Discretion, Good Faith and Employer Control Over Executive Remuneration

*M J Moir**

Contractually-conferred discretions often lie at the heart of an executive employee's remuneration. Typically the employer's power to award additional remuneration is described in executive contracts as a 'sole' or 'absolute' discretion. How then might an employee challenge an opportunistic or arbitrary exercise of the employer's discretionary power? This article argues that the question should be approached as an issue of construction, in which the language of the contract controls the standard to be applied to the exercise of the employer's discretion. Consistent with the structure of Australian contract law, this approach does not involve resort to free-standing implied terms or quasi-administrative law concepts but allows room for the operation of 'implicit good faith' as a principle of construction. Ultimately, the intention of the parties as disclosed by their contract will determine whether a court may interfere with the exercise of an employer's discretion.

Introduction

Provisions for discretionary payments are nowadays a common incident of executive employment contracts. Such payments may take a variety of forms, including cash bonuses and share options, and may constitute a major portion of an employee's remuneration. At the same time, discretionary forms of remuneration always run the risk of disappointment for employees in that they may be withdrawn or cancelled at the election of the employer. To quote Bayley J in *Taylor v Brewer*, the decision to grant remuneration over and above the fixed salary may rest solely 'in the breast of' the employer.[1] Indeed, the employer's power to award additional remuneration is often emphatically described in the terms of the contract of employment as a 'sole' or 'absolute' discretion. The significance of these words lies in the apparent exclusion of any constraint upon the employer. Moreover, the express words of the contract cannot be passed over because the parties to the contract are taken to have agreed to confer an apparently untrammelled discretionary power on the employer. How, therefore, could an employee challenge an opportunistic or patently self-interested exercise of the employer's discretion when he or she has obviously agreed to confer broad discretionary power on the employer?

This article analyses the question by reference to case law in Australia, England and Canada, where the courts have adopted techniques of construction and the implication of contractual terms, in order to restrain freedom of contract and to control an employer's discretionary power. The article considers whether such developments are consistent with the structure of Australian contract law, and suggests that the use of implied terms of 'good faith' or 'mutual trust and confidence' runs into a number of difficulties, not

* Barrister, Sydney.

1 (1813) 1 M & S 290; 105 ER 108 at 109.

least that the courts do not have a general power to rewrite contracts. Rather, in deciding the effect of a discretionary pay clause in a contract of employment, it is suggested that the court is fundamentally engaged in the task of construction against the relevant contractual background. Whether a court may interfere with the exercise of a discretion must necessarily be decided by reference to the intention of the parties as disclosed by their contract. Depending on the implication to be drawn from the express terms of the contract, the court may infer that an employer's discretion involves purely subjective elements or that it incorporates a higher objective standard.

The cases illustrate that where the emphatic adjective 'sole' or 'absolute' is used, the courts will expect executive employees to show a high tolerance for disappointment before they seek judicial redress. As explained below, this approach is underpinned by sound economic reasons and risk management principles. Nevertheless, it is possible to discern that the courts in Australia and elsewhere have tended to intervene in at least three types of contractual disputes:

1) The parties to the employment contract have specified objective criteria by which the employer's discretionary power should be exercised.
2) The subject-matter of the discretionary pay provision in truth has something of an 'earned through services or performance' character.
3) The discretion has not been exercised in 'good faith' — either in the sense that the discretion was exercised unreasonably or unfairly, or for reasons of dishonesty, spite or prejudice.

These categories are not definitive. Some cases even see the overlapping of these categories. Generally, however, they help to illustrate that the language of the contract controls the standard to be applied to a 'sole' or 'absolute' discretion. The first and second categories show that the subject-matter of the discretion may lead to a construction in which the employer's seemingly unfettered power is controlled by limits arising from the agreement. Here, judicial control of an express discretion can be achieved by construction rather than implication of a term.

The third category goes one step further. It suggests that, irrespective of whether the particular contract imposes a subjective or objective standard, the employer's discretion must be exercised in good faith. Both Australian and English cases find that there is an implied universal duty of good faith or mutual trust requiring a reasonable exercise of discretion. This article disagrees, and instead argues that good faith is implicit in employment contracts and applies as a default principle of construction in interpreting the 'sole' or 'absolute' discretion. Furthermore, the principle has a distinct but narrow meaning. It is not a principle of what 'fairness' or 'reasonableness' requires in the circumstances of the particular case. Rather, good faith is equated with honesty, or lack of spite or prejudice. Notwithstanding these limitations, it is suggested below that good faith acts as an important safeguard for an employee against the risk of opportunism and abuse caused by self-interest.

Overall, this article suggests that Australian courts are well-equipped to resolve disputes about contractual discretions through resort to principles of construction and the operation of good faith implicit in employment contracts,

without the need to use implied terms. Before turning to these issues, it is relevant to consider an important threshold question which may arise in the context of discretionary executive remuneration — namely, whether a promise by an employer to exercise a broad, and apparently unconditional, discretion amounts to an enforceable legal promise? As discussed below, litigation in Australia has focused much attention on this question.

Discretion and Legally Binding Promises

The overarching discretion of an employer to award additional remuneration may consist of a hierarchy of sub-components: whether it is awarded at all, the amount awarded, the form and timing of the award. Faced with the range of discretions available to the employer, including whether to provide any award at all, it may be difficult for a court to escape the conclusion that there is no legal promise capable of furnishing consideration for a contract, or that the agreement is void for uncertainty. After all, what has the employee exchanged in return for a promise that the employer might at some future point, and for any reason it deems advisable, award an element of additional remuneration on top of the existing salary? And how is the promise enforceable due to its inherently open-ended texture? It is well established that a promise which is left to the discretion of the promisor to perform does not create a legally binding contract.[2] As Lord Devlin expressed it, 'there cannot be a promise in the air'.[3]

Australian courts have addressed this issue in relation to employment contracts,[4] and have generally been astute to adopt a construction which preserves the validity of the agreement while maintaining that judges will not spell out the agreement where the parties have failed to do this for themselves.[5] As Beatson notes, courts are reluctant to make a finding of 'pure discretion' where this would mean there is no binding contract.[6]

An example of this approach is the English decision of *Powell v Braun*.[7] There the employer wrote to his female secretary that, instead of a salary increase, he would pay her an annual bonus based on the net trading profits. The employer's letter continued: 'I cannot say at this juncture what the amount will be, but I am sure you will not be disappointed with it from year to year'. Subsequently, the employer refused to pay and contended there was no firm promise to pay anything. Evershed MR held that the parties never intended the bonus to be 'purely discretionary',[8] because it was payable in lieu of a salary increase earned through the employee's proven good performance and fulfilled promise to undertake additional responsibilities. Using language

2 See J W Carter, E Peden and G J Tolhurst, *Contract Law in Australia*, 5th ed, LexisNexis Butterworths, Sydney, 2007, pp 126–7.

3 Lord Devlin, 'The Treatment of Breach of Contract' [1966] *Cambridge LJ* 192 at 211.

4 See *Placer Development Ltd v Commonwealth* (1969) 121 CLR 353 at 356–7 per Kitto J; [1969] ALR 801; (1969) 43 ALJR 265; BC6900480, citing all the earlier cases.

5 See, eg, *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130 at 135 per Kirby P; 26 IR 411.

6 J Beatson, 'Public Law Influences in Contract Law' in J Beatson and D Friedmann (Eds), *Good Faith and Fault in Contract Law*, Clarendon Press, Oxford, 1995, p 267.

7 [1954] 1 All ER 484; [1954] 1 WLR 401.

8 Ibid, at All ER 486.

familiar with modern restitution lawyers, Denning LJ concluded that the employer clearly bound itself to pay something — namely, 'the amount which a fair and just man would pay in the exercise of his reasonable discretion'.[9] The court held that the employee was entitled to a reasonable sum based on the company's net trading profits.

Powell v Braun was followed by the South Australian Supreme Court in *Woodhouse v ADA Manufacturing Co Ltd.*[10] The parties entered an oral agreement in which the employee would receive a bonus based on the profits of the business 'as an incentive to exert the utmost possible effort to advance the company's interests'.[11] However, the amount of profits was in the discretion of the company's directors. Justice Reed resorted to construction of the contract and held there was no intention that the promise to pay bonus was 'illusory'.[12] The employee possessed the type of skills for whom the employer was prepared to offer a share in its profits. His efforts had also made a substantial contribution to company profitability. Justice Reed applied the principle of *quantum meruit*, and held that the employee was entitled to a reasonable sum.

