

## Article Information

Author: Tim Lange

Service: Employment & Labour

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## Pre-employment misleading and deceptive conduct: be careful what you promise

**In Rakic v Johns Lyng Insurance Building Solutions (Victoria) Pty Ltd (Trustee) [2016] FCA 430, the Federal Court awarded an employee compensation of over \$300,000 for loss suffered after she was misled by representations made to her by Johns Lyng prior to taking up her role as General Manager.**

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*The case should serve as a cautionary tale to other organisations that many kinds of statements made to prospective employees, such as those about future remuneration or the profitability or financial position of the company, must only be made where there is reasonable basis to do so.*

### Facts

Svetlana Rakic was employed by Pattersons Insurerbuild Pty Ltd (**Pattersons**) between October 2012 and April 2013. Around 8 April 2013 she left her employment at Pattersons and took up the role of General Manager at Johns Lyng Insurance Building Solutions (Victoria) Pty Ltd (**Johns Lyng**), remaining in this role until she was made redundant, around 24 February 2014.

Ms Rakic brought a claim alleging that Johns Lyng had engaged in misleading and deceptive conduct in contravention of sections 18 and 31 of the Australian Consumer Law (**ACL**). Ms Rakic alleged that in discussing her potential employment, Johns Lyng had made representations to her, that:

1. its profits and sales in the 2012/13 financial year (**FY13**) were likely to meet or exceed its 2010/11 financial year (**FY11**) and 2011/12 financial year (**FY12**) profits and sales; and
2. it was probable that for at least the next twelve months, Johns Lyng would remain as profitable as it had been in the previous two years; and
3. that there was no reason, of which Johns Lyng was aware, for it not to meet its sales and profitability forecasts for FY13.

Ms Rakic alleged that these representations were important given that she was to be remunerated partly by way of a percentage of net profit. Ms Rakic alleged that she relied on these representations when she left her previous employment and accepted employment with Johns Lyng. She claimed that but for the representations, she would have remained in her employment at Pattersons, or would have been employed elsewhere and received equivalent remuneration.

Ms Rakic also raised two contractual claims in relation to her entitlement to 2.5 per cent of the net profit of Johns Lyng and in relation to the financial responsibility for the lease payments of her vehicle.

### The ACL

The general prohibition on misleading and deceptive conduct is contained in clause 18 of the ACL, which provides that: “A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.”

Clause 31 of the ACL is specifically directed at employment arrangements. It provides that

“A person must not, in relation to employment that is to be, or may be, offered by the person or by another person, engage in conduct that is liable to mislead persons seeking the employment as to:

- (a) the availability, nature, terms or conditions of the employment; or

(b) any other matter relating to the employment.”

Clause 4 of the ACL provides that if a representation is made with respect to any future matter and the person making the representation does not have reasonable grounds for making the representation, it is taken to be misleading.

## **Decision**

To determine Ms Rakic’s ACL claim, the Court needed to address the following four questions:

1. Were the representations made, and made in trade and commerce?
2. Were the representations misleading or deceptive?
3. Did Ms Rakic suffer loss or damage because of Johns Lyng’s conduct?
4. What was the amount of loss or damage suffered?

### **Were the representations made, and made in trade and commerce?**

Ms Rakic alleged several events establishing the representations: a conversation with a director of Johns Lyng on 20 March 2013, an email from another director on 21 March 2013 and then the failure to inform Ms Rakic prior to mid-April 2013 of any deterioration in sales and profits.

Justice Bromberg found that these events established the three representations Ms Rakic alleged. In Ms Rakic’s conversation with the director, she was told that Johns Lyng had been very profitable in the last few years, and even greater profit was forecasted for FY13. Although this was not a “guarantee” or a “warranty”, the statements were to be considered in the context that the forecasts were given nearly three-quarters of the way through the financial year and had been prepared by the Chief Financial Officer (CFO).

Further, the director had described Johns Lyng as “the foundation business of [the] company”, the “jewel in the crown business”, the “founding business” and a “very strong and respected business for many years.” A number of statements had been made to reassure Ms Rakic about the difference between her remuneration at Pattersons and what Johns Lyng could offer.

Justice Bromberg considered the fact that Ms Rakic was “not an unsophisticated representee” and had “significant commercial aptitude.” While she would have known that success cannot be guaranteed, she would have reasonably expected that the directors and the CFO were in a good position to make the predictions that they did.

Justice Bromberg was satisfied that the representations were made “in trade or commerce.” His Honour considered the judgment of Kenny J in *Walker v Salomon Smith Barney Securities Pty Ltd* (2003) 140 IR 433. In that case, Kenny J concluded that misleading and deceptive conduct in the course of negotiations for employment could support a claim under s 52 of the *Trade Practices Act* (the predecessor to clause 18 in the ACL). Justice Bromberg concluded that there was no reason why the same principle should not apply to clause 18. Justice Bromberg noted that, regardless of whether clause 18 applied, the representations were made “in relation to employment that is to be, or may be, offered” within clause 31 and the same liability for damages would arise in either case.

