

THE HIGH COURT

2009 1509 S

BETWEEN

ROLAND LICHTERS

PLAINTIFF

V

DEPFA BANK PLC

DEFENDANT

2009 1510 S

BETWEEN

JURGEN HASS

PLAINTIFF

V

DEPFA BANK PLC

DEFENDANT

JUDGMENT of Mr. Justice Hedigan delivered on the 18th day of January, 2012

1. The plaintiffs were at the material time employed by the defendant bank. The defendant, DEPFA Bank plc. is a public limited company with a registered office at 1, Commons Street, Dublin 1.

2. In this action, Mr Lichters claims:-

- (1) Judgment in the sum of €190,000.00.
- (2) Interest pursuant to statute.
- (3) Such further or other order as seems fit.
- (4) The costs of these proceedings.

Mr Hass claims:-

- (1) Judgment in the sum of €40,000.00
- (2) Interest pursuant to statute.
- (3) Such further or other order as seems fit.
- (4) The costs of these proceedings.

Background Facts

3.1 The plaintiffs were employed by the defendant bank until their resignations in April 2008. Mr Lichters commenced employment with the defendant in August 1997. In 2004, he took up a position in Dublin as Head of Global Market Risk. Mr. Hass commenced employment with the defendant bank in August 1998. In 2002, he took up a position in Dublin as Associate Director, Group Strategy with DEPFA Europe. Both plaintiffs had contracts with the defendant which provided that part of their remuneration structure included the provision of a bonus. The terms of the bonus were governed by the defendants' 'Incentive Compensation Program' ("ICP") which provided for a "cash bonus pool" and a "deferred stock plan".

3.2 Clause 2 of the ICP provided for the "cash bonus plan". It sets out the purpose of that plan as being:-

"In order to incentivise performance and to give recognition to value added to the operations of the company"

The ICP then goes on to set out that in each year, there would be a cash bonus pool established and that awards of cash to employees might be made. Rule 2.2(e) provided that as soon as reasonably practical after the making of a cash award to an employee, the company should pay him a cash bonus of the amount of the award. Clause 3 of the ICP provided for a "deferred stock plan" and that purpose is stated to be:-

"In order to incentivise and retain executives and staff"

Clause 1.2(b) of the ICP provided as follows:-

"No person shall be entitled as of right to receive an award and the decision as to who shall receive any award and the time and extent of any award made to him shall, subject to the rules, be made by the committee at its absolute discretion.

Under the deferred stock plan, stock awards were lost if the employee was no longer employed by the defendant on the vesting date.

3.3 The "deferred stock plan" established under the provisions of the ICP, required the Compensation Committee of the Board of Directors of the defendant to establish an amount to be applied for the purchase of shares in the company for each year. The amount to be applied was paid to the trustees of the deferred stock plan. The trustees of the deferred stock plan were then to purchase the shares and allocate them to employees as per the instructions of the Compensation Committee. The allocated shares would then vest in accordance with various provisions of the deferred stock plan.

3.4 Clause 3.5 (b) (iii) of the ICP provided that shares would vest immediately upon a change in control. There was a change in control of the defendant in October 2007. The entire share capital of the defendant was purchased by Hypo Real Estate Group. This had the effect of making it impossible for the defendant to allocate further shares. On 13th February, 2008, the defendant wrote to Messrs. Lichters and Hass informing them that in respect of the year ending 31st December, 2007, it had decided to award them a deferred cash bonus in lieu of allocating shares. Mr. Lichters was awarded a cash bonus of €200,000 and a deferred cash bonus of €180,000 in lieu of shares. Mr. Hass was awarded a cash bonus of €40,000 and a deferred cash bonus of €40,000 in lieu of shares. The deferred sums were to be paid if Messrs. Lichters and Hass remained in the defendant's employment as of February 2010. Messrs. Lichters and Hass both left the defendant's employment in April 2008 and were therefore not paid the deferred cash bonus. They claim that in imposing the deferred cash scheme the defendants acted in breach of contract. In the within proceedings, they seek payment of the sums deferred.

Plaintiffs' Submissions

4.1 Messrs. Lichters and Hass understood and believed that they would be awarded a cash bonus for their performance in 2007 and that it would be paid to them in accordance with the provisions of Clause 2 of the ICP. They had received payments pursuant to the ICP for the years 2005, 2006 and 2007 in reflection of their work with the company in each preceding year, respectively. The annual letters sent to Messrs. Lichters and Hass notifying them of this bonus contained the following statement:-

"The Award (where applicable) will be in addition to any bonus guaranteed to you under the terms of your contract. The Cash Award will be payable with your next monthly salary (subject to local payroll processing dates) under local conditions and in local currency (where applicable)."

