areas for improvement or modification of performance can be identified. Such criteria, if valid, fortify an employer against the possibility of allegations of unfairness which may be levelled by employees.[45]

5. *Share Option Schemes*

It is well established that share option schemes are classified as a related condition or collateral arrangement for the purposes of s105 of the Act.[46] It is undeniable that share option schemes constitute an 'asset of potentially significant value'[47] and as such it is unsurprising that an increasing number of cases focus on the interaction between the unfair contracts jurisdiction and this popular method of supplementary remuneration. Given the fact that these schemes fall within the purview of the unfair contracts provisions, they provide a useful example of the scope and operation of the Commission's powers under s106.

Generally, if it is found that a share option scheme is unfair it will be varied so as to enable the options to be exercised during a 'reasonable' period.[48] However this outcome is not a mandatory one and the Commission can use its discretion in order to determine the most appropriate remedy in the circumstances before it.

---

43 Id at para 94.

44 Id at para 84.

45 Id at para 85.

46 See, for an example *Westfield v Helprin* (1997) 82 IR 411.

47 *GIO Australia Ltd v O'Donnell* (1996) 70 IR 1 at 24.

48 See *Stephen Michael Sasse v National Dairies Ltd*, IRC 2290 of 1998 at 21.

The review of the following cases aims to chart the course of the jurisprudence in this area in order to determine the types of share option schemes that offend principles of fairness. All the cases analysed in this part involved unfair share option plans of varying complexity.

A. Adams v Westfield Holdings Ltd

The respondent approached the applicant in May of 1995 to offer him a senior position of employment. At that time the applicant held a secure, executive position with National Australia Fund Management with a remuneration package valued at approximately $195 000 per annum.

The respondent lured the applicant from that employer and the applicant took up a position remunerated in accordance with the following components:

- base salary;
- if the applicant performed well he would receive an annual bonus of up to 40 per cent of his salary; and
- the applicant would be allocated 30000 share options per annum in the respondent company. These options could only be exercised after the expiration of a five year period. 'Directors believe that by providing an opportunity for executive directors and senior executives to directly link their rewards to the creation and growth of Shareholder wealth, the new [share option] Schemes will create a performance based incentive that is directly tied to the future growth and expansion of the group.'[49]

On termination of his employment in 1998, the applicant received one month's notice and three months' payment in lieu of notice but was not paid any bonus for the financial year ended 30 June 1998. The applicant, at the discretion of the Board of the respondent, received an entitlement to exercise 45000 of the allocated 150000 share options which he had accumulated throughout the course of his employment.

It should be noted that the applicant's termination was not related to poor performance or behaviour. In contrast, Adams appeared to be an effective employee whose salary was regularly increased each financial year.[50] He was made redundant because the wholesale trust scheme of which he was a part was being dismantled on the ground that it did not appear to be a successful long-term venture for the respondent.

(i) At First Instance[51]

On the facts, Justice Hungerford found that the respondent had misrepresented the employment package in a number of respects, particularly with regard to:

---

49 [2000] NSWIRComm 112 (30 June 2000); (2000) 99 IR 382.

50 Id at para 37. On commencement of employment the applicant's base salary was $225000. Each January in 1996, 1997 and 1998 his salary was increased by $12000, $8000 and $5000, respectively.

51 Above n49.

- The criteria which needed to be satisfied in order to qualify for the yearly financial bonus payments. During his last year of employment the applicant achieved 'superior performance' and yet he did not receive any bonus. Adams was not advised of the fact that the bonus could be withheld despite superior performance and that the bonus may have been conditional on the success or failure of particular projects.[52]
- The exercise of share options. The applicant was not advised before beginning his employment that, subject to the 'absolute discretion' of the respondent, his share entitlements would lapse completely if he was terminated at any time within the first five years of employment.[53]

Perhaps more importantly, Justice Hungerford found that the share option and the bonus programmes were inherently unfair on the basis that both schemes seemed to operate at the 'absolute discretion' of the Board. The inadequacy and unfairness of an option scheme which did not provide for circumstances of redundancy becomes patently obvious when one considers the fact that the outcome for an employee who is dismissed for dishonesty, poor performance and the like is exactly the same as the outcome for an employee who is made redundant due to organisational and operational changes. The fact that Adams was left with only 30 per cent of his share options and no bonus for the financial year ending in June 1998 reflects elements of unfairness which satisfy the requirements of s106. Consequently, the conclusion ultimately reached by Justice Hungerford is one based on the premise that a scheme whereby no provision is made for the execution of rights to share options on redundancy is unfair.

Hungerford J ordered that the applicant's contract of employment be altered to reflect the position that if the applicant was made redundant then he was entitled to exercise any or all of the share options granted to him and the options could be exercised no later than 30 months after his employment terminated.[54] This conclusion can be contrasted with the orders made in *GIO Australia Ltd v O'Donnell*[55] and *Westfield Ltd v Helprin*,[56] where it was decided that the share options made available to the terminated employees should be proportional to the completed service of the option qualifying period. His Honour distinguished this case from the orders made in these earlier decisions on the basis that Adams' redundancy was in no way connected to issues of poor performance.[57] It is arguable that such a distinction was not a valid one, given that the claims of poor performance in *GIO* and *Helprin* were not actually substantiated or valid reasons for termination.

His Honour found that Adams was entitled to a 40 per cent bonus for the financial year ending in June 1998 because he had satisfactorily fulfilled all

52 Id at para 4–5.
53 Id at para 6.
54 Id at para 81.
55 Above n47.
56 Above n46.
57 Above n49.

performance-related requirements set for him. The contract of employment was also varied to provide for 10 months' notice on termination.[58]

(ii) On Appeal[59]

On appeal, findings of fact, principles of law and the actual orders made were challenged. A Full Bench of the Commission[60] upheld the appeal on limited grounds.

