GOOD FAITH PERFORMANCE IN EMPLOYMENT CONTRACTS

Traditional principles of Contract law are ebbing before a flood tide bearing a more radicalised idea of the contract of employment. Some may identify in this innovation a reaction to the tradition of free market individualism expressed in the ideas of sanctity of contract, the search for agreement and the maxim *caveat emptor*. Parties to a contract may now be prevented from the pursuit of their selfish interests notwithstanding express terms of a contract which ostensibly appear to justify this. Express agreement may yield to obligations which are imposed by law. Amongst these significant developments is the importation of a duty binding each party to the employment contract to act in good faith, (1) a duty which appears to be very different from the long recognised duty of the employee to serve faithfully. (2)

At present the nature of this new duty appears to be illusive. Nevertheless, its importation poses difficult questions about how far the re-alignment of the employment relationship might extend. The authorities appear to establish the concept of an actionable abuse of a contractual right notwithstanding the relevant conduct ostensibly falls within the express power conferred. But this only poses complex questions. Against what standard is such abuse to be identified? Is the good faith obligation merely a device to allow the court to enforce the contemplation of the parties at the time of contract? Is the proper focus the spirit rather than the letter of the bargain, thus departing from orthodox canons of construction? This note examines some recent decisions which have placed some reliance on the idea of good faith performance.

The Nature of Good Faith Performance

One recent application of the duty to act in good faith restricts the operation of contractual discretionary powers by identifying the fundamental purposes for which power was conferred. It confines the employer's decision-making so as to uphold those purposes. It may thus preclude reliance on the full scope of contractually expressed discretionary powers where to do so would be to the unreasonable detriment of the employee. This was so in the recent decision in *Clark v. BET plc* (3) where the issue concerned the quantum of damages to be awarded in an action for wrongful dismissal. Here, by his contract, a company chief executive had a right to have his salary reviewed annually and "increased by such amount *if any* as the board shall in its absolute discretion decide."

(emphasis supplied) The contract further stated that in reaching its decision the board had to "consider" the remuneration policy of other companies. The director claimed that he was entitled (*inter alia*) to damages including the salary increases of 10.5% he would have received during his notice period.

According to orthodox contractual principles, it would have been open to the court to decide that the board enjoyed an absolute discretion limited only by the duty to "consider" other companies' practices. It might therefore have fulfilled its contract merely by directing its mind to those other pay awards, and their surrounding circumstances, and resolved to award no pay increase (since a duty "to consider" is a different matter from a duty to "adopt"). It would certainly have been under no obligation to exercise the express discretion to award a pay rise since the clause as drafted appeared to contemplate the possibility that no increase might be awarded. However, Timothy Walker J. held that under the express terms of the contract the director had a right to receive an annual increase in his salary; only the amount (if any) lay in the discretion of the board. The judgment continued to refine this by super-imposing duties which would not be unfamiliar to the Administrative lawyer. The board appeared to have an implied duty to exercise its discretion honestly and in accordance with objective principles, including the contractually relevant consideration of the pay structures of other companies and the profitability of BET. Controversially his lordship added:

"..if the board had capriciously or in bad faith exercised its discretion so as to determine the increase at nil....that would have been a breach of contract." (4) Subsequently, he stated that:

"Nor should I assume that any discretion would have been exercised so as to give the least possible benefit to the plaintiff if such an assumption would on the facts have been realistic." (5)

The court eventually ventured into the controversial arena of wage setting by determining the actual pay increase the director might have received but for his dismissal. (6)

Good faith performance in *Clark* was evidently deployed to control the broad discretion the board exercised under the express terms of the contract. (7)

The obligation to perform in good faith precluded contractual performance in the manner most favourable to the employer where this prejudiced the employee notwithstanding that the contract *ex facie* might have justified this. Performance according to the letter of the contract could thus constitute a breach of it. It seems therefore that good faith performance is not exclusively concerned with the construction of the express words of the bargain. The question must then be asked: what alternative, higher, standard prevails?