4.2 In February 2008, Messrs. Lichters and Hass received a letter awarding them their bonus for 2007. The bonus consisted entirely of cash and the total amount payable to them was in line they claim, with the level of reward that they expected to receive. However, the defendant purported to defer the payment of part of the bonus and to impose conditions on the making of the said payment that were never agreed to by Messrs. Lichters and Hass. Indeed, the conditions were not notified to them until the date of letter awarding the cash bonus i.e. 13th February, 2008. The plaintiffs submit that the defendant was not entitled to defer any part of their cash bonus. The express terms of the ICP provided for the immediate payment by the defendant to the plaintiffs of any cash bonus. That in the plaintiffs' submission is the end of the matter.

4.3 In refusing to pay the deferred component of the bonus, the defendant relies upon provisions in the February 2008 document that provided that the plaintiffs had to be in employment with the defendant in February 2010. This provision, they argue, is manifestly unenforceable being in restraint of trade. The law in relation to such provisions was set out by Costello J. in *John Orr Limited v. Orr* [1986] WJSC 836:-

"The principles of law to be applied in the issue are not in controversy and can be briefly stated. All restraints of trade in the absence of special justifying circumstances are contrary to public policy and are therefore void. A restraint may be justified if it is reasonable in the interests of the contracting parties and in the interests of the public. The onus of showing that a restraint is reasonable between parties rests on the person alleging that it is so. Greater freedom of contract is allowable in a covenant entered into between an employer and employee. A covenant against competition entered into by the seller of a business which is reasonably necessary to protect the business sold is valid and enforceable. A covenant by an employee not to compete may also be valid and enforceable if it is reasonably necessary to protect some proprietary interest of the covenantee such as may exist in a trade connection or trade secrets. The courts may in certain circumstances enforce a covenant in restraint of trade even though taken as a whole the covenant exceeds what is reasonable, by the severance of the void parts from the valid parts."

In the instant case, the defendant has not advanced "any special justifying circumstances" such as would lead the Court to enforce the clause. Further, and critically, the defendant cannot even establish that the restriction was incorporated in the plaintiff's contract in circumstances where the plaintiff never agreed to it. In *Finnegan v J & E Davy* [2007] ELR 234, Smyth J. found that a precisely analogous term referable to bonus payment was in restraint of trade. He found that no evidence had been tendered to justify the provision and that, in any event, that to enforce such a condition it must be fairly and reasonably brought to the other party's attention. The provision that the defendant seeks to rely upon was imposed after the event.

4.4 The defendant was obliged to make discovery of any documents generated by the Compensation Committee in relation to the awards to Messrs. Lichters and Hass. It is remarkable that notwithstanding this obligation, no such documentation has been discovered. Furthermore, the defendant has not said what payments were made on account to the trustees for 2007 in accordance with the provisions of the ICP and whether the trustees had purchased any shares prior to that date. It is remarkable that there was no effort to consult with senior executives; instead, the bank unilaterally changed the entire ICP scheme. Not only was the deferred stock scheme changed, but the compensation committee was dissolved. The compensation committee had a central role in determining whether bonuses should be paid. The defendant had discretion whether or not to award a bonus; however, once it decided to award a bonus, that was the end of the discretion. There was no discretion in the ICP to replace stock with cash. In these circumstances, Messrs Lichters and Hass are entitled to payment of the sums deferred.

Defendant's Submissions

5.1 The deferred stock plan, provided for in Clause 3 of the IPC provided for the awarding of deferred stock which would vest on 1st, 2nd and 3rd anniversary of the award. Following the acquisition of the defendant bank by Hypo Real Estate (HRE), it was no longer possible for the defendant to make awards under the share award scheme as provided in the ICP. Although it was not required to do so, the defendant introduced a deferred cash bonus in lieu of a deferred stock bonus. The deferred cash award was subject to similar limitations as the previous deferred stock award and was for the purposes of incentivising employees to remain in the defendant's employment. The terms and conditions of this award were set out in the letter of 13th February, 2008 and the accompanying document entitled "information on deferred component of performance related bonus". The defendant maintains that these deferred awards were subject to the condition that they were only payable to Messrs. Lichters and Hass if they remained in the employment of the bank in February 2010.