In Australian commercial law, there is good authority to support a presumption in favour of finding enforceable promises even though the promisor has a wide discretion as to the manner of performance. In *Thorby v Goldberg* the discretion related to the party's authority to alter a company's articles of association 'in light of the latest practices and of the size and importance of this venture'.[13] In upholding the discretion, Kitto J said that 'an agreement is not void for uncertainty because it leaves one party or group of parties a latitude of choice as to the manner in which agreed stipulations shall be carried into effect, nor does it for that reason fall short of being a concluded contract'.[14]

In relation to employment contracts, the High Court of Australia has observed that the question 'is usually whether the intention of the agreement is that the employer shall be entitled to decide whether any remuneration at all shall be paid and if so how much, or is that he shall be bound to pay at all events a reasonable remuneration'.[15] Justice Kitto stated the general rule of construction as follows:

> It is that wherever words which by themselves constitute a promise are accompanied by words showing that the promisor is to have a discretion or option as to whether he will carry out that which purports to be the promise, the result is that there is no contract on which an action can be brought at all.[16]

It follows that the discretionary promise by an employer will not be enforceable where the basis of payment is beyond ascertainable knowledge, in the sense that it is left entirely to the discretion of the employer and is not

9 Ibid.
10 [1954] SASR 263.
11 Ibid, at 268.
12 Ibid.
13 (1964) 112 CLR 597 at 604; BC6400700.
14 Ibid, at 605.
15 *Placer Development Ltd v Commonwealth* (1969) 121 CLR 353 at 356; [1969] ALR 801; (1969) 43 ALJR 265; BC6900480.
16 Ibid.

capable of objective measurement. *Obu v A Strauss & Co Ld* (*Obu*) provides an illustration.[17] The employer agreed to pay the monthly sum of £50 plus commission which the promisee expressly 'agreed to leave to the discretion of the company'. The Privy Council held that this part of the agreement was unenforceable, the court being unable to determine the basis and rate of the commission. To do so would involve the court transferring to itself the exercise of the discretion as to commission which the agreement vested in the employer. Similarly, in *Way v Latilla* the House of Lords held that there was no concluded contract as to the amount of profit share the employee was entitled to derive from the employer's business of obtaining gold-mining concessions in West Africa. The parties had simply not turned their minds to the quantum of profit share or its method of calculation.[18]

The authorities suggest that an employer's discretionary promise will be unenforceable where the promise is, as a matter of objective reality, devoid of content. Thus, in *Obu* it was impossible for the court to draft or complete the commission arrangements which the parties had left up in the air. On the other hand, an employer's conditional promise to pay additional remuneration should not be regarded as illusory where the calculation of the payment is referable to objective standards.[19] Further, terms like 'sole' or 'absolute' will not be viewed as decisive in determining whether an employer's discretionary promise crosses the line between illusory and real. Rather, the court will adopt a practical approach, even though the dividing line may be difficult to ascertain in some instances. There are sound policy reasons underpinning this approach, including that it promotes the attainment of the parties' expectations and principled agreement-making. To use the words of Romer LJ in *Powell v Braun*, it 'reflects very little credit' on an employer to make a promise and then say that the promise rings hollow.[20]

In cases like *Woodhouse v ADA Manufacturing* and *Thorby v Goldberg*, the machinery relating to the discretionary promise — the net profits of the business and the company's articles of association — was in existence, so that the promise was not meaningless. But what if the employer failed to establish the contractual machinery — such as a bonus scheme — under which the employee was eligible to receive payment at the option of the employer? Will there still be a legally binding promise, or will this failure operate to defeat the expectations of the employee?

This question was considered in *Biotechnology Australia Pty Ltd v Pace* (*Pace*).[21] There, the formal letter of offer for a senior research scientist provided: 'I confirm a salary package of $A36,000 per annum, a fully maintained company car and the option to participate in the company's senior staff equity sharing scheme'.[22]

However, there was no such scheme when the employee commenced work, and none was later established. The majority of the NSW Court of Appeal held

17 [1951] AC 243.
18 [1937] 3 All ER 759.
19 See *Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd* (1982) 149 CLR 600 at 614–17; 43 ALR 68; [1982] HCA 53; BC8200112.
20 [1954] 1 All ER 484 at 487; [1954] 1 WLR 401.
21 (1988) 15 NSWLR 130.
22 Ibid, at 133.

that the scheme's non-existence infected the employer's promise with fatal uncertainty. Justice McHugh said that the option to participate in a *non-existent* scheme was an illusory promise as it could not be valued. This situation may have been different 'if the parties had agreed on the number and class of shares which Dr Pace was to receive'.[23] Further, the employer did not make a binding promise to institute the share scheme, even though both parties assumed that the scheme would come into existence.

Pace demonstrates that the non-existence of the contractual machinery may lead to a construction in which the employer's discretionary promise falls short of lawfully binding obligation. However, the particular contract may require the court to fill the hiatus left by the absence of the machinery where the subject-matter of the discretion remains objectively ascertainable. For example, a promise to pay a 'fair and just' bonus would appear to be something that is objectively ascertainable.[24]

Further, the court may consider whether the employer has engaged in repudiatory conduct by failing to establish the relevant machinery. Here, the majority's conclusion in *Pace* that there was no binding promise to institute the share scheme is problematic given the express language adopted in the employer's letter of offer. The court's findings also confirmed that both parties assumed the scheme would be established, consistent with the language adopted by the parties. Was there not an implied promise by the employer to establish the share scheme and thus provide the employee with the contractual opportunity or chance of obtaining shares?

This issue was considered more recently by the NSW Court of Appeal in *Silverbrook Research Pty Ltd v Lindley*.[25] Here, the employee's service agreement provided that the employer would set objectives at the end of each quarter, assess the employee's performance against those objectives and, subject to an overriding discretion, pay a 'Performance Bonus' if the set objectives were met. The employer failed to set the objectives, with the consequence that the employee was not paid bonuses. The majority of the court held that the employee was deprived a valuable commercial opportunity due to the employer's failure to set up and undertake a process of assessment of her performance. President Allsop noted that the discretion available to the employer did not mean that this opportunity had no value because, on a 'reasonable construction' of the contract, the employer could not unreasonably withhold the bonus once the set objectives were satisfied.[26] The employee was awarded damages for loss of this opportunity.

Lindley is a striking illustration of how an employer's unexplained failure to establish the contractual machinery contemplated by the express terms may not withstand scrutiny. Further, as discussed below, the decision highlights that contractual doctrine will look toward whether the employer's discretion has been exercised honestly and conformably with the purposes of the contract.

---

23 Ibid, at 155.

24 *Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd* (1982) 149 CLR 600 at 617; 43 ALR 68; [1982] HCA 53; BC8200112.

25 [2010] NSWCA 357; BC201009826 (*Lindley*).

26 Ibid, at [5].

Beyond contract law, an employee may seek redress under ss 18 or 31 of Sch 2 of the Competition and Consumer Act 2010 (Cth) to place the employee in the position they would have been had they not relied on the employer's representation that a bonus or share scheme would apply. Unlike common law damages for breach of contract, statutory compensation for misleading and deceptive conduct is measured on a quasi-tortious basis, with the object of placing the plaintiff in the position he or she would have been had the misrepresentation not been made.[27] Of course, the making of a promise which is not performed or a prediction which is not fulfilled is not of itself misleading or deceptive.[28] However, a promise or prediction may contain an implied representation of present fact, such as the promisor's intention (to establish an incentive payment scheme) or capacity to perform the promise. If such implied representations are false, then the promise may be misleading or deceptive under the legislation.[29]

Discretion and Risk Management

Judicial control of the exercise of contractual discretionary rights has attracted attention recently, although its origins are much older.[30] For instance, there are cases like *Dallman v King* in which it has been said that a capricious exercise of discretion will not do.[31] Traditionally the courts are guarded about interfering with the exercise of a discretion freely conferred by one party on another. As Professor Collins notes, the principle of respect for freedom of contract or party autonomy runs deep within the institution of contract law.[32] Indeed, it is a longstanding principle of contract law that 'if a contract makes express provision . . . in almost unrestricted language, it is impossible in the same breath to imply into that contract a restriction'.[33]

Historically Australian courts have affirmed that courts are not armed with the power or authority to set aside bargains simply because, in the eyes of judges, they appear to be harsh, unfair or unreasonable.[34] In other words, the courts cannot rewrite the parties' agreement, and express terms granting discretionary power in broad and uninhibited terms simply cannot be air-brushed out of existence.

From an economic perspective, Collins points out that there may be powerful reasons why rational actors confer broad discretionary power on one party to the contract, including that permitting discretion may be the only

27 See, eg, *Nikolich v Goldman Sachs JB Were Services Pty Ltd* [2006] FCA 784; BC200604574 at [298]–[307] per Wilcox J.

28 *Global Sportsman Pty Ltd v Mirror Newspapers Ltd* (1984) 2 FCR 82 at 88; 55 ALR 25; (1984) ASC 55-334; (1984) ATPR 40-463.

29 *University of Western Australia v Gray (No 20)* (2008) 246 ALR 603 at 982 per French J; 76 IPR 222; [2008] FCA 498; BC200802595.

30 T Daintith, 'Contractual Discretion and Administrative Discretion: A Unified Analysis' (2005) 68 *MLR* 554.

31 (1837) 4 Bing NC 105; 132 ER 729 at 730, cited in Daintith, above n 30, at 567.

32 H Collins, 'Discretionary Powers in Contracts' in D Campbell, H Collins and J Wightman (Eds), *Implicit Dimensions of Contract: Discrete, Relational, and Network Contracts*, Hart Publishing, Oxford, 2003, p 222.

33 *Nelson v British Broadcasting Corporation* [1977] IRLR 148 at 151 per Roskill LJ.

34 See, eg, *Louth v Diprose* (1992) 175 CLR 621 at 654 per Toohey J; 110 ALR 1; 67 ALJR 95; BC9202680.

adequate response to future uncertainty.[35] Accepting that risk allocation and risk management are key functions of contracts and nearly every contractual term bears some impact on risk,[36] an employee who agrees to a discretionary remuneration clause takes the risk that the employer will be unable or unwilling to pay the additional remuneration. For example, the employee takes the risk that the performance of the contractual employing entity may be adversely affected by economic conditions and thereby the entity will be prevented from paying a bonus, or that the value of the entity's share option scheme might be reduced by a market re-rating of the entity. The employee is, however, prepared to take his or her chances in the hope of gaining access to (in some cases, vastly) superior levels of remuneration, perhaps for comparatively little extra exertion or effort.

