WHITE & CASE

Insight: Employment

January 2013

Forfeiture, penalty and repudiation: terminating the employment of highly paid employees

Two recent cases in the English courts have focused on important issues for employers of senior and highly remunerated employees, particularly those in the financial services sector where payments under incentive plans are often linked to active service and used both to retain talent and to deter key individuals from leaving to join competitors.

In the first case, *Imam-Sadeque v BlueBay Asset Management (Services) Ltd*, the High Court considered whether Mr Imam-Sadeque had breached the implied and express terms of his contract of employment when leaving to join a new start-up called Goldbridge, which was preparing to compete with BlueBay. It also considered whether the penalty doctrine applied to render the terms of a settlement agreement between the parties unenforceable insofar as Mr Imam-Sadeque was unable to exercise incentive awards worth £1.7 million upon a breach of that agreement.

In the second case, *Geys v Société Générale, London Branch*, the Supreme Court had to determine whether a repudiatory breach of the contract of employment by either party brings the contract to an end automatically or whether the contract is only terminated when the other party accepts the repudiation. It also considered the manner in which notification of termination of employment should be given. In doing so, the Court had to identify whether Mr Geys' employment terminated on 18 December 2007 or on 6 January 2008, the latter date giving rise to an entitlement to a termination payment of more than €12.5 million.

This Insight highlights the key lessons to be learnt by employers from these two cases.

Imam-Sadeque v BlueBay Asset Management (Services) Ltd [2012]

Facts

Mr Imam-Sadeque was a highly paid senior employee of BlueBay. In 2011, he decided he wanted to leave BlueBay but if he did so voluntarily he would be deemed a Bad Leaver for the purposes of his deferred incentive plan which would result in him forfeiting fund units which were due to vest in early 2012 and estimated to be worth approximately £1.7 million. He entered into a settlement agreement which stated that he would be deemed a Good Leaver for the purposes of his fund units provided he complied with the terms of the settlement agreement and his employment agreement. These agreements contained obligations of confidentiality, non-solicitation and non-competition.

Stephen Ravenscroft
Partner
+ 44 20 7532 2118
sravenscroft@whitecase.com

Helen Joseph
Associate
+ 44 20 7532 2751
hjoseph@whitecase.com

White & Case LLP
5 Old Broad Street
London EC2N 1DW
Tel: + 44 20 7532 1000
Fax: + 44 20 7532 1001

Mr Imam-Sadeque agreed to join Goldbridge but did not inform BlueBay of this. In the period both before and after he was placed on garden leave up to the termination of his employment on 31 December 2011, he attended various meetings and communicated extensively by text and telephone with members of Goldbridge. These communications included discussions regarding Goldbridge's business plan, Mr Imam-Sadeque's new role and the recruitment of Mr Nixon, a BlueBay employee. Mr Imam-Sadeque also attended various meetings with a head-hunter and Mr Nixon himself to discuss his recruitment to Goldbridge.

BlueBay argued that Mr Imam-Sadeque had acted in repudiatory breach of contract and was not entitled to have the status of a Good Leaver. Mr Imam-Sadeque denied that he had acted in repudiatory breach of contract and claimed that the provisions in the settlement agreement amounted to a penalty because even a minor breach had the effect of depriving him of his fund units.

Decision

The High Court held that the steps taken by Mr Imam-Sadeque to assist Goldbridge to establish, plan and launch a competitive business, his failure to disclose the establishment of this competitive threat to BlueBay and his participation in the recruitment of Mr Nixon amounted to repudiatory breaches of contract, including breaches of his implied duty of fidelity and his express duties to act in the best interests of BlueBay, not to engage in competitive activity, not to disclose confidential information and not to poach employees.

In determining the scope of Mr Imam-Sadeque's duty of fidelity, the Court paid particular attention to the inter-relationship between the implied and express terms of his employment, his seniority and importance to the success and profitability of BlueBay, his ability to influence the competitive threat of Goldbridge and the extent of that threat. It was not persuaded that there was any attenuation of this duty during the period of garden leave, nor was it prepared to accept that by entering into a Non-Disclosure Agreement with Goldbridge Mr Imam-Sadeque was relieved of his positive obligation to inform BlueBay of the competitive threat.

