Neutral Citation Number: [2018] EWHC 660 (Comm)

Case No: CL-2017-000491 & CL-2017-000493

**IN THE HIGH COURT OF JUSTICE**
**BUSINESS AND PROPERTY COURTS**
**OF ENGLAND AND WALES**
**COMMERCIAL COURT**

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 27/03/2018

**Before** :

**Mrs Justice Cockerill**

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**Between :**

| | |
|---|---|
| **(1) JOHN ERIC DANIELS**<br>**(2) GEORGE TRUETT TATE** | **Claimants** |
| **- and -** | |
| **(1) LLOYDS BANK PLC**<br>**(2) LLOYDS BANKING GROUP PLC** | **Defendants** |

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**PAUL LOWENSTEIN QC and ALISTAIR WOODER** (instructed by Fox Williams LLP) for the **First Claimant**

**DAVID CRAIG QC and IAIN QUIRK** (instructed by Mishcon de Reya LLP) for the **Second Claimant**

**ANDREW HOCHHAUSER QC and JANE RUSSELL** (instructed by Allen & Overy LLP) for the **Defendants**

Hearing dates: 26, 27 February 2018

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# Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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**Mrs Justice Cockerill**:

## Introduction and Route Map

1. In this application two former executive directors and employees of the Defendants, Mr Daniels and Mr Tate, seek summary judgment on their claims against the Defendants in relation to Integration Awards under the Bank's Long-Term Incentive Plan (the "**LTIP**"). They say that they met the targets specified in the awards made to them, that shares therefore vested in early 2012 but that the Defendants did not (as they should have done) transfer the shares to them.

2. The Defendants have pleaded defences that they were permitted to withhold the shares because of a discretionary rule in the rules of the LTIP and that either they exercised the power under this rule validly or that, if they did not, an exclusion clause in the rules means that the Claimants cannot claim for any loss.

3. I will consider the issues under the following headings:

   i) Factual Background: Paragraphs 4-46

   ii) The Issues: Paragraph 47

   iii) Legal Tests for Summary Judgment: Paragraphs 48-49

   iv) Issue 1 – Was the addition of Rule 6.4 to the LTIP Rules pursuant to Rule 17 valid?: Paragraphs 50-117

   v) Issue 2 – Did the Integration Awards vest?: Paragraphs 118-154

   vi) Issue 3 – Was the discretion under Rule 6.4 unlawfully exercised?: Paragraphs 155-171

   vii) Issue 4: Does Rule 15.7 prevent the Claimants seeking relief?: Paragraphs 172-184

   viii) Issue 5: The Claimants' Agreements: Paragraphs 186-207

   ix) Conclusion: Paragraph 208.

## Factual Background

*The Parties and their roles*

4. The First Claimant (Mr Daniels) was employed as Chief Executive Officer of the Second Defendant (then known as Lloyds TSB Group Plc) in October 2001. On 20 September 2010, the First Claimant and the Second Defendant entered into Heads of Terms relating to the retirement and cessation of his employment ("Heads of Terms"). He retired as Chief Executive Officer in March 2011.

5. The Second Claimant (Mr Tate) was originally employed by the First Defendant in August 2003 as Managing Director, Corporate Banking. He later became Acting Group Director, Wholesale & International Banking, in April 2004, and was appointed Group Executive Director, Wholesale & International Banking, on 1 August 2004. On 2 February 2012 he and the First Defendant entered into a Compromise Agreement in relation to his employment. Pursuant to the terms of that agreement, he retired from his position on 31 January 2013.

6. In 2006, the Second Defendant introduced a new long-term incentive plan (the **"2006 LTIP"**). The purpose of the 2006 LTIP was to deliver shareholder value through linking the receipt of shares to an improvement in the performance of the Second Defendant over a three-year period. The 2006 LTIP was amended on several occasions following its introduction; inter alia to implement regulatory changes. Only one of those amendments is relevant here. The 2006 LTIP was amended on 22 February 2012 (the **"2012 Amendment"**). A rule introduced by this amendment "**Rule 6.4**" is at the heart of the dispute before me.

7. The Defendants say that this amendment was to reflect the changing regulatory landscape within the financial services industry, following the financial crisis of 2008. The Financial Services Authority (now the Financial Conduct Authority) introduced a remuneration code (the **"Remuneration Code"**) which sought to reform the approach of financial institutions to risk and performance. The Remuneration Code was updated on 1 January 2011 to reflect the Capital Requirements Directive III (2006/48/EC and 2006/49/EC) which imposed obligations preventing the rewarding of excessive risk-taking by introducing concepts of performance adjustment and malus. By the 2012 Amendment provisions were included to allow for forfeiture of Awards and under Rule 6.4 "Other Adjustments".

*The relevant rules*

8. The rules of the LTIP (the "**LTIP Rules**") provided for the grant of *"Conditional Awards"* of shares (a conditional right to acquire shares granted under the Plan), which would vest in the employee participant if specified "*Performance Conditions*" were satisfied. In particular:

> "Rule 1.4:
>
> Performance Conditions
>
> When granting an Award, the Company may make its Vesting conditional on the satisfaction of one or more conditions recommended by the Committee linked to the performance of the Company. A Performance Condition must be objective and specified at the Award Date and may provide that an Award will lapse if a Performance Condition is not satisfied.
>
> Rule 1.5:
>
> Other conditions
>
> The Company may impose other conditions when granting an Award. Any such condition must be objective, specified at the Award Date and may provide that an Award will lapse if it is not satisfied."

The *"Award Date"* is defined as the date which "the Committee" sets for the grant of an Award. "*Committee"* is defined as "a duly authorised committee of the board of directors of the Company".

9. Where an Award was subject to a Performance Condition, the Committee would determine whether that Performance Condition had been satisfied as soon as reasonably practicable after the end of the Performance Period. Rule 6.1 (as amended in 2012 – amendments in underline) provided:

> "Where an Award is subject to a Performance Condition, as soon as reasonably practicable after the end of the Performance Period, the Committee will determine whether and to what extent any Performance Condition or any other condition under rule 1.5 (Other conditions) has been satisfied and if any adjustment is to be made under rule 6.4."

10. If the Committee determined that the Performance Condition was satisfied, the Conditional Award vested in the employee participant (Rule 6.2).

> "Where an Award is subject to a Performance Condition, [omitted], an Award Vests, to the extent determined under rule 6.1 above, on the date on which the Committee makes its determination under rule 6.1 or, if on that date a Dealing Restriction applies, the first day following the date on which the Dealing Restriction ceases to apply".

*"Vesting"* is defined as "a Participant becoming entitled to have the Shares transferred to him subject to these rules."

11. The consequence of this provision was that (at least prior to 2012) the employee participants' entitlement to the Conditional Award depended solely on the satisfaction of the Performance Conditions: neither the Remuneration Committee, nor any other body at the Bank, had the discretion to refuse to honour a Conditional Award if the Performance Condition had been satisfied.

12. However, in February 2012 the new Rule 6.4 was adopted which provided:

> "The Committee may adjust downwards (including to nil) the number of Shares in respect of which an Award Vests if in their discretion they determine that the performance of the Company, any Member of the Group, any business area or team and the conduct, capability or performance of the Participant justifies an adjustment."

13. Once an Award had vested, the LTIP Rules provided at Rule 7.1 that:

> "the Company will arrange … for the transfer … or issue to or to the order of the Participant of the number of Shares in respect of which the Award has Vested".

14. Thus prior to 2012 there was no discretion in the Board, the Remuneration Committee or anyone else to decide that shares should not be transferred or issued to the

employee participant once the Award had vested. It was ultimately common ground that nothing changed in this respect by virtue of the 2012 Amendment.

15. The LTIP Rules also contained an exclusion at Rule 15.7 in the following terms:

> "15.7 No Employee has any right to compensation for any loss in relation to the Plan, including any loss in relation to:
>
> 15.7.1 any loss or reduction of rights or expectations under the Plan in any circumstances…
>
> 15.7.2 any exercise of a discretion or a decision taken in relation to an Award or to the Plan, or any failure to exercise a discretion or take a decision."

16. Finally - and very importantly for the argument which has been deployed before me - Rule 17.1 provided:

> "**17 Changing the Plan and termination**
>
> 17.1 Committee's powers
>
> Except as described in the rest of this rule 17, the Committee may at any time change the Plan in any way."

The rule then goes on to provide in Rules 17.2 and 17.3 that changes to the advantage of participants must be approved by the Company in general meeting, that "minor changes" to benefit the administration of the Plan to comply with or take account of any proposed or existing or changed legislation or for tax purposes need not be approved by the Company in general meeting and that *"the Committee may give written notice of any changes made to any Participant affected."*

*The factual backdrop*

17. In or about January 2009, the Bank acquired HBOS plc ("**HBOS**"). As can be readily imagined, integration of HBOS into the Defendant was a major undertaking, requiring extensive strategic planning and managed execution. In April and May 2009, the Second Defendant made conditional awards of shares under the 2006 LTIP to 217 employees, including both Claimants, in relation to performance of the on-going integration of HBOS plc within the Second Defendant's business (the "Integration Awards").

18. Thus, on 8 April 2009, the Bank wrote to Mr Daniels, informing him that he had been granted two awards under the LTIP. One was an LTIP award of 1,714,522 shares geared to the Bank's financial progress and profitability (which forms no part of this claim and which need not be considered further) and one was the Integration Award which was of 1,143,014 shares under the LTIP. The letter stated (as material):

> "The receipt of shares under these awards, in 2012, is subject to the satisfaction of performance conditions and these are summarised in the attached appendix.

> The more detailed performance conditions, including the performance condition metrics and thresholds for vesting, will be sent to you, in due course, when the detail has been agreed by the Remuneration Committee…"

19. The Performance Conditions appended to that letter stated that the release of 50% of the shares would be *"dependent on the achievement of target run-rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of £1.5 billion by the end of 2011"* and the release of the remaining 50% of the shares would be *"dependent on the outcome of a Balanced Scorecard of non-financial measures of the success of the integration in each of 2009, 2010 and 2011"*.

20. A certificate headed "2009 Integration Award Certificate" stating the date of award and the number of shares awarded under the 2006 LTIP was duly issued to each Claimant. It stated that the participation in the Plan was subject to the rules of the Plan which could be amended, suspended or terminated at any time and that there was no entitlement to compensation or any other benefit in respect of the plan. It also stated: *"Receipt of the shares is conditional upon satisfaction of the performance conditions which are summarised in the booklet accompanying this certificate"*.

21. Mr Tate, who was conditionally awarded 706,791 Integration Award shares, received materially identical documentation.

22. The Performance Conditions were set out in greater detail in a document entitled "*Performance Conditions for Integration Awards made on 29 May 2009*" (the "**Detailed Performance Conditions"**). This document specified that:

    i) The 50% of the Award that was dependent on a balanced scorecard of non-financial measures would be broken down into three equally weighted annual tranches. The employee participant would "*bank*" each tranche if, in the relevant year, the Bank had satisfied certain specified metrics designed to measure the synergies achieved as a result of the acquisition of HBOS.

    ii) The 50% of the Award that was dependent on financial measures of synergy would also be broken down into three annual tranches. The employee participant would "*bank*" each tranche if:

        a) for 2009 and 2010, the Bank satisfied "individual cumulative run rate targets based on the trajectory to meet the 2011 targets";

        b) for 2011, the Bank had achieved cumulative synergies of £1.5bn by the end of 2011 as a result of the acquisition. The Award would vest at the maximum level if £2bn of synergies had been achieved by the end of 2011.