The core proposition on which the grounds of appeal were based was the apparent urgent need on the part of the Commission to enunciate guidelines which should be followed by judges in s106 matters in order to ensure uniformity of result rather than ad hoc decision-making. Mr Shaw, who appeared for the appellant, submitted that:

> This case is an appropriate vehicle to enable the development of more consistent principles to determine the quantum of compensation in unfair contracts cases, given the ad hoc approaches taken to date. The development of more coherent principles would be calculated to assist the early resolution of s106 matters.[61]

The perception that the orders made by the Commission under s106 are in the form of a 'lottery' of result is a view purportedly shared by the New South Wales Government given the contents of the Bill. The Full Bench answered Mr Shaw's criticisms in terms which could equally be applied to the Bill:

> The law relating to unfair contracts in New South Wales has developed into a substantial and important area of jurisprudence within the jurisdiction of the Commission. Within this jurisdiction there have been an increasing number of cases in recent years involving claims by senior corporate executives or highly paid employees seeking relief under s106 (or its predecessor). The case law has developed to address particular features associated with the employment contracts or arrangements for this class of employee ... We reject categorically Mr Shaw's analogy of a lottery. Such a submission ignores the very substantial body of precedent that has been built up around s106 and its predecessors over the past 42 years and, indeed, ignores the constraints within the section itself.[62]

In this case, the financial outcome of Justice Hungerford's decision was that the respondent received benefits which totalled more than $1.4 million — five times the benefit actually obtained on termination. On the appellant's submissions, the order in itself was the result of judicial error. It was argued that 'any compensation above that required to adequately compensate the applicant for the loss suffered would place the applicant in a position of windfall gain'.[63] The respondent countered that argument with the view that '[s]o long as a relevant nexus exists

58 Id at para 80.

59 *Westfield Holdings v Adams* [2001] NSWIRComm 293 (21 December 2001).

60 Coram of Wright, Walton & Boland JJ.

61 Above n59 at para 8.

62 Id at paras 53–54.

63 Id at para 78.

between the unfairness declared by the Court and the avoidance or variance which follows there is no limit to the approach that may be taken by the Court in assessing what payment is just in all the circumstances'.[64]

The Commission was directed to the High Court case of *Brown v Rezitis*,[65] but ultimately held that that decision was not authority for the proposition that a money order must be based solely on restitution of the aggrieved party. 'Restitution so understood may be appropriate in particular cases, but the fundamental guiding principle is that which is stated in the statute itself, namely, what is just in the circumstances of the case.'[66] That is, while restitution may be one factor which impacts on the orders made, it will not necessarily be the only factor. The intricacies of each individual case will determine what is a 'just' result.

The appellant also proposed that the Commission should, in determining the appropriate orders to be made, have regard to the established principles for the assessment of compensation at common law and under the *Trade Practices Act* 1974 (Cth).[67] In particular it was suggested that common law principles relating to the assessment of compensatory damages should be applied when resolving s106 matters — that is, that the injured party should receive compensation which places them in the same position they would have been in had the contract been performed or the tort not committed.[68]

The Full Bench rejected the analogies drawn by the appellant between orders made under s106 and the remedies available in contract and tort claims at common law, and remedies under the *Trade Practices Act*. The very wording of s106 indicates that the legislature intended the Commission to focus its attention on issues that were broader than common law principles. This was recognised by the Full Industrial Court in *State of New South Wales v Health and Research Employees' Association of New South Wales*[69] where it was stated that:

> Indeed, the existence of s88F [now, s106] indicates that the legislature found that common law remedies were not necessarily appropriate and it seems to follow, insofar as argument by analogy might be useful that, though persuasive, reliance solely upon common law rules as to 'damages' may well be inappropriate.[70]

Similarly, any analogies drawn between s106 and ss82 and 87 of the *Trade Practices Act* become fundamentally flawed when the specific wording of the former is taken into account. As such, it is unnecessary to have regard to the latter when dealing with the orders to be made under s106.[71]

64 Id at para 77.
65 Above n25.
66 Above n59 at para 102.
67 Id at para 103.
68 Id at para 104. The common law principle is set out in detail in *Robinson v Harman* (1848) 1 Ex 850 at 855, and more recently in *Haines v Bendall* (1991) 172 CLR 60 at 63.
69 (Industrial Court, Fisher CJ, Bauer & Hill JJ, 31 March 1993).
70 Extracted from n59 at para 80.
71 Id at para 129.

One of the areas[72] where the Commission recognised that common law principles could offer assistance was in regard to mitigation. However, it should be noted that the application of mitigation is limited inherently by the specific words used in s106. If the commonsense approach is adopted it becomes immediately apparent that, in certain circumstances, it is necessary to have regard to whether an applicant has sought to limit their loss by seeking alternative employment[73] when undertaking the balancing act which necessarily occurs in assessing what would be a 'just' resolution in the particular case. Mitigation is not a blanket concept which will be applied to all s106 orders made. It is convenient to make the following distinctions:

- Notice periods — The Commission explained the underlying purpose of providing an employee with notice on termination at para 138:

> It has been said that the function of a period of notice is to give an employee the opportunity to adjust to the change in circumstances that results from the termination of his or her employment and to seek other employment ... Notice provisions focus on the future of an employee and are intended to compensate, to the extent possible, for the disruption, cost and hardship caused by the periods of unemployment that commonly follow termination.

Given the reasoning adopted above, it may be appropriate for the Commission, if it considers it 'just in the circumstances', to take into account issues of mitigation when determining what constitutes a reasonable period of notice in the circumstances of the specific case before it.

On the facts of this matter, the Full Bench reduced the six months' payment in lieu of notice ordered by Hungerford J by one month to account for the consultancy work which Adams commenced shortly after his termination.[74]

- Severance/redundancy payments — The Commission accepted the definition of a severance payment which was articulated in the *Termination, Change and Redundancy* case:[75]

> A severance payment, however, is intended to provide a payment as compensation for the loss of non-transferable credits and entitlements that have been built up through length of service, and for inconvenience and hardship imposed by the termination of employment through no fault of the employee.

---

72 The Full Bench accepted that common law principles may be instructive but only in limited circumstances: 'This means that, for example, where a contract or arrangement has been found to be unfair, and the unfairness has been caused by fraudulent misrepresentation or negligent misstatement, in making any money orders under s106(5) it is proper for the trial judge, in appropriate cases, to have regard to the common law principles relating to the assessment of damages' (id at para 130).

73 When referring to the concept of mitigation, it is prefaced on the basis that the principle of mitigation will not be applied where the employee 'refused to take up alternative employment, and that refusal was reasonable in the circumstances of the case': *Paviour-Smith v National Mutual Life Association* (1999) 91 IR 8 at 61–62; cf *Rejder v Nationalpak Pty Ltd* (unreported, Glynn J, Matter No IRC 5119 of 1998, 13 December 1999) (id at para 136).