The High Court also held that the penalty doctrine did not apply to the relevant provisions of the settlement agreement for two reasons:

1. they merely set out a condition precedent (namely compliance with the terms of the settlement and employment agreements) for Mr Imam-Sadeque's re-classification as a Good Leaver. Forfeiture of his fund units did not occur as a result of a breach of the settlement agreement, but rather because he remained a Bad Leaver under the terms of the incentive plan having failed to satisfy that condition precedent; and

2. even if forfeiture had occurred as a result of a breach of the settlement agreement, what was forfeited were contingent future interests in the fund units which is not equivalent to the requirements for payment of a monetary sum or transfer of property under the penalty doctrine.

However, the Court also went on to say that even if the penalty doctrine had been applicable in principle, it would not have regarded the relevant provisions of the settlement agreement as penal so as to be unenforceable, notwithstanding its view that any breach which was more than de minimis would have triggered the forfeiture of the fund units. In reaching this conclusion, the Court was satisfied that the settlement agreement contained a bundle of rights and obligations which had been freely negotiated between sophisticated parties of comparable bargaining power and were commercially justifiable for one or other or both sides.

Key practical lessons for employers

- Include express terms in the contract of employment requiring employees to act in the best interests of the employer, to report their own wrongdoing and that of others, and to report a competitive threat.
- Ensure that settlement agreements contain clear conditions precedent for the payment of any sums or benefits and allow for appropriate retention until such conditions have been met.
- Review bonus and incentive plans and consider whether provisions regarding clawback or forfeiture of deferred benefits could be regarded as penal or a restraint of trade (the latter was not considered in this case).
- For start-ups and companies entering into new areas of business, be aware that an NDA with a prospective employee in respect of business plans and structures may not override that employee's duty to disclose a competitive threat to his current employer, and draft press releases regarding new recruits with caution.
- There may be concerns whether this case fully reflects the industrial realities of recruiting senior employees, and also some doubt as to the comparable bargaining power between parties entering into a settlement agreement. In either case, it is sensible to take legal advice on the particular facts and circumstances of any such recruitment or departure.

Geys v Société Générale, London Branch [2012]

Facts

Mr Geys was the Managing Director of the European Fixed Income Sales, Financial Institutions Division at Société Générale, London Branch. The Bank purported to terminate Mr Geys' employment with immediate effect on 29 November 2007 without giving any reasons or stipulating that it was relying on its rights to make a payment in lieu of notice ("PILON"). On 18 December 2007, the Bank made a payment of £31,899.29 into Mr Geys' bank account without informing him that this payment was being made. On 2 January 2008 Mr Geys' solicitors wrote to the Bank affirming his contract of employment and requesting an explanation as to what the sum of £31,899.29 represented. By letter dated 4 January 2008 and deemed to be received by Mr Geys on 6 January 2008, the Bank informed him that it had terminated his employment with immediate effect on 29 November 2007 and the payment made on 18 December 2007 was his PILON.

Under the terms of Mr Geys' contract he was entitled to a termination payment upon the termination of his employment, and this payment increased significantly to more than €12.5 million if his employment terminated on or after 1 January 2008. Mr Geys therefore argued that that the earliest date his employment could have terminated was 6 January 2008, being the date he was finally notified that the Bank had exercised its right to make a PILON. The Bank argued that a repudiatory dismissal of Mr Geys on 29 November 2007 would have automatically terminated the contract even if its repudiation was not accepted (the "automatic theory"), but that in any event the latest date on which Mr Geys' employment terminated was 18 December 2007, being the date upon which the PILON was made.

Decision

The Supreme Court held that where either an employer or employee acts in repudiatory breach of contract the employment contract will not come to an end until the other party chooses to accept such repudiation of the contract (the "elective theory"). On the facts, this meant that the Bank's attempt to terminate with immediate effect on 29 November 2007 failed because Mr Geys did not accept this breach and affirmed the contract on 2 January 2008.

The Court also held that Mr Geys' employment was only validly terminated on 6 January 2008 when the Bank notified Mr Geys that it had exercised its contractual right to terminate his employment with a PILON. The simple fact that the PILON had been made earlier on 18 December 2007 was not enough without a notification of such PILON to Mr Geys.

Key practical lessons for employers

- Ensure all new contracts of employment contain PILON clauses.
- Audit existing contracts to determine existence of PILON clauses. Consider amending those without PILON clauses, particularly for senior/highly paid employees with longer notice periods.
- Be clear and unambiguous in any termination documentation when exercising the right to terminate by making a PILON.
- Where an employee seeks to leave without giving due notice, consider whether to accept that repudiatory resignation or whether to affirm the contract. This is particularly relevant where there may be concerns about competitive activity by that employee.
- The "elective theory" can give rise to difficulties for employers with contractual disciplinary procedures. Consider whether any such procedures should be modified so as to be non-contractual.