23. On 8 July 2009, the Bank wrote to Mr Daniels to inform him that his Award had been increased to 1,496,843 shares (Mr Tate's Integration Award was adjusted to 925,583) in order to compensate for the dilutive effect of a rights issue. The letter further stated that *"The awards are still subject to the performance conditions, as agreed by the*

*remuneration committee, so the adjusted number of shares shown above is the maximum number of shares that you would receive if the performance conditions were to be met in full and you are still employed within Lloyds Banking Group at the time of vesting*". The Bank subsequently further increased Mr Daniels' Award to 2,304,135 shares to compensate for further dilution. Mr Tate's Award was adjusted to 1,424,778 shares.

24. On 25 February 2010, the Bank's Remuneration Committee determined that the Performance Conditions for the 2009 tranche of the Award had been satisfied. This was communicated to the Claimants in April 2010.

25. In September 2010, it was announced that Mr Daniels would retire as chief executive in a year's time.

26. On 20 September 2010, Mr Daniels agreed heads of terms for his retirement with the Bank (the "**Heads of Terms**"). The Heads of Terms stated that certain of their sections (not including the LTIP section) were not legally binding. They said that in relation to LTIP the summary was "*subject to the rules of [the] plan*". They also said that:

> "in relation to the LTIP … the summary of the treatment that will apply to the Executive's options and awards under these plans as set out in these Heads of Terms is subject to the rules of each plan and assumes that the Executive retires on the terms set out in these Heads of Terms and that no other circumstances apply. If the Executive leaves for any other reason, the summary treatment in these Heads of Terms will not apply and the treatment will follow the rules of the plans".

27. The LTIP section read materially as follows:

> "-The Executive to be treated as a 'Good Leaver' (Rule 8.2 'retiring with the agreement of LBG') in respect of existing but unvested awards as at the retirement date.
>
> -Awards will therefore not lapse on cessation of employment but continue until the end of the relevant performance period. Shares will be released in line with the normal vesting dates at the end of the relevant performance period if and to the extent that conditions have been met and must be pro-rated for service (up to the cessation of employment) during the relevant performance period. Assuming a retirement date of 30 September 2011, the vested pro rata amount of the Executive's LTIP awards, assuming all performance conditions are achieved, will be as follows:

| **Award** | **Vested Amount** |
|---|---|

| | |
|---|---|
| 2008 | 36/36 |
| 2009 | 33/36 |
| 2010 | 21/36” |

28. On 26 January 2011, the Bank’s Remuneration Committee determined that the Performance Conditions for the 2010 tranche of the Award had been satisfied. Again, this was communicated to the Claimants in April 2011.

29. On 28 February 2011, Mr Daniels retired as Chief Executive. In September 2011, he retired from the Bank altogether. On 12 September 2011, the Bank wrote to Mr Daniels to “*formally confirm*” arrangements. The letter said that:

> “Your awards remain subject to the performance conditions which were advised to you when the awards were made, and the number of shares you will receive at the end of the relevant 3-year performance measurement period will be determined by that performance. If the relevant performance conditions are not met the associated elements of that award will lapse.”

30. Under the LTIP Rules, any Award would be reduced *pro rata* in the event that the employee participant left the Bank before the expiry of the Performance Period to which it was subject. Since Mr Daniels was retiring shortly before the expiry of the three-year Performance Period, the letter confirmed that there would be a pro-rated reduction to his Award to take this into account.

31. On 24 January 2012, a meeting of the Bank’s Remuneration Committee took place (the “**January 2012 Meeting**”). The constitution of the Remuneration Committee was a sub-set of the Board. Pursuant to its terms of reference, only non-executive directors were permitted to serve on the Remuneration Committee. At that meeting, the Remuneration Committee considered whether the Performance Conditions had been satisfied. The minutes record that:

> “the Committee agreed that the decision in respect of the Integration award was straightforward. The awards should be made in full … the 2009 integration awards should vest at 100% with a vesting date of 2 March 2012 or as soon as practicable thereafter subject to the Company Secretary confirming that nothing had changed to affect the performance levels and the resulting payouts.”

32. On 2 February 2012, Mr Tate signed a compromise agreement (dated on the face of the document 2 March 2012), agreeing terms for the termination of his employment (the “**Compromise Agreement”**). Clause 6.4 of the Compromise Agreement provided that any entitlement to the receipt of shares under the LTIP “*shall be*

*determined in accordance with the rules and conditions of the Plan"* and *"You hereby waive all other rights (including rights to compensation) in relation to the Plan."*

33. On 15 February 2012 Mr Daniels had a telephone discussion with the then Chairman of the Bank's Board, Sir Win Bischoff. Mr Daniels' case is that in that conversation Sir Win told Mr Daniels that if he did not agree to waive the Award, the Board would not agree to pay him.

34. A further meeting of the Remuneration Committee took place on 22 February 2012 (the "**February 2012 Meeting**"). At that meeting, the Remuneration Committee approved or purported to approve certain amendments to the LTIP rules pursuant to Rule 17.1 (the "**2012 LTIP Rules**".)

35. It was at this point that the new Rule 6.4, introducing the discretion to amend or reduce an LTIP award was introduced. The meeting notes state that *"Pending further consultation … it was agreed that the decision reached by the Committee on 24 January 2012 regarding the vesting of the Integration LTIP following discussion with UKFI should be deferred"*.

36. On 14 March 2012, at 5pm a full Board meeting took place (the "**March 2012 Meeting**"). All of the members of the Remuneration Committee (apart from Sir Julian Horn-Smith who was absent from both the Remuneration Committee and the Board meetings and Mr Ryan who expressly recused himself from the Board's decisions) participated in the decision-making at this meeting.

37. The minutes of the meeting reveal that the Board considered the legal and reputational risks that could arise in connection with the Integration Awards, particularly in the context of a consultation exercise that had been conducted with significant shareholders of the Second Defendant's Group as well as with the Association of British Insurers and the National Association of Pension Funds.

38. This consultation had apparently revealed that there was little appetite to reward those executive directors (including Messrs Daniels and Tate) who had participated in the decision for Lloyds TSB to acquire HBOS; in particular for them to be rewarded for *"one 'positive' element of what was now seen as an overall significantly 'negative' transaction"*. Mr Tony Watson (the chair of the Remuneration Committee) reported to the Board that "*one shareholder had expressed significant reservations about the Company deciding not to honour contractual commitments*".

39. After this discussion, the minutes record that:

> "the meeting of the Board was then adjourned pending consideration by the Remuneration Committee of the position with respect to the performance conditions attracting to the Integration Award".

40. A meeting of the Remuneration Committee then took place. This was separately minuted. At this meeting, the Remuneration Committee decided that the performance conditions attaching to the Integration Award had been satisfied. It:

> "agreed and resolved that the performance conditions attaching to the Integration Award had been satisfied in full"

41. The full Board meeting then reconvened and the minutes of that meeting resume. As the minutes record, Mr Watson:

> "confirmed that the Remuneration Committee had determined that the performance conditions attaching to the Integration Award had been satisfied in full. As a result, under the rules of the Plan, the Integration Award would vest with immediate effect."

42. However, the Board then resolved that the Bank would honour all Integration Awards with the exception of those granted to the four individuals who had been executive directors at the time of the acquisition of HBOS, which included Messrs Daniels and Tate. The Board resolved that no shares would be transferred to those individuals. The minutes record that it reached this decision having taken into account the factors discussed earlier at the Board Meeting, the risks or other potential consequences for the Group, that related to or could arise from decisions concerning the Integration Award, on the basis that that it was in the best interests of the Group and its shareholders generally.

43. On 29 March 2012, Mr Daniels' solicitors, Fox Williams LLP ("**Fox Williams**") wrote to the Bank, demanding that it honour the Award. On 17 April 2012, the Bank wrote back, stating that "*the Board concluded that it was in the best interests of the Group, and its shareholders generally, not to release to your client any shares under or with respect to the Award*". The Claimants note in submissions that the Bank did not seek to argue that its decision had been in accordance with the LTIP Rules and that when Fox Williams made that observation in a further letter, the Bank still did not suggest in its reply that its decision had been justified by the LTIP Rules (or any other rules).

44. Similarly, Mr Tate notified the Defendants in March 2012 that he considered their actions to be breaches of his contract.

45. There was no further correspondence put before the court until 4 August 2017, when both Claimants commenced proceedings against the Bank, claiming relief that included a declaration that they were entitled to the Award, and an order requiring the Bank to transfer the shares due under the Award to them.

46. In its Defence to both Claimants' actions, served on 29 September 2017, the Bank asserted that the Board had been entitled to decide to withhold Mr Daniels' Award pursuant to Rule 6.4 of the February LTIP Rules.

**The Issues**

47. Emerging from this outline of the facts, there are five issues that fall to be determined:

i) Was the LTIP validly amended pursuant to Rule 17.1 so as to include Rule 6.4?

ii) Did the Integration Awards vest either on 24 January or 14 March 2012?

iii) Was the decision not to transfer or issue the Integration Awards to the Claimants an unlawful exercise of discretion?

iv) Does the operation of Rule 15.7 prevent the Claimants from seeking the relief sought in any event?

v) Do the agreements reached by each Claimant with the Defendants preclude an otherwise valid exercise of Clause 6.4?

## Legal Tests for Summary Judgment

48. In each case, of course, the answer at this stage has to be tested against the standard for summary judgment pursuant to CPR 24.2 (a).

49. The test in question is that of *"no real prospect of success"*. The relevant principles are well known and have been considered inter alia in *TFL Management Services v Lloyds TSB Bank* [2014] 1 WLR 2006 and *EasyAir Ltd (trading as Openair) v Opal Telecom Ltd* [2009] EWHC 339 (Ch). I do not attempt any generalised summary of the principles to be drawn from the various cases but note in particular the following factors:

i) The burden of proof is on the applicant for summary judgment;

ii) The court must consider whether the claimant has a 'realistic' as opposed to a 'fanciful' prospect of success: *Swain v Hillman* [2001] 1 All ER 91;

iii) The criterion 'real' within CPR 24.2 (a) is not one of probability, it is the absence of reality: Lord Hobhouse in *Three Rivers DC v Bank of England (No.3)* [2001] 2 All E.R. 513 [2003] 2 A.C. 1 at paragraph 158;

iv) At the same time, a 'realistic' claim is one that carries some degree of conviction. This means a claim that is more than merely arguable: *ED & F Man Liquid Products v Patel* [2003] EWCA Civ 472 at [8];

v) The court must be astute to avoid the perils of a mini-trial but is not precluded from analysing the statements made by the party resisting the application for summary judgment and weighing them against contemporaneous documents (ibid);

vi) However disputed facts must generally be assumed in the claimant's favour: *James-Bowen v Commissioner of Police for the Metropolis* [2015] EWHC 1249 per Jay J at paragraph 3;

vii) An application for summary judgment is not appropriate to resolve a complex question of law and fact, the determination of which necessitates a trial of the issue having regard to all the evidence: *Apovdedo NV v Collins* [2008] EWHC 775 (Ch);

viii) If there is a short point of law or construction and, the court is satisfied that it has before it all the evidence necessary for the proper determination of the question and that the parties have had an adequate opportunity to address it in argument, it should grasp the nettle and decide it: *ICI Chemicals & Polymers Ltd v TTE Training Ltd* [2007] EWCA Civ 725;

ix) However, in reaching its conclusion the court must take into account not only the evidence actually placed before it on the application for summary judgment, but also the evidence that can reasonably be expected to be available at trial. The court should hesitate about making a final decision without a trial, even where there is no obvious conflict of fact at the time of the application, where reasonable grounds exist for believing that a fuller investigation into the facts of the case would add to or alter the evidence available to a trial judge and so affect the outcome of the case: *Royal Brompton Hospital NHS Trust v Hammond (No 5)* [2001] EWCA Civ 550, *Doncaster Pharmaceuticals Group Ltd v Bolton Pharmaceutical Co 100 Ltd* [2007] FSR 63;

x) The same point applies to an extent to difficult questions of law, particularly those in developing areas, which tend to be better decided against actual rather than assumed facts: *TFL* at [27].