Often, risk taking is an essential attribute for a successful executive's career. For such employees, it may seem perfectly natural to extend the business risks to their personal rewards for work and thereby put 'at risk' a significant proportion of their remuneration. From the traditional viewpoint of contract law, 'if he is not willing to run the risk he should introduce into the express terms of the contract the clause which protects him'.[37]

Equally, a discretionary remuneration clause in an employment contract may be a potent risk management tool for an employer. It may guard against the risk of a poorly-performing executive, and be used to '"weed" out' poor performers.[38] For example, share option schemes typically *commit* the executive to high performance in running the company through the incentive of an ownership stake in the enterprise. The risk of poor company performance is thereby shared and divided between the company's executives and its shareholders. In addition, bonus pool arrangements — where an individual's share of money can be directly affected by another employee's performance or behaviour — might create 'a low threshold of toleration' for any perceived lack of performance amongst fellow employees.[39] In this way, discretionary pay mechanisms may be a subtle and effective device for an employer to promote loyalty, self-regulation and a degree of competition among its employees.

Apart from the internal disciplinary control that it may exert upon employees, discretionary pay may assist an employing entity to protect against the risks to its financial performance posed by fluctuating market conditions. The more elements of an executive's remuneration that are 'at risk' and discretionary, the greater the capacity for the company to keep a lid on executive remuneration during periods of economic downturn or market turbulence.

The allocation of risk associated with discretionary pay clauses reinforces the law's traditional concern with the express terms of the contract. There may

35 Collins, above n 32, pp 226–31.

36 J Carter, 'Contractual Issues for Trustees' (2001) 17 *JCL* 274 at 276.

37 *Luxor (Eastbourne) Ltd v Cooper* [1941] AC 108 at 120 per Viscount Simonds; [1941] 1 All ER 33; (1941) 57 TLR 213; (1940) 46 Com Cas 120.

38 See *Horkulak v Cantor Fitzgerald International* [2004] All ER (D) 170 (Oct); [2004] IRLR 942; [2005] ICR 402; [2004] EWCA Civ 1287 at [18].

39 See *Horkulak v Cantor Fitzgerald International* [2003] All ER (D) 542 (Jul); [2003] EWHC 1918 (QB); [2003] IRLR 756 [2004] ICR 697 at [19] per Newman J.

be compelling economic reasons why the parties have explicitly agreed to repose a 'sole' or 'absolute' discretion in the employer. But how, then, should the law address the risk of opportunism or abuse in the exercise of an unfettered discretionary power?

Some commentators have pointed out that extra-legal sanctions (such as the risk of reputational loss) provide an effective way of deterring opportunistic behaviour, and that judicial review of contractual discretion should be eschewed altogether, especially in commercial cases.[40] However, this has not been the approach adopted by courts in Australia and elsewhere over recent years. Instead, the courts have developed a variety of techniques to impose limits on the exercise of contractual discretions.

Judicial Techniques for Controlling Discretion

One important technique to emerge in modern English cases has been recourse to concepts borrowed from administrative law. For example, it has been held that an employer's discretion in an employment contract is, like the statutory discretion of a public authority in public law, subject to an obligation that it should not be exercised irrationally or perversely.[41]

This concept can be traced to the administrative law doctrine of *Wednesbury* unreasonableness,[42] so that the test of irrationality or perversity to be applied by the court is whether 'no reasonable employer would have exercised his discretion in this way'.[43] Thus, in *Clark v Nomura*, the court awarded substantial damages in respect of the employer's failure to pay a senior equities trader an 'individual performance'-based bonus under his employment contract.[44] In adopting a test of perversity, Burton J held that no rational employer faced with the trader's strong performance would have exercised its discretion to award no bonus.

Recent Australian cases support the idea that administrative law concepts analogous to *Wednesbury* unreasonableness act as fetters on the employer's contractual discretion. In *Kamp v Transurban Ltd* the Victorian County Court held that the employer's decision to decline a bonus to a senior finance manager was 'irrational and perverse and could not be made by any reasonable decision-maker'.[45] The court found that the manager was eligible to be paid project bonuses recognising his contribution under the employment contract.[46] The manager played a significant role in establishing a new project and 'bringing the major investor on board'.[47] However, he was paid no project bonus following his redundancy. Judge Kennedy held that the employer's

40 See, eg, J Morgan, 'Against Judicial Review of Discretionary Contractual Powers: *Lymington Marina v Macnamara*' [2008] *LMCLQ* 230.

41 See, eg, *Horkulak v Cantor Fitzgerald International* [2004] All ER (D) 170 (Oct); [2004] IRLR 942; [2005] ICR 402; [2004] EWCA Civ 1287 at [46]–[47]; *Clark v Nomura International plc* [2000] IRLR 766 at 774. In a commercial context, see *Socimer International Bank Ltd v Standard Bank Ltd* [2008] 1 Lloyd's Rep 558 at 577 per Rix LJ.

42 See *Associated Provincial Pictures Houses Ltd v Wednesbury Corp* [1948] 1 KB 223 at 229 per Lord Greene MR; (1947) 45 LGR 635; [1947] 2 All ER 680; (1948) 63 TLR 623.

43 *Clark v Nomura International plc* [2000] IRLR 766 at 774–5.

44 Ibid.

45 [2009] VCC 0611 at [145] (15 June 2009).

46 Ibid, at [96], [128]–[129].

47 Ibid, at [144].

discretion miscarried because the decision to award nil bonus was 'without any justification whatsoever'.[48] Judge Kennedy adopted the same approach in *Watson v Swatch Group (Australia) Pty Ltd*, although in that case it was held that the decision to refuse a bonus could have been made by the reasonable employer.[49]

Such an emerging trend in both Australia and England raises the question of whether the analogy with discretionary powers exercised by statutory public bodies is appropriate. This article suggests not. Unlike administrative law, contract law is founded on concepts of party autonomy and freedom of contract. These concepts do not sit comfortably with mandatory rules dealing with the powers and duties of administrators. Further, the importation of administrative law principles is likely to create uncertainty and detract attention from whether the contractual discretion has been exercised for the purposes for which it was intended.[50]

Another important methodology found in recent Australian and English decisions has been to recognise an obligation on the employer not to exercise its discretionary powers in an arbitrary or unreasonable way, by reference to implied terms of the contract of employment.

The leading English case is *Horkulak v Cantor Fitzgerald International*.[51] The employee was a senior manager working on interest rate swaps in money markets. He claimed damages for wrongful dismissal after he resigned due to alleged bullying by the chief executive. The English Court of Appeal upheld the claim, and awarded substantial damages for non-payment of discretionary bonuses under the employment contract. The court approved the earlier dicta in *Clark v Nomura* that the employee was entitled 'to a bona fide and rational exercise of . . . discretion as to whether or not to pay him a bonus and in what sum'.[52] Lord Justice Potter observed that the courts impose an implied term to this effect, and that the absence of such an implied obligation would 'fly in the face of the principles of trust and confidence which have been held to underpin the employment relationship'.[53]

Before *Horkulak* broke the ice, the case of *Clark v BET plc* was important in deciding that an employer's 'absolute' discretion is constrained by an overarching concept of rationality.[54] In that case, the relevant clause in the contract stated:

> The executive's salary shall be reviewed annually and be increased by such amount if any as the board shall in its absolute discretion decide. In making their decision the board shall consider a comparative group of companies similar to that used in Section 4 of the report 'Review of Executive Remuneration' dated 14 December 1993 produced by William M. Mercer Ltd.[55]

---

48 Ibid, at [145].
49 [2010] VCC 1067 at [205]–[255] (20 August 2010).
50 V K Sims and R J Goodard, 'Controlling Contractual Discretion' (2002) *Cambridge LJ* 268 at 270.
51 [2004] All ER (D) 170 (Oct); [2005] ICR 402; [2004] IRLR 942; [2004] EWCA Civ 1287 (*Horkulak*).
52 Ibid, at [46].
53 Ibid, at [30] and [47].
54 [1997] IRLR 348.
55 Ibid, at [9].

In assessing damages for wrongful dismissal, Timothy Walker J held that if the board had decided to award no pay increase at all, this would have amounted to the board exercising its discretion 'capriciously and in bad faith' and thereby breaching the contract.[56] Similarly, in *Clark v Nomura* the discretionary language of the contract was mediated through implied terms requiring a reasonable exercise of discretion.[57] Some English scholars have attempted to draw the various threads of the cases together by arguing that the employer's obligations expressed in different terms should simply be treated as a single obligation — that the employer should exercise its discretion in a manner consistent with the implied term of mutual trust and confidence now accepted in English law.[58]

With that in mind, what is the state of the law in Australia? In Australia there has been judicial support for the idea that rights or powers granted by an employment contract ought to be fettered with implied terms requiring 'good faith' and 'mutual trust and confidence'.[59] Under this approach, the implied terms are synonymous with objectively reasonable behaviour such that in both Australia and England the trust and confidence implied term means, in short, that an employer must treat its employees fairly.[60]

Recent Australian cases have extended this approach to contractual discretions over executive remuneration. In *Rankin v Marine Power International Pty Ltd* the employer operated a discretionary 'Great Rewards' scheme for senior management.[61] Under this scheme, the employee received bonuses until his employment was terminated. He sought damages for non-payment of a bonus during the final year of employment. Justice Gillard explained that, consistent with its duty to maintain a relationship of trust and confidence, the employer was obliged 'to act honestly and fairly' in administering the rewards scheme.[62] However, his Honour found no evidence of 'wrongdoing' because the employee's manager gave genuine consideration as to whether to recommend that a bonus be paid.