74 Above n59 at paras 203–204.

75 (1984) 8 IR 34 at 62, 73.

The function of a severance or redundancy payment is such that it would not be appropriate for the Commission to offset any payment on the basis of a mitigation argument. Any payment ordered is in the form of a debt, and it is well established that the principle of mitigation does not apply to debts.[76] On the basis of this same reasoning payments made in relation to bonuses and share option schemes are also not subject to mitigation, given that such payments are 'analogous to debts owed and payable at the time of termination'.[77]

Finally, the Full Bench accepted, as a prima facie principle, that a trial judge faced with a s106 matter should have regard to the 'overall quantum of any compensation order and determine whether it was proportional to the unfairness evidenced in the contract or conduct'.[78] While this assessment may lead a trial judge to review his or her approach to the individual elements which comprise the money orders, it would not be appropriate to 'set off' one head of claim against another head of claim.[79]

Ultimately, the appeal was successful but on very limited grounds. The Full Bench upheld Justice Hungerford's conclusions with regard to notice payments on the basis that there was no evidence of an appealable error. Similarly, the Commission found that the order made at first instance with regard to the bonus payment was also correct on the facts. Their Honours did note that one month's notice and nine month's remuneration as both notice and redundancy payments was at the 'high end of the acceptable range applicable to this matter'.[80]

With regard to Hungerford J's finding that Adams should have the opportunity to exercise all the options which would have become available to him on the expiration of the five-year qualifying period, the Full Bench held that that conclusion was not open to His Honour on the facts. Their Honours drew particular attention to the fact that Adams had had exposure to share option schemes during his employment with other corporations. While it was accepted that Adams did not actually realise that his share options would be 'handcuffed', a reasonably prudent person would have made proper inquiries as to the terms and conditions governing the scheme.[81] The orders of Hungerford J were varied so as to allocate to Adams the volume of shares that equalled the proportion of his completed service of the option qualifying period.

B. Canizales v Microsoft Corporation and Ors[82]

Microsoft Corporation employed the applicant in 1989 in the United States of America. In 1995, he was transferred to Sydney and was eventually employed by the New South Wales subsidiary, Microsoft Pty Ltd. After the applicant's arrival in Sydney, the respondent contracted with Publishing and Broadcasting Limited to form a joint venture company, ninemsn Pty Ltd. The applicant was seconded to work for the joint venture in July 1997, for a period of two years.

76 Above n59 at para 148.
77 Id at para 205.
78 Id at para 156.
79 Id at paras 159–160.
80 Id at para 165.
81 Id at para 184.
82 [2000] NSWIRComm 118 (1 September 2000); (2000) 99 IR 426.

On 15 May 1998 the applicant's employment was terminated. Subsequently, the applicant invoked the Commission's jurisdiction under s106. The applicant sought orders relating to a reasonable notice period, a fair severance package and the benefits of a share options scheme.

The share option plan was granted to the applicant in July 1995 and was to vest to four-twelfths of the grant in July 1999 — on the condition that the applicant was still employed by Microsoft. The benefit relating to the shares which the applicant lost on termination was valued at approximately $14 million as at February 2000.

In order to appreciate the orders ultimately made by Justice Peterson, it is necessary to gain a degree of understanding as to the operation of the Microsoft scheme. For those Microsoft employees covered by the scheme, the first step that was taken was the granting of options over a specified number of shares. Groups of these shares became available to the employee only on their vesting dates. The share price on the date of the initial grant is used to fix the price to be paid for the shares when the options are actually exercised — that price is the 'strike price' of the shares.[83] If the market price of the shares increases in the time period between grant and vesting then the employee has the opportunity to buy the shares at the strike price and accrue the differential between the strike price and the market price. Historically, the Microsoft share price has trended steeply upwards.[84]

A Microsoft employee involved in the company's share option plan also has the additional benefit of being involved in any 'splits' of the company's shares. A split occurs when the company wishes to increase the number of shares on issue and as such the existing share pool is divided. The price of each share is reduced, but the parcel of shares held by participating shareholders increases — that is, the shareholder is left with the same value in dollar terms, but with a share portfolio of a different composition. However, in Microsoft's case, it is suggested that after a split the share price quickly returns to its pre-split level, conferring a substantial benefit on those shareholders who participated in the split.[85]

The applicant participated in regular option grants as well as a number of stock splits. The actual scheme of which the applicant was a member was called the 'Junior Jumbo Plan'. This plan differed from the 'Jumbo Plan' in that while a greater number of share options were actually granted in the 'Junior' programme, these shares had fewer vesting dates and were subject to a longer vesting period of five and a half years.

The Junior Plan did not make any provision for the early vesting of shares on termination. In contrast, the Jumbo Plan provided that a terminated employee has the benefit of any share options which have already vested at the date of termination, as well as the right to exercise any share options which would have vested within the six month period following the date of termination.[86] The applicant raised his concerns about the effect of an involuntary redundancy on an employee's share options with the Vice President of Human Resources before he

83 Id at paras 11–14.

84 Id at para 11.

85 Id at para 12.

86 Id at para 39.

became a member of the plan. He was assured that 'Microsoft would do the right thing by its senior executives in the event of a redundancy'.[87]

Microsoft's purpose in developing the Jumbo and Junior Jumbo Plans was to provide an incentive to its executives to stay with the company for the long term. Specifically, its aim was to 'attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to such individuals, and to promote the success of the Company's business'.[88] Justice Peterson concluded that while past service was being rewarded, the principal purpose of the schemes was to ensure that successful employees were retained in order to add additional value to Microsoft and not one of its competitors.[89]

The termination of the applicant's employment was contrary to a number of assurances that he had been given from senior officers within Microsoft. The applicant's termination was unexpected and beyond his control. He reasonably expected that his employment would continue until at least July 1999, one of the vesting dates for his share options. In the words of Justice Peterson, '[t]he termination of the applicant in these circumstances smacks of unfairness.'[90]

Peterson J ordered that the applicant be entitled to the share options which would have accrued to him by way of vesting within the period ending in July 1999.[91] Instead of a monetary payment in lieu of the shares, the applicant was given three months from the date of the judgment in which to exercise the shares.