**Issue 1: Was the addition of Rule 6.4 to the LTIP Rules under Rule 17.1 valid?**

50. The Claimants say that the Bank's amendment of the LTIP Rules by inserting Rule 6.4 was objectionable in that (1) it was a retrospective amendment of the terms of the Awards; (2) it came after they had completely performed their side of the contract by satisfying the Performance Conditions for about two and a half years; and (3) it purported to make the Awards subject to the discretion of the Remuneration Committee, where previously it had only been subject to satisfaction of the objective Performance Conditions.

51. They submit that as a matter of law, the purported insertion of Rule 6.4 was ineffective, because, on a proper construction, Rule 17.1 does not authorise the Remuneration Committee to unilaterally make changes to the LTIP Rules that are detrimental to the employee participant with retrospective effect. Such a construction, they say, is consistent with authority, common sense and the language of the LTIP Rules themselves.

52. The Claimants advanced their argument by reference to six principles.

53. First, they submit that it is well established that a unilateral power to vary a contract to the detriment of the other party can only be conferred by clear words (see for example *Lewison on the Interpretation of Contracts* ($6^{th}$ ed.) paragraph 7.18, *Treitel on Contract* (14th ed.) ed Peel, 2-096). Both Claimants pointed me to the authority of *Amberley (UK) Ltd v West Sussex County Council* [2011] EWCA Civ 11; (2011) 14 CCL Rep 178, where Aikens LJ (with whom the remainder of the Court of Appeal agreed) said that:

> "there is no doubt that, subject to any possible statutory safeguards (which it is not suggested are applicable in this

> case), parties to a contract can agree that one party shall be able, unilaterally, to vary the terms of the contract to the detriment of another. But, as Staughton LJ said in Lombard Tricity Finance Ltd v Paton, that is an unusual provision in a contract and, in general, clear words would be required to achieve that result" (para 22, emphasis added). (See also Esso Petroleum Company Ltd v Addison [2003] EWHC 1730 (Comm), para 132)."

54. To similar effect is the dictum of Moore-Bick J (as he then was) in "*Esso Petroleum Company Ltd v Addison*" [2003] EWHC 1730 at [132]:

> "… I do not doubt that parties are free to make an agreement under which one of them effectively puts himself in the power of the other in relation to some aspect of the contract – see the comments of Staughton LJ in Lombard Tricity Finance Ltd v Paton [1989] 1 All ER 918 at page 923 – but it would be an unusual thing to do and I do not think that one should readily accept that it was what the parties intended. In deciding the matter it is, of course, necessary to examine both at the language of the contract and its commercial context"

55. The Claimants submit that this principle operates with particular force in the employment context where there is an obvious inequality of bargaining power, and where the Court will generally be particularly reluctant to interpret such a clause as allowing an employer to make changes detrimental to an employee's rights: *Wandsworth LBC v D'Silva* [1998] IRLR 193 per Lord Woolf, MR.

56. I was also referred to *Khatri v Cooperatieve Centrale Raiffeisen-Boerenleenbank BA* [2010] EWCA Civ 397, where the Court of Appeal held that a clause providing that "*the bank maintains the right to review or remove this formula-linked bonus arrangement at any time*" was not sufficiently clear to allow the employer to unilaterally vary the formula for calculating the employee's bonus for the present year, as distinct from conveying an indication that everything might change in a subsequent year. Jacob LJ at [39] also said that:

> "I reach this conclusion with no regret. If banks decide to reward their employees by means of purely discretionary bonuses then they should say so openly and not seek to dress up such a bonus with the language of entitlement qualified by a slight phrase which does not make it absolutely clear that there is in fact no entitlement at all. If you are to give with one hand and take away with the other, you must make that clear."

57. The Claimants submit that words therefore have to be clear – not simply in the sense of being comprehensible – but as being clear and apt to do the job they are called on to do. They say there are no such clear words in the LTIP Rules and that like the wording in *Khatri*, the wording of Rule 17 is nowhere near clear enough. They argue that if the Bank had intended to be able to unilaterally amend the LTIP Rules with retrospective effect, it could easily have said so in Rule 17.1. They remind me that since the LTIP Rules were drafted by the Bank's legal advisors, they are to the extent that there is any ambiguity, to be construed *contra proferens*.

58. As to the authorities on which the Defendants rely the Claimants submit that they do not, when properly analysed, support the propositions for which they are cited, given the very different contexts in which they arise.

59. As a second line of argument the Claimants said that the authorities indicated that this kind of "moving the goalposts" was not acceptable against a background where an employee participant can serve the Bank over multiple years in reliance on a contract which specifies that they will receive a substantial award if certain performance conditions are satisfied. This "moving of goalposts" was especially egregious in the context of an argument by the Bank that it was not required to notify the employee participant of any amendments.

60. In this context I was referred to the judgment of Rix LJ in *Mallone v BPB Industries plc* [2002] EWCA Civ 126; [2002] ICR 1045, which the Claimants submitted had clear resonances with this case. In *Mallone* a company used a numerator of zero in a discretionary pro-rata calculation to effectively cancel a former employee's share options where, on the face of the scheme, the employee had a right to exercise the share option subject to some discretionary pro-rata calculation unless he had been dismissed for misconduct.

61. Rix LJ considered the objectively ascertainable purpose of the discretionary provision and considered it significant that options were granted as a reward for past performance and vested after three years. He went on to say:

> "43. I recognise that such share option schemes can lead to controversy. A poorly performing executive may be represented as leaving in failure but with valuable options. Alternatively the options may not be worth anything or very much at the time of departure, but may subsequently become valuable because of improvements in the performance of his company after his leaving, or because of the re-rating of the market. Thus the scheme can operate in a way which might seem arbitrary.
>
> 44. But such possibilities are always present. An executive might be able to exercise his options before his departure, perhaps in anticipation of his employer's displeasure. Considerations such as these, however, are not, itseems to me, a valid reason for treating the whole scheme as a sort of mirage whereby the executive is welcomed as a participant, encouraged to perform well in return for reward, granted options in recognition of his good performance, led on to

> further acts of good performance and loyalty, only to learn at the end of his possibly many years of employment, when perhaps the tide has turned and his powers are waning, that his options, matured and vested as they may have become, are removed from him without explanation. "

62. I was also referred to *Norman v National Audit Office* [2015] IRLR 634, where the EAT considered it almost inevitable in every case that unilateral variations would be notified to employees [51], although even then that *"does not, in our judgment, establish that the employer is therefore establishing the right to make the changes unilaterally and without the consent of the employee."*

63. The Claimants' third (related) submission was that if the Bank were entitled to unilaterally amend the LTIP Rules with retrospective and detrimental effect, they would become a mere declaration of the Bank's intent, rather than a legally-binding contract. The only right that an employee participant would truly possess would be the requirement that the Bank should act reasonably in exercising its discretion to unilaterally vary the LTIP Rules (and such other constraints as might apply to that discretion). As a matter of authority this is wrong: exclusion and other clauses should not be construed so widely that they reduce the contract to a mere declaration of intent. In this regard I was referred to the classic statement of Lord Wilberforce in *Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361, p.432:

> "[An exception clause] must reflect the contemplation of the parties that a breach of contract, or what apart from the clause would be a breach of contract, may be committed, otherwise the clause would not be there; but the question remains open in any case whether there is a limit to the type of breach which they have in mind. One may safely say that the parties cannot, in a contract, have contemplated that the clause should have so wide an ambit as in effect to deprive one party's stipulations of all contractual force; to do so would be to reduce the contract to a mere declaration of intent."

64. The Claimants' fourth argument focussed on Rules 1.4 and 1.5 of the LTIP Rules. They submitted that the effect of Rules 1.4 and 1.5 of the LTIP Rules was to prevent the Bank from retrospectively subjecting their awards to new conditions, such as Rule 6.4, that had not been specified when the Award was first made. They point to the fact that those rules stipulate that any Performance Conditions or other conditions on the vesting of an Award must be specified at the Award Date (which was April 2009). Rule 6.4 was introduced only on 22 February 2012, after the performance period had ended (and after the Heads of Terms and the Compromise Agreement had been concluded).

65. They submit that on any fair reading of the Rules, Rule 6.4 was either a Performance Condition (within the meaning of Rule 1.4) or an "*other condition*" (within the meaning of 1.5) in that:

    i) The new rule would create a discretion exercisable by reference to "*the performance of the Company, any Member of the Group, any business area or team and the conduct, capability or performance of the Participant ….*". The Claimants submit that it is difficult to see how these are anything other than performance conditions.

    ii) Alternatively, Rule 6.4 must be an "*other condition*" within the meaning of Rule 1.5, since it purported to make the vesting of awards conditional on the discretion of the Remuneration Committee.

66. As such, the Claimants submit that Rule 1.4 and 1.5 required any Performance Conditions or other conditions to be "*objective*". A discretion is necessarily and obviously subjective. Accordingly, Rule 6.4 could not validly be introduced into the LTIP Rules by amendment, since it did not meet the criteria for a valid Performance Condition or "*other condition*".

67. The Claimants' fifth argument was that as a matter of construction, the language of the LTIP Rules confirms that Rule 17.1 was not intended to authorise the Bank to make unilateral variations with retrospective effect. They point to the fact that the LTIP Rules distinguish between "*the Plan*" and "*the terms of the Award*". So, Rule 1.1 provides that "*an Award granted under the Plan, and the terms of that Award, must be approved in advance by the Committee*". Rule 17.1 provides that "*the Committee may at any time change the Plan in any way*".

68. It follows, they say, that this rule does not provide that the Remuneration Committee may change the terms of the Award. Although the definition of "*Plan*" provides that the LTIP Rules may be "*changed from time to time*", there is no similar suggestion that the terms of Awards may be changed from time to time. It follows that, as in *Khatri*, the Remuneration Committee can only change the LTIP Rules under Rule 17.1 with effect for the future, but cannot change the terms of Awards that have already been made.

69. This, they say, is consistent with where the Rules do provide for certain narrower powers to change the terms of existing Awards. For example, Rule 1.4 provides for a power to change the Performance Conditions and Rule 7.5 authorises the Remuneration Committee to decline to pay certain dividends under existing Awards.

70. They also point to Rule 16.4 which provides that *"the Committee has the power from time to time to make or vary regulations for the administration and operation of the Plan but these must be consistent with its rules"* and submit that that provision only makes sense if there are some circumstances in which the Remuneration Committee cannot amend the LTIP Rules, since there would otherwise be no point in providing that any regulations must be consistent with the LTIP Rules.

71. They therefore submit that Rule 17.1 should be construed as applying to changes that related to Lloyds' own obligations, rather than the right to make detrimental changes to the rights of employees.

72. Finally, the Claimants submit that the effect of what the Bank has sought to do via Rule 17.1 in this case would be outside the scope of Rule 17. That, they say, authorises the Bank to change the existing Plan, not substitute a different type of share scheme altogether. In support of this they cite the judgment of Longmore LJ in *Triodosbank NV v Dobbs* [2005] EWCA Civ 630; [2005] 2 Lloyd's Rep 588 at [16]:

> "it is important to distinguish between a true variation of an existing obligation and the entering of what is in fact a different obligation even though it may purport to be no more than a variation. In that sense it is perfectly possible (and, indeed, right) to put a 'limit on the power to vary'"

73. As for the Defendants' reliance on regulatory background and in particular the Remuneration Code, they submit that this did not and could not sensibly be construed as requiring or authorising the Defendants to act in breach of contract. They point to the Remuneration Code (as revised on 1 January 2011) itself which makes clear at Rule 19A.1.4 G, that: "*Subject to the requirements of SYSC 19A.1.5R, in the FSA's view SYSC 19A.1.3 R does not require a firm to breach requirements of applicable contract or employment law."*

74. Thus, the Claimants submit that Rule 17 is either inapt or not sufficiently clearly worded to achieve such an unreasonable outcome. At best they say, even if the Bank was authorised to make unilateral variations with retrospective effect pursuant to Rule 17.1, Rule 6.4 should not be construed as retrospective in effect.

