Bonuses, breaches of fidelity and the penalty doctrine

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For those employees whose remuneration includes contingent future interests in fund units, ensuring they retain their entitlement upon leaving is a key concern. Success in doing so may depend on whether employers can establish a breach of the duty of fidelity or enforce forfeiture provisions.

In *Imam-Sadeque*, Popplewell J recently considered the scope of the duty of fidelity and the application of the penalty doctrine in the context of a claim for deferred remuneration.

Facts

Fahim Imam-Sadeque was employed by BlueBay Asset Management Services in a senior sales role. He was awarded fund units, which were due to vest in January and March 2012, said to be worth £1.7 million. If Mr Imam-Sadeque left his employment voluntarily before those vesting dates, he would be a 'bad leaver' as defined in the bonus plans and forfeit the 2012 fund units.

On 6 July 2011, after a meeting with BlueBay to discuss concerns about him, Mr Imam-Sadeque decided to leave. He approached ex-BlueBay staff who were in the process of setting up a rival asset management firm, Goldbridge Capital Partners LLP, and agreed terms to join as a partner.

Mr Imam-Sadeque did not tell BlueBay of his intentions but approached BlueBay with a proposal to leave by mutual agreement. The compromise agreement reached provided that he would be treated as a 'good leaver' for the purpose of the vesting of the 2012 fund units if he complied with the obligations in his employment contract and the compromise agreement.

He was placed on garden leave for four months, during which time a press release announced the launch of Goldbridge and named Mr Imam-Sadeque and Damian Nixon, another BlueBay employee, as part of the venture. BlueBay wrote to Mr Imam-Sadeque to explain that his work for a competitor was in breach of the non-poaching terms of the compromise agreement and therefore he would not be a 'good leaver'.

Despite this, at the end of his garden leave, Mr Imam-Sadeque sent BlueBay a re-affirmation letter warranting that he had not been in material breach of his duties. After the January 2012 vesting date had passed, he issued court proceedings seeking a declaration of his entitlement to the 2012 fund units and specific performance of their allotment to him and/or damages. BlueBay denied the claims.

Duty of fidelity

The judgment contains a helpful summary of the scope and content of the duty of fidelity in the context of an employee who is not in a fiduciary position. Particular aspects of the duty, which are likely to be of importance to practitioners, are considered below.

Reporting competitive threats

The judge considered that there may be a duty on employees to report competitive threats, irrespective of personal involvement. He said that whether or not there was such a requirement would depend upon the terms of the contract, the nature of the employee's role and responsibilities, the nature of the threat and the circumstances in which he becomes aware of it. He considered that a senior manager who becomes aware of a competitive threat to an aspect of the business for which he is responsible would normally come under such a duty, whereas a junior employee without such responsibility would not.

The judge used different employees at a supermarket to illustrate the point: the manager of a branch of a supermarket in the high street would normally be obliged to tell his superiors if he learned that a rival supermarket chain was proposing to open a store next door, whereas a junior employee working in the unloading bay would not.

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He held that on the facts of this case, Mr Imam-Sadeque had a duty to report the competitive threat from Goldbridge 'from the moment that it became a serious and viable project'.

No attenuation of duty of fidelity during garden leave

The judge dismissed the submission made on behalf of Mr Imam-Sadeque that his duty of fidelity was attenuated whilst on garden leave. The employee enjoys the benefit of being paid in full without having to carry out any positive work obligations and the employer pays for the continued right to insist upon the employee performing his negative obligations for so long as he is employed. He recognised that one of the common purposes of garden leave is to secure the employee's loyalty to the current employer during the notice period and to delay the transfer of his loyalty to a new employer until after its expiry.

The judge noted that, as Maurice Kay LJ observed in *Tullett Prebon*, whether and to what extent the duty of fidelity is attenuated during garden leave is dependent on the particular factual circumstances and that Maurice Kay LJ did not endorse the dicta of Sir Richard Scott V-C in *Symbian* to the effect that the duty of good faith and fidelity did not subsist during garden leave (a point with which the Court of Appeal did not deal in *Symbian*). The judge said that the factual circumstances, which he identified as important to the content and scope of the duty of fidelity, are of almost equal importance during the period of Mr Imam-Sadeque's garden leave.

NDA did not relieve duty to disclose competitive threat

One of the more surprising parts of Mr Imam-Sadeque's case was the suggestion that his signing a non-disclosure agreement with Goldbridge had an impact on his duty of fidelity to BlueBay: to require him to disclose to his current employer what he learned as part of his discussions with his new employer would be to undermine his entitlement to freely explore the possibility of moving to a new employer before leaving his current employer.

The judge rejected that submission. He held that if a senior employee learns of a competitive threat, he cannot relieve himself of the duty of fidelity by virtue of having entered into a contractual duty towards the rival not to fulfil it. If he could, the duty of fidelity could be bypassed or severely emasculated by entering into a non-disclosure agreement.