The fact that the applicant was given the benefit of the share options which were valued at $14 million is often proffered as a justification for the conclusion that s106 fosters an industrial relations system which is biased towards employees, at the expense of their employers. However, the conclusions reached by the Commission in this case are not startling when the monetary figures are disregarded:

> The share options are in the end of utterly fantastic value, such that an employee is capable of receiving what on any view is a ridiculously large sum for work done, appears not to influence the scope here for a remedy.[92]

Of all the cases reviewed in this Part, *Canizales* is perhaps the least controversial in terms of the appropriate remedy granted for obvious unfairness. Not only did the Junior Jumbo Plan fail to make any provision for the vesting of shares on redundancy, but the senior executives of Microsoft continually made assertions to the applicant about the certainty of the vesting of his shares, at least

87 Id at para 19.

88 *Terms of Microsoft's 1991 Stock Option Plan*, see id at para 20.

89 'Given the language in the option plan documents ... the conclusion is unavoidable that the Junior Jumbo grants were conceived with one view in mind: to retain and reward senior staff over a lengthy future period of 7.5 years ... This no doubt reflected one's past performance, but the principal motivation was retention, not reward for past service': id at para 31.

90 Id at para 150.

91 Id at para 164.

92 Id at para 2.

up until July 1999. In fact, the issues raised in *Canizales* may be such that other avenues for legal recourse, particularly equitable claims relating to promissory estoppel,[93] would have been available to the applicant, although s106 was obviously the most convenient.

C. *Graham v Macquarie Bank*[94]

The applicant joined Hill Samuel Australia Ltd (which later became Macquarie Bank) in 1983. Since 1996, the applicant had held the position of Deputy Managing Director of the Bank. The salary package of Executive Directors, of which Graham was one, comprised three parts:

a) Basic Costs Responsibility (BCR) — base salary;
b) Directors Profit Share (DPS) — allocated annually from the profit pool to reflect the individual achievement of each Director;
c) Partly Paid Shares (PPS) — allocated to Directors annually in a similar proportion to the DPS points.

The terms of the employment arrangements between the respondent and its Executive Directors was such that only if a Director died would the DPS vest 100 per cent and be paid to the Director's estate. A forfeiture of DPS entitlements applied to any director giving notice to the respondent prior to 1 April in any year.[95]

The applicant's employment was terminated in December 1991. The respondent claimed that this termination was a result of the applicant's poor management style. Justice Kavanagh did not accept this proposition and found that even if poor performance was the reason behind the termination, the applicant had been denied procedural fairness. The respondent failed to: 'fully and frankly discuss such complaints with the applicant'; to make clear to the applicant the gravity of his employment situation; to give any warning about the applicant's perceived poor management style; or 'enter into any consultation with the applicant as to any criticism of his management style'.[96]

Justice Kavanagh held that:

> The termination, without just cause was beyond the applicant's control. In the making of the employment contract, the applicant had every reasonable expectation of a long and secure employment at a senior executive level with a dynamic and developing corporate environment.[97]

In terms of the orders made by the Commission, 12 months' salary payment was ordered to reflect a reasonable period of notice. Justice Kavanagh found that the DPS scheme was inherently unfair in that there was no provision for the

93 This possibility was raised by Joellen Riley in a speech presented at the 'Section 106: Repeal, Amend or Do Nothing' forum conducted by NSW Young Lawyers Industrial Law Committee, 29 August 2001.

94 [2000] NSWIRComm 253 (15 December 2000).

95 Id at para 25.

96 Id at para 129.

97 Id at para 132.

retention of any accrued benefits if employment was terminated other than for just cause. In this case, the payments vested over a 10 year period — 'certainly a long period of time in which to allow access to a cash payment already earned and allocated'.[98] In recognition of this unfairness, Kavanagh J ordered that the applicant be paid his complete allocation of DPS for 1990–1991, reflecting his past service, and three-quarters of the DPS allocation for 1991–1992 taking him up to his December 1991 termination.[99]

D. Henshaw v Sqribe[100]

The applicant commenced employment with the respondent as a Manager of Sales and Marketing in 1997. In 1998 he was appointed to the position of Managing Director. Following a merger in 1999, the applicant was made redundant.

The applicant's initial employment came about because he was headhunted by the respondent. He was lured away from secure employment by the promise of 10000 share options in the American parent of the respondent. 'It was the prospect of acquiring those options that led the applicant to accept the position.'[101]

The vesting dates for the options were as follows:

- 25 per cent of the option shares 12 months after the grant date (that is, August 1998); and
- 2 1/12 per cent of the options on the first day of each succeeding month from September 1998 to August 2001.

The share option scheme further provided that the option term would terminate if the employees' employment came to an end.

On termination, the applicant was offered payment equivalent to four months' base salary and US$20000 in consideration of the share option scheme. The applicant rejected this offer and commenced s106 proceedings.

Justice Peterson found that six months' payment in lieu of notice was fair under all the circumstances. With regard to the share option plan, His Honour also found elements of unfairness. However, it is interesting to note that this unfairness did not arise from the actual structure of the plan itself. In fact, Justice Peterson described the vesting dates of the options as 'unexceptionable'.[102] The unfairness that was identified arose from the failure of the plan to make any provision for share options if an employee was made redundant:

> The failure, again, of the Sqribe Plan was not to make any prescription in relation to redundancy. Any termination, other than for theft, fraud, embezzlement or disclosure of trade secrets and the like, was to have the same consequences for the vesting of options. Any other dismissal for cause, such as poor performance..., or

98 Id at para 153.
99 Id at para 164.
100 [2000] NSWIRComm 279 (22 December 2000).
101 Id at para 5.
102 Id at para 36.

> any other form of misconduct warranting instant dismissal, would achieve the same vesting as a redundancy of any staff, including a Managing Director.[103]

Of particular interest in this judgment is the fact that the exercise of management prerogative in designing and implementing a share option plan with wide ranging vesting dates was not considered unfair. Rather, unfairness arose from the absence of any provisions dealing with the treatment of an employee's options on redundancy. Justice Peterson found that the grant of options should vest only up until the end of the reasonable period of notice — that is, the applicant's share options would only continue to vest during his six month notice period.[104]

After the substantive judgment was delivered the parties were given the opportunity to confer on the declarations which should be made. As the parties failed to reach an agreement, Justice Peterson later revisited the issue of the appropriate money order to be made which represented the value of the shares awarded.[105] His Honour considered that there were three methods available to him by which the amount could be quantified:

- a calculation of the average monthly stock price, based on the average closing price for each relevant month — which, in this case, amounted to US$44318; or
- a calculation using a rolling average closing price — the 'high-low' average closing stock price which produced a total of US$67092; or
- a calculation utilising the average closing stock price for the whole relevant period — which amounted to US$44601.