This decision was followed in *Watson v Swatch Group* where it was held that the employer 'did properly consider' whether a discretionary bonus should be paid in light of evidence concerning the executive's poor performance in controlling corporate expenditure.[63] In *Kamp v Transurban* it was held that the implied trust and confidence term required the employer to exercise its discretion to award bonuses fairly and responsibly.[64]

---

56 Ibid, at [11].
57 [2000] IRLR 766, especially at 774–5.
58 See, eg, M Freedland, *The Personal Employment Contract*, Oxford University Press, Oxford, 2003, pp 223–7; D Cabrelli, 'Discretion, Power and the Rationalisation of Implied Terms' (2007) 36 *Indust LJ* 194.
59 See, eg, *Taske v Occupational & Medical Innovations Ltd* (2007) 167 IR 298; [2007] QSC 118; BC200704149 at [52].
60 See *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2007) 69 NSWLR 198; (2007) 167 IR 121; [2007] NSWSC 104; BC200700695 at [134]–[135]; *Eastwood v Magnox Electric plc* [2005] 1 AC 503 at 523; [2004] All ER (D) 268 (Jul); [2004] 3 All ER 991; [2004] 3 WLR 322.
61 (2001) 107 IR 117; [2001] VSC 150; BC200102544.
62 Ibid, at IR 161.
63 [2010] VCC 1067 at [241]–[243].
64 [2009] VCC 0611 at [87]–[88] and [146].

The 'implied term approach' is a controversial one yet to be endorsed by the High Court.[65] This controversy reflects a wider extensive debate in Australian contract law about whether contractual rights and discretions are limited by implied duties requiring 'good faith' in the sense of reasonableness.[66]

This article argues that, in the context of contractual discretions concerning executive remuneration, the implied term approach is flawed. If the parties have seen fit to agree that the employer should have a broad and unconditional discretion as to particular components of an executive's remuneration, then (except where the discretion is objective or the employer takes advantage of its discretion in a dishonest or deceitful manner) it is difficult to see why effect should not be given to their agreement. Furthermore, the language of trust and confidence is not normally objective, and invites the court to exercise a potentially wide range of value judgments about fairness in discretionary executive remuneration.

From an economic perspective, the implication of a term alters the consensual distribution of risks between the parties, as expressed by the discretionary pay provision in their contract. As noted earlier, a provision entitling the employer to exercise an absolute and uncontrolled discretion may be attractive to the parties for commercial or entrepreneurial reasons, including that it helps to manage the risks associated with running the business and creates an opportunity for achieving higher levels of personal profit from employment. To superimpose an additional 'trust and confidence' term (requiring that the employer exercise its discretion fairly or with reasonable justification) potentially renders the risk allocation function of the discretionary pay provision of little practical value.

The Constructional Approach Toward Discretionary Power

Having criticised the approach based on implied terms or analogy with administrative law, how should the law in Australia respond, if at all, to the risk of an opportunistic or abusive exercise of discretion by an employer?

It is suggested that extra-legal sanctions are unlikely to be an effective way of discouraging such behaviour in an employment context. While an employer may suffer reputational damage or loss of employee morale/productivity as a result of opportunistic behaviour, it is by no means certain that this will act as an effective deterrent. Rather, it is argued that an approach based on construction of the contract and the particular discretion to determine its appropriate meaning can be deployed to address this risk. Here, the language of the contract sets the criteria by which the exercise of the employer's discretion is to be judged.

An example of this approach is the Canadian decision of *Greenberg v Meffert*.[67] In that case, a real estate agent's contract of employment provided

65 For a recent summary of the conflicting lines of authority in Australia on the validity of an implied term of mutual trust, see *Guthrie v News Ltd* [2010] VSC 196; BC201003041 at [215] per Kaye J.

66 See, eg, E Peden, '"Implicit Good Faith" — or Do We Still Need an Implied Term of Good Faith?' (2009) 25 *JCL* 50.

67 (1985) 18 DLR (4th) 548 (*Greenberg*).

that 'in the event that a listing is sold after the sales agent's employment is terminated, any commission he or she receives will be at the sole discretion of the company, and the commission earned on the listing will be disbursed at the company's discretion'.[68] The employer refused to pay commission on a sale that took place after termination of the agent's employment, and argued that the contract entitled it to refuse payment for any reason it saw fit. The Ontario Court of Appeal noted that whether the employer's 'sole discretion' is controlled by objective or subjective standards depends on construction of the contract. In this respect, the court held that the trial judge's reference to judicial review of the discretionary power of administrative authorities was 'not apt'.[69] Justice Robins acknowledged that discretionary provisions in agreements may impose only a subjective standard where the matter to be decided involves elements of personal judgment. However, the court stated:

> The subject-matter of the discretion in this case is 'the commission earned on the listing'. It is significant that that commission was earned while the [agent] was in the company's employ; the services rendered to earn the commission were fully performed before the employment was terminated, and, but for the termination, the [agent] would have been entitled to the commission when the property was sold. Regardless of whether the agent remained with the company, the company profited from his performance when a sale of the listing was effected.[70]

In view of these factors, it was held that the commission in truth had something of an earned through services character and therefore should not be withheld without reasonable grounds for so doing. Justice Robins continued, '[t]o construe the discretionary power as the company urges . . . would mean no more than "we will pay you your commission only if we feel like it". That construction renders the clause meaningless, indeed illusory'.[71]

A similar approach based on construction was adopted in the English case of *Mallone v BPB Industries*.[72] The contract provided an 'absolute discretion' to the company's directors to determine 'the appropriate proportion' of the number of share options granted to Mr Mallone under the company's senior executive share option scheme.[73] After several years of employment, Mr Mallone's share options in the scheme were cancelled following his dismissal as managing director of the company's Italian subsidiary. Counsel for Mr Mallone urged the court to follow *Clark v Nomura* such that the employer's discretion was subject to an implied standard not to act capriciously or arbitrarily. However, the court shied away from this line of reasoning. Instead, the court appeared to resolve the dispute by resorting to construction of the contract.

Lord Justice Rix noted that the discretion of the directors, although called an absolute discretion, was still one to find 'the appropriate proportion'.[74] The court identified that the 'objectively ascertainable purposes of the scheme' were that 'options are granted in reward for past performance, and in

68 Ibid, at 549.
69 Ibid, at 553.
70 Ibid, at 555.
71 Ibid.
72 [2002] ICR 1045 (*Mallone*).
73 Ibid, at [12].
74 Ibid, at [40].

anticipation of future loyalty, and, if you like, future performance'.[75] Lord Justice Rix recognised that such share option schemes can operate in ways which might seem quite arbitrary, owing to market variability and the timing of an employee's departure or exercise of options. However, he noted that these considerations were not a valid reason for treating the whole scheme 'as a sort of mirage':

> whereby the executive is welcomed as a participant, encouraged to perform well in return for reward, granted options in recognition of his good performance, led on to further acts of good performance and loyalty, only to learn at the end of his possibly many years of employment, when perhaps the tide has turned and his powers are waning, that his options, matured and vested as they may have become, are removed from him without explanation.[76]

Accordingly, the subject-matter of the discretion led to a construction in which the employer's discretionary power was controlled by limits arising from the contract. It followed that the employer had not engaged in a rational exercise of the discretion, which was the appropriate standard to be applied on a proper construction of the contract.

It may be argued that an approach based on construction rather than implied terms simply forms another technique to enable a judge to reach what he or she considers to be a fair outcome in executive remuneration. In other words, the two approaches rest on 'a distinction without difference' and simply reflect an arid academic debate about methodology.[77] However, the real practical difficulty is that implied terms have been used by the courts to adopt rules and requirements *independent* from the express terms of the contract. This helps to explain why the courts have taken the view that 'reasonableness' should be incorporated by an implied term of mutual trust or good faith. Yet this approach appears to be inconsistent with fundamental aspects of modern contract law.[78] For example, whether a term is implied by law or as a matter of fact, it should always remain subject to the express terms of the contract. However, this is not the way in which implied terms have been used by courts to curtail an employer's discretion.

By contrast, an approach based on construction does not involve the court superimposing a rule or requirement that may not have been desired by the parties for sound commercial reasons. Rather, the principles of construction require the court to give priority to the language in which the parties themselves have expressed their contract, and thereby not overlook the risk allocation function of the discretionary pay provision. To this end, the court is entitled to objectively examine the surrounding circumstances and the impugned exercise of discretion.

In those cases involving reliance upon implied terms and quasi-administrative law concepts, it is possible to see that the court could have interfered with the exercise of the employer's discretion through a

---

75 Ibid, at [41].

76 Ibid, at [44].

77 *Russell v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (2007) 69 NSWLR 198; (2007) 167 IR 121; [2007] NSWSC 104; BC200700695 at [109] per Rothman J.