75. Accordingly, the Bank may not rely on Rule 17.1 to justify the adoption of Rule 6.4 with retrospective effect for the Claimants' Awards, and the Board was not, therefore, entitled to refuse to honour the Awards.

76. The Defendants submit that the 2012 Amendment, which was adopted by the Remuneration Committee on 22 February 2012, was the applicable LTIP at the relevant time and that there is no reason why Rule 6.4 should not be applicable.

77. They point out that the 2006 LTIP was amended several times following its introduction and amended versions were introduced in 2007, 2011, 2012 and 2015. There were no objections to these amendments.

78. They note that Rule 1 of the 2006 LTIP (contained in each version of the plan) provided that all awards granted under the 2006 LTIP were "*Award[s] granted under the Plan…*". "Plan" was defined as *"The [Second Defendant's] Long-Term Incentive Plan 2006 as changed from time to time"*. They accordingly submit that the 2012 Amendment comes into play because it was the version applicable at the time that the relevant decisions were made by the Remuneration Committee and the Board on 14 March 2012.

79. Furthermore, Rule 17 of the 2006 LTIP (contained in each version of the plan) concerns "Changing the Plan and termination" and expressly stated:

> *"Except as described in the rest of this rule 17, the Committee may at any time change the Plan in any way"*.

80. Rule 17 therefore gave a wide power to the Remuneration Committee to amend the plan *"in any way"*. The only express limit to that power was set out in the *"rest of this rule 17"* in the 2006 LTIP (and in each subsequent iteration).

81. As for the submissions regarding lack of notice, they say that these go nowhere; the only changes that required other approval (in the form of shareholder approval) were changes to the plan which were to the advantage of present or future participants (according to Rule 17.2.1). Consequently, changes to the plan which were to the disadvantage of present or future participants did not require approval. If such approval was necessary then there would have been express provision for this in Rule 17 and there was not. While they entirely accept the principle that clear words are needed they submit that the words of Rule 6.4 are exactly that - clear.

82. They also submit that the position on the authorities is by no means such a one way street as the Claimants would suggest. In *Khatri* they submit the term was very different with much clearer indicia of entitlement. They submit that in fact, a unilateral power of amendment is to be construed widely, referring me to *British Airways Plc v Airways Pension Scheme Trustee Ltd* [2017] Pens L.R. 16 at paragraphs 422 to 423 where it was held that British Airways' consent to a unilateral power to amend to increase benefits to pensioners was not a requirement.

83. The Defendants also submitted that although the power of unilateral variation is not unfettered, the courts will only intervene where there is some improper purpose or to prevent capricious or arbitrary action: *Paragon Finance v Nash* [2002] 1 WLR 685 at paragraph 36 (and also Chitty 22-039; and below generally in relation to contractual discretion).

84. In this case they said they were as far from an improper purpose as could well be imagined in that the reason for the introduction of the amendments was essentially to comply with the regulatory requirements and the specific exercise of the discretion was made in the light of consideration of the interests of the Group and the views of shareholders.

85. As regards the "moving the goalposts" submission and the related "declaration of intent" argument, the Defendants submitted that this was simply not the case. As far as concerns *Mallone,* that case was not analogous because there the question in issue related to an attempt to deprive someone of matured options, not options which had not yet matured. The basis of the decision was therefore not related to the options' existence but rather to the fact that the employer there had acted in a way no reasonable employer could have done, hence falling foul of the line to be found in cases like *Paragon v Nash*.

86. In relation to the "declaration of intent" point the Defendants submitted that this does not amount to a test of principle and that indeed *Suisse Atlantique* reinforces the respect which must be given to freedom of contract, for example at p.410D:

> "So long as one remembers that one is construing a document and not applying some rule of law superimposed upon the law of contract so as to limit the freedom of the parties to enter into any agreement they like within the limits which the law prescribes one can apply one's mind to each contract as it comes up for consideration."

87. Here they submit, in the absence of UCTA or other statutory controls, one is simply looking at the controls imposed by the law for the exercise of contractual discretion.

88. As regards retrospectivity, the Defendants submit that the answer to this is that Rule 6.4 applies to any shares which had not yet vested; and applied in the Claimants' case because their shares never, in fact, vested. The critical date, so far as Rule 6.4 is concerned, is the date when the decision-making (including the exercise of discretion contemplated by Rule 6.4) took place which, in respect of the Claimants, was 14 March 2012. Since that date post-dated the date when Rule 6.4 was introduced, Rule 6.4 was in play when the relevant decisions were taken and the relevant discretions exercised.

89. As to principles, the Defendants again referred me to *Paragon Finance v Nash* noting that in this case, the relevant decision was made on 14 March 2012 pursuant to the rules that applied at the time. However, even if the rule change was back- dated, that does not, in itself, lead to invalidity: the "touchstone" is fairness: *IMG v German* [2010] Pens. L.R. 23 at paragraph 147. In this case, the amendment was fair since it reflected the changing regulatory environment.

90. In relation to the point that Rule 17.1 cannot permit a rule change detrimental to employees that did not have to be notified, they submitted that *Khatri* is not authority for the proposition that there is a requirement to notify employees of rule changes (whether detrimental or otherwise): it concerned acceptance by conduct on the part of an employee in relation to the terms of an offer. Much will also depend on the terms of the particular contract – in a number of the authorities cited by the Claimants the contracts did have such a requirement – which did not exist in the LTIP Rules.

91. As regards the arguments on construction, the Defendants submit that the point as regards Rules 1.4 and 1.5 is misconceived. Rule 6.4 (and the discretion contained within it) is not a "*condition*" in the sense of the Performance Conditions or other conditions: it is a mechanism exercisable via the exercise of a discretion to permit a downwards adjustment after the satisfaction of the performance conditions has taken place.

92. To the extent that it is argued that Rule 6.4 was ultra vires Rule 17.1 because it imposed an additional condition and he had already rendered performance, the Defendants submit that it is not correct that Rule 6.4 imposed an additional condition – it is a different exercise predicated on performance having already taken place.

93. On the distinction between amendments to the Plan and to Awards the Defendants say that this is an artificial distinction taken against the reality that there is no absolute entitlement prior to the decision on vesting taking place. "Banking" of parts of an

Award means no more than that a preliminary decision has been taken that parts of the performance criteria have been met. This is illustrated by the fact that it could not be argued that there was any right before at the earliest 24 January 2012.

94. They also submit that the distinction by reference to Rule 16.4 is fallacious; there is nothing which prevents the Rules themselves being amended at any time.

95. As regards the Claimants' final argument, that Rule 17.1 only authorises a change to the plan, rather than a wholesale substitution of it, the Defendants submit that is not correct that the plan was substituted: it was merely changed to deal with a new situation, namely the requirements of the regulatory framework.

*Discussion*

96. One of the features of the argument was that the parties came at this issue from slightly different perspectives, with the Claimants looking at Rule 17.1 and Rule 6.4 more disjunctively, and with greater focus on the Rule 17.1 arguments (viewed primarily as a question of construction albeit with input from the Rule 6.4 content) while the Defendants elided the arguments under the two rules and placed much more emphasis on Rule 6.4 and the role of the law as to contractual discretion.

97. It has seemed to me that there is a certain amount of force in taking the bulk of the arguments as to principle together at this stage, not least because the Claimants' argument as to Rule 17.1 necessarily considered in detail the nature of Rule 6.4; it was not an exercise of Rule 17.1 *per se* that was objected to, but the exercise of Rule 17.1 so as to produce a rule which had the effects contended for by the Defendant. I will therefore to a certain extent bring the arguments of principle in relation to Rule 6.4 into account in this discussion.

98. Ultimately what is being said for the Defendants is that Rule 17.1 is a clear broad clause which gave them a contractual discretion to change the rules within the LTIP as to vesting of Awards and to do so (i) in a way which enables them (in the exercise of a discretion within certain parameters) to cancel an Award granted subject to certain performance conditions and whose performance conditions have been met and (ii) to do that without notice to the participant.

99. If such a discretion exists it is capable of being supervised by the courts only in a very limited range of circumstances. Save in exceptional cases (such as *Braganza v BP Shipping* [2015] UKSC 17; [2015] 1 W.L.R. 1661) the court's intervention will only be justified in cases where the discretion has been exercised arbitrarily, capriciously or irrationally (see the cases cited below in relation to the Defendants' arguments under Rule 6.4).

100. That limited scope of review however means that one must look carefully first at whether the discretion relied upon exists – just as one would look carefully at the purpose for which the discretion is said to be exercised. Further the question of purpose forms a part of the exercise of contractual construction when determining whether the discretion contended for exists.

101. It is in essence a contractual construction approach, bearing in mind the nature of the terms contended for, which brings one to the results which one sees in the cases cited

in the different limbs of the Claimants' argument. Parties are of course perfectly free to agree whatever terms they wish, but before concluding that a party has made an agreement which puts him in the power of his contractual counterparty the court will want to look at the wording of the contract and its commercial context. In this context Lord Diplock in *Suisse Atlantique* referenced the following dictum of Atkin LJ (as he then was) in *The Cape Palos* [1921] P. 458, 471-472:

> "I am far from saying that a contractor may not make a valid contract that he is not to be liable for any failure to perform his contract, including even wilful default; but he must use very clear words to express that purpose..."

102. The authorities justify the conclusion that where a term has such a result the court will not be very ready to conclude that that was the parties' intention and will tend to scrutinise both words and context closely. I do not accept the submission by reference to the *British Airways* case that a unilateral power of amendment is to be construed widely. The authority does not say this, and the case was a very particular one involving a complex clause which permitted unilateral amendment unilaterally by Management Trustees following a vote, and in circumstances where the trustees were equally split between the parties whose interests were likely to differ.

103. The authorities also show that one part of the context which the Court is entitled to consider, is the nature of the relationship; and the fact that a party is an employee vis á vis his contractual counterparty will tend to increase the Court's vigilance when considering words and the commercial context. This is natural when one considers the imbalance of power which is often inherent in such a relationship.

104. One then looks to the words of the relevant clause or Rule. Here it was more or less common ground that clear words are needed; but the debate between the parties was as to what that meant. I do not necessarily accept the submission that the clear words must always be clear in the sense of apt and pointed to the specific discretion sought to be invoked. I see no reason why relatively broad words in the correct context in a tightly drawn agreement might not give the degree of clarity required (see for example *Lombard Tricity Finance v Nash* [1989] 1 All ER 918).

105. But it is clear that it will generally be the expectation that broad words are not enough; as appears from the dicta referenced above and was made clear in *Paragon v Nash* where a term was clear beyond peradventure and the only question could be the fetters on the discretion as a matter of implication of terms. So too is this clear from the approach to the words in *Khatri* where words which could clearly have encompassed a right to a broad change were held only apt to cover a change for the future.

106. One can sensibly take stock of the present case at this point. This is a case where a broad power to alter a party's contractual rights to its detriment is in question. It is also a case where, even if the case does not concern an employment contract *per se,* it does concern the employment relationship and terms which are put forward by the Defendant employers and not negotiated in a bipartite fashion. While, given Mr Daniels' and Mr Tate's positions, the full weight of the "imbalance of power" considerations may not come into play, there is nothing in this case which would

make it other than one where the words relied on would have to be very carefully scrutinised.

107. When one does so, one discerns a distinct parallel to *Khatri*. While one may not be directly juxtaposing the language of entitlement with a “slight phrase” by way of qualification, the phrase used is very much of the same ilk. The indications therefore are not favourable.

108. What does one gain from a consideration of the words themselves within the broader commercial context? In my judgment there is quite a lot to say here. Firstly the right which is sought to be extensively qualified is, if not couched in terms of pure entitlement, one which derives from objective criteria - the satisfaction of which give rise to an absolute entitlement. This lends further force to the *Khatri* parallel.

