Recent case law impacting share plans

Last week the High Court granted summary judgement allowing the claim of Eric Daniels and Truett Tate for shares they were granted by their former employer, Lloyds Banking Group. This is an important case that underlines several factors which Remuneration Committees should bear in mind when dealing with long term incentive plans.

In 2009 Lloyds granted awards to a number of executives, including Eric Daniels (former CEO) and Truett Tate (head of wholesale and international banking). The awards were subject to specific performance conditions relating to the integration of HBOS into Lloyds (including annual milestones across a three-year performance period). At the end of the performance period in 2012, Lloyds' Remuneration Committee accepted that the performance conditions had been satisfied in full. However, Lloyds attempted to insert a new provision into the rules, which gave it a discretionary power to "adjust downwards (including to nil) the number of Shares in respect of which an Award Vests".

The key elements of the judgement were as follows:

- The attempt by Lloyds to add in a retrospective power of discretion was found to be invalid. The court was particularly sensitive to the fact that the parties had an employment relationship and the power of variation was interpreted in light of that relationship (i.e. subject to increased vigilance due to the inherent imbalance of power between employee and employer). The conclusion of Cockerilll J was that the power to alter the plan was limited to a “fall-back power of tidying up” and not a “swingeing power to rewrite the terms of the LTIP Awards”.
- If a discretionary power is conferred as part of an incentive arrangement, the courts will interpret it narrowly with reference to the content of the clause. In this case, Lloyds argued that it had a broad discretion (akin to that associated with a discretionary bonus scheme). The court rejected this interpretation and preferred the view that it was more like “a parametered discretion” that must be exercised by reference to the relevant factors (the clause in question required that the conduct, capability or performance of the participant should justify an adjustment).
- Where an employer does reserve itself a discretion, a court will intervene if it is felt that the employer has acted arbitrarily, capriciously or irrationally. The judge in the Daniels case acknowledged that there was room for argument as to whether Lloyds had failed this test (although the outcome of the case was not ultimately affected by it). However, she did note that the Board and Remuneration Committee minutes presented by Lloyds failed to demonstrate why an adjustment should be made to Mr Tate and Mr Truett's awards (in contrast, most other Lloyds' executives were allowed to keep their shares).
- An exclusion clause in the LTIP rules was interpreted narrowly and could not be applied generally to any claim resulting from the LTIP.
- The fact that Mr Daniels and Mr Tate had entered into termination agreements, limited the ability of Lloyds to make subsequent amendments to the LTIP that would affect their awards. The awards could be subject to the determination of the remaining performance criteria, but that did not give Lloyds the ability to change the underlying rules with respect to the awards held by former employees.

FIT comment:

The fact that summary judgement was granted reflects the weakness of the case offered by Lloyds; the court saw no point in proceeding to a full trial as the bank's defence had "no real prospect of success". That said, we think that this case offers some useful commentary on how the courts are likely to interpret and deal with disputes regarding employee share awards.

From a practical perspective, our view is that discretionary powers (whether to positively or negatively assess performance, or malus/clawback provisions) should be clearly defined and understood by all parties. Although it was not a particular consideration of this case, our view is that any supporting communication documents given to employees should also clearly explain the scope and effect of any discretionary provisions.

Moreover, where an employer aims to rely upon discretionary powers, it must document the rationale for use of those powers clearly. This is especially true where the decision might be challenged as 'capricious', e.g. because it singles out specific individuals for positive/negative treatment. Remuneration Committees can expect that some of the decisions they make will be subject to challenge and they must be prepared to defend each exercise of discretion in a court or tribunal.

This case did not consider the general efficacy of malus or clawback provisions. However, it is a useful reminder that the courts are likely to examine the wording of such provisions very closely. Given the increased scrutiny surrounding malus/clawback provisions in the wake of the collapse of Carillion, we recommend that companies carefully consider the clarity of malus/clawback drafting in their incentive plans and, in addition, consider developing guidance notes regarding the circumstances when such powers may be invoked and communicate those notes to persons potentially affected.

Lastly, we feel that this case also underlines the importance of getting one's "house in order" when agreeing terms for the exit of senior executives. If the rules of an incentive plan are not up to date, then the courts will be loath to allow subsequent amendments to affect the terms of awards held by former employees and, if the company wishes to reserve power to reopen the contents of a compromise agreement (for example if malus/ clawback circumstances subsequently come to light), this should be expressly reserved in the compromise agreement.

If you would like to discuss this case or review the terms of your incentive plans, then please contact your usual FIT contact.

Age discrimination case

Another recent case is the decision reached by the Court of Appeal in Air Products v Cockram. It concerns the case of an executive who resigned at the age of 50 and forfeited unvested share awards, despite his claim that he should benefit from a good leaver provision for retiring employees. The provision in question provided that a leaver would be entitled to retain unvested awards if he/she was aged 55 or older. Mr Cockram argued that this treatment amounted to age discrimination.

The Court of Appeal agreed with the decision of the employment tribunal that found that, although the retirement provision was discriminatory, it "was a proportionate means of achieving a legitimate aim which could be objectively justified".

The case is significant, because it gives companies some comfort that the inclusion of a specific retirement provision can be justified, despite amounting to age discrimination. However, in our view, Remuneration Committees should still be careful when they determine whether employees should benefit from such provisions; the Court of Appeal noted that the assessment of whether a provision is discriminatory or not will depend upon the facts of each case.

Sharesave savings holiday

The Autumn Statement 2017 included an announcement that the government was planning to extend the "savings holiday" for employees on parental leave from 6 months to 12 months. This change was due to come into effect from 6 April 2018. However, due to questions regarding implementation of the proposed changes, the government has decided to delay the launch until September 2018.

In addition, it has been announced that the extended savings holiday will apply to all plan participants, not just those on qualifying parental leave.

This is good news and will give companies and plan administrators more time to make the necessary changes to rules, documentation and IT systems.

If you operate a Sharesave plan and have any questions regarding the changes that may need to be made to plan documentation or processes, please contact your usual FIT contact.

Share schemes annual reporting reminder

The deadline for the filing of companies' HMRC annual share scheme returns for the 2017/18 tax year is approaching on 6 July 2018. Online filing is compulsory if a scheme has been registered with HMRC; if there are no reportable events during the tax year, a nil return must still be filed. Failure to submit returns by the deadline will result in automatic late filing penalties (£100 in the first instance but rising in value the longer the return remains outstanding). HMRC is pursuing a stricter approach regarding filing obligations; over 7,000 first instance penalties were issued for failure to submit returns in 2016/17 and many of those companies also received higher order penalties for continued failure to submit returns.

The reporting process has not changed from last year, but it is recommended that returns are submitted as early as possible. If you have any questions regarding the reporting process, please contact your usual FIT contact.

Remember - the deadline for gender pay submissions is 4 April

If you wish to discuss anything arising from this briefing, please ask your usual contact at FIT or call us on 020 7034 1111 or email us at Info@fit-rem.com.

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