78 See, eg, *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45; 120 LGERA 335; [2002] HCA 5; BC200200231 at [86]-[91] per Kirby J.

constructional approach. For example, in *Clark v Nomura*, the contract provided for a 'discretionary bonus scheme which is not guaranteed in any way and is dependent upon individual performance'.[79] Was it not enough to find that those last words of the clause established an objective criterion against which the exercise of the employer's discretion could be judged — namely, the trader's performance? Indeed Burton J found that these words imposed a 'contractual straightjacket' on the employer's discretion.[80] In *Clark v BET plc* the wording of the contract indicated that the employer's discretion was not at large. As Timothy Walker J pointed out, the use of the words 'the executive's salary shall . . . be increased' plainly indicated a contractual right to receive an upward annual adjustment in salary.[81] In assessing the amount of increase, the employer was obliged to consider executive salaries from 'a comparative group of companies' which were published in an independent survey report.[82] These clauses serve to illustrate that the parties to the contract may themselves specify the standard or criteria by which the employer's discretionary power should be exercised.

In *Commerzbank AG v Keen* a proprietary trading desk manager sought damages for alleged under-payment of bonuses during the first 2 years of his employment and non-payment of a bonus for the final year.[83] He and his small team earned substantial profits for the bank. However, he received very large bonus payments (almost €3 million per annum) during his first 2 years of employment. Relevantly, his contract of employment provided:

> You are eligible to participate in the bank's discretionary bonus scheme . . . Factors which may be taken into account by the bank in deciding whether or not to award a bonus and the amount of any bonus include:
>
> - The performance of the bank
> - The performance of your business area
> - Your individual performance and your contribution to the bank's performance and the performance of your business area
> - The strategic objectives of the bank
> - Whether you will be remaining in the employment of the bank.

The clause continued:

> No bonus will be paid to you if on the date of payment of the bonus you are not employed by the Bank or if you are under notice to leave the bank's employment . . .[84]

The English Court of Appeal noted that 'the bank has a very wide contractual discretion'.[85] Lord Justice Mummery considered that the bank's decision not to award additional bonus payments was amply justified by reference to the factors set out in the contract of employment. The manager was one of the bank's highest paid employees, and the bank had suffered

79 *Clark v BET plc* [2000] IRLR 766 at [34].
80 Ibid, at [40].
81 [1997] IRLR 348 at 349.
82 Ibid.
83 [2006] All ER (D) 239 (Nov); [2007] IRLR 132; [2007] ICR 623; [2006] EWCA Civ 1536 (*Commerzbank*).
84 Ibid, at [7].
85 Ibid, at [59].

losses during the first 2 years of his employment. In addition, the express terms made it clear that the manager was not entitled to a bonus if he was not employed by the bank on the date of payment. Accordingly, the court held that there was no real prospect of success in establishing the alleged breaches of contract and the bonus claims were summarily dismissed.

Although the court's decision in *Commerzbank* made reference to administrative law and implied terms, the resolution of the dispute was essentially approached as a matter of construction. The virtue of the clause in question was its clear and unambiguous language such that the employee knew exactly where he or she stood. The dismissal of the manager's claim for the discretionary bonus said to have been earned by him during his final year of employment was explicable on the basis that there was simply no entitlement under the express terms of the contract, and thereby no discretion to be exercised by the employer. This situation was in contrast to cases like *Greenberg* and *Horkulak* where it was construed from the particular context that the application of the post-termination cut-off point for payment of commission or bonus still rested within the overarching discretion of the employer.

The Privy Council case of *Reda v Flag Ltd* provides a further example of consideration being given to the underlying rationale for a bonus or options scheme as a guide to the construction of the express terms.[86] Two executives were employed on 3 year contracts. The contracts contained a provision entitling them to participate in any stock option plan established by the employer. The contracts were terminated early by the employer. Shortly after the employment came to an end, the employer introduced a stock option plan. The employees claimed that they were entitled to compensation, essentially due to 'loss of a chance' to participate in the plan. In rejecting their claim, the Privy Council held that the purpose of the plan was to create 'an incentive [for executives] not to leave Flag's employ voluntarily or refuse an extension of their contracts'.[87] Therefore, the grant of stock options to an employee on the eve of his departure lacked any commercial sense.

What this analysis suggests is that it remains open for the parties to an employment contract to confer on an employer an unrestrained discretionary power over executive remuneration. However, the drafting of the contract will be of central importance, together with the surrounding circumstances known to the parties and the purpose of the relevant clause.[88]

Good Faith as the Default Standard of Behaviour

It has been suggested above that the question of whether an employer's 'absolute' discretion is objective or subjective depends on construction of the contract. This approach is aided by the normal rules of construction, including that the parties are obliged to cooperate in doing all things necessary for the

86 [2002] All ER (D) 201 (Jul); [2002] IRLR 747; [2002] UKPC 38.
87 Ibid, at [67].
88 *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165; 211 ALR 342; [2004] HCA 52; BC200407463 at [46]-[47].

performance of the contract,[89] and not to hinder or prevent the fulfilment of the purpose of the express promises in the contract.[90]

Allied with these orthodox principles of construction is the idea that good faith is a necessary ingredient in contract law and thereby sets a default standard of behaviour in contractual relations.[91] Such implicit good faith has been recognised by the courts to control the operation of a contractual discretion, irrespective of whether the particular discretion is objective or subjective. However, as stated earlier, there is some controversy about whether good faith means honesty, or honesty and reasonableness. The question arises, therefore, whether good faith sets an inherent standard governing the exercise of an employer's discretionary power and, if so, how that standard might operate?

The cases shed some light on this issue. In *Greenberg*, the circumstances involved dishonest conduct. Following the termination of his employment, the real estate agent contacted his former manager and sought assurances that his commission was protected. Mr Greenberg was informed by the manager: 'don't worry the company won't screw you'.[92] Unbeknown to Mr Greenberg, the manager and another sales agent had devised a scheme to divide his commission which involved the other agent being shown in the employer's records as the 'listing salesman' so that this agent received the commission worth $57,625. In turn, the agent paid his manager a 'consulting fee' of $30,000. The court had little trouble in finding that 'this kick-back arrangement, or bribe as the trial judge termed it'[93] involved improper conduct.

The court held that the purported exercise of the employer's discretion to deny the commission payment was essentially dishonest. The court stated that the proposition that a discretion must be exercised honestly and in good faith was 'so fundamental as to require no elaboration'.[94] Justice Robins continued:

> The collusive conduct here clearly deprived the discretion of those qualities and contaminated the decisional process. That patently improper conduct vitiated not only the reasonableness required in the objective criteria but the good faith and honesty required whether the discretion is objective or subjective. In either case the decision to deprive the appellant of any commission was not made honestly and in good faith and cannot stand.[95]

It was recognised in *Greenberg* that good faith in the sense of honesty, as distinct from reasonableness, was implicit in the employment contract and therefore the employer's discretion was limited by good faith requiring honest exercise of the power. A similar approach is discernible in the English Court of Appeal's judgment in *Mallone*. There the observations by Rix LJ about not treating the employer's share option scheme 'as a sort of mirage' indicate that an employee who has played the game faithfully with the one employer over

89 *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at 448–9; 131 ALR 422.
90 *Shepherd v Felt and Textiles of Australia Ltd* (1931) 45 CLR 359 at 378; [1931] ALR 194; (1931) 5 ALJR 110; BC3100017.
91 See the discussion in Peden, above n 66.
92 (1985) 18 DLR (4th) 548 at 551.
93 Ibid, at 556.
94 Ibid.
95 Ibid.

many years is entitled to an honest exercise of the employer's discretion without financial detriment to himself.[96] Similarly, there may be something so prejudicial or spiteful that the purported exercise of the discretion simply cannot stand. Lord Justice Warrington in *Short v Poole Corporation* gave the example of the red-haired teacher, dismissed because she had red hair.[97]

Australian courts have equally recognised that the employer should not double-cross the employee in the exercise of its discretion over remuneration. If this implicit understanding is breached, then the courts are likely to interfere with the employer's decision. *Ikin v Cox Bros (Aus) Ltd* provides an illustration of this longstanding principle in Australian law.[98] In that case, the employer used language knowing that its words would be misunderstood by the employee. The employee's contract contained a term that 'at the sole discretion of the . . . [head office] a bonus will be considered at balancing periods'. The employee asked the managing director when the bonus would be paid. He was told: 'You wait till [next year] and you won't then be a disappointed man.' When the employee pointed out that he had nothing in writing, he was told: 'No, you don't want an agreement; we understand and trust each other, and agree man to man.'[99] However, the bonus remained unpaid when the employee left his job the following year.

Initially, a jury returned a verdict in favour of the employee for breach of contract. On appeal, the Full Court of Tasmania held that the verdict should stand. The court held that, despite the employer's denials, the jury was entitled to accept the employee's evidence about his conversation with the managing director, and that this conversation constituted a binding oral contract for the payment of a bonus.[100] Justice Clark invoked the concept of good faith as underlying the contract by stating that the jury might reasonably have construed the conversation to mean '[y]ou can rest assured that you will be paid something at all events in addition to your salary, but how much is to be determined by me, when the time comes, and I have the facts before me, and you can trust me to act in good faith in determining what the sum will be'.[101]

More recently, the majority of the NSW Court of Appeal in *Silverbrook Research Pty Ltd v Lindley* appeared to recognise that a default standard of honesty applied to the exercise of an employer's discretion. President Allsop observed that the relevant discretion was to be 'exercised honestly' and further rejected any general principle that an employer is 'always entitled' to exercise contractual powers in an employment contract capriciously or arbitrarily.[102] It is interesting to note that these concepts were applied by the court at the stage of construction of the particular contract in question. The court also expressly acknowledged that, consistent with the requirement of honesty, there may be many circumstances in which it is legitimate for the employer not to pay the bonus.[103]

---

96 [2002] ICR 1045 at [44].
97 [1926] Ch 66 at 90; [1925] All ER Rep 74.
98 (1929) 25 Tas LR 1.
99 Ibid, at 2.
100 Ibid, at 4 per Nicholls CJ, 4–5 per Crisp J.
101 Ibid, at 6.
102 [2010] NSWCA 357; BC201009826 at [6]–[7].
103 Ibid, at [6], citing financial stringency or employee misbehaviour.