In order to determine which method was the most appropriate, His Honour approached the issue from the viewpoint that his assessment was really an assessment of the value of the options to the employee, as distinct from the cost to the employer. That is, on termination, it was the applicant who was deprived of the opportunity to freely choose when to exercise his options.

Keeping in mind the fact that the determination must be made from the employee's perspective, Peterson J found that the second method was preferable, on the basis that it was a more 'appropriate indicator of the likely result' had the applicant actually been given the opportunity to deal with his shares at the time of termination.[106] Justice Peterson recognised that the value of shares are 'contingent on a number of factors, one of which is the vagaries of the market and another the

103 Id at para 37.
104 Id at para 39.
105 *Henshaw v Sqribe* [2001] NSWIRComm 196 (31 August 2001).
106 Id at para 12.

whim or wisdom of the employee's selling decisions'.[107] It should be noted that His Honour did emphasise the importance of considering the future selling pattern of the applicant based on the probabilities. In this case the applicant's practice, established by the evidence, was that he had previously traded his shares immediately after exercising his options.[108]

E. *Shane Mitchell Calvert v Yahoo! Inc*[109]

The applicant began his employment with Yahoo! UK in 1997. When he relocated to Australia he negotiated an employment contract as a salesperson with the respondent in Sydney. His contract allowed for a salary of $50000 per annum, $20000 bonus and options under a Share Option Plan.[110] In this case, the applicant had secured the largest worldwide internet advertising contract before beginning in Australia, and common sense dictates the conclusion that his base salary was representative of only a small portion of his overall remuneration.

The purpose of the Share Option Plan was to 'attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive ... and to promote the success of the Company's business ...'[111] The shares were granted on 8 July 1997 and vested to 25 per cent after the first year and to 1/48ths on each month after. The shares fully vested after a period of four years. The agreement provided that the shares which had vested could, subject to a number of conditions, be exercised for a period of 30 days after termination.

The applicant's sales performance was called into question on a number of occasions before he was eventually terminated. However, in the months prior to the applicant's termination, the respondent acknowledged that it set sales targets which were 'arbitrary, unrealistic and unfair'.[112] His Honour used the same terms to describe the way in which the applicant's performance was measured.

The Commission varied his contract of employment to include a term of two months' notice. A provision was also incorporated into the contract to allow for the options to continue to vest during the reasonable period of notice. The evidence established that the applicant's pattern on vesting was to exercise his right to purchase the options and immediately on-sell the shares.[113] Therefore, Justice Kavanagh ordered that the respondent pay the applicant an amount equivalent to the value of the shares in the market place at the dates of vesting, on 6 January 1999 and 6 February 1999.

107 Id at para 9.

108 Id at para 11.

109 [2001] NSWIRComm 136; (2001) 106 IR 36.

110 It should be noted that on beginning employment with Yahoo! Inc in Australia, the share options which the applicant had accumulated since the beginning of his employment in the UK continued to vest.

111 Above n109 at para 41.

112 Id at para 27.

113 Id at para 42.

In monetary terms, the order of payment amounted to $400000, as the value of the shares in early 1999 far exceeded their value as at the date of the judgment because of the intervening downturn in the value of internet stocks. While the Commission's approach of ordering payment for the value of the shares when they had a significantly higher market price may appear novel, it is nevertheless sound. Were it not for the respondent's harsh and unfair conduct, the applicant would have, on the evidence of his past behaviour, exercised his right to purchase the shares on vesting in January and February and should not have been deprived of the benefits of an early exercise simply because of the timing of the Commission's ruling.

F. Current Position Regarding Share Option Schemes

If we look at the above decisions in isolation, or if we focus our attention only on the actual monetary figures involved, the purpose of s106 and its application to share option plans is obscured.[114] However, if the Commission's judgments are taken in their totality, then the presence of a developed practice and process for identifying and remedying unfairness becomes evident. There are clear jurisprudential principles which have developed over the last few years in relation to how the Commission will deal with share option plans and how it will determine what actually constitutes unfairness.

It is now established that employee share plans which do not make provision for the accrual of benefits on termination other than for just cause will be found unfair if reviewed by the Commission. If an employee is made redundant then he or she should have access to some or all of their granted share options. The proper approach to this calculation should be based on the proportionality principle — that is, the employee should be granted a percentage of the total shares which reflects the length of their service under the share plan.[115] In terms of vesting periods, shares should continue to vest during the reasonable notice period[116] or for a period which is dictated by the intricacies of the employment arrangement.[117]

After finding that a share option scheme is unfair and making a determination as to the number of share options which should be awarded, the general approach involves allowing the successful applicant a period of at least several months[118] to

114 This issue was addressed by the Full Bench in *Westfield Holdings*, above n59, where it was stated that: '... the fact that outcomes in proceedings under s106 in favour of applicants are now in some cases being measured in millions, rather than thousands of dollars is not so much a reflection of the manner in which the Commission in Court Session exercises its jurisdiction. Rather, it is largely a function of the labour market, particularly in the finance and technology sectors, and the relatively high level of remuneration, including arrangements as to share options and bonuses, paid to many senior executives' (at para 55).

115 This was the approach in *Graham*, above n94. It can be contrasted with Justice Hungerford's decision in *Adams*, above n49, which was reversed by the Full Bench of the Commission on appeal (above n59).

116 As was the case in *Graham*, above n94, and *Henshaw*, above n100.

117 As was the case in *Canizales*, above n82, where the specific date at issue was July/August 1999.

118 Three months was allowed in *Canizales*, above n82.

exercise the options. This outcome is more realistic than a monetary order because the applicant then has to assess the market realities and determine for him or herself when to exercise the options. If this approach is not appropriate[119] and the parties are unable to reach a consensus themselves, then the Commission will make a ruling regarding the monetary orders which it considers just on the evidence before it.[120]

6. *Criticisms of the Unfair Contracts Jurisdiction*

In November 2001 the Department of Industrial Relations released the Bill, which is directed towards altering, and limiting, the Commission's scope for varying or setting aside work contracts on the grounds of unfairness. The objects of the Bill significantly erode the discretion of the Commission both in terms of determining whether unfairness exists and in ascertaining the appropriate relief to remedy any unfairness identified. The potential amendments are discussed below. It should be noted that even if all of the provisions set out in the Bill are not transplanted into the Act, it is probable that some change will occur which seeks to implement one or more of the proposed objects.