Breach

The judge held that Mr Imam-Sadeque was in breach of the duty of fidelity he owed to BlueBay in assisting Goldbridge and in recruiting Mr Nixon. He was in repudiatory breach of both his employment contract and the compromise agreement, and his re-affirmation letter was untrue.

The judge held that the result of the breaches by Mr Imam-Sadeque was that the provisions of the compromise agreement, by which he would be deemed a good leaver for the purpose of the vesting of the 2012 fund units, never came into effect because they were conditional upon compliance with the other terms of the compromise agreement and receipt by BlueBay of a true re-affirmation letter. (The judge rejected Mr Imam-Sadeque's submission that the compromise agreement required only that a re-affirmation letter be sent, and not that its contents were true.) Thus Mr Imam-Sadeque's claim failed unless he could rely on the doctrine of penalty.

The penalty doctrine

The penalty doctrine renders unenforceable a contractual term by which a contract breaker is required to pay (or forfeit) a sum upon breach where the predominant contractual function of the provision was to deter breach rather than to be compensatory.

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The judge held that the penalty doctrine did not apply to the provisions of the compromise agreement in this case for two reasons. First, nothing in the compromise agreement caused Mr Imam-Sadeque to lose the benefit of the 2012 fund units upon breach of the compromise agreement. The forfeiture of the 2012 fund units occurred by reason of Mr Imam-Sadeque being a bad leaver under the terms of the bonus plans when he left and the bonus plans were not said to be unenforceable as a penalty.

Second, even if the forfeiture were to be treated as occurring by reason of breach of the compromise agreement, what was forfeit were contingent future interests in the 2012 fund units and these were not to be treated as equivalent to the payment of a sum of money by Mr Imam-Sadeque upon breach so as to come within the doctrine.

The judge went on to consider whether the provisions of the compromise agreement were penal in any event and concluded they were not, for the following reasons:

- the compromise agreement was freely negotiated by sophisticated parties of comparable bargaining power, including that Mr Imam-Sadeque had received legal advice on its terms;
- the compromise agreement contained a variety of rights and obligations each of which had a commercial justification for one or other or both sides;
- the financial effect on BlueBay of a failure by Mr Imam-Sadeque to perform the obligations required under the compromise agreement and employment contract would be difficult to quantify and might exceed the value of his 2012 fund units, and so it could not be said that the value of the rights forfeited exceeded the greatest loss which could conceivably be suffered from the breach;
- it would be unjust if Mr Imam-Sadeque could escape his bargain and confine BlueBay to a claim in damages for loss which, although real and substantial, might be irrecoverable;
- the commercial objective of the bonus plans is that there is no vesting unless the employee is in employment on the vesting dates, or has not resigned, or received notice of termination for serious misconduct. FIS should not be in a better position because of the compromise agreement than he would have been in had he remained at work and been guilty of serious misconduct;
- although the treatment of the 2012 fund units provided a strong incentive for Mr Imam-Sadeque to fulfil the obligations he undertook pursuant to the compromise agreement, and to deter him from breach, taken as a whole the terms were not predominantly intended as a deterrent against breach.

Practical implications

It is fair to note that the judge was particularly critical of Mr Imam-Sadeque and the judgment ought to be read in that context. However, the rulings on the scope of the duty of fidelity will be welcomed by employers facing the threat of competitive activity from a current employee.

One question that the judge did not find it necessary to decide in this case is whether the duty of fidelity also placed Mr Imam-Sadeque under a positive obligation to seek to dissuade Mr Nixon from leaving BlueBay. That issue may arise in a future case.

The case also gives rise to some practical tips:

- even though Mr Imam-Sadeque did not owe BlueBay a fiduciary duty, BlueBay successfully argued that the content of the duty of fidelity which he owed was 'more akin' to a fiduciary duty given that it was an express term of his contract that he act in BlueBay's interests, rather than simply have regard to them. Thus it is worth considering with care the language of the express terms of the contracts of senior employees with a view to imposing on them an implied duty of fidelity which is 'more akin' to a fiduciary duty than might otherwise be the case and such as to require an employee to report to his employer a competitive threat of which he becomes aware;
- in drafting compromise agreements in future, it may be prudent to ensure that only repudiatory breach would result in forfeiture, so as to minimise the risk of an employee successfully arguing that such forfeiture (for any breach, however minor) would be penal.

KEY:

Imam-Sadeque	*Imam-Sadeque v BlueBay Asset Management (Services) Ltd* [2013] IRLR 344
Symbian	*Symbian Ltd v Christensen* (unreported, 8 May 2000)
Tullett Prebon	*Tullett Prebon plc & ors v BGC Brokers LP & ors* [2011] IRLR 420 CA