DIFC Court of Appeal considers ‘good faith’ in employment contracts

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In a claim brought against a financial services group operating from the DIFC by its former CEO, the DIFC Courts have again considered the concept of good faith in the context of an employment contract.

John Vitalo vs Atlas Mara Management Services Limited [2018] DIFC CFI 018 (5 September 2018), H.E. Justice Ali Al Madhani;

John Vitalo v Atlas Mara Management Services Limited [2019] DIFC CA 012(23 March 2020), Justice Sir Jeremy Cooke, Justice Wayne Martin, H.E. Justice Shamlan Al Sawalehi.

Background to the dispute

The claimant was employed by the defendant as its group CEO, initially under an employment contract dated 1 April 2014 and then by a contract dated 1 August 2015 under which he sued (‘Employment Contract’). He claimed that he was enticed to take the role after various representations and assurances were given to him by the defendant, particularly about the level of health insurance coverage he and his family would receive.

In mid-February 2017, the claimant was given six months’ notice of the termination of his employment. The defendant offered a settlement agreement at that time, which the claimant rejected. He subsequently brought proceedings in the DIFC Courts, alleging that the defendant had breached relevant terms of his contract in that it had failed to offer him the opportunity to purchase continuation of medical insurance coverage (‘The Health Insurance Claim’) and it had failed to increase his allowance by an amount that should have been adjusted annually (‘The Indexation Claim’). He also brought a claim under statute, alleging that the defendant had failed to pay him an amount equating to unused holiday leave in breach of DIFC employment law then in force (DIFC Law No.4 of 2005 as amended; ‘the 2005 DIFC Employment Law’) (‘The Holiday Allowance Claim’).

In total, the claimant sought over AED 13,000 (US$3,500), AED 341,000 (US$93,000) and AED 496,000 (US$135,000) for the three heads of claim respectively, to a total of over AED 850,000 (US$232,000).

Additionally, on the basis of the three claims, he sought a penalty payment pursuant to Article 18(2) of the 2005 DIFC Employment Law, equivalent to his last daily wage from 14 days after the date of his termination. This was calculated at AED 16,544 (US$4,500) per day, to a total amount of over AED 6,104,000 (US$1.6 million) by the time of trial in September 2019.

The defendant denied the claim in its entirety, in summary, asserting that: (i) the employment contract did not provide for the extra-contractual and post-termination medical cover claimed; (ii) the defendant had lawfully exercised a contractual discretion not to uprate the allowance payments, which the contract provided for and which the claimant was notified of; (iii) the claimant had taken all accrued vacation leave prior to termination, which was mutually agreed between the parties; and (iv) the claimant was not entitled to any statutory penalty under Article 18(2), nor any kind of interest.

The defendant also brought a counterclaim alleging that, first, the claimant had unlawfully withheld AED 451,410 (US$123,000) plus interest of fees paid to the defendant by virtue of his appointment as a director of an affiliate of the defendant in Nigeria, a position he only held on behalf of his employer, the bank, and the fees for which should, said the bank, have been remitted to his employer; and second, the bank claimed a set-off for 41 days of holiday that the defendant alleged the claimant had taken without entitlement.

Proceedings in the DIFC Court of First Instance

The claimant initially sought immediate judgment on the Holiday Allowance and Indexation Claims, which was denied by H.E. Justice Ali Al Madhani following a hearing on 20 June 2018. The Judge ordered a trial of the whole claim and counterclaim, which took place in September 2018 in front of him. The Judge found against the claimant on all grounds and the defendant was successful on one of the two limbs of its counterclaim.

The Health Insurance Claim failed on various grounds, including the finding that, although Article 51(a) of the DIFC Contract Law (DIFC Law No. 6 of 2004 as amended) permitted pre-contractual negotiations to be taken into account when interpreting the meaning of an agreement and the parties' common intention, an 'entire agreement' clause in the employment contract precluded the Judge from taking them into account. In any event, he did not find that the pre-contractual negotiations constituted an offer by the defendant, nor the existence of any collateral contract.

The Holiday Allowance Claim also failed. The claimant had a long-planned holiday booked for a period coinciding with his garden leave, which he said should not be counted towards his holiday entitlement. He accepted that had he not been on garden leave, he would have taken that period as acknowledged holiday leave. Upon the proper construction of the employment contract and in light of the applicable DIFC Employment Law, the Judge found that it was 'convenient' for the claimant to take his unused holiday entitlement during his notice period and garden leave in accordance with the defendant's instructions, which satisfied the contractual obligation that holiday be taken at a 'mutually acceptable' time for both parties. He therefore had no unused holiday allowance. As a result, the second ground of the counterclaim also failed, because the days in which the claimant was not working during his garden leave could not be counted as excess holiday.