109. Second there is a distinction in the wording of the Rules between the Plan and Awards made under the plan. So English Law governs *“the Plan and all Awards and their construction”* and Clause 1.1 refers to *"an Award granted under the Plan"*. This is indicative that Awards may be treated as a different category; something effectively completed, subject to satisfaction of conditions, on their grant. There is no absolute entitlement; but there is a contingent entitlement, depending on defined contingencies. This is, I note, consistent with what Rule 1.6 and 2.1 provided for and we actually see in relation to the Claimants' Awards – the issuance of a formal certificate which is or is supplemented by a deed.

110. Thirdly there is the structure which is put in place for Awards; in particular as to the timing and type of conditions under Rules 1.4 and 1.5. Whether or not Rule 6.4 would be a Performance Condition or an Other Condition, what is plain is that the plan contemplates objective conditions which are plain at the Award date (so that the recipient knows what he/she has to do). That is on its face inconsistent with change, post grant, particularly change to a discretionary regime. So far as the issue about whether Rule 6.4 would be a Performance or Other Condition, I would conclude that it was not, because it was an *ex post facto* discretion and did not impose a condition which had to be satisfied. But this only serves to reinforce the incompatibility of Rule 6.4 with the contractual scheme, which is based on a “cards on the table” objective criteria-based approach.

111. Rule 17 itself is entitled *“Changing the Plan …”*. It contains no mention of Awards. It has the umbrella section relied on and is then divided broadly into 2 sections. The first relates to what are obviously seen as major changes affecting the Company (benefiting the participants). They all relate to the structure of the Plan. They require approval at a general meeting. The second applies to what are termed "minor changes", which are broadly of an administrative nature. Again, they relate essentially to the structure of the Plan. It appears that Rule 17.1 is designed as a "catch all" for other changes to the Plan which do not fall into either category.

112. Accordingly, reading Rule 17 as a whole by itself and also reading it against the broader context of the LTIP Rules (including also the specific provisions for changes elsewhere) I do not consider that its purpose is directed to alterations to Awards, but rather to alterations (probably of a minor nature) to the structure and administration of the Plan which are not caught by the specific regimes in Clause 17.2. Further I do not consider that its wording is apt, taken in context, to permit the introduction of such a

Rule. This approach is in my view supported and not undercut by Rule 16.4 which indicates an intention to have a power to micromanage by regulations that which the Plan structured by the Rules (as amended by the relevant part of Rule 17). I would also say that the uneasy fit of the putative Rule 6.4 into the scheme of Rule 6 (to which I refer under the next issue) chimes with this conclusion.

113. I consider that this approach finds support when one conducts the iterative process referred to in the recent key judgments of the Supreme Court on the topic of contractual construction and particularly the passage from the judgment of Lord Clarke of Stone-cum-Ebony JSC's in *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900 at [21] which has subsequently been endorsed in the *Arnold v Britton* [2015] AC 1619 and *Wood v Capita* [2017] A.C. 1173:

> "the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other."

114. Does it make better sense that the parties should have intended a fallback power of tidying up or a swingeing power to rewrite the terms of the LTIP Awards? The answer to this is plain: the former is far more coherent with the overall scheme and purpose.

115. The answer reached above is also supported by the various authorities on which the Claimants relied in the context of their third, fourth and sixth submissions, all of which are essentially saying that when you have an approach which produces a result which lacks sense or completely recasts the obligations under the original contract, the clause which purports to do this (whether exclusion clause, power of variation or discretionary amendment) should not generally be read in that sense.

116. I do not think that this is the kind of difficult point of law which is dangerous to decide at the summary judgment stage. It is not necessary to decide it by reference to assumed facts and there is no suggestion that the issue of construction will be informed by any factual matrix evidence not before the court. I therefore conclude that Rule 17 did not bestow a power or discretion to alter the Rules as was done by the addition of Rule 6.4. It follows that the Defendants' reliance on Rule 6.4 is misplaced that they have no real prospects of success on this point and the Claimants are entitled to summary judgment.

117. It is however appropriate to go on and to consider the other issues, not least because Issue 2 is really at the heart of the dispute and has an impact on the question of remedies.

## Issue 2: Did the Integration Awards vest?

118. The First Claimant's position is that the Integration Awards vested on either the 24 January 2012 - which is when the Remuneration Committee determined that the relevant performance conditions had been met - or 2 March 2012, which is when the minutes of 24 January 2012 state that the Integration Awards would vest or on 14 March when the Remuneration Committee met again.

119. The backdrop on which the Claimants rely included the Rules and the booklet issued to them. They say that these speak clearly as to the process of vesting. So they point to that part of the booklet which explains that the Shares would be released subject to the rules of the Plan and to the extent that the Performance Conditions were satisfied and as regards the "scorecard" explains how the award was broken down into three equally weighted tranches, which crystallised and were *"banked"* each year, to be released at the end of three years, subject to the Remuneration Committee's assessment of overall performance at the end of the period.

120. In particular they rely on the passage which says:

> "Whether and to what extent the Performance Conditions have been satisfied will be determined by the Committee as soon as practicable after the end of the relevant performance period. The date on which the Committee so determines will (if applicable) be the Vesting Date and the relevant number of Shares (if any) will be released (or the Award otherwise satisfied in accordance with the Plan rules) as soon as reasonably practicable after that date."

121. They then also point to the distinction in the Rules between Vesting (dealt with in Rule 6) and Consequences of Vesting (dealt with in Rule 7). The distinction between these two stages is, they say, accepted by the Defendants; pointing to that distinction being drawn in Mr Sinnott's witness statement and in the Defence.

122. Rule 6.1, they submit, sets out the rules for determining whether Performance Conditions have been met. As to timing of vesting following that determination, they point to Rule 6.2 which states in terms: *"an Award vests … on the date on which the Committee makes its determination under rule 6.1"*. Thus, once Performance Conditions are determined to be satisfied, vesting follows automatically. If Rule 6.4 applies, it comes into the equation at the time of and as part of the same exercise as determination of the satisfaction of Performance Conditions (as the reference to Rule 6.4 within the body of Rule 6.1 indicates).

123. They submit that the second stage, the consequences of vesting, was dealt with in Rule 7, which provided:

> "**7. Consequences of Vesting**
>
> 7.1 Conditional Award

> As soon as reasonably practicable after the Vesting of a Conditional Award, the Company will arrange…for the transfer (including a transfer out of treasury) or issue to or to the order of the Participant of the number of Shares in respect of which the Award has Vested."

124. Accordingly, once the Award had vested, the Second Defendant was obliged (*"the Company will arrange"*) to arrange for the transfer or issue of the Shares. The only discretion at this stage was as to whether to pay the Award in cash rather than by the transfer or issue of shares, under Rule 7.6 (*"The Company may, subject to the approval of the Committee, decide to satisfy… a Conditional Award by paying an equivalent amount in cash…"*). That is consistent with the definition of Vesting under the Rules, which provides: *"'Vesting'…in relation to a Conditional Award, means a Participant becoming entitled to have the Shares transferred to him subject to these Rules…"*.

125. In this case the Claimants say that the process worked as follows:

i) In accordance with the Performance Conditions booklet and the Rules, the Committee determined for each of the first two years (2009 and 2010) that the Performance Conditions had been met and the Shares were banked for that year, and in respect of the final year (2011) that the Performance Conditions were met and the Award vested in full.

ii) In respect of the first year, at the Committee's meeting on 25 February 2010: *"It was confirmed that targets for all measures had been achieved or exceeded…, the Committee approved the proposal that the maximum number of shares be banked under the first tranche of the 2009 integration award and that they be released at the end of the performance cycle."*

iii) This was confirmed in the Second Defendant's Annual Report for 2009: *"Performance against the first year of the award has been assessed and all targets have been met or exceeded."*

iv) The same decision was made in respect of the second year, and the maximum number of shares banked.

v) Again, this was confirmed in the Second Defendants' Annual Report 2010: *"Performance for each of the first two years of the award has been assessed and all targets have been met or exceeded."*

vi) For the third and final year (and in respect of the Award as a whole):

a) First, at the 24 January 2012 meeting: *"The Committee agreed that the decision in respect of the Integration Award was straightforward. The awards should be made in full…The 2009 integration awards should vest at 100% with a vesting date of 2 March 2012 or as soon as practicable thereafter subject to the Company Secretary confirming* *that nothing had changed to affect the performance levels and the resulting payouts"*.

b) Secondly at the meeting of the Remuneration Committee on 14 March 2012: *"The Committee agreed and resolved that the performance conditions attaching to the Integration Award had been satisfied in full"*. The Committee confirmed that the Performance Conditions had been met and that the Integration Award would *"vest in full with immediate effect"*.

126. That, they say, ends the matter. A determination as to satisfaction of the Performance Conditions was taken, and the shares vested either on 24 January, or on 2 March 2012 or at latest on 14 March 2012.

127. If the latter, Rule 6.4 never arises even if it was validly introduced, because no adjustment was made at the relevant time. Firstly, the Claimants say that there was no determination by the Committee under Rule 6.4 that: (a) the performance of the Second Defendant, any Member of the Group, any business area or team; and, (b) the conduct, capability or performance of the Claimants justified an adjustment. Indeed, there was no determination in respect of either matter (both having to be satisfied before a discretion could be exercised to adjust the number of Shares in respect of which an Award would vest).

128. Secondly, they say that in any event no discretion was exercised under Rule 6.4 to adjust the number of Shares that vested in the Claimants' to nil. On the contrary, the Committee determined that their awards vested in full and that they did so with immediate effect.

129. They say that this is actually consistent with a fair reading of the minutes: following the decision of the Committee that the Award would vest with immediate effect, the Board decided that no Shares would be *"transferred or issued"* to the Claimants *"in respect of which the Integration Award had vested"*. That phrase reflects the real situation, and the Board's appreciation of the two stage process. They note that the use of the language *"transferred or issued"* was lifted from the Rules, mirroring the language of the second stage of the process, i.e. the consequences of vesting, which required the transfer or issue of Shares as soon as reasonably practicable after vesting (under Rule 7). The Claimants remind me that it is plain that the Board had the Rules in front of them, as well as having General Counsel and an HR Director present, so there can be no argument that this is imprecision of language.

130. The Claimants also dispute that the Board, as opposed to the Remuneration Committee, could have been the body making the decision regarding vesting or under Rule 6.4. They submit that on a true construction of the LTIP Rules it is the Committee which was to determine whether the performance conditions had been met, and it is the Committee that was entitled to exercise a discretion as to whether to make some adjustment (and if so the amount of such adjustment) to the number of Shares that would vest.

131. They point to the fact that the LTIP Rules expressly refer to decisions by "*the Committee*", not "*the Board*". "*The Committee*" is defined in the LTIP Rules as "*a duly authorised committee of the board of directors of the Company*". It follows that "*the Committee*" cannot be the Board since it is defined as being a committee "*of the Board*". This means that the Committee must be a sub-set of the greater Board. If it had been intended that Rule 6.4 could be invoked by the Board as well as the "*duly authorised committee*", the rule would doubtless have said so.