The recognition of implicit contractual good faith (as distinct from an implied term of good faith) is significant because it does not lead to the result that objectively reasonable conduct must be implied. Nor does implicit good faith require a discretionary balancing of employer and employee interests in order to achieve fair outcomes in executive remuneration. Rather, the question is whether it is shown that the discretion was not exercised honestly, or that it involved spite or prejudice.

Examined in this light, good faith is a less onerous standard than a requirement of objectively reasonable behaviour. A party may act irrationally while being honest. An employer's discretion may have been capricious or arbitrary, but nonetheless conceived in good faith.[104] Or as Talleyrand wrote, '[g]ood faith never authorises deceit but it admits of reserve; and reserve has this peculiarity that it increases confidence'.[105]

Good faith, therefore, does not authorise subterfuge in the exercise of an employer's discretion. However, it may still allow an employer to act entirely in its own interests, provided this is consistent with the purposes of the contract and the implicit obligation to act honestly. In this way, the recognition of implicit contractual good faith may avoid the court falling into the alluring trap that 'good faith' must be incorporated by an implied term and thereby given a content more onerous than appropriate or necessary. As noted earlier, whether a standard higher than implicit good faith is imposed on the employer's discretion is a matter of construction flowing from the particular contract in question. Theoretically, it remains possible for the parties to 'contract out' of the implicit requirement of good faith. However, absent any illegitimate pressure, it is difficult to conceive of circumstances in which one party would expressly authorise the other party to engage in dishonest or spiteful conduct toward them. Consequently, no contractual discretion should be viewed as absolute, in the sense of authorising dishonest conduct in the exercise of the discretion.

An important corollary of this argument is that although the contract might confer a very wide discretion on the employer to be exercised according to its own subjective judgment, this does not mean that objective considerations are entirely irrelevant. The issue of whether the employer exercised its discretion in good faith is a classical jury or factual question, focusing on the subjective motives and intentions of those persons acting on behalf of the employer. In turn, this requires an objective assessment by the court of what the employer did (not limited to what it says it did) and what the employer believed (not confined to what it says it believed). In other words, the court is not bound to accept the employer at its word. As illustrated by *Greenburg* and *Ikin*, the court is entitled to discount or reject the evidence given on behalf of the employer if there is an objective evidentiary basis for the court to find that the discretion was exercised dishonestly or for a patently improper purpose.

Likewise, in *Commerzbank* the court was prepared to entertain witness statements and circumstantial evidence concerning the real purpose motivating the bank's actions, notwithstanding that it required an

104 See *Minster Trust Ltd v Traps Tractor Ltd* [1954] 3 All ER 136 at 145 per Devlin J; [1954] 1 WLR 963; *Mallone v BPB Industries* [2002] ICR 1045 at [39] per Rix LJ.

105 D Cooper, *Talleyrand*, Grove Press, New York, 1932, p 359.

'overwhelming case' to convince the court that the bank's very broad discretion was improperly exercised.[106] Indeed the court expressed disquiet about the lack of evidence from any officer within the bank who was personally involved in the decision-making process.[107]

In this way, it is suggested that the default standard of good faith introduces an objective evidentiary limitation applying to the exercise of the employer's 'absolute' discretionary power. As stated earlier, it is possible for a court to conclude through construction that a more onerous standard than good faith applies to the employer's contractual discretion. Nevertheless, this limited element of objectivity — stemming from the operation of implicit good faith — establishes an important restraint on the possible abuse of an employer's unfettered discretionary power.

Conclusion

It has been observed that a common feature of discretionary bonus systems is that everyone who received one grumbled about it: no-one was ever satisfied with what they got![108] There may be an element of truth to this. However, it is well recognised that it is not the role of the courts to rewrite the parties' agreement, whether under the guise of implied terms or by reference to administrative law. Whatever else may be said about the courts' role, it is clear that interpreting the contract of employment and giving effect to its terms is of critical importance in determining whether a court may interfere with the exercise of discretion.

This article has suggested that an approach based on construction is the most appropriate method to give effect to the parties' intentions and the risk allocation function of discretionary pay provisions. The cases suggest that objective standards will apply in many instances, based on a construction of the contract and the particular discretion. Even if the employer's discretion might be exercisable on purely subjective or self-interested grounds then the implicit requirement of good faith, and the court's possible intervention to enforce it, acts as an important deterrent against patently improper conduct.

106 [2006] All ER (D) 239 (Nov); [2007] ICR 623; [2007] IRLR 132; [2006] EWCA Civ 1536 at [23]–[25].

107 Ibid, at [45].

108 See *Keen v Commerzbank AG* [2006] EWHC 785 (Comm) at [25].

Recent Case

Recovery of Damages for Wrongful Resignation

*M J Moir**

***Purcell v Tullett Prebon (Aust) Pty Ltd* [2010] NSWCA 150; BC201007186.**

An interesting question as to the recovery of damages for wrongful repudiation of an employment contract arose in the appeal to the NSW Court of Appeal in *Purcell v Tullett Prebon (Aust) Pty Ltd*.[1] The question was whether the premature resignation of an employee put an end to the duty to perform work, or whether the employer maintained the contractual right to direct the employee to return to work so that, on the employee's failure to return, the employer was entitled to terminate the contract and sue for damages.

The case gave rise to a potential conflict between two distinct, but related concepts. On the one hand, the conventional rule that an employee's resignation has the effect of 'terminating the employment relationship' supported the view that the employer could not unilaterally reinstate the relationship by directing the employee to report for work.[2] On the other hand, the 'elective theory of termination' supported the view that the innocent party was entitled to affirm the contract and not accept the employee's repudiation by issuing a binding direction for him to resume work.[3] It was the latter principle which emphatically prevailed.

The decision in *TP Australia* raised two other important issues. First, it considered the circumstances under which the innocent party may, during the performance of an employment contract, decline to accept a repudiation by the other party to the contract. The outcome of the case suggests that a party's right to elect either to terminate or continue with the employment contract is unfettered provided that it is conceived in good faith — in the sense that the exercise of the election is honest and genuine, as distinct from objectively reasonable.

Second, the case considered the question of whether a liquidated damages clause in the employment contract was unenforceable as a penalty. This issue was regrettably not pursued in the appeal and therefore did not need to be answered. Nevertheless, the case gives some insight into how the traditional learning as to penalty clauses might fit into the dynamics of an employment contract.

* Barrister, Sydney.

1 [2010] NSWCA 150; BC201007186 (*TP Australia*).

2 Ibid, at [19].

3 Ibid, at [20].

Background

The facts were that the parties entered into a written contract of employment for a fixed 2 year term. The employer conducted business as a financial broking company and the employee (Purcell) was one of its brokers. He was a very successful broker who earned substantial profits for his employer. Purcell resigned some 15 months prior to the expiry of the fixed term, and 5 days later commenced to work for one of the employer's competitors.

The employer through its solicitors gave Purcell a written direction to take paid 'garden leave' under the contract and elected to 'continue [his] employment in accordance with its terms'. The employer continued to pay Purcell his base remuneration of $325,000 per annum.

Litigation ensued before the Equity Division of the NSW Supreme Court.[4] Initially, the employer obtained an interlocutory injunction restraining Purcell from working for its competitor.[5] Subsequently, Brereton J granted a 'permanent' injunction restraining Purcell from working for any of the employer's competitors for a 6 month period following the resignation.[6] He also granted a declaration that the contract had not been terminated and remained on foot.

Immediately before the expiry of the injunction, the employer gave Purcell a written direction to attend for work 'in accordance with the Contract'. The direction required Purcell to resume work the next business day after the injunction. The employer's letter stated that if Purcell did not comply then 'you will be in breach of your obligations in the Contract'. The correspondence expressly reserved the employer's right to terminate the contract for breach.

Purcell was undeterred and commenced to work for the competitor. On the same day the employer's solicitors wrote to Purcell's solicitors alleging that his failure to return to work for the employer constituted a final repudiation of the contract. The letter stated that the employer elected to terminate the contract, and it claimed liquidated damages of $503,100 under cl 10.4.

Clause 10.4 provided:

> . . . if your contract of employment is terminated for breach or repudiation on your part, including if you resign or otherwise seek to leave the employment of TPAust without serving TPAust with a required notice for the period to the Contract End Date . . . you shall on the day following termination of your employment . . . pay to TPAust, as a debt due and owing, an amount calculated as follows:
>
> 50% x Your Average Net Brokerage x No of Whole months from the date you cease providing services to TPAust to the Contract End Date.

The employer argued that the contract was kept alive following Purcell's resignation and that it entitled the employer to give a binding direction to return to work, provided that the employer was ready and willing to perform

4 The proceedings for injunctive relief are discussed in A Coulthard, 'Garden Leave, The Right to Work and Restraints on Trade' (2009) 22 *AJLL* 87.

5 *Tullett Prebon (Australia) Pty Ltd v Simon Purcell* [2008] NSWSC 437; BC200803198.