Two radically different possibilities are suggested. The first is that primacy is given to the contractual contemplation of the parties. This might be a comparatively uncontroversial innovation since by its search for presumed intention it is merely a different expression of freedom and sanctity of contract. However, as attractive as this limited development may be to some, the courts may find themselves inevitably drawn towards a very different and more objective standard. (8) This would be so because of the evidential difficulty which must be encountered in searching for the presumed intention of the parties at the time of contract. The absence of clear evidence on this issue would invite the court to substitute some judicially identified idea of reasonableness for any presumed agreement thereby exposing the fiction of the search for agreement. (9) Similarly, who is to say that parties with divergent interests share a common expectation as to the *future* exercise of contractual discretionary powers?

If this analysis is correct, the smuggling of some perception of good industrial practice into the contract of employment under the shadowy cloak of good faith may become an inevitable response to the uncertain and almost inevitable fiction of contractual expectation. This development towards juridifying standards of good industrial practice has already been presaged by the range of conduct which has been held capable of breaching the contract of employment. (10) Good faith may accelerate this growth and generate a new commitment to industrial justice.

Good Faith and Trust and Confidence

Some decisions are expressly founded on a duty to perform in good faith; (11) in others the duty is less distinctly articulated, and may appear to be intertwined with the more familiar duty binding each party to do nothing to

destroy the mutual relationship of trust and confidence, which itself derives from a change in legal culture. (12) This was so in the recent case of *Adin v. Sedco Forex International* (13) where Lord Coulsfield in the Court of Session, Outer House formulated one of the issues in the case as follows: "whether the general obligation, often referred to as the obligation of trust and confidence *or of good faith*, ... was implied in this contract...." (emphasis supplied). (14) Some decisions which rely on the duty to maintain trust and confidence, without express reference to a duty to perform in good faith, are nevertheless consistent with the emerging duty. Similarly, decisions which controversially expand the duty to co-operate may also exemplify one aspect of good faith performance. This is particularly so where the breach comprises conduct undertaken with an intention to injure the employer's business. (15)

Similarly, the failure of the employer to take reasonable steps to safeguard an employee from harm threatened by third parties has recently been confirmed as a breach of trust and confidence. This duty is also consistent with the idea of good faith performance, which can require one contacting party to have regard to the interests of the other. (16) Good faith may also require one contracting party to allow the other to perform their part. It has now been held that a repudiatory breach occurs where an employee who has received a warning on capability grounds is given no support from the employer in endeavouring to improve. This is so because without support the opportunity to improve is without value. Hitherto tribunals have derived this result from the trust and confidence principle; in other jurisdictions it could be explained as an application of the doctrine of good faith performance. (17) The ideological foundation of many of these decisions establishes a unitary model of employment which identifies a common interest between employer and employee in the success of the commercial venture, the achievement of which depends upon mutual co-operation and support. It is, however, too early to suggest that this model informs all aspects of the employment relationship. (18) It will fall to future developments to identify how far the co-operative model can extend.

Malik v. BCCI, (19) which is a decision of major importance endorsing and extending the co-operative model, indicates that this process is already in train. Here the House of Lords held that there is a duty binding the employer not to conduct the business so as to destroy trust and confidence in a manner that would inhibit the employee's future employment prospects. Lord Nicholls

emphasised that "..the purpose of the trust and confidence implied term is to facilitate the proper functioning of the contract." (20) He continued, ".. the purpose of the trust and confidence term is to preserve the employment relationship and to enable that relationship to prosper and continue..." (21) As indicated below, these formulations illustrate the potential synergy between the implied duties of trust and confidence and good faith.

The facts were that Malik and another were employees of bank alleged to have been corrupt and dishonest. Their employments were terminated by reason of redundancy when the bank went into liquidation. Neither employee was guilty of any wrongdoing but, because their names were linked to such a business, their good standing in the financial services sector was destroyed so that it had not been possible for them to work in financial services since their dismissals. They sought and obtained damages for injury to reputation reflecting their loss of earnings.

The House of Lords held that if the employer's conduct is a breach of the duty to maintain trust and confidence which prejudicially affected an employee's future employment prospects so as to give rise to continuing financial loss, and it was reasonably foreseeable that such loss was a serious possibility, in principle damages would be recoverable if injury to reputation (and so future employment prospects) could be established in evidence as a consequence of the breach.