132. The Claimants also referenced a number of passages in the Terms of Reference which they say are plainly drafted contemplating that *"the Committee"* means *"the Remuneration Committee"*. So, the Remuneration Committee was specifically authorised to "*determine and approve … all aspects of remuneration in respect of … the Group Chief Executive*". Further, as a matter of Lloyds' corporate governance more generally, the Remuneration Committee was in relation, inter alia, to the LTIP, to: "*determine the design of, eligibility for and targets for, any longer term performance related pay schemes operated by the company. Subsequently review performance against these targets and agree any payments proposed".*

133. The Claimants also point to the distinction drawn in the Rules between "*the Committee"* and *"the Company"*, which is referred to in multiple other places, including in Rule 7. They submit that where the LTIP Rules are intended to confer a discretion that can be exercised by the Board, they refer to *"the Company"* rather than *"the Committee".*

134. They also point by way of relevant factual matrix to certain corporate governance aspects. The Remuneration Committee was made up of non-executive directors who necessarily would not be potential beneficiaries of awards under the LTIP and who would, therefore, have no actual or potential conflicts of interest in making the relevant determinations and exercising the relevant discretions under the LTIP. This, say the Claimants, is just as matters have to be given the background where *"remuneration decisions place the executive directors in a position of acute conflict of interest"* (Gower on Principles of Modern Company Law (10th ed.), Davies and Worthington, p.395). This they say is reflected in the UK Corporate Governance Code ("CGC"), which requires the Board to delegate responsibility for setting the remuneration of executive directors to the Remuneration Committee.

135. They also submit that the structure of the meeting – with the break for the Remuneration Committee to meet – is consistent with this position. If the Board thought it could and was exercising the power under Rule 6.1 there would be no need to convene the Remuneration Committee.

136. Against this the Defendants say that the reality is that the Integration Awards never vested. The Defendants submit that when it comes to this aspect, the court can only properly give summary judgment if it accepts the Claimants' case on the March meeting. The Remuneration Committee's position, as at 24 January 2012, was conditional: the Awards "*should*" vest subject to "*the Company Secretary confirming that nothing had changed to affect the performance levels and the resulting payouts*". There was plainly a contemplation that something further should be done. There was no clear determination. To the extent that the Court is not satisfied this is correct however, they submit the point is plainly arguable.

137. Once that point is cleared out of the way, they say that the 2 March date cannot assist. That date was named on a hypothesis that "*nothing had changed*". But they say, between 24 January 2012 and 14 March 2012 something had changed: a consultative exercise with shareholders was undertaken which revealed shareholders' dissatisfaction with rewarding the Claimants for one positive element of what was now seen as an overall significantly negative transaction. Further, the LTIP was amended on 22 February to include a power of downwards adjustment in Rule 6.4.

138. As for the March meeting, the Defendants submit that one needs to look at the minutes sensibly against their background, which includes the fact that the meeting came less than a month after the same committee approved Rule 6.4. In that context they submit it is nonsensical to suggest that Rule 6.4 is not in play simply because it is not expressly name checked in circumstances where it is plain that the Rules were before the Board and the Remuneration Committee. They submit that the reliance on the phrase "*would vest with immediate effect*" is misplaced because it has been taken out of context and the salient words are "*under the Rules of the Plan*" which appear next to it. This means that all of the rules needed to be considered and a final decision was not made by the Remuneration Committee because the Remuneration Committee referred the matter back to the Board, who took the final decision. They submit that this is supported by a careful reading of the whole meeting session, in particular bearing in mind the absence of a specific conclusion that the shares did as opposed to "would" vest, the crossover of references to consultations with shareholders and the decision to refer back to the Board (including all members of the Remuneration Committee) after the close of the Remuneration Committee meeting.

139. All of this, they say, points firmly to a conclusion that what happened was that a final decision regarding vesting was not made by the Remuneration Committee and that the decision of the Board was that the shares did not vest as regards the executive directors, including the Claimants.

140. On the subject of whether the Board could be the Committee within the meaning of Rule 6, the Defendants submitted that it was illogical to say it could not, since the Board was the fount of authority, which it delegated to committees. The authority in question was therefore effectively that of the Board. As for the corporate governance points, the Defendants submitted that these were hollow in circumstances where, in the first place, all directors had an open invitation to attend the Remuneration Committee meetings, and in the second place effectively all the attendees at the Board meeting were themselves non-executive directors who had a positive right to attend any Remuneration Committee meeting.

*Discussion*

141. On this issue I have no difficulty in concluding that the arguments of the Claimants are correct as regards the 14 March meeting, although I accept the submission that as regards the January meeting (and the 2 March date) the question of vesting is at least arguable for the Defendants. The decision in January does read as an "in principle" decision, and that is supported both by the reference to a later date for vesting (which would not cohere with the Rules) and the reference which also exists to consulting with UKFI before the matter was progressed.

142. However, the scheme under Rules 6 and 7 is clear. The first stage of the process is vesting, under Rule 6. Vesting is, on the clear words of the Rule, inextricably linked to the determination of satisfaction of Performance Conditions. There is no specific provision for a decision to vest at all; Rule 6.2 strongly implies that vesting follows automatically from a determination of the performance condition having been met (at least to the extent of that determination).

143. How this fits in with the operation of Rule 6.4 (were it valid) is a little opaque; however what is clear is that Rule 6.4 forms part of the vesting process, and that both are decisions for "*the Committee*". My own conclusion would be that Rule 6.4 is envisaged as being considered as part of the vesting decision making and no final decision on vesting would be taken (*pace* Rule 6.2's wording) until that exercise was complete.

144. Whether or not the Board could be the Committee in question (to which I shall come below) on the facts here the minutes disclose a threefold process. The first is a discussion of background factors. The second is a deliberately separated meeting of the Remuneration Committee which on its face deals with satisfaction of the Performance Conditions. The context suggests strongly that the reason for the convening of a separate meeting was to determine vesting under Rule 6. This is supported by the way the Remuneration Committee proceeded. It dealt with the satisfaction of the Performance Criteria not informally, but formally and within the conventions of meetings, and specifically with a formal proposal and resolution. It seems absolutely plain on the face of the minutes that a determination was made that the Performance Conditions had been satisfied. *Prima facie* that indicates that the shares vest.

145. They would only not do so if there were a determination as part of the same process that an adjustment had to be made under Rule 6.4. There is no sign at all of the Remuneration Committee engaging with this process; indeed it was not suggested that they did.

146. Further (again leaving aside the question of whether the Board could make a Rule 6 determination) when the Board meeting reconvened what they recorded (again within a formal Board minute) was that a decision had been taken that the shares would vest. I do not see anything in the use of the word “would” which derogates from the consistent picture presented of a determination under Rule 6 by the Remuneration Committee, particularly in the context of the wording of Rule 6.2.

147. That being the case, the role for the Board would be to deal with transfer of the shares. And again, this is exactly what the minutes on their face record; and entirely consistently with Rule 7, which places transfer as a "Company" i.e. Board role. As to the suggestion that one sees in the exercise which the Board performs an exercise of the Rule 6.4 role, I find this, despite Mr Hochhauser QC's very skilful argument, utterly unconvincing.

148. Firstly there is no sense in divorcing the exercise of the Rule 6.1 and Rule 6.4 functions, and no justification in the text which plainly envisages the two being performed by the same group and which, by reference to Rule 6.2, strongly indicates that the two exercises need to be performed at the same time.

149. Secondly if the Board is to do both, there would be no sense in breaking for a Remuneration Committee meeting.

150. Thirdly, it is in practical terms impossible to find a Rule 6.1 determination by the Board. It is plain that in fact that decision was taken by the Remuneration Committee.

151. Fourthly there is practically no material from which one can spell out a Rule 6.4 exercise by the Board. The Board explicitly invoked both Rule 6.1 and Rule 7 wording. But there is no "read across" from Rule 6.4 to the minutes. In terms of substance the majority of the material on which the Defendants were forced to rely sits well before the Remuneration Committee meeting. It does not appear contextually to be likely to be a Rule 6.4 exercise. And in terms of details for the reasons which I set out below, it does not appear that what was considered, even patching bits together from different parts of the minutes, covers the requisite elements of Rule 6.4.

152. Accordingly I find that the Remuneration Committee did make a decision on vesting at the 14 March meeting, and did decide that the shares should vest in full. They did not purport to exercise Rule 6.4 (and if Rule 6.4 did stand as valid, they would have no obligation to do so ("may adjust" is the wording)). It follows that the shares vested as of 14 March 2012. It was rightly accepted that if this were the case, there was no scope for refusing to transfer some or all of the shares within the Rules. Accordingly the Defendants' defence on this issue has no real prospects of success.

153. I should add that I would in any event have found that the Board was not "*the Committee*" for the purposes of the exercise of Rule 6 powers. The wording of the Rule expressly contemplates the Rule 6 decision being made by a Committee, as opposed to by "*the Company*", which is how the Board's role is apparently usually indicated in the Rules. Internally in the Rules there are other references (for example at Rule 13.3) which make it clear that the Committee contemplated is the Remuneration Committee. Further the Remuneration Committee's own terms of reference make it clear that they are the committee contemplated.

154. The plain answer as a matter of construction matches with the surrounding circumstances. It was the Remuneration Committee which decided on the adoption of Rule 6.4. This matches with the org chart which shows the Board's powers being delegated to the Remuneration Committee as regards such matters. This is itself consistent with the previous role of the Committee, and with the role of the Committee in this case – the convening of a Remuneration Committee meeting part way through the 4 March Board meeting is otherwise nonsensical. It is also consistent with the kind of transparency which was called for both by external and internal corporate governance standards.

**Issue 3: Was the decision under Rule 6.4 an unlawful exercise of discretion?**

155. This point is academic, in the light of the findings I have made above. It was entirely correctly conceded for the Defendants that if the shares vested there could be no lawful exercise of the discretion.

156. However again for completeness I shall consider what the answer would have been if I had found that the shares did not vest.

157. The Claimants initially concentrated fire on the question of whether, if Rule 6.4 was valid, what was done was within the scope of an adjustment.

158. The Claimants submit that Rule 6.4 only authorised the Bank to make an "*adjustment*" to the Awards. On a proper construction of Rule 6.4, the word "*adjustment*" referred to a slight recalibration of the Award and did not, therefore, permit the Bank to make the swingeing reduction to nil that it ultimately did. They say that the word must be construed narrowly and point to the Concise Oxford English Dictionary (12th ed) definition as to "*alter (something) slightly in order to achieve a correct or desired result*". They say that Rule 6.4 authorised a slight reduction to Awards such as those of Mr Daniels, perhaps in the region of 10% at the very most.

159. As for the wording "*including to nil*", they say that this is merely designed to make clear that, if an Award is already very small, a slight adjustment might mean that the employee participant receives nothing at all. It does not authorise the Bank to reduce a large Award to nil, since that cannot fairly be described as a mere adjustment.

160. Aside from this the Claimants submit that on the facts the evidence is clear that the Defendants did not exercise the discretion in line with its terms. In particular they say there is no hint of consideration having been given to individual performance, as Rule 6.4 required.

161. The Defendants took an overall "bigger picture" approach submitting that Rule 6.4 encapsulated a discretion and that the limits of review in such cases are effectively where the discretion is exercised in a manner which is arbitrary, capricious or otherwise irrational. So in *Clark v Nomura International plc* [2000] IRLR 766 at paragraphs 40-41 a proprietary trader was awarded a nil bonus even though he had generated substantial profits for the bank and the Court found such treatment to be irrational.

162. They also referred me to the judgment of the Court of Appeal in *Horkulak v Cantor Fitzgerald International* [2005] ICR 402 where Potter LJ giving the judgment of the Court stated at para 30:

> "a requirement necessary to give genuine value, rather than nominal force or mere lip-service, to the obligation of the party required or empowered to exercise the relevant discretion. While, in any such situation, the parties are likely to have conflicting interests and the provisions of the contract effectively place the resolution of that conflict in the hands of the party exercising the discretion, it is presumed to be the reasonable expectation and therefore the common intention of the parties that there should be a genuine and rational, as opposed to an empty or irrational, exercise of discretion. Thus the courts impose an implied term of the nature and to the extent described."