A. Jurisdictional/Monetary Thresholds

> The object of this Bill is to amend the *Industrial Relations Act* 1996:
> a) to prevent an unfair contract order being made to set aside or vary a contract if, when an application for the order is made, or, if the contract is terminated, immediately before termination, the contract is:
> i) a contract of employment providing for annual remuneration of the employee exceeding $250,000, or
> ii) a contract (other than a contract of bailment, or contract of carriage, to which Chapter 6 applies) under which, in the 12 month period immediately before the application, financial benefits received, or receivable, by the applicant exceed $250,000, and
> b) to limit the power to make orders to set aside or vary contracts, or for the payment of money in connection with such contracts, if the resultant financial benefit payable exceeds a maximum in total of $125,000 in connection with a contract of employment or $250,000 in connection with any other form of contract, and
> ...
> e) to require an application for an unfair contract in relation to a contract that has been terminated to be made within a period of 3 months after termination of the contract, and ...

Object a) effectively seeks to place a monetary cap on those employees who are able to utilise the Commission. Just as those who earn over $75200 are precluded from accessing the unfair dismissal provisions, this change would

119 As was the case in *Calvert*, above n109.

120 The Commission reviewed the different available methods in *Henshaw*, above n100.

implement a similar limit upon the exercise of the Commission's jurisdiction under s106, albeit that the figure would initially be set at a much higher level.

What if a monetary ceiling was placed on those employees who were able to seek a remedy under s106? How would this arbitrary figure be justified? Before the release of the Bill the Labor Council of New South Wales suggested that if a monetary cap was placed on access to the Commission, the figure should equal approximately $318 000 (equivalent to an SES Level 8 salary).[121] If the proposed limit of $250 000 was implemented, what are the likely positive and negative ramifications of this limitation?

From a 'big business' perspective, the advantage for companies is that they will not be susceptible to apparently inflated claims of compensation from failed former executives. Apparently, 'big business' would then receive the security and certainty they require to operate efficiently within the New South Wales economic community.[122] From another perspective, trade union concerns about the amount of time which the Commission devotes to s106 claims at the expense of the claims of the 'ordinary' worker would be calmed.[123]

One negative ramification would be that those workers who earn over the arbitrary, seemingly random, figure chosen as the monetary ceiling would be denied the opportunity to access the Commission and would thus, in the majority of cases, be denied the opportunity to complain about:

- unfair dismissal procedures;[124]
- lack of procedural fairness;
- receiving no redundancy or severance payments; and/or
- share option plans which operated to deprive redundant employees of a rightful benefit.

Object b) also seeks to set a monetary cap — but a cap on the dollar value of orders made by the Commission pursuant to s106. The imposition of a $125 000 limit would severely restrict the Commission's ability to remedy unfair contracts, particularly the contracts of senior executives. If a ceiling is to be placed on monetary orders it would be more appropriate if it was in a similar form to the limitation set down in the unfair dismissal provisions[125] — that is, taking the unfair dismissal regime as an example, a limit of six months' remuneration.

121 Mark Lennon, Labor Council of New South Wales, in a speech presented at the 'Section 106: Repeal, Amend or Do Nothing' forum conducted by NSW Young Lawyers Industrial Law Committee, 29 August 2001.

122 Olga Ganopolsky, Australian Business Limited, in a speech presented at the 'Section 106: Repeal, Amend or Do Nothing' forum conducted by NSW Young Lawyers Industrial Law Committee, 29 August 2001.

123 See Part 4A above.

124 Claims for unlawful or wrongful termination of employment would have to be brought in the ordinary courts.

125 Chapter 2 Part 6 of the *Industrial Relations Act* 1996. This is discussed in Part 4A of this paper.

As the Bill currently stands, the cap does represent six months' remuneration for an employee earning $250 000 per annum (the suggested maximum remuneration which an employee can earn if the Commission is to have the power to review their employment contract under s106). While the $250 000 limitation is not appropriate in itself, for the reasons detailed above, if it were adopted the maximum monetary order which could be awarded to an employee earning that maximum would be six months' remuneration. If six months is the maximum for employees earning $250 000, then six months remuneration should also be the maximum for employees earning remuneration of less than $250 000 per annum. This would ensure substantive uniformity across income levels.

The only limitation which would serve to enhance the operation of s106 would be the inclusion of a provision similar to that described in object e). At present there is no statutorily imposed time limit for the lodgment of s106 claims. The requirement that an application be made within a period of three months after the termination of the contract would ensure that employers are not defending claims for indefinite periods after the conclusion of the employment relationship. Three months would also represent a reasonable period of time whereby former employees can seek advice and determine whether they will pursue any legal claims.

B. Share Option Limitations

> The object of this Bill is to amend the *Industrial Relations Act* 1996:
>
> ...
>
> g) to prevent an application for an order, or order being made, to set aside, or vary, a contract on the basis that is [sic] unfair because of the operation of, or in any other respect relating to, the benefits, rights or entitlements given by, or in respect of, certain schemes or arrangements with respect to shares or other securities or the acquisition of shares and other securities under the contract, or
>
> h) to prevent benefits, entitlements or rights under such a securities scheme from being taken into account in assessing any amount of money payable in connection with a contract that is set aside or varied.

It would be absurd to exclude share option schemes or arrangements from the purview of the Commission. In many of the cases described above, share options accounted for one of the most important and substantial components of remuneration. 'Share option plans have become a more common element of remuneration packages in the private sector and may increase the level of an executive's benefits quite significantly.'[126] Given the increasing popularity of these schemes, their lure to potential employees and the common link between options and employee performance, the Commission must have the ability to review these schemes to determine the presence or otherwise of fairness.

Some employers have taken the view that the s106 jurisdiction fosters uncertainty because of the degree of discretion accorded to judges to determine whether unfairness is present and, if found, to determine the appropriate remedy.