In respect of the Indexation Claim, the Judge considered the term in the employment contract under which the claimant's allowance for housing, car, education costs, utilities and other items "will be adjusted annually for local (Dubai) inflation (as determined by the [defendant]) based on education, housing and utilities cost indexes". The defendant had declined to apply an inflation-linked uplift at all.

The claimant argued that there was a clear, positive obligation on the defendant to adjust his allowance, and that the adjustment should have been carried out with regard to relevant indices in accordance with Article 53 of the DIFC Contract Law, which stated that "Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect". Specific indices for education, housing and utilities were available from the Government of Dubai, which the claimant submitted the Court should apply in the defendant's stead. The inclusion of other, non-specified, indices in the calculation of indexation was to deprive the words used (particularly the reference to specific allowance items) of their specific intent, meaning and effect. The Court was, he said, obliged to interpret the contract according to the parties' common intent, with relevant background, including a request by the claimant's legal representative during negotiations that salary and allowances or benefits "shall be adjusted annually for inflation as reported by the UAE Ministry of Finance". The indexation of allowances was to be treated differently to other terms, including rights to bonuses, pay in lieu of notice, and his duties as CEO. The wording did not, said the claimant, entitle the defendant not to apply an inflation uplift at all, nor to take into account indices extraneous to those mentioned in the contract in determining the uplift. The claimant cited the uplifts given to other employees, who had received indexed uplifts of four per cent significantly higher than the headline inflation rate.

The defendant's central response was to submit that the wording of the clause meant that the allowance 'will be adjusted' but only if the defendant had 'determined' or exercised a contractual discretion in favour of the company. The words 'as determined by the company' were selected and inserted deliberately, giving, said the defendant, an important discretion expressly in its hands, without any right to increase the living allowance. The claimant was well aware of this discretion, which the defendant said was common practice prior to his termination as the claimant had himself been the discretionary decision-maker in other instances. If the Court did find a positive obligation to apply an uplift, the defendant submitted the choice of uplift was at its discretion, including a deflationary uplift based on previous Dubai economic fluctuations. The operation of the indexation would have an important bearing on damages.

The Judge was unpersuaded that the natural and ordinary meaning of the relevant clause meant anything other than the defendant possessed a discretion as to whether there would be any increase. The claimant had not taken issue with previous decisions by the defendant not to exercise the discretion and award any uplift throughout the duration of his employment, and there was no evidence of other employees receiving an uplift.

Because the claimant's three claims failed, the claim for a statutory penalty also failed.

The Judge found in the defendant's favour on the second counterclaim, for fees paid to the claimant as a director but not subsequently transferred to the defendant. However, on the evidence, the disparity between the sums paid by the claimant by way of an interim payment on account on the one hand, and the actual sums the Court found were due to be paid on the other, was only US$1, which the Court ordered to be paid.

As a result, because the defendant had defeated all three claims against it, and was 50 per cent successful on its counterclaim (with its unsuccessful counterclaim only 'a very small amount' of the overall issues in the trial), the claimant was ordered to pay the defendant's costs of the proceedings on the standard basis.

Proceedings in the DIFC Court of Appeal

The Judge gave the claimant permission to appeal in respect of his findings on the Indexation Claim, the Holiday Allowance Claim, the claim for a statutory penalty and on costs. Justice Sir Jeremy Cooke gave the only judgment of the Court, with which Justice Wayne Martin and H.E. Justice Shamlan Al Sawalehi concurred. The Court of Appeal began with guidance on the interpretation of contracts under DIFC law with reference to English common law jurisprudence:

> *"Whilst the parties also sought to rely on pre contract negotiations and post contract conduct, the fact remains that the form of words was negotiated as between lawyers and no common intention can be found in the preceding exchanges beyond an ultimate agreement to the form of words used. Furthermore, post contract conduct is often explicable on more than one basis, which does not help much in construing the words used. We refer to the latter later in this context, but the focus must be on the words used in accordance with the principle set out in Article 49(2) of the Contract Law, No 6 of 2004. We were referred also to this Court's decision in Damac Park Towers v Youssef Issa Ward [2015] DIFC CA 006 at paragraphs 79-85 and the trio of decisions of the Supreme Court in England, culminating in Wood v Capita [2017] UKSC 24 and particularly the approach to construction set out in paragraphs 8-15 with the iterative process and the balancing there referred to between the textual and contextual approach with reference to the commercial objectives and a construction which accords with business common sense. We accept that those principles are of application."*

The Court of Appeal rejected all four grounds of appeal, finding that the Judge at First Instance had not erred in respect of any of the grounds.