5.2 The defendant submits that the bonuses paid to Messrs Lichters and Hass for 2007 were entirely consistent with the bonuses paid in previous years. In 2004, Mr Lichters received a cash bonus of €100,000 and stock of €100,000. In 2005, he received a cash bonus of €120,000 and stock of €120,000. In 2006, he received a cash bonus of €175,000 and stock of €175,000. In 2007, he received a cash bonus of €200,000 and deferred cash in lieu of stock of €180,000. Mr. Lichters could not have expected a cash bonus in 2007 of €380,000. The 2007 bonus was entirely consistent with the pattern in the preceding years. The same situation applies to the bonus paid to Mr Hass. In 2004, Mr Hass received a cash bonus of €40,000 and stock of €40,000. In 2005, he received a cash bonus of €45,000 and stock of €40,000. In 2006, he received a cash bonus of €50,000 and stock of €50,000. In 2007, he received a cash bonus of €40,000 and deferred cash in lieu of stock of €40,000. The 2007 bonus was consistent with the pattern in the preceding years. It is submitted by the defendant that the award of the deferred cash bonus was a reasonable exercise by the defendant of its discretion in circumstances where it could no longer award stock.

5.3 The defendant submits that the award of a deferred cash bonus in lieu of a deferred stock bonus is not in restraint of trade. The purpose of the deferred stock bonus was to "incentivise and retain executives and staff." Messrs. Lichters and Hass were entitled to resign from the defendant bank and were free to take up employment wherever they wished. The contractual provisions which were the subject of dispute in Orr related to restraint in respect of soliciting the plaintiff company's customers and competing with the plaintiff company after employment had terminated. No such restraints whatsoever are created by either the deferred stock plan under the ICP or the deferred cash bonus granted in February 2008. The plaintiff also referred to *Finnegan v J & E Davy* [2007] ELR 234 and asserted that a precisely analogous term referable to bonus payments was restraint of trade. The provisions which were the subject of the dispute in Finnegan were not analogous. The High Court in *Finnegan* struck down a unilateral retrospective alteration which resulted in the entirety of the plaintiff's bonus being subject to a deferral process. The situation in the instant case is entirely different. The plaintiff in this case has received a cash bonus comparable with his previous year cash bonus and a deferred cash bonus in lieu of a deferred stock bonus also in a comparable amount.

5.4 Whilst the IPC is stated to be entirely discretionary, it is accepted by the defendant that the discretion must be reasonably exercised. The defendant in this case has exercised its discretion towards Messrs. Lichters and Hass in a reasonable fashion by providing them with a cash bonus comparable with their previous year and a deferred cash bonus comparable with the previously existing, but no longer possible, deferred stock plan. The exercise by employers of their discretion in these types of circumstances has been considered in a number of cases. In *Clarke v Nomura International* [2000] IRLR 766, the following test is set out by the Court of Appeal:-

"An employer exercising a discretion which on the face of the contract of employment is unfettered or absolute, will be in breach of contract if no reasonable employer would have exercised the discretion in that way."

It is submitted that the manner in which the defendant awarded Messrs. Lichters and Hass a cash bonus was entirely consistent with prior years payment and the manner in which it exercised its discretion to grant them a deferred cash bonus in lieu of the now impossible deferred stock bonus was entirely reasonable and could not be said to be perverse or irrational. In these circumstances, the court is asked to dismiss the plaintiff's claim herein.

Decision of the Court

6.1 The issues are common to both cases and may be dealt with in one judgment.

6.2 The contract of employment was one which included a bonus scheme as an integral part of the plaintiff's remuneration package. The terms of this bonus scheme are to be found in the ICP. It is the ICP which is central to this case. Its terms were, firstly, that it was discretionary. The employer had the absolute discretion as to whether it would or would not make an award and the time and extent thereof if it did so. Clause 1.2 (b) of the ICP states as follows:-

"No person shall be entitled as of right to receive any award and the decision as to who shall receive any award and the time and extent of any award made to him shall, subject to the Rules, be made by the committee at its absolute discretion."

There were two elements to this bonus scheme i.e. a cash bonus plan and a deferred stock plan. The cash bonus was provided for in clause 2. The purpose of this plan was:

"In order to incentivise performance and to give recognition to the value added to the operations of the Company..."

The deferred stock plan was provided for in clause 3 and its purpose was a different one i.e.