126 Above n59 at para 55.

However, the above analysis dealing with share option schemes demonstrates that the Commission has developed a set of principles that are consistently applied to determine what constitutes unfairness.

It is now patently obvious that a share option plan will be considered unfair if provision is not made to secure the rights of redundant employees on termination. Similarly, the substantial jurisprudence developed in relation to reasonable notice periods provides a mechanism through which employers can assess their obligations to employees on termination. While it may not be possible at the initiation of an employment relationship to determine the appropriate period of notice, at termination it is within an employer's ability to determine, with reasonable certainty, how the Commission would rule in terms of the notice period which would be just in the particular circumstances. If uncertainty of result is the criticism which has led to the inclusion of objects g) and h) then that criticism, and the draft provisions which are built on it, are completely inappropriate and groundless.

C. Further Proposed Changes

> The object of the Bill is to amend the *Industrial Relations Act* 1996 to:
> ...
> c) to ensure that only the terms of the contract (and not the conduct of the parties) are taken into account by the Commission in ascertaining whether a contract is unfair, and
> d) to enable the Commission to take into account whether or not the applicant took any action to mitigate loss in assessing the amount of money payable in connection with a contract that is set aside or varied, and
> ...
> f) to ensure that an application cannot be made for an unfair contract order if a claim has been or could be made for unfair dismissal by a party to the contract, and ...

The foundation for much of the Act appears to be the uniqueness of employment contracts, as distinct from other business contracts. In fact, the term 'employment relationship' is often more apt to describe work arrangements than 'employment contract' because the latter is too restrictive a description of the interactions between employers and employees. This has long been a justification used by the Commission in finding that a contract may not be unfair at the time it was entered into but that it subsequently became an unfair contract because of the conduct of the parties.

A restriction such as that imposed by object c) on the discretion of the Commission to consider only the contract, and not the conduct of the parties, seems to assume that employment contracts always consist of precise, written agreements. In reality this is simply not so. This was recognised by the High Court in *Concut v Worrell*,[127] where the terms of the employment relationship at issue

127 [2000] HCA 64 (14 December 2000); (2000) 103 IR 160; (2000) 176 ALR 693.

'were found partly, but not exclusively, in the written instrument'.[128] While that case did not deal with a s106 claim, it did address the fundamental concepts underlying employment relationships.

The very features of employment arrangements — relationships which are 'personal, and often quite close and trusting'[129] — distinguish employment-related contracts from more general business contracts. If the Commission was limited to the contract between the parties and was not permitted to inquire into their conduct, significant injustice could befall employees whose actual duties and obligations vary from the contract which they entered into at an early stage in their employment. The Full Bench of the Commission, in *Reich v Client Server*,[130] emphasised that when determining the fairness of an employment arrangement 'it is difficult, we think, in conceptual terms to separate the contract itself from the conduct of the parties in performing it.'[131]

Finally, objects d) and f) are unnecessary amendments, given the dicta of the Commission in *Westfield v Adams*[132] and *Beahan v Bush Boake*[133] respectively. The first of these objects seeks to incorporate principles of mitigation into the calculation of money orders but fails to illuminate how or when these principles should actually be applied. The Full Bench in *Westfield* comprehensively reviewed the different heads of damages in order to determine when, and to what extent, mitigation should be considered appropriate. Irrespective of whether object d) is incorporated into the legislation or not, mitigation will be relevant in relation to notice periods, but not severance payments, bonuses or share option schemes.[134]

Similarly, the principle in *Beahan* would continue to apply, irrespective of the existence of a provision in the form of object f). That is, a s106 claim will be maintainable under that provision unless it is an 'unfair dismissal claim in disguise'. It is improbable that any substantive distinction could be drawn between s109A and a provision mirroring object f).

One of the many criticisms aimed at the unfair contracts provisions, and arguably one of the justifications for legislative reform, has been the apparently disproportionate amount of time which the Commission devotes to hearing s106 matters. Is the concern expressed by trade unions, and to an extent the Government,[135] about the Commission's 'improper' focus on s106 claims justifiable? There does not appear to be any empirical evidence upon which such

128 Id at para 11.
129 Id at para 50.
130 Above n19.
131 Id at para 28.
132 Above n59.
133 Above n34.
134 Refer to the discussion in Part 5Aii.
135 The purpose of the NSW Government's introduction of s109A was to stem the flow of 'unfair dismissal' claims dressed up as 'unfair contracts' claims. In the Amendment Act's Second Reading Speech, the Attorney General went so far as to say that: 'the explicit restrictions on access to the NSW unfair dismissal jurisdiction ... earning less than $66,200, or other prescribed amount — are being circumvented by those who can afford to litigate an unfair contract claim.'

claims can be based. In contrast, the statistics which are available seem to indicate the opposite. In 1999, there were 3201 unfair dismissal applications and 321 unfair contracts applications.[136] Some practitioners have also argued that the Commission lists matters quickly[137] and that, in reality, a large number of s106 claims never actually reach judicial determination because of the effectiveness of compulsory conciliation measures.[138]

Even if it could be established that the Commission was unable effectively to deal with other employee claims because of the overload of s106 applications, it is ridiculous to suggest that the appropriate response would be to limit the substantive operation of the unfair contracts provisions. If the Commission is over-extended, then the problem is one of resourcing. It is absurd to suggest that the correct way of addressing a procedural or resourcing issue is to alter substantive rights in order to reduce the number of applicants appearing before the Commission.

There are a number of potential solutions which would address procedural problems without limiting current legal rights of recourse.[139] The Commission already implements a fee structure which addresses the perceived financial position of applicants making a claim under s106 and applicants making a claim under the unfair dismissal provisions. As from 1 September 2001, the fee for filing a s106 claim in the Industrial Relations Commission is $561. This can be contrasted with the $50 filing fee payable for the lodgment of an application for unfair dismissal.[140] The differences between the fees indicates that the Commission already recognises that s106 is being utilised by employees of more significant means that those employees who earn under $75200 and come within the purview of the unfair dismissal regime.

136 Statistics available from the Department of Industrial Relations: <http://www.dir.nsw.gov.au/action/irinnsw/ud.html> (21 October 2001).

137 Ron Baragry, in a speech presented at 'Section 106: Repeal, Amend or Do Nothing' forum conducted by NSW Young Lawyers Industrial Law Committee, 29 August 2001.