6 *Tullett Prebon (Australia) Pty Ltd v Simon Purcell* (2008) 175 IR 414; [2008] NSWSC 852; BC200807684.

the contract. Both Ward J and the Court of Appeal accepted this argument.[7] At both levels, there was considerable discussion of statements in *Visscher v Giudice*[8] about the extent to which a unilateral repudiation of the employment relationship puts an end to the contract of employment. No doubt there is a difference between the two cases in that *Visscher* was a statutory unfair dismissal case involving wrongful conduct on the part of the employer, while *TP Australia* was one of wrongful repudiation by the employee during the currency of a fixed term contract. But, as both Ward J and the Court of Appeal recognised, the legal basis of the employment relationship was equally applicable in the case of employer and employee repudiation.[9]

The law of 'master and servant' developed distinctive principles relating to the basis of the employment relationship that are explicable by reference to historical considerations. As Rothman J explained in *Russell v Trustees of the Roman Catholic Church for the Archdiocese of Sydney*,[10] the relationship between the master and servant was originally regarded as one of status in which the servant could not lawfully leave his employment without the master's permission. Later the common law recognised that the relationship was based on contract rather than status, so that the employer's right of control was qualified by the express or implied terms of the employment contract. However, the obligation of obedience remained of central importance to the employment relationship.[11]

There has been some disagreement in the United Kingdom as to whether the common law principles recognised that the obligation to perform work could be completely extinguished once the employment relationship came to an end.[12] For instance, it has been suggested that if the contract of employment remained on foot, then only those terms of the contract not dependent on the existence of the relationship of employer/employee could survive.[13] On this view, the obligation to obey a direction to attend work did not survive the repudiation of the employment relationship.

In Australia, since the decisions of the High Court in *Automatic Fire Sprinklers Pty Ltd v Watson*[14] and *Byrne v Australian Airlines Ltd*,[15] the general principle is that ordinary principles of contract law are applicable to

---

7 *Tullett Prebon (Aust) Pty Ltd v Purcell* [2009] NSWSC 1079; BC200909222; *TP Australia* [2010] NSWCA 150; BC201007186.

8 (2009) 239 CLR 361; 258 ALR 651; [2009] HCA 34; BC200908001 (*Visscher*), see further L Keats, 'What Shall We Do with a Demoted Sailor? The High Court Decides in *Visscher*' (2010) 23 *AJLL* 121.

9 *Tullett Prebon (Aust) Pty Ltd* [2009] NSWSC 1079; BC200909222 at [40]–[42]; *TP Australia* [2010] NSWCA 150; BC201007186 at [24]–[25].

10 (2007) 69 NSWLR 198; 167 IR 121; [2007] NSWSC 104; BC200700695 at [88].

11 *Attorney-General (NSW) v Perpetual Trustee Co (Ltd)* (1952) 85 CLR 237 at 299–300 per Kitto J; [1952] ALR 125; (1952) 25 ALJR 762; BC5200100.

12 See, eg, *Vine v National Dock Labour Board* [1957] AC 488 at 500; [1956] 3 All ER 939; *Thomas Marshall (Exports) Ltd v Guinle* [1979] Ch 227 at 237–40; [1978] 3 All ER 193; [1978] 3 WLR 116; [1979] FSR 208; *Gunton v Richmond-upon-Thames London Borough Council* [1981] Ch 448 at 459 per Shaw LJ, 467–9 per Buckley LJ, 474–5 per Brightman LJ.

13 See the discussion in *Rigby v Ferodo Ltd* [1988] ICR 29 at 34 per Lord Oliver of Aylmerton; [1987] IRLR 516.

14 (1946) 72 CLR 435; [1946] ALR 390; (1946) 20 ALJR 189; BC4600020 (*Automatic Fire Sprinklers*).

15 (1995) 185 CLR 410; 131 ALR 422; BC9506439.

employment contracts. Thus in *Byrne v Australian Airlines Ltd*, the majority rejected the view that contracts of employment are sui generis in that certain forms of repudiation (such as wrongful dismissal or walkout) automatically terminate the contract without the need for their acceptance.[16] Their Honours considered that the better view is that contractual principles apply to employment contracts and that acceptance by the victim of a repudiation is necessary to terminate a contract.

In *Visscher* the court restated the conventional principles of repudiation. In rejecting the doctrine of 'automatic determination', the majority of the court recognised that employment contracts have unique characteristics, including that the employment relationship may be effectively brought to an end by a unilateral repudiation, even though the repudiation is not accepted and the contract itself is not terminated. The majority was equally mindful that courts would not traditionally grant specific performance of employment contracts. However, it was held that to treat an employment contract as automatically discharged by a unilateral repudiation 'would be to elevate a problem concerning remedies to a substantive principle concerning the termination of contracts'.[17]

In order to avoid difficulties such as these, counsel for Purcell reformulated the elective theory of termination. He submitted that, although a breach of employment contract amounting to a repudiation did not forthwith determine the contract, the severance of the employer/employee relationship did terminate those rights and duties which depended upon a subsisting relationship. It followed that Purcell's resignation, while wrongful, terminated the employer's right to direct him to perform work and his duty to comply.

One significant argument in favour of this substantial narrowing of the elective theory seems to have been that it would be unfair to enforce an employer's direction for a recalcitrant employee to perform work when a wrongfully dismissed employee cannot claim wages after dismissal.[18] It appears, however, that such considerations of mutuality in the employment relationship were clearly outweighed by other factors governing the court's approach to the issues.

Decision as to duty to perform work and right to terminate

The issues in *TP Australia* were concisely stated at the beginning of the judgment:

> whether the employer had the right under the contract to direct [Purcell] to return to work, and whether it was ready and willing to perform its obligations under the contract, so that, on his failure to return, it was entitled to terminate for breach.[19]

On the facts of the case, the employer had kept the contract alive 'for the benefit of both parties' following the resignation.[20] As the employment

16 Ibid, at CLR 427–8.
17 *Visscher* (2009) 239 CLR 361; 258 ALR 651; [2009] HCA 34; BC200908001 at [55].
18 *TP Australia* [2010] NSWCA 150; BC201007186 at [17].
19 Ibid, at [4].
20 Ibid, at [24].

contract was still in force, Purcell could be directed to report for work. The direction was 'an offer to reinstate [Purcell] in his employment under the contract'[21] so that if Purcell had returned to the employer's premises the employment relationship would have been reinstated under the existing contract. Accordingly, it was held that the employer's direction was valid and effective.

Implicit in the court's reasoning was the notion that the employee could not dismiss himself before the end of the unexpired term. The principle applied in the case was that employment contracts (like other contracts) are not terminated by a repudiatory breach unless the victim of the repudiation elects to treat the contract as having come to an end.[22] This approach reflects the underlying concern of the law relating to repudiation — that contracts should be honoured rather than broken, and the innocent party rather than the party breaking the contract should decide whether the contract is to continue or come to an end.

One can perhaps have some sympathy for the employee not wanting to turn up for work after having already faced litigation at the hands of the employer. The difficulty was, however, that he had contracted to provide services to the employer (and no one else) for the 2 year period. His argument that the employer's direction was invalid because the relationship of employer/employee had broken down was logically rejected on the basis that 'this would enable him to take advantage of his wrong'.[23] Handley AJA stated that the law has not recognised a doctrine of 'partial automatic termination' which would give a guilty party the right at any moment to put an end to some of his contractual obligations.[24]

The decision did not directly address the suggestion that, in light of the rule established in *Automatic Fire Sprinklers* that an employee wrongly dismissed could not claim wages,[25] it would be 'one-sided' or inequitable to enforce the employer's direction. However, the relevance of this rule is doubtful if the situation had been reversed and Purcell had been wrongfully dismissed before the expiration of the term. This is because, in the case of a fixed term contract that does not otherwise provide for termination, the assessment of damages would normally be based on the salary that would have been earned in the unexpired term (less any income earned in mitigation).[26]

There is one further point of distinction. Whereas the right to claim wages is dependent on the employer's cooperation, the right to direct the performance of work is dependent on the employer's readiness and willingness to perform its obligations under the contract. In *TP Australia*, this issue was significant because Purcell asserted that the employer's direction was merely 'a device for terminating the contract and the employer did not really want [Purcell] to return'.[27] The court stated that the employer's

21 Ibid.
22 Ibid, at [20].
23 Ibid, at [18].
24 Ibid.
25 See ibid, at [16].
26 See, eg, *Reynolds v Southcorp Wines Pty Ltd* (2002) 122 FCR 301; 115 IR 152; [2002] FCA 712; BC200203008 at [37].
27 [2010] NSWCA 150; BC201007186 at [28].

willingness to perform its obligations was not simply a question of fact. It applied the principle enunciated by Dixon CJ in *Rawson v Hobbs* that 'nothing but a substantial incapacity or definitive resolve against doing in the future what the contract requires' is sufficient to establish an absence of readiness and willingness.[28]

The managing director of the employer gave evidence that Purcell would have been welcomed back 'with open arms'. The primary judge rightly doubted the sincerity of this evidence. However, Ward J found that the employer was willing to keep the contract in existence for financial, not personal, reasons. The contract still had 9 months to run when Purcell was directed to return, and the advantage of increased revenues from Purcell's dealings with clients over this 9 month period was a 'logical business reason' for the employer wanting to reinstate him.[29]

The Court of Appeal did not find any good reason to disturb these findings. Thus, it was held that the employer was entitled to terminate the contract and recover damages upon Purcell's failure to resume work.

Performance after repudiation — Whether election fettered

The court, having determined that the employer was ready and willing to perform the contract in the hope of enticing a good performer to return, added that it was 'not unreasonable' that the employer 'wished to bring matters to a head so that the relationship would either be re-established or the contract terminated for breach'.[30] This observation might suggest that the employer's election to continue with the contract is ineffective if, to an impartial observer, the employer has acted unreasonably.

