

## **GUIDANCE NOTE**

### **Dismissing Senior Executives**

**April 2013**

#### **Issues to consider**

An employer considering the dismissal of a senior executive, usually due to perceived poor performance, will have to address a number of issues:-

- Payments due under the contract or compensation for loss of salary and other contractual benefits.
- Compensation for unfair dismissal, discrimination or breach of other employment rights.
- Garden leave, confidentiality and restrictive covenants.
- Share options.
- Pension rights.
- Taxation of payments.
- Resignation or removal as a director.

A key question is timing and how any disruption or damage to the business can be minimised. The departure of a senior executive is likely to be highly sensitive, both from an external commercial and reputational aspect and from an internal perspective. There may be a desire to act quickly and to avoid the possibility of a protected and damaging dispute. For this reason an employer often seeks to achieve a departure on agreed settlement terms with appropriate safeguards being included in the document recording the agreement.

#### **Reason for termination**

It is important to be clear about the reason for the proposed termination or dismissal. This will affect how the departure should be handled and the level of any settlement that should be offered.

Unless there is evidence of gross misconduct or some other ground for summary termination, the executive will be entitled to be given the period of notice provided for by the contract/service agreement or, in the event of immediate termination, compensation for breach of contract, i.e., lack of notice. The contract should be checked to ascertain whether it provides for summary

termination in specified circumstances, e.g. a criminal conviction or bankruptcy, and, if not, the contractual notice period, whether there is any garden leave clause and the contractual benefits to which the executive is entitled.

Unless there is a justified and legally admissible reason for dismissal, the executive will have potential grounds for an unfair dismissal claim in addition to his contractual rights. Acceptable reasons for dismissal include misconduct, poor job performance, redundancy and “some other substantial reason” of a kind such as to justify dismissal.

Where there is proven misconduct or a genuine redundancy, there may still be grounds for an unfair dismissal claim if a fair procedure is not followed. The rubric “some other substantial reason” may apply where there has been a breakdown in trust and confidence between the individual and other senior executives, but such cases can give rise to a major conflict.

In practice, poor performance is the most common reason for dismissing a senior executive. Unless there has been obvious gross negligence (which is highly unlikely) this is not a ground for summary termination. Moreover, unless there has been a series of formal warnings or a performance improvement process has been put in place, there will be a basis for a potential unfair dismissal claim. In order to protect the organisation’s commercial and business interests, the employer may be reluctant to incur the delays which would ensue from following a warning or PIP process and instead will wish to aim to achieve agreement on a severance package.

An employer may be threatened with a discrimination claim if the executive believes that the reason for termination relates to age, sex, race, disability, sexual orientation, gender reassignment, marriage/civil partnership, pregnancy/maternity or religion or belief. There is no limit to the amount of compensation that can be awarded for discrimination and a discrimination claim is sometimes threatened on tactical grounds during settlement negotiations. Similarly there is no cap on compensation where an unfair dismissal claim is based on a protected public interest disclosure by the individual, i.e. a whistleblowing claim. An employer who is considering dismissing an executive should give careful consideration as to whether there is a risk of a discrimination or whistleblowing claim.

### **Handling the dismissal process**

Once the reason for termination has been identified, the employer should consider how best to handle the process taking into account the terms of the contract/service agreement, the extent to which the employer wishes to rely on any restrictive covenants in the contract, whether there should be a period of garden leave and the potential cost of terminating the contract in different ways, including the impact of tax and national insurance on the payments that will be made.

It is rare for the employer to allow the executive to work out all or any of their notice period, i.e. to attend at work. However, immediate termination would normally release the executive from any restrictive covenants as it constitutes a breach of contract. If the employer wishes to preserve restrictive covenants, the contract should be checked for a garden leave clause, in which event the executive can be served with notice of termination and placed on garden leave.

Alternatively, if the contract contains a PILON clause (payment in lieu of notice), immediate termination with payment in lieu of notice will not be a breach of contract and restrictive covenants will remain effective (if otherwise enforceable). If there is no garden leave clause or PILON clause, the employer should include a term in the settlement agreement imposing an obligation on the executive to observe the restrictive covenants in the employment contract.

It is normally preferable for the employer to negotiate the severance and settlement terms either before giving notice or during the notice period rather than terminating immediately and then negotiating. Negotiations should be conducted on a “without prejudice” basis so that, if agreement cannot be reached, evidence of what was offered will be inadmissible in any subsequent legal proceedings.

Where agreement has been reached, the severance terms (including any garden leave period) should be incorporated in a formal compromise agreement on which the executive must obtain independent legal advice and which should contain a waiver of any further or future claims, i.e. the terms should be in full and final settlement of all claims. Frequently an employer will agree to provide a reference as part of the settlement package. When drafting the terms of a reference, the duty to take care to provide one which is true, accurate and fair and which does not give a misleading impression should be borne in mind.

Payments made to the executive during the notice/garden leave period will be subject to tax and national insurance contributions as will any payment made under a PILON clause. Any other compensation for lack of (full) notice and/or in respect of potential claims for unfair dismissal and/or discrimination (sometimes referred to as compensation for loss of employment rights or loss of office) is normally tax free up to £30,000. Any amount in excess of £30,000 will be taxable and the employer must deduct tax in accordance with HMRC’s requirements when making the payment.

When considering and negotiating the amount of compensation, the following should be taken into account: basic salary, any bonus or commission scheme, contractual benefits such as car, life insurance, private medical cover, permanent health insurance, pension rights, share options. Some benefits can often be continued post termination, e.g. private medical cover. Consideration should also be given as to whether to allow the executive to retain their company car for a specified period or, alternatively, to buy the car at an agreed price deductible from the severance payment.

Where share options have vested but not been exercised, the employer may have discretion to allow the executive to exercise the options in the usual way. In the case of options which have not vested, most schemes provide that these will be lost and that the executive is not entitled to be compensated for their loss.

Loss of future pension accrual can be a significant factor in calculating compensation. It can also be tax efficient for a proportion of compensation to be paid into the executive’s pension scheme (subject to Revenue limits) where the total figure exceeds £30,000.

*The comments in this guidance note are of a general nature only. Full advice should be sought on any specific problems or issues*

**ASHTON BOND GIGG**  
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