138 Jeff Phillips, in a speech presented at 'Section 106: Repeal, Amend or Do Nothing' forum conducted by NSW Young Lawyers Industrial Law Committee, 29 August 2001. The Commission will only arbitrate on a s106 claim after the parties have attempted to settle their dispute through conciliation. It is only when, in the opinion of the Commission, all reasonable attempts to settle the matter by conciliation have been made but have been unsuccessful that the Commission will ultimately determine the issue: s109 of the *Industrial Relations Act* (NSW) 1996.

139 Joellen Riley has suggested that a sliding scale of fees which relate to the size of the claim or conversely, the claimant's level of remuneration could be implemented: above n93. Alternatively, Jeff Phillips has raised the possibility of legislating so that if an award of compensation is in excess of a certain sum, then a proportion of the award must be paid back into the Commission: ibid.

140 Figures available from: <http://www.lawlink.nsw.gov.au/ir.nsf/pages/fees> (accessed 17 October 2001).

D. Outcome of Legislative Change

If the substantive provisions of the Bill were legislatively implemented, it is arguable that the common law might provide some relief for 'unfairness' claims if the Commission's jurisdiction was limited. Common law claims for reasonable notice on termination are not unknown or even extraordinary. In *Quinn v Jack Chia (Australia) Ltd*,[141] a reasonable period of notice of 12 months was implied into an employment contract, irrespective of the fact that the contract itself provided for only one month's notice. In determining the length of the notice period the Supreme Court of Victoria took into account a number of factors which are remarkably similar to the factors which influence the Commission when dealing with notice under s106. Some of the issues identified by the Court included:

- the plaintiff's age;
- the seniority and importance of his position;
- his salary — which equalled $100000; and
- the fact that the plaintiff was lured to work for the respondent at the expense of his own business venture.[142]

The enactment and implementation of s106 has meant that the development of the common law has been stunted by statutory intervention. Recent changes to the common law in relation to employment were emphasised by Justice Peterson in *Gambotto v John Fairfax Publications Pty Ltd*.[143] His Honour drew attention to the English decision in *Scally v Southern Health and Social Security Health Board*,[144] where the House of Lords relied on the implied term of trust and confidence to find that all employees in a certain category had to be notified by an employer of their entitlement to certain benefits. Peterson J identified changes in legal culture as the impetus to the evolution of the implied term of trust and confidence.[145] His Honour claims that:

> The major importance of the implied duty of trust and confidence lies in its impact on the obligations of the employer ... And the implied obligation as formulated is apt to cover the great diversity of situations in which a balance has to be struck between an employer's interest in managing his business as he sees fit and the employee's interest in not being unfairly and improperly exploited.[146]

It is not controversial to state that employers have an implied duty to act reasonably. This duty was emphasised in *Johnson v Unisys Limited*.[147] The applicant in that case was a 52 year old former director of the respondent. Over the

141 [1992] 1 VR 567.

142 See also the decision of *Rankin v Marine Power International Pty Ltd* [2001] VSC 150 where the period of reasonable notice in a common law claim was 12 months.

143 [2001] NSWIRComm 87 (1 May 2001).

144 (1991) 4 All ER 563; [1992] 1 AC 294.

145 Above n143 at para 27.

146 Id at para 27.

147 [2001] UKHL 13 (22 March 2001).

term of his employment he suffered from work-related stress and his employers were aware of his particular psychological vulnerability. In January 1994 the respondent made allegations against the applicant regarding his poor conduct. At the end of January he was summarily dismissed. Before the House of Lords the applicant argued that the respondent had breached an implied term whereby an employer will not without reasonable and proper cause conduct itself in such a way as to damage the relationship of trust and confidence between the parties.[148]

The House of Lords established that the employee had a reasonable cause of action based on a breach of the implied obligation of trust and confidence. However, the majority did recognise that statutory procedures have advanced at the expense of the development of the common law.[149] Their Honours suggested that now that statutory remedies have been developed in this area of employment, there is limited opportunity for common law development. Similar comments could be made in relation to the New South Wales statutory regime.

If the unfair contracts provisions were limited in their application, affected employees could argue that unfairness in relation to share option schemes falls within the limits of a claim that the employer has breached its implied duty of trust and confidence — particularly if the employee's share option plan operates as a 'handcuff' and the employee was unaware at the time of entering into the plan that the options were conditional on a certain period of continued service.[150] Leaving aside the probability of being able to launch a successful claim, the pertinent question which must be asked is whether the outcome we desire is one where the extensive skills and expertise of the Commission are sidelined in preference to possible claims in the Supreme Court.

7. Conclusion

It is undeniable that s106 has developed substantially since its introduction in 1959. However, the principal purpose behind its enactment has not changed. Fairness and a just outcome in circumstances where parties to a contract or arrangement are not necessarily equal bargaining partners are still the bases for the Commission's approach.[151] In many respects s106 can be viewed as successful in terms of its ability to remain relevant as employment relationships evolve and develop. The Commission's approach to share option schemes is indicative of this.

Plans for legislative reform to limit the operation of the jurisdiction and the various criticisms which have been levelled by different groups seem largely valueless if they are indeed based on issues of resourcing or lack of certainty. It is too simplistic to equate fairness with lack of certainty, especially when the

148 Id at para 8.

149 Id at para 23.

150 As was the case in *Luke Harper v Candle Australia Limited* [2001] NSWIRComm 77 (10 April 2001).

151 The Full Bench of the Commission recognised this in *Westfield Holdings*, above n59 at para 56.

Commission has had the opportunity to develop a myriad of principles to deal with the intricacies of employment relationships.

The introduction of the Bill demonstrates the Government's desire to limit the breadth of the Commission's jurisdiction. The proposed changes are fundamentally flawed both in their structure and scope of operation, and seek to undermine the very purpose for which s106 was developed. The removal of share option arrangements from the purview of the Commission is an example of this. The exclusion of these schemes will only promote their growth in circumstances which breed unfairness. Finally, those objects of the Bill which place stringent jurisdictional thresholds on those employees who are able to access the Commission in order to assert their claims of unfairness in the terms of their employment contracts are obtuse — the importance of fairness should not be undervalued in any relationship of employment, irrespective of the salary of the employee involved.