Their lordships rejected the bank's submission that the employees were unaware of the bank's wrongdoing during their employment and so the employees' confidence in their employer could not have been undermined. This argument postulated a subjective standard which their lordships held was inappropriate. As Lord Nicholls observed: "the objective standard provides the answer to the (respondents) submission that unless the employee's confidence is actually undermined there is no breach. A breach occurs where the proscribed conduct takes place: here, by operating a dishonest and corrupt business. Proof of a subjective loss of confidence is not an essential element of the breach.". (22) Their lordships also rejected the submission that the dishonest conduct complained of had to be aimed at the employees individually and not at third party clients.

This decision will allow claims for damages where it is reasonably foreseeable that employment prospects will be harmed (and are actually harmed) as a result of the employer's breach of trust and confidence, even if the dismissal occurs principally for other reasons (such as, in this case, redundancy). How many cases will now arise depend on the developing scope of the implied term.

The *Malik* decision, although ostensibly founded on the duty to maintain trust and confidence, might also be explicable in terms of good faith performance. This is especially so if good faith essentially requires minimum moral or ethical standards in the manner in which the parties deal with each other. According to this view obligations transcend the duty to perform a promise to a broader ethical conception of contractual behaviour. (23) Fundamentally, the decision endorses the co-operative model of employment upon which the emerging doctrine of good faith rests, and it significantly continues the process of juridifying good industrial standards.

The courts are involved in a profound experiment by importing the continental doctrine of good faith performance. Values other than that which requires adherence to the literal terms of a bargain inform many of the decisions reached on the basis of good faith notwithstanding the value in upholding a bargain freely struck.

Some commentators will object that the courts are ill-suited to the task of establishing standards of industrial justice by means of an expanded and radicalised conception of the implied term. Commercial certainty suffers where agreement is overridden by broader notions of good faith. And there are questions about how far this process can go. Will the courts in effect re-write contracts to redistribute windfall benefits or unexpected burdens? Will good faith extend to negotiations? How far will the employer have to have regard to the interests of the employee? Will modern employment theories which emphasise team working and "ownership" of the business venture inform the future shape of legal rights? How far, in essence, will the courts abandon a conflictual for a co-operative model of employment? Good faith may prove to be a formidable challenge.

FOOTNOTES

(1) The literature on the good faith doctrine is immense. The following are offered as examples: Burrows, (1968) 31 MLR 390; Summers, (1968) Virginia L Rev 195; Collins, [1992] MLR 556; Burton, 94 LQR 369; and Farnsworth, (1987) Columb L Rev 217. The implied duty to maintain trust and confidence, to which reference is made below, has been another important development which was recently approved by the House of Lords in *Malik v. BCCI* [1997] IRLR 462.

(2) The duty to serve faithfully is arguably a distinct obligation binding the employee, whereas the duty to act in good faith binds each party. For a discussion of the former see Smith & Wood, *Industrial Law* 6th edit, (1996) pp. 120 *et seq.*, but note that the learned authors refer to the duty of fidelity as the duty to serve in good faith.

(3) [1997] IRLR 348.

(4) at 349.

(5) *Ibid.*

(6) Contrast *Re Richmond Gate Property Co. Ltd* [1965] 1 WLR 33.

(7) It must not be forgotten, however, that the court had to identify the loss the plaintiff would have received during his notice period. By comparing the plaintiff's case with that of other employees the court examined how the discretion would have actually been exercised. At one level of reasoning, this is not to interfere with a discretion but to honour it. This is a different case from that in which a court would be invited to *overturn* the exercise of an employer's discretion to award (or not to award) a pay increase. However, As Timothy Walker J. emphasised *obiter* (see above text at note (4)) the courts appear to enjoy a power to do so. This is already established where the employer's actions disadvantage an individual employee in a manner which is capricious or perverse: *Gardner v. Beresford* [1978] IRLR 63; *Pepper & Hope v. Daish* [1980] IRLR 13.

(8) In *Malik v. BCCI* (above n. (1)) their lordships held that trust and confidence may be breached without the actual confidence of the employee in his employer being undermined. This means that a repudiatory breach of contract results from the breach itself and not the employee's perception of the employer's conduct.

(9) Already the courts insist on the possession of reasonable grounds to justify the exercise of a contractually reserved discretion: *White v. Reflecting Roadstuds Ltd* [1991] IRLR 331; *McLory v. Post Office* [1993] IRLR 159. Further, the employer must have reasonable grounds on which to hold any opinion which would deny the employee a benefit. *Mihlenstedt v. Barclays Bank* [1989] IRLR 522.

(10) Examples include *BAC v. Austin* [1978] IRLR 322; *Wigan BC v. Davies* [1979] ICR 411 *Walker v. Northumberland CC* [1995] IRLR 35.

(11) E.g., *Clark v. BET plc* [1997] IRLR 348; *Kramer v. South Bedfordshire Community Health Care Trust* [1995] ICR 1066; *Imperial Group Pension Ltd. v. Imperial Tobacco Ltd.* [1991] IRLR 66; *Mihlenstedt v. Barclays Bank* [1989] IRLR 522

(12) Lord Steyn in *Malik v. BCCI* (above n. (1)) at p. 468 thought the development of this latter duty was made possible by a change in legal culture which has imposed far greater duties on employers. Lord Slynn of Hadley in *Spring v. Guardian Assurance plc* [1994] IRLR 460 at p.474 stated that the implied duty has expanded so as to require employers "to take care of the physical, financial and even psychological welfare of the employee". In *Malik* Lord Steyn summed up the duty as one designed to strike a balance between an employer's need to manage the business effectively and the employee's interest in not being unfairly and improperly exploited (at p. 468). On the implied term generally, see Smith & Wood, *Industrial Law* 6th edit, 1996 pp. 97 *et seq*.

(13) [1997] IRLR 280, 284.

(14) at p. 283. See also *Imperial Group Pension Ltd v. Imperial Tobacco Ltd.* [1991] IRLR 66.

(15) *B.T. v. Ticehurst* [1992] IRLR 219; *Secretary of State v. ASLEF No.2* [1972] 2 All ER 949 and see further n. (16) below on the nature of the duty identified in *Barque Quilpue v. Brown* [1904] 2 KB 264.

(16) *Donovan v. Invicta Airways* [1970] 1 Lloyds Rep 486, *Smith v. Croft Inns Ltd* [1996] IRLR 84, and *Burton v. De Vere Hotels Ltd* [1997] ICR 1 concern the implied duty to maintain trust and confidence in this context. How far good faith requires one party to have regard to the interests of another is unclear. The courts have stated that there is a duty implied by law requiring each party not to do anything to prevent the other party performing the contract or to delay him in performing it: *Barque Quilpue v. Brown* [1904] 2 KB 264, esp 271. In the United States there may be a more positive duty to co-operate in the other's performance (see Summer (1968) Virginia L Rev at p. 196) which might normally preclude the unwarranted exposure of the other party to the risk of harm.

(17) *Associate Tyre Specialists (Eastern) Ltd v. P A Waterhouse* [1976] IRLR 386. See further n (15) above on the duty to co-operate in the performance of the contract by the other party. In *M'Intyre v. Belcher* 14 CB (NS) 654, 664 Willes J. observed: "(I)f I grant a man all the apples growing on a certain tree, and I cut down the tree, I am guilty of a breach." . This suggests that the offer an employee an opportunity to improve, followed by conduct rendering that opportunity valueless could comprise a breach of the implied duty of good faith.

(18) This is so because there remain many examples of a conflictual model, for example, the absence of a duty to increase a worker's wages to preserve its real value against inflation: *Murco v. Forge* [1987] IRLR 50.

(19) [1997] IRLR 462.

(20) at p. 464.

(21) at p. 465.

(22) at p. 464.

(23) The historical development of good faith is considered in J F O' Connor, *Good Faith in International Law, Dartmouth* (1991), Ch.2. Economic analysis of good faith may provide support for ethical standards in so far as it asserts that a fundamental purpose of the good faith requirement is that it reduces the risk of contracting.