US Incentive Plans, EU Employees and Conflicts of Law

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This StayCurrent summarises important new incentives and employment law developments affecting US employers with operations in Europe.

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1. Enforcement of Foreign Law-Governed Restrictive Covenants in Share or Bonus Awards

Multinational employers frequently offer senior employees who are based overseas the opportunity to participate in incentive and bonus arrangements that are governed by US law. Such arrangements often contain provisions protecting the employer’s interests. Any doubt concerning the enforceability of such provisions in the EU now appears to have been resolved in employees’ favour. In Duarte v Black & Decker [2007] EWHC 2720 the UK High Court ruled that restrictive covenants contained in an employee share incentive scheme, which was governed by the law of the State of Maryland, were not enforceable by English Courts.

1.1 Governing Law

The EU Rome Convention (“Convention”) provides that a contract is governed by the system of law chosen by the parties.

However, in the case of a contract of employment, “a choice of law made by the parties shall not have the result of depriving the employee of the protection afforded to him by the mandatory rules of law . . .” (Article 6).

Therefore, even though the law of a foreign jurisdiction may be chosen as the law governing a contract of employment, certain mandatory rules of European law will still apply to that employment. This in effect allows an employee working in Europe to take advantage of the greater protection afforded either by the mandatory rules of local law or the law chosen by the parties.

The Convention also provides that when the chosen law is manifestly incompatible with the public policy of the jurisdiction in which a party is litigating, a court may refuse to implement the chosen law (Article 16).

1.2 Duarte v Black & Decker

Mr Duarte applied to the High Court for a declaration that restrictive covenants contained in a Long Term Incentive Plan agreement (“LTIP”) were unenforceable.

The LTIP governed the terms of a cash-based incentive scheme offered to ‘high potential’ employees of Black & Decker. Under the LTIP, participants received additional remuneration over a two-year period. The objective of the LTIP was to reward and retain the participants who, in turn, were expected to contribute significantly to the achievement of Black & Decker’s aims and objectives.
The LTIP contained two restrictive covenants: a non-compete covenant attempting to prevent participants from working for any of 50 named competitors; and a non-solicit covenant attempting to prevent participants from hiring any employee of Black & Decker. Both restrictions were stated to be in force for a period of two years following the termination of a participant’s employment. The LTIP was governed by the law of the State of Maryland. Mr Duarte, an employee based and working in England, was a participant in the LTIP.

Mr Duarte resigned from Black & Decker in July 2007 to work in a senior role with a competitor of Black & Decker, Techtronic Industries Co Inc (“Techtronic”). Black & Decker attempted to prevent him from taking up the position with Techtronic, relying on the restrictive covenants in the LTIP. The High Court agreed with Mr Duarte and found that the restrictive covenants were unenforceable.

Following the reasoning in Samengo-Turner (below), the High Court concluded that the LTIP agreement was “...obviously intended to operate as part of an overall package of Mr Duarte’s employment terms.” The LTIP agreement was therefore treated as a contract of employment for the purposes of the Convention.

Interestingly, the Court determined that English law on restrictive covenants is not mandatory, so Article 6 was not engaged. However, the Court then considered whether the restrictive covenants would be upheld under the law of Maryland. Following extensive examination of Maryland law and with the assistance of expert witnesses, the High Court concluded that the covenants would not be enforceable under the chosen law.

Importantly, the Court added that, even if the restrictive covenants were capable of being enforced under the law of Maryland, they were contrary to English public policy and would therefore have been set aside in accordance with Article 16 of the Rome Convention.

2. EU Jurisdiction and Employment Contracts

The Court of Appeal issued a stark warning to multinational companies based outside the EU about the jurisdictional rights of EU-based employees in Samengo-Turner and Ors v J&H Marsh & McLennan (Services) Limited and Ors [2007] EWCA Civ 723. The Court ruled that Marsh & McLennan, and two of its subsidiaries, could not sue three former UK-based employees in New York, even though that was the forum agreed by the parties in the contract, stating that “a multinational business must be expected to be subject to the employment laws applicable to those they employ in different jurisdictions”.

EC Council Regulation 44/2001 governs jurisdiction and the enforcement of judgments in civil and commercial matters (the “Regulation”). Section 5 of the Regulation deals with jurisdiction over individual contracts of employment and provides that an employer may bring proceedings only in the courts of the Member State in which the employee is domiciled.

Proceedings were issued in New York against the former UK employees (the “Claimants”) in relation to alleged breaches of the Claimants’ US bonus agreements, which contained non-compete obligations. The Claimants contested the jurisdiction of the New York court and submitted a claim in England seeking declarations on jurisdiction and a worldwide anti-suit injunction against the relevant companies in the Marsh & McLennan group. The Claimants relied on Section 5 of the Regulation.