In the United Kingdom, there is some support for the view that the right to elect to keep a contract alive after a repudiation is restricted. For example, in the well-known House of Lords decision in *White and Carter (Councils) Ltd v McGregor* Lord Reid suggested that the courts will not allow a party to elect in favour of continuation if the party has 'no legitimate interest' in performing the contract.[31] This possible restriction on freedom of contract was said to be a matter of public policy in that a party should not be permitted to 'saddle the other party' with an unwanted contract.[32] However, this approach has not yet prevailed in Australia where the rule appears to be that a right of election (either to terminate or continue with the contract) is not fettered by a requirement of reasonableness.[33]

In the present case, the court's observation should be read in the context of the employee's argument that the direction for him to resume work was a device for terminating the contract and thereby lacked genuineness. As noted earlier, the court rejected this argument and held that the employer was entitled to have the status of the contract finally resolved, rather than wait for

28 Ibid, at [36], citing (1961) 107 CLR 466 at 481; 35 ALJR 342; BC6100450.
29 *Tullett Prebon (Aust) Pty Ltd v Purcell* [2009] NSWSC 1079; BC200909222 at [87]–[88].
30 *TP Australia* [2010] NSWCA 150; BC201007186 at [33].
31 [1962] AC 413 at 431; [1961] 3 All ER 1178; [1962] SC 1; [1962] 2 WLR 17.
32 Ibid, at AC 430–1.
33 See, eg, *Champtaloup v Thomas* [1976] 2 NSWLR 264 at 271.

it to expire. Viewed in this light, the reasoning of *TP Australia* does not suggest that a party's right to elect to continue with the employment contract must be objectively reasonable. However, this does not dispense with the requirement of genuineness.

True it is that the direction given by the employer for an employee to perform work must be lawful and 'reasonable'. But, as the court noted,[34] the direction did not require Purcell to do anything unlawful or anything he had not done while working under the contract. This analysis did not require the court to consider whether the employer acted 'unreasonably' in affirming the contract.

In this respect, it is noteworthy that the case involved the employer exercising its rights of election on multiple occasions — starting with the election to continue with the contract immediately after the employee walked out, then the further election to continue 6 months later (on the expiry of the injunction), and the final election to terminate the contract upon the employee's continuing absence from work. The reasoning of *TP Australia* does not indicate that the employer's freedom of election had to be exercised 'reasonably' on each occasion. Rather, the victim of the continuing repudiation was entitled to rely on its unfettered right to elect, provided that the exercise of the election was honest and genuine.

Such an approach would seem desirable in that it promotes freedom of contract but acknowledges that this does not entail freedom to exercise an election devoid of genuineness. It is also consistent with the contemporary concern to promote good faith (in the sense of honesty) in Australian contract law.[35] In an employment context, *TP Australia* is an important affirmation of the principle of freedom of contract, but it does not exclude the requirement of good faith in the sense of genuineness.

Liquidated damages — Some concluding remarks

Most of the cases on agreed damages clauses in employment contracts which have come before Australian courts have involved provisions for repayment of training costs and education expenses.[36] *TP Australia* is interesting because the clause in question was considerably wider. In essence, the parties agreed to a formula for the calculation of the employer's likely loss of profits in the event of wrongful resignation.

The primary judge decided that the liquidated amount payable under cl 10.4 of the contract was not a penalty. Adopting the High Court's test in *Ringrow Pty Ltd v BP Australia Pty Ltd*,[37] Ward J found that the formula in cl 10.4 was not 'out of all proportion' to the employer's likely losses by reference to general expectations in the broking industry that revenue is roughly two times

34 *TP Australia* [2010] NSWCA 150; BC201007186 at [23].

35 In a commercial context, see the recent discussion about good faith in *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* (2010) 15 BPR 28,563; [2010] NSWCA 268; BC201008314 at [5]–[19] per Allsop P.

36 See, eg, *Pigram v Attorney-General (NSW)* (1975) 132 CLR 216; 6 ALR 15; 49 ALJR 147; BC7500022; *Amos v Commissioner for Main Roads* (1984) ASC 55-294; 6 IR 293; *Arlesheim Ltd v Werner* [1958] SASR 136 at 140–1.

37 (2005) 224 CLR 656; 222 ALR 306; [2005] HCA 71; BC200509730 (*Ringrow*).

salary.[38] Her findings were not challenged on appeal, and therefore cl 10.4 entitled the employer to recover the amount of $503,100 as 'a debt due and payable the day after the contract was terminated'.[39]

Although cl 10.4 did not receive detailed treatment in the appeal, there are a number of points worth briefly mentioning. In the first place, the actual losses incurred by the employer were approximately $100,000 less than the liquidated sum. Ward J held that this did not mean cl 10.4 was penal in nature.[40] This finding was probably correct in that, generally speaking, the law does not require exact symmetry between the estimated sum and the amount likely to be awarded in a common law claim.[41] However, some commentators have pointed out that a requirement of substantial accuracy has been applied by the High Court in several pre-*Ringrow* cases to strike down agreed damages clauses as penalties, in circumstances where the pre-estimation of damages is a relatively straightforward task.[42] Even applying the *Ringrow* test, the view has been expressed that it is generally inappropriate for a court to look at the difference between the actual loss and the amount determined under a formula adopted by the parties for calculating agreed damages.[43] Such an approach diverts attention away from whether, at the time it was agreed, the application of the formula would produce an amount 'out of all proportion' to the loss or damage likely to be suffered.

Following recent English authority, Ward J also held that the amount determined under cl 10.4 was not subject to the mitigation rules.[44] It did not matter whether the employer was able to replace Purcell with a broker who generated profits which Purcell would have done had he remained in employment. In principle, this approach would seem correct in that, once the parties had arrived at a genuine pre-estimate of the loss, it would defeat the purpose of a liquidated damages clause for the parties to engage in costly litigation about whether the steps taken in mitigation by the innocent party are reasonable.

It was also important that cl 10.4 provided for a sliding scale which, to adapt the words of Lord Radcliffe in *Bridge v Campbell Discount Co Ltd*,[45] slid in the right direction. This did not escape Ward J's attention, who noted that the liquidated amount under cl 10.4 was proportional to the amount of time left to run under the contract.[46]

---

38 *Tullett Prebon (Aust) Pty Ltd v Purcell* [2009] NSWSC 1079; BC200909222 at [119]. Therefore, the employer's likely loss of profit caused by the breach was equivalent to 50% of the broker's average monthly revenue generated over the remainder of the contract term.

39 *TP Australia* [2010] NSWCA 150; BC201007186 at [40].

40 *Tullett Prebon (Aust) Pty Ltd v Purcell* [2009] NSWSC 1079; BC200909222 at [124]–[125].

41 As outlined by Mason and Wilson JJ in *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 190; 68 ALR 185; 60 ALJR 741; BC8601381, the parties are allowed a generous margin.

42 See E Peden and J W Carter, 'Agreed Damages Clauses — Back to the Future?' (2006) 22 *JCL* 189 at 194–6.

43 Ibid, at 197.

44 *Tullett Prebon (Aust) Pty Ltd v Purcell* [2009] NSWSC 1079; BC200909222 at [126], citing *Murray v Leisureplay plc* [2005] All ER (D) 428 (Jul); [2005] IRLR 946; [2005] EWCA Civ 963.

45 [1962] AC 600 at 623; [1962] 1 All ER 385; [1962] 2 WLR 439.

46 *Tullett Prebon (Aust) Pty Ltd v Purcell* [2009] NSWSC 1079; BC200909222 at [123].

However, one aspect of the clause which did not receive attention is that it did not take into account the benefit for the employer (and the corresponding detriment for the employee) of the accelerated recovery of the broking revenue. Clause 10.4 required Purcell to pay the liquidated sum on the day after the termination of the contract, irrespective that the balance of the profits for the unexpired term would not otherwise have been generated immediately. The clause did not expressly provide for any rebate for accelerated payment of the revenue. The High Court has said that agreed damages clauses must make some allowance for the time value of money and acceleration of payment may amount to a penalty.[47]

It may be that this factor was not considered in *TP Australia* because the contract had already expired by the time the case was heard. Nevertheless, the High Court authorities referred to above indicate that the benefit of any accelerated recovery is assessed at the time of entry into the contract, not at the date of the trial. This is consistent with guarding against the 'in terrorem' feature of penalty clauses. In the present case, the earlier that the contract might have been terminated for repudiatory breach, the higher the detriment for the employee. It may be the case that the formula set out in cl 10.4 made some allowance for the acceleration of revenue. However, this was not apparent on the face of the clause.

Overall, the decision in *TP Australia* highlights the advantages for an innocent party in obtaining an agreed damages clause in the employment contract. Such clauses may apply for the benefit of the employee as well as the employer. The decision also illustrates that the parties to a fixed term employment contract will be in a position to make an accurate pre-estimation of the loss. Nevertheless, the drafting of the clause will be critical in determining whether the agreed amount of damages is properly characterised as compensatory rather than punitive or deterrent.

47 See *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359; 45 ALR 632; 57 ALJR 172; BC8300062; *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170; 68 ALR 185; 60 ALJR 741; BC8601381; *Esanda Finance Corp Ltd v Plessnig* (1989) 166 CLR 131; 84 ALR 99; 63 ALJR 238; ASC 55-699.