The Court's treatment of the Indexation Claim is of note to DIFC practitioners. After considering the evidence before Justice Al Madhani and his reasoning, Justice Cooke referred to the English High Court decision of Brogden v Investment Bank [2014] EWHC 2785 (Comm) as authority for the proposition that:

> *"where a contract gives responsibility to one party to make an assessment or exercise a judgment, on a matter which materially affects the other party's interests and about which there is ample scope for reasonable differences of view, the decision is properly regarded as a discretion which is subject to the implied constraints that it must be taken in good faith for proper purposes and not in an arbitrary, capricious or irrational manner."*

The Employment Contract was such a contract and a determination of the material clause on indexation fell to be "made without a formula which governs that determination and leads only to one objective result." There was "inevitably, an inbuilt discretion in the decision maker". The defendant was therefore under a "duty to make a determination as to any adjustment to be made and that such determination had to be made rationally and in good faith – not arbitrarily, capriciously or perversely".

The Court allowed the defendant a margin of appreciation to "take into account factors outside and beyond the specific indices relied on by the Appellant which could play a part in a rational good faith decision, including the particular personal circumstances of the Appellant or the educational needs of his family" as nothing in the Employment Contract barred this. The wording of the term "gave a freedom" to the defendant "in applying the elements that are referred to, rather than tying it to a straight application of them, even if that were theoretically possible".

The claimant had claimed that he was entitled to a fair determinative procedure to be carried out by the defendant on his behalf. The Court agreed: "As a matter of analysis, if there was a failure to consider specifically the appropriate adjustment to be made to the living allowance and there was a duty to make a rational, good faith determination of what that adjustment should be, which appears to be the position on the evidence, that would amount to a breach of contract. That breach would sound in damages which would reflect what that decision ought to have been".

However, the Court did not agree with the logical supplement that, on the facts, the application of a rational, good faith determination would necessarily have led to an uplift of his allowances. The claimant's remuneration and benefits package had been considered in the round each year, and the defendant's remuneration committee had come to a decision which reflected the totality of awards to the claimant, not just in the allowances subject to the Indexation Claim. The claimant could not show that he would have

received an overall different package of benefits each year even if the 'appropriate' indices had been applied.

Analysis

The idea of good faith in contractual terms is an evolving area of English law, described by Bingham LJ in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433 as a connotation of "'*playing fair*', '*coming clean*' or '*putting one's cards fact upwards on the table*'", and "*in essence a principle of fair open dealing*". English law does not view it as a doctrine per se, unlike civilian laws such as the UAE Civil Code, Article 246 of which obliges that "*the contract must be performed in accordance with its contents, and in a manner consistent with the requirements of good faith*". DIFC law recognises implied obligations that "arise from good faith and fair dealing" (Article 57, DIFC Contract Law), although that Article was described as "*say[ing] nothing about the implication and application of terms in particular contracts and particular situations*" in Hana Al Herz v DIFCA [2013] DIFC CA 004 (27 November 2014) at [121].

The English development of good faith requirements has come as part of the development of principles of contractual interpretation. In *Yam Seng v International Trade Corp* [2013] 1 All ER (Comm) 1321, Leggatt J found that the "*basis of the duty of good faith*" lay in the "presumed intention of the parties and meaning of their contract". He gave some content to the duty, acknowledging its sensitivity to context, but considered a "core value" of honesty (the absence of deceit), and behaviour that was not improper, commercially unacceptable or unconscionable.

The duty of good faith is implied, in English law, in contracts that are described as 'relational', meaning agreements characterised, inter alia, by a mutual intention for a long-term relationship, an intention for the parties' roles to be performed with integrity and fidelity, trust and confidence, an exclusivity of relationship, and a common collaborative purpose. By their nature, employment contracts are relational contracts, and employment disputes have provided fertile ground for the advancement of the concept of good faith in the DIFC.

The Court of Appeal in Vitalo referred to the previous decision of the then-Deputy Chief Justice, Sir David Steel, in granting the defendant's application for summary judgment in *Papadopoulos v Standard Chartered Bank* [2017] DIFC CFI 004 (27 February 2018), a claim by an employee against his employing bank arising from a failure to pay him a bonus, the payment of which was, in the material term, at the bank's "absolute discretion". The Deputy Chief Justice was "unable to accept" that the contractual discretion to pay was unfettered, and considered it "clearly arguable" that there was an implied term that any decision should be rational and accordingly not arbitrary, capricious or perverse (so-called *Braganza rationality: Braganza v BP Shipping Ltd* [2015] UKSC 17). However, on the facts, he found that there had been no grounds to raise an arguable case that the discretion had been exercised irrationally, and he dismissed the action.

Both *Papadopoulos and Vitalo* have established good faith as a proper consideration in the exercise of discretion in employment contracts in the DIFC. Both cases were decided under the 2005 DIFC Employment Law, but nothing in the current DIFC Employment Law, Law No.2 of 2019 as amended, will reduce the likelihood of this area of jurisprudence expanding, particularly as the types and forms of agreements recognised by the DIFC Courts as relational contracts increases.

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