"In order to incentivise and retain executives and staff"

6.3 The event which precipitated this action was the takeover of DEPFA Bank by HYPO Real Estate Group. This commenced early in 2007 and was completed by October 2007. It is common case that following this take over there could be no stock awards of DEPFA shares in February 2008. Although Mr Hass does not recall reading it, there does appear to have been a notification by email to the effect that in relation to the bonus package for 2007, there would be a split into a cash award and a deferred cash award. Gabriela Rappensberger for HRE gave evidence that it would not have been possible within the time available to set up a bonus share scheme. This would be highly complex with global tax issues arising. A general meeting would need to be called. If there were to be an award under the bonus scheme for 2007, some other method would need to be used to replace the deferred DEPFA shares. She testified that in a takeover situation, the retention of key people was of the highest importance. It could determine the success or failure of the takeover. In order to include this incentive to remain, some form of deferred bonus needed to be found. HRE decided to replace the deferred shares with deferred cash. Whereas the deferred shares had previously vested on the first, second and third anniversary of the award, the full cash deferred would be paid in one single payment on the second anniversary of the award. She thought this

was a reasonable compromise.

6.4 This new scheme was constructed without negotiation with the plaintiffs. The essential change was deferred cash in place of deferred shares. It is common case that had either DEPFA or HRE shares been awarded, they would have been worthless by the end of 2008. The evidence was that the deferred cash was paid to the DEPFA employees who remained in the employment of the defendant in 2010.

6.5 The question for the Court is whether this change in the bonus part of the plaintiffs' remuneration package was a breach of their contract of employment. The plaintiffs claim also that the retention provision re deferral was a condition in restraint of trade and should not be enforced. In relation to this last element, the plaintiffs rely on the judgment of Costello J. in *John Orr Ltd v. Orr* [1986] WJSC 836. The relevant part of that judgment is set out above. I note in particular the phrase:-

"A restraint may be justified if it is reasonable in the interests of the contracting parties and in the interests of the public."

6.6 I doubt whether the retention condition can be correctly characterized as being in restraint of trade. Both plaintiffs in fact left the defendant company and are working for competitors in the same field, albeit they both forfeited the deferred cash award by doing so. They were perfectly entitled to do so. However, even if it were a contract in restraint of trade, it is surely one that the plaintiffs have accepted in taking the benefit of the same over the years since they started working for the company. It is difficult to see how they can challenge the condition on that basis at this stage.

6.7 Even if it were a condition in restraint of trade, is it one that may be justified as per Costello J's dictum as cited immediately above? Is it reasonable in the interests of the plaintiffs and the public? No interest of the public is raised or argued in this regard herein. The real question must be, is it reasonable in the light of the plaintiffs' interests. HRE clearly was in a difficult situation. If they were to award bonuses to the staff of DEPFA, they had to find a way of replacing the value of the deferred shares that had previously formed a part of the scheme. The solution they arrived at is to be judged by what criterion? The court must bear in mind the employer had an absolute discretion as to whether to award a bonus. It is agreed herein that that discretion must be exercised reasonably. In *Clarke v Nomura International* [2000] IRLR 766, the Court of Appeal for England and Wales considering this type of situation observed:-

"An employer exercising a discretion which on the face of the contract of employment is unfettered or absolute, will be in breach of contract if no reasonable employer would have exercised the discretion in that way."

6.8 I accept and gratefully adopt that formulation. It seems to me that this criterion sets a very high hurdle for the plaintiffs to overcome. The bonus award they received in 2008 was, respectively, in the case of Mr. Lichters, in excess of the award he had received the previous year of €175,000 cash and deferred stock of €175,000. In respect of 2007, he received in 2008, a cash bonus of €200,000 and deferred cash payable on the second anniversary in the amount of €180,000. Mr. Hass, on the other hand, received slightly less in respect of 2007 than he had in respect of 2006 i.e. €50,000 cash and €50,000 deferred stock in 2006, against €40,000 cash and €40,000 deferred cash in 2007. Nobody apparently knew or could reasonably have guessed that if they had received stock it would have been worthless by the end of 2008. I do not think, therefore, I should take that into account. The plaintiffs referred me to the case of *Finnegan v J & E Davy* [2007] ELR 234, where the High Court struck down a unilateral retrospective deferral of the plaintiff's entire bonus. It seems to me that the facts of *Finnegan* are substantially different and I do not consider this case assists the plaintiffs.

6.9 Whether in the context of a contract in restraint of trade, if that is the case, or to determine the proper exercise by the defendant of its discretion as an employer, the question for the court is as to whether it can be considered that in the circumstances of this case, no reasonable employer would have acted as the defendant company did. By any measure, it appears to me that in the circumstances that prevailed, the scheme decided upon by the defendant company to replace the previous bonus scheme was a fair and reasonable one and in the interests of the plaintiffs and all the other employees at that time. It seems to me that the plaintiffs have fallen a long way short of meeting the standard of unreasonableness necessary to overturn the actions of the defendant company herein, either under their contract of employment or on the basis of a restraint of trade. I must therefore dismiss the claims of both plaintiffs.