163. The third main case to which I was referred was *Keen v Commerzbank* [2007] ICR 623. In that case the claimant was paid substantial bonuses for 2003 and 2004 but contended that they were nevertheless irrationally low. That argument was rejected by the Court of Appeal. Mummery LJ (which whom Jacob LJ agreed) said:

> "39 … I must make it clear that it is not the function of the court to usurp the Bank's exercise of its discretion. It is for the Bank to decide whether to pay a bonus and, if so, how much, when and in what amount and form. The court is not entitled to substitute itself for the Bank. The court is not a bank. It does not employ the staff of the Bank or pay them. The court's function is limited to deciding whether the Bank acted in breach of the contract term relating to the discretionary bonus decisions in the years 2003 and 2004.
>
> 40 Mr Keen agreed with the Bank that it has a discretion to decide whether he is paid a bonus on top of his basic annual salary and, if so, how much. The only function of the court is to decide on the legal limits to the Bank's contractual discretion and whether the Bank has acted within or outwith the limits. Apart from that consideration the Bank, not the court, is the judge of what it should pay its staff. ….
>
> 58. In my judgment, the claim that the bonus pool decisions for 2003 and 2004 were irrational or perverse faces difficulties which Mr Keen is unable to surmount.
>
> 59. First and foremost, the Bank has a very wide contractual discretion. Mr Keen has to show that the discretion has been exercised irrationally. It cannot be said that the decisions of the Bank on bonuses for 2003 and 2004 are irrational on their face. The burden of establishing that no rational bank in the City would have paid him a bonus of less than his line manager recommended is a very high one. It would require an overwhelming case to persuade the court to find that the level of a discretionary bonus payment was irrational or perverse in an area where so much must depend on the discretionary judgment of the Bank in fluctuating market and labour conditions".

164. Finally reference was made to the rather unusual case of *Braganza v BP Shipping* [2015] ICR 449 where these authorities were reviewed by the Supreme Court at paragraph 57 of Lord Hodge's judgment:

> "57 In cases such as Clark v Nomura International plc , *Keen v Commerzbank AG and Horkulak v Cantor Fitzgerald International [2005] ICR 402* the courts have reviewed

> contractual decisions on the grant of performance-related bonuses where there were no specific criteria of performance or established formulae for calculating a bonus. In such cases the employee is entitled to a bona fide and rational exercise by the employer of its discretion. The courts are charged with enforcing that entitlement but there is little scope for intensive scrutiny of the decision-making process. …"

165. In line with these authorities the Defendants submitted that Rule 6.4 creates a discretion and that it is for the Claimants to show that the Defendants' decision not to transfer or issue the Integration Awards was irrational and that they had not done so.

166. The Defendants' position is that its exercise of discretion pursuant to Rule 6.4 was lawful and there was no breach of contract. The factors in Rule 6.4 are a list of individual factors, to be read disjunctively. Accordingly an exercise of the discretion by reference only to factors relevant to the Defendants was perfectly permissible; there needed to be no individual element and an exercise confined to such considerations did not constitute an arbitrary capricious or irrational exercise. But in any event, they submit, a fair reading of the minutes of the 14 March meeting demonstrated consideration both of issues relevant to the Defendants' interests, but also matters relevant to individual performance. There could therefore be no breach of the requirements of the clause.

*Discussion*

167. So far as this topic is concerned, I reach the following conclusions. First, I do not consider that the reading which the Claimants suggested in relation to adjustment was compelling. The word "*adjustment*" is plainly qualified by the words "*including to nil*". There is no qualifying wording such as one would expect if a two layer system, such as that suggested by the Claimants, was to operate. What is more, to regard a change as minor simply because the total "adjusted" is smaller in case B than case A is fallacious. In either event the recipient is being deprived of 100% of his or her entitlement. Furthermore such an approach would involve unacceptable uncertainty as to where the minor effects ceased, such as to preclude an adjustment to nil. One must conclude that the word "*adjustment*" may not be the most suitable word, but the intent is clear. Rule 6.4 permits on its face an alteration of the shares earned by reference to the defined criteria to any extent deemed appropriate in the light of the relevant circumstances.

168. It is not however a pure discretion; the limits which the authorities set down in cases of exercise of contractual discretion are to some extent defined by the content of the clause. The authorities to which the Defendants referred were essentially cases of pure discretionary bonuses; the position here, with a parametered discretion sitting atop an objective system is somewhat different. What the Bank must do is exercise the discretion by reference to those parameters (so it cannot act rationally but without regard to these parameters); and within the exercise of those parameters it must not act arbitrarily, capriciously or irrationally (for example by assessing a particular criterion by reference to imaginary evidence). Accordingly the reliance by the Defendants on the pure contractual discretion cases here was to some extent

misplaced. It would not be necessary to show arbitrariness or capriciousness or irrationality at large, but only by reference to the criteria of Rule 6.4.

169. I would, had the matter turned on this question, have been very careful on the question of whether this was a suitable question for summary determination, not least because the argument did seem to emerge at the door of the court. However since it cannot make any difference and the conclusions, even if not determinative alone are of relevance to some of the points above, it is worth dealing with the point.

170. The first question is whether the rule imported a dual consideration (performance of Company/Member/business area/team plus conduct/capability/performance of the participant) or a single basket of considerations with the "and" being read disjunctively. On this, I cannot see how, in the context of this sentence where it precedes three alternatives, "and" can realistically be read disjunctively. Nor indeed, in terms of the purpose of the Scheme (a relevant factor in considering any contractual discretion), would a set up where an adjustment could be made by reference solely to the performance of any Member of the Group or business area, and without any relevant consideration by reference to the affected individual, seem to make any sense.

171. The second question is whether there is evidence of consideration of the relevant test in the Minutes. If the test is dual, in my judgment there is not. Even if the test were single, while the minutes plainly do touch on the question of the Group's performance, they do not on their face suggest that there was separate consideration of whether that factor justified an adjustment. The position would be similar to the *Mallone* case, where (see [41-42]) the power had to be shown to have been exercised rationally and on the face of the evidence there was no sign of consideration of why it was permissible to take away the earned bonus of an employee who had not committed any misconduct. However this might well be an area where the Defendants would suggest that more evidence was necessary if the outcome were to turn on it.

### Issue 4: Whether Rule 15.7 prevents the Claimants from seeking the relief sought

172. The Defendants rely on Rule 15.7 as a complete answer to the Claimants' claim even if it is found that there has been an unlawful exercise of the discretion in Rule 6.4, though it cannot bite if (as I have found) Rule 6.4 is itself invalid.

173. The operation of Rule 15.7 denies Claimants a right to "*compensation for any loss*" in relation to the Plan in two circumstances:

i) Firstly, where there is *"any loss or reduction of rights or expectations under the Plan in any circumstances"* pursuant to Rule 15.7.1; and

ii) Second, in relation to *"any exercise of a discretion or a decision in relation to an Award or to the Plan"* pursuant to Rule 15.7.2.

174. The Defendants say that the clear words of Rule 15.7.1 cover "*reduction of rights or expectations under the Plan in any circumstances*". The exclusion, therefore, is broad and is wide enough to entitle the bank to withhold the transfer of shares. Furthermore, the Unfair Contract Terms Act 1977 does not apply in the employment context.

175. For the Claimants it was submitted that this is an exclusion clause and, as with the position on Rule 17.1, it is trite law that it "*must be expressed clearly and without ambiguity*" if it is to be found to be effective - especially so where, as here, it is intended to protect the party who had control of the drafting process and the benefit of sophisticated legal advice (Chitty, 15-008, 012).

176. They submit that read correctly, Rule 15.7 only excludes the right to "*compensation*" for any "*loss*" in relation to the Plan and that the primary relief they seek is not "*loss*" since they seek (a) a declaration by each that he is entitled to receive his Award and (b) an order that the Bank should transfer or issue to him the shares due under the Award, neither of which remedies can be described as "*compensation*".

177. The Claimants also dispute the efficacy of the clause to exclude claims for damages in that:

   i) Whilst Rule 15.7.2 purports to exclude claims relating to "*any exercise of a discretion*", their case (ex hypothesi successful) is that the Board had no discretion to exercise.

   ii) As to Rule 15.7.1, it is "*inherently unlikely*" that the parties intended to exclude all damages claims, in that if that were the case the contract would be *"effectively devoid of contractual content since there is no sanction for non-performance by the Respondent"* (*Kudos Catering (UK) Ltd v Manchester Central Convention Complex Ltd* [2013] 2 Lloyd's Rep 270, [19], where the Court of Appeal (Tomlinson LJ) refused to uphold as a general exclusion a term which stated: *"The Contractor hereby acknowledges and agrees that the Company shall have no liability whatsoever in contract, tort (including negligence) or otherwise for any loss of goodwill, business, revenue or profits … "*).

178. Further they submit that Rule 15.7.1 does not purport to exclude claims for breach of the LTIP Rules (claims *qua* participant of the Plan); rather, it purports to exclude claims qua employee such as claims for loss or reduction of rights or expectations e.g. as a result of unlawful dismissal. Where the Bank acts in breach of the LTIP Rules, it cannot be said that the employee participant's rights have been "*lost*" or "*reduced*"; they have merely been breached, and can be enforced by legal proceedings. As such, Rule 15.7.1 does not exclude their claims for breach of their rights under the LTIP Rules.

179. Alternatively, they say that Rule 15.7.1 (in contrast to Rule 15.7.2) only applies to breach of the Plan, not breach of the terms of an Award. As such, it does not exclude claims by persons (such as Mr Daniels) in whose favour an Award has already been made. Rather, its purpose is to exclude claims by disappointed employees in whose favour an Award was not made.

180. The Defendants submit that there is nothing in these arguments. They submit that the Claimants' approach effectively denudes the clause of any meaning and that as part of the Plan the clause is plainly apt to exclude claims under that same plan. The loss of a right to a transfer of shares is still, they say, a loss within the meaning of the clause. There has been an exercise of a discretion, even if not expressly. As for the breach/loss argument Mr Hochhauser QC characterised them as being "like a horse

and carriage" – one cannot have loss without breach, and so the argument is fallacious.

181. The *Kudos* case is said to be distinguishable in that there it was clear (at least to the Court of Appeal) that the very broad exclusion was a qualification to the indemnity provisions and not a blanket exclusion. Here they submit there is no equivalent yardstick for the operation of the clause and the words are clear, and on ordinary contractual principles (see again *Suisse Atlantique*) should be made to operate.

*Discussion*

182. I do not see here the distinction which the Defendants sought to draw between this case and the *Kudos* case. That case may be rather more extreme, in terms of the breadth of the blanket exclusion in that case, but there are otherwise similarities. Both deal with an exclusion which taken by itself is wide and might be said to exclude recovery for a potentially surprising range of losses. Both are to be found, not in the context of a heading: "*General Exclusion Clause*" or some other heading which reinforces that that is what they are aiming to do, but under a sub-heading which points in a different direction. In *Kudos* the heading was "*Indemnity and Insurance*". Here Clause 15.7 appears three quarters of the way down the provisions under the heading "*Terms of Employment*".

183. It is in my view worth reiterating a passage from that judgment, where Tomlinson LJ outlines the kinds of considerations which must assist the construction of broad words in this kind of context - and which demonstrates the crossover between the factors relevant here and in relation to the first issue:

> "19. … if the judge's construction of Clause 18.6 is adopted, [the contract is] effectively devoid of contractual content since there is no sanction for non-performance by the Respondent. It is inherently unlikely that the parties intended the clause to have this effect. ... As Lord Wilberforce said in the Suisse Atlantique case [1967] 1 AC 361 at 431–2 … [quoted above]
>
> 20 Nonetheless, where language is fairly susceptible of one meaning only, that meaning must be attributed to it unless the meaning is repugnant to the contract in which case it may be necessary to ignore it – see per Briggs J in EU Network Fiber v Abovenet [2007] EWHC 3099 at paragraph 257.
>
> 21 But as Lord Clarke of Stone cum Ebony pointed out in The Rainy Sky case, ... at paragraph 21:—….. [quoted above]
>
> To similar effect is a passage … from the judgment of Hoffmann LJ, as he then was, in Co-operative Wholesale Society Limited v National Westminster Bank, at page 99. …
>
>> "This … does not however mean that one can rewrite the language which the parties have used in order to make the contract conform to business common sense. But language is a very flexible instrument and, if it is capable of more than one construction, one chooses that

> > which seems most likely to give effect to the commercial purpose of the agreement."
>
> There also in my view comes into play the presumption that neither party to a contract intends to abandon any remedies for its breach arising by operation of law – see per Lord Diplock in Modern Engineering v Gilbert-Ash [1974] AC 689 at 717. Lord Diplock went on to say that clear words must be used to rebut this presumption and the judge plainly thought that the words here used were sufficiently clear for that purpose. The judge should not in my view have reached that conclusion without first examining the context.
>
> 22 As I have already observed above, the judge cited some of these passages from the authorities but, in my view, he fell into error in thinking that the ascertainment of the meaning of apparently clear words is not itself a process of contractual construction. He failed to consider the words of the clause in their wider context."

