

Inspired thinking



The impact of new age discrimination legislation on director dismissals

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Introduction

If only Lord Browne had been able to keep his powder dry for just a few more months. He would then have had the backing of new age discrimination legislation to support his bid to stay on as Chief Executive of BP beyond his proposed retirement date, at age 60, in February 2008.

But an analyst's note in mid-July brought the matter to a head early, suggesting that he might wish to delay his retirement beyond that date. According to the stories in the press, BP's Chairman Peter Sutherland swung immediately into action, and with the backing of non-executives demanded that Lord Browne give certainty to the market (and presumably potentially de-motivated successors) by confirming his retirement date. He was requested to do this within four days — at the presentation of BP's interim results. At the end of those four days, Browne announced he would be retiring in 2008, though in December, ten months beyond the proposed date of February, allowing him to lead BP's centenary celebrations.

Yet things might have been quite different if the analyst's note had been issued after 1 October 2006. Lord Browne might have argued that after eleven highly successful years as CEO of BP, the only obvious reason for being asked to retire at 60 was his age. And, moreover, that all of the current contenders to replace him appear to be a good ten years younger.

All of which suggest unlawful age discrimination under the Employment Equality (Age) Regulations 2006 about to come into force.

The new age rules

The regulations make it unlawful to discriminate against employees (including directors) on grounds of age. Compensation for breach of the regulations is unlimited and is based on the employee's actual losses, including pay, benefits, lost pension benefits, stock options etc.

The burden of proof in discrimination cases tends to favour the individual rather than the company. In brief, an employee has only to show a set of facts that would suggest age discrimination in the absence of an adequate explanation from the company. The burden then shifts fairly easily to the company to prove that age discrimination played no part in the decision to dismiss the individual.

For directors, who because of age and seniority will have difficulties finding comparable roles and remuneration packages, such potential compensation awards could be huge. A director forced to retire at 60 where the only retirement age the organisation can justify is 65, would claim compensation based on five years' lost salary, benefits and pension. Even if the individual has only a twelve month contractual notice period, age discrimination laws will override that provision to allow the director also to claim the additional four years' losses.

For companies, the legal, financial, corporate governance and PR impacts could be substantial. Board members, particularly chairmen, who are

involved in the decision to remove the director may face personal liability if found to have acted in breach of the age regulations.

Exception to age discrimination

There are certain exceptions to age discrimination, most notably where the employee is required to retire at 65. However, any lower retirement age (such as 60) must be justified by the company as 'a proportionate means of achieving a legitimate aim'. Described by the DTI as 'the tough test' that employers will have to satisfy, it basically means that the company (namely the chairman and board) will have to prove that:

- The company has a real business need (in this case, for an earlier retirement age of 60 rather than 65);
- The earlier retirement age is an appropriate and necessary way of responding to that need;
- It has considered the potential discriminatory impact of that early retirement age on the individual, including its severity; and
- It has considered whether there is another reasonable alternative to achieving that business need in a way that might avoid or minimise age discrimination, and that that lesser route has either been taken.

In the absence of case law, we can only speculate at the moment on what the tribunals will regard as objective justification for forcing a chief executive or director to retire early and what alternatives might be regarded as reasