



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.

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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] 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.