184. This passage underlines the importance in this exercise of construing exclusion clauses of both paying due respect to the words used, but also (and particularly where they yield a surprising result) balancing the factors indicated by context and commercial context. It seems to me that the Defendants are in effect inviting me to fall into the same error as was committed by the first instance judge in *Kudos* - looking at the words without their wider context. Once the context is properly considered, the result is, in my judgment, inescapably the same as that which followed in *Kudos*.

185. The clause has to be seen as having special reference to claims which are properly characterised as employment claims and not claims in the context of the Plan generally. In this context the wording makes perfect sense – and indeed the example given (of loss or reduction of rights consequent on lawful or unlawful termination of employment) reinforces that approach. Certainly the words are not sufficiently clear, given the context and the surprisingly extensive effect of such a construction, for the Defendants' construction of this clause to succeed.

**Issue 5: the effect of the Claimants' agreements**

*Mr Daniels' Heads of Terms*

186. On 20 September 2010, Mr Daniels agreed Heads of Terms for his retirement with the Bank. He relies on the fact that the section addressing the LTIP was said to form *"legally binding obligations of LBG and the executive"* and that the Heads of Terms stated that his Award would be *"released in line with the normal vesting dates at the end of the performance period if and to the extent that conditions have been met"*. He therefore says that the Bank's refusal to honour his Award, notwithstanding its admission that the Performance Conditions have been satisfied, is inconsistent with the obligations that it assumed in the Heads of Terms.

187. Insofar as the Bank relies on the argument that the Heads of Terms were expressed to be "*subject to the rules of each plan*", Mr Daniels submits that on a proper construction of the Heads of Terms, Rule 17.1 of the LTIP Rules was not incorporated. He points to Chitty on Contracts (32nd ed) paragraph 13-082 which states that:

> "if clauses are incorporated by reference into a written agreement, and those clauses conflict with the clauses of the agreement, then, in the ordinary way, the clauses of the written agreement will prevail. Moreover, the incorporating provision may be so general or wide as to have the effect of incorporating more than can make any sense in the context of the agreement, in which case the surplus may be rejected as insensible or inconsistent."

188. He says that such an inconsistency exists here because:

i) The Heads of Terms were cast in terms of "would be entitled" with the sole qualification to that being that he ultimately left the Bank by reason of retirement, and not for any other reason.

ii) The purpose of an agreement in the nature of the Heads of Terms is to achieve certainty and finality (Foskett on Compromise (8th ed.), 6-01). Rule 17.1 cannot, therefore, have been incorporated into the Heads of Terms, since the Bank's obligations would then have been subject to open-ended, unilateral change. Moreover, a clause providing for unilateral variations in the future has no role in a contract, like the Heads of Terms, designed to bring the parties' relationship to an end.

189. He also points to the authorities which say that where standard terms are incorporated into an agreement, "prima facie *a reference to standard terms and conditions is a reference to the terms and conditions current at the date of the contract*" (*Ford Motor Company of Australia Ltd v Arrowcrest Group Pty Ltd* [2002] FCA 1156, [6]). Accordingly, he says the Heads of Terms incorporated the LTIP Rules as at the date of the Heads of Terms, namely 20 September 2010, without any subsequent amendments made pursuant to Rule 17.1.

190. Mr Daniels also submits that the Bank's reliance on the *"no other circumstances apply"* provision is misconceived in that it amounts to a submission that this provision gave it an open-ended discretion to refuse to honour the Heads of Terms if *"other circumstances"* apply which he says cannot be the case; that would mean that the Bank could have repudiated the Heads of Terms for practically any reason; if that had been intended the parties would have specifically provided that the LTIP section was not intended to be legally binding (as they specifically did for the Salary Review, Annual Incentive and Pension sections).

191. He submits that the correct construction of the relevant sentences is that the Heads of Terms were only applicable if Mr Daniels left the Bank by reason of retirement. In the event that he left in "*other circumstances*" (i.e. dismissal for misconduct,

redundancy etc), the Heads of Terms were inapplicable. However he did leave by means of retirement and is therefore entitled to rely on the Heads of Terms.

*Mr Tate's Compromise Agreement*

192. It was pursuant to this agreement that Mr Tate agreed to the termination of his employment with effect from 31 January 2013.

193. Mr Tate relies in particular on Clause 6.4 of the Compromise Agreement, which provided:

> "A draft letter is appended at Schedule 4, based upon Your Termination Date, giving You further information about Your Executive Share Scheme Options and LTIP awards under the Plan."

194. The letter in turn referred to and attached details regarding Mr Tate's Integration Award at Appendix B, which stated:

> "Your Integration Award
>
> Your award currently remains subject to the performance conditions and the number of shares you will receive at the end of the 3-year performance measurement period will be determined by that performance.…The performance for Years 1 and 2 of the 3-year performance period have now concluded, the performance has been measured and the combined maximum payout for 2009 and 2010 has been banked for you. That equates to 58.25% of your original Award. In addition, you will be entitled to any shares banked in respect of year 3."

195. Mr Tate says that it is plain that this (in particular the references to "banking" and "will receive" or "will be entitled") is all the language of contractual entitlement. It is also in marked contrast to such clauses as clauses 3.1 and 3.2 of the contract in relation to bonus awards (rather than LTIP awards), which provided in terms that the awards were *"subject to malus provisions"*.

196. He also points to the provisions which indicate finality is intended. He says Recital (A) to the Compromise Agreement made clear that the agreement recorded *"the terms on which they have agreed to settle all outstanding claims"*. It was not a part of those terms that the Integration Award could be denied on a basis which was not within the Rules or performance conditions for that award. He also points to the fact that Clause 14.1 stated that *"the terms of this agreement are in full and final settlement of all claims…"*.

197. Like Mr Daniels he submits that a cross reference to LTIP terms must be a reference to terms at the time of the letter, not later terms. As well as referring back to *Khatri* at

[39] he points to the judgment of Lord Fraser in *Smith v South Wales Switchgear Co Ltd* [1978] 1 WLR 165 (regarding standard terms of sale), at p.171G:

> "It seems to me that the reference to general conditions without any further description must be taken to refer to the edition current at the date of the contract... If the appellants had asked for a copy of the general conditions that is the version which ought to have been sent."

198. Mr Tate also refers to the judgment of Christopher Butcher QC (as he then was) in *MPloy Group Ltd v Denso Manufacturing UK Ltd* [2014] EWHC 2992 (Comm) in support of the proposition that clear words in the Compromise Agreement itself would be required before words of incorporation were effective to incorporate future amendments made to those terms from time to time:

> "64…The contract does not contain any wording to the effect that it is MGL's terms and conditions 'in force from time to time' which are applicable, and I do not consider that such words can be read into Clause 1.3… A fortiori, I do not consider that it is possible to read into Clause 1.3 the more elaborate provision that the applicable terms will be MGL's standard terms from time to time of which notice has been given to DMUK.
>
> 65. … it is possible for parties to a contract to agree that terms adopted by one of the parties from time to time will apply to their relationship, or to include an express power on one party to vary the contract. … clear language would be required for a contract to be construed as having such an effect, and a term which would have such an effect will not generally be implied. … I also consider that some support for this approach is provided by *Wandsworth v Da Silva* [1998] IRLR 193, per Lord Woolf MR at [31], which, albeit obiter, is germane; and by *Security and Facilities Division v Hayes* [2001] IRLR 81. Both those are cases about employment contracts, but I consider that there is no reason why a similar approach is not warranted in the present context.
>
> 66. Applying such an approach to the present case, there was no clear or unambiguous language providing for the application of MGL's terms of business applicable from time to time. I find this unsurprising, as a provision such as that for which MGL contends would be open to abuse, and would be one which a commercial party such as DMUK would be unlikely to accept."

199. He also points to the entire agreement clause which provided that *"the terms of this Agreement constitute the entire agreement and understanding between the parties*

*hereto"* (clause 18) as reinforcing the argument that the terms of the Compromise Agreement did not include amendments to the Rules which were not made until after it was concluded.

*The Defendants' approach to the agreements*

200. The Defendants rely on the fact that both agreements refer back to the rules of the LTIP. For example clause 6.4 of the Compromise Agreement provided that:

> "Any entitlement to the receipt of shares under any subsisting share awards under the Company's Long-term Incentive Plan ("LTIP") (the "Plan") shall be determined in accordance with the rules and conditions of the Plan".

201. They say that the language, read overall, is plainly conditional and that there is no sense of entitlement conveyed beyond the right to receive a determination in accordance with the rules of the Plan. They referred to a future determination; there is no reference to accrual, and there is no language of guarantee in the words used (as there could have been). Those rules always included Rule 17 which enabled changes at large, and by the time of the determination of entitlement they included Rule 6.4.

202. So far as it was suggested that Rule 17 should be read as confined to procedural changes it was submitted that this was inconsistent with Clause 16, which specifically dealt with procedural changes. Accordingly Rule 17 effectively had to have a wide application.

203. So far as the *Ford* case was concerned the Defendants pointed to the fact that the terms in that case did not contain a similar power to amend comparable with Rule 17.

204. So far as concerns the First Claimant's reliance on the Heads of Terms, which was concluded on 20 September 2010, and the contention that the parties could not have intended that the Second Defendant would be unilaterally entitled to vary them by introducing Rule 6.4 it is submitted that is incorrect in that the rules of the plan expressly contain a power of amendment.

205. Accordingly, they say, the Integration Awards were made subject to the 2006 LTIP as amended and the relevant amended version at the time the decisions were taken with respect to the transfer or issue of the Claimants' shares on 14 March 2012 was the 2012 Amendment. This means that the rules in play when the decision-making on 14 March 2012 took place included Rules 6.4, and 17. Nothing in the Second Claimant's Compromise Agreement nor the First Claimant's Head of Terms alters that position.

*Discussion*

206. This point can be dealt with briefly. While I am not persuaded that the language in either agreement was as such to convey an absolute entitlement, I do consider that the reference to the Rules is, absent any reference to such terms "*as are in effect from time to time*" or similar clear wording, best read as a reference to the terms then in place. That seems to me to be consistent with the bulk of the authority as outlined

above. It is also consistent with the language of the documents, including the reference to "banking" earlier tranches. That language on its face indicates an entitlement subject only to determination of remaining performance criteria, which is itself consistent with the Rules as they existed at the time.

207. So I do not accept the submission that the Claimants' rights were firmly "crystallised" at the time of their respective agreements; there was still scope for it to be found that the final Performance Criteria had not been met. However even if Rule 17 would otherwise have been apt to permit the introduction of Rule 6.4, that rule could not have been effective vis á vis Mr Daniels and Mr Tate who signed off on what were intended to be final deals before that clause was ever (purportedly) introduced.

## Conclusion

208. For the reasons given I accordingly find that the Defendants' defences have no real prospects of success, and that the Claimants' applications for summary judgment succeed.