The Court concluded that Section 5 of the Regulation was engaged, and that the Claimants had the right not to be sued in New York. The Court held:

- the US bonus agreements were part of the UK contracts of employment – it was not possible to ascertain the terms of the Claimants’ employment without looking at both the contract of employment and the bonus agreement; and

- any company in the Marsh & McLennan group wishing to sue on the terms of the bonus agreement would therefore be required to sue in the courts of the employee’s domicile.

Comment: Employers seeking to enforce restrictive covenants contained in share incentive and bonus agreements that are governed by US law against UK participants, must be mindful that English courts will not uphold such covenants if:
(a) they are not enforceable under the chosen law of the agreement; or (b) they contravene English public policy.
The Court granted a worldwide anti-suit injunction preventing action against the Claimants in any jurisdiction other than the English courts.

Further, where an English court considers that an ancillary agreement (e.g. a bonus, non-solicitation or proprietary information agreement) forms part of the contract of employment and that ancillary agreement contains a jurisdiction other than that of the employee’s domicile, it is unlikely that the court will give effect to the jurisdiction provision contained in the ancillary agreement. Unless agreement on an alternative jurisdiction can be reached with the employee after the dispute arises, the employer is bound by the Regulation.

**Comment:** Multinational corporations are prohibited from suing EU-based employees under contracts of employment in a jurisdiction other than that of the employee’s domicile.

### 3. Age Discrimination

The Equal Treatment Framework Directive (the “Directive”) was introduced in 2000 in order to harmonise Member State legislation regarding discrimination in employment and occupation on many grounds, including age. The UK implemented the age aspects of the Directive through the Employment Equality (Age) Regulations 2006 (the “Regulations”). The Regulations allow UK employers to set compulsory retirement ages of 65 or above. This provision has been challenged by the Heyday group, part of the UK charity, Age Concern. Heyday is contending that the Directive does not allow mandatory retirement ages and therefore has not been properly implemented by the Regulations.

A preliminary reference to the European Court of Justice (the “ECJ”) was made by the UK High Court in order to resolve compatibility issues between the Directive and the Regulations.

Although a ruling on the Heyday application is not expected until 2009, a recent decision in the Spanish case, *Palacios v Cortefiel Servicios SA* (C-411/05) (“Palacios”), provides a useful indication as to how the Heyday reference may be determined.

Mr Palacios brought a claim for age discrimination after he was compulsorily retired at the age of 65. A reference was made to the ECJ by the Spanish Court seeking a ruling on: whether the Directive precludes a national law providing for compulsory retirement age; and, if so, whether the national court is required to disapply the law in question.

The Advocate General opined that the principle of non-discrimination on the grounds of age does not apply to national laws that provide for compulsory retirement ages. The Advocate General went on to say that if he was wrong on the first point, he considered that compulsory retirement ages would be justifiable.

The ECJ disagreed with the Advocate General’s view and confirmed that the Directive does not cover national retirement ages. However, it agreed that the provisions of Spanish law were justified.

**Implications for Heyday**

Following the *Palacios* judgment, the UK Government will not be able to rely on the defence that compulsory retirement ages are beyond the scope of the Directive. Pending the ECJ’s decision in Heyday, the President of the UK Employment Tribunal Service has ordered that all current and future claims raising the compatibility of the Regulations with the Directive in respect of age discrimination claims and compulsory retirement be stayed.

### 4. Association of British Insurers – Amended Guidelines

The Association of British Insurers (“ABI”) has published new guidance regarding executive remuneration in order to promote the success of companies over the longer term. The guidelines are aimed at companies with main market listings. However, it is intended that companies listed on the UK alternative market, AIM, are also compliant and it is recommended practice for other companies to adhere to the guidance.

Substantive changes to the existing guidance include:

- **Pensions** – It is often not tax efficient for executives to be members of a company pension scheme and frequently executives receive payment or benefits in lieu as an alternative. The guidance sets out a new procedure for disclosing these benefits; rather than aggregating the value of the benefit with the
individual’s salary, the benefits should be disclosed as benefits in lieu of participating in the pension scheme.

- **Performance Criteria** – Guidelines relating to total shareholder return ("TSR") calculations recommend that companies average over a short period of time and avoid lengthy averaging periods. This guidance is surprising in the view of the market approach to calculation, as TSR is very sensitive to the price of a company’s shares at the start and end of the performance period. In order more accurately to reflect their performance, some companies have averaged TSR over a period of months rather than weeks.

- **Expected Value of Share Awards** – When utilising a share incentive scheme, companies are required to disclose the expected value of share awards when they are granted, taking into account probability of meeting performance provisions. The new obligation requires the company to disclose any changes to the awards or structures, including the expected value of shares and reasons justifying the changes.

- **Acquiring Shares** – The guidelines now require the disclosure of the source of the shares when it is necessary to acquire shares in order to satisfy the awards made under a share incentive scheme.

- **Change of Control** – In the event of a change of control, the underlying performance of the company to the date of change will be the focal determinant of the awards.

The new guidance also imposes more stringent obligations on companies in relation to executive remuneration; even though the wording may only contain minor amendments, the practicalities need to be scrutinised thoroughly.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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