### **Were the representations misleading or deceptive?**

Justice Bromberg then went on to consider whether the representations were misleading or deceptive. The issue with both representation 1 and 2 was whether there were reasonable grounds for the representations. Justice Bromberg rejected Johns Lyng’s assertion that it was not liable so long as the director acted reasonably in passing on the information given to him by the CFO, or that the forecaster had acted reasonably in drawing information from the forecasts. His Honour said:

*“The question is whether there was an objectively reasonable basis for the subject matter of the representations: whether there were facts within Johns Lyng’s knowledge that were objectively reasonable and supported the prediction that profits in FY13 would meet or exceed those in FY11 and FY12 and the prediction that Johns Lyng would remain for the next twelve months as profitable as it had been for the previous two years.”*

Justice Bromberg engaged in a detailed analysis of Johns Lyng’s financials to ascertain whether it had reasonable grounds for making the first two representations. He ultimately concluded that there was not, because there was good reason to believe that FY11 and FY12 figures would not be surpassed. Johns Lyng sought to simply rely on their past profits, and failed to take into account substantially diminished revenues and profits due to events that had occurred in the first seven months of the financial year. Johns Lyng had also been having difficulties with the insurer Suncorp, and was ranked 16th out of 17 on its panel of insurance builders. Given these difficulties, the forecaster should have “resolv[ed] doubt in favour of caution.”

Ms Rakic was unsuccessful in establishing that representation 3 was misleading and deceptive. The issue was whether Johns Lyng was aware of matters that it knew made it otherwise than likely that it would meet its FY13 forecasts. Ms Rakic was unable to provide sufficient evidence that Johns Lyng did not have a genuine belief in its forecasts. However, Justice Bromberg was careful to note that just because persons may have had a positive belief as to the likelihood of the FY13 profit forecast, this did not take away from his Honour's findings that the first two representations did not have a reasonable basis.

### **Did Ms Rakic suffer loss or damage because of Johns Lyng's conduct?**

Justice Bromberg accepted that Ms Rakic left her previous employment and entered into a contract with Johns Lyng in reliance on the representations. At the time of Johns Lyng's offer, Ms Rakic's remuneration was \$230,000 per annum, plus superannuation and various other entitlements including a motor vehicle. Johns Lyng's offer was \$115,000 (inclusive of superannuation), a motor vehicle and 2.5 per cent of Johns Lyng's profit. Other than the profit share, Johns Lyng's proposed remuneration was less than half her current remuneration. Johns Lyng then proceeded to represent to her that 2.5 per cent of the profit for FY13 would equate to over \$100,000. In Justice Bromberg's view, the suggestion that this representation would have had no or no substantial effect on Ms Rakic's decision to accept the offer "verge[d] on implausible."

### **What was the amount of loss or damage suffered?**

To determine damages, Bromberg J considered the hypothetical "most-likely scenario" absent Johns Lyng's conduct. This involved estimating when and for what remuneration Ms Rakic would have left her previous employment, and her likely remuneration after the date of hearing.

The value of Ms Rakic's previous package with Pattersons was approximately \$270,000. Justice Bromberg was of the opinion that Ms Rakic was dissatisfied with Pattersons, but she was not so dissatisfied that she would have left for a substantially less remunerative job. In light of Ms Rakic's dissatisfaction, she would have been likely to eventually leave Pattersons. However, she would be unlikely to find a job at comparable remuneration in a short amount of time, as there were very few similar positions available. Over time she may have been more willing to compromise on her salary. On this basis, Justice Bromberg decided that the "most-likely outcome" was that she would have remained at Pattersons for around 2.5 years and then left for a job that offered a package of around \$220,000. The Court's approach was to take this most-likely scenario, and then subtract the amount actually earned by Ms Rakic plus the amount likely to be earned post-hearing. Ms Rakic's loss was calculated to be \$333,422.

### **The contractual claims**

Ms Rakic claimed that she was entitled to 2.5 per cent of the \$2.875m net profit of Johns Lyng in FY13. Johns Lyng denied that she was entitled to this amount.

The relevant clause in Ms Rakic's contract provided for Ms Rakic's "salary" and "remuneration" and included an entitlement to 2.5 per cent of net profits. Bromberg J was of the view that this contractual dispute could be resolved according to the general principles of contractual construction. The natural meaning of the words "salary" and "remuneration", which provide context to the clause, suggest that a proportional relationship between work and profit share was intended. This is what a reasonable person would have understood from the language used in the contract.

Although the clause did not specifically provide for the profit share to be calculated on a pro rata basis, Bromberg J held that it was inherent in the nature of an entitlement to salary and remuneration to accrue pro rata. Therefore, as Ms Rakic worked for 2 months and 23 days of FY13, she was entitled to 2.5 of 23% of the FY13 profit.

Ms Rakic's claim regarding financial responsibility for the lease payments of her vehicle was unsuccessful. She contended that it was an oral term of her contract that Johns Lyng would assume responsibility for the payments, based on a conversation she had with a director prior to commencing employment. The Court did not accept this claim, noting that the conversation pre-dated the written contract of employment, and that the alleged oral term was inconsistent with the written contract.

### **Lessons for Employers**

The significant sum awarded to Ms Rakic as compensation highlights the risks associated with providing inaccurate information during recruitment.

It is understandable that a company headhunting prospective employees may be inclined to make statements that suggest working for their organisation will be lucrative. However, a company should exercise caution when making statements about its financial position and conveying forecasts about its future profitability and job security. This is especially important when recruiting high-level employees whose remuneration is not fixed and depends on the profitability of the

company.

Representations should only be made in pre-employment discussions if there is a “reasonable basis” for making them. Making representations that cannot be legitimately substantiated, such as through proper accounting reports or business plans, may leave the employer exposed to the risk of defending a misleading and deceptive conduct claim if things don’t go as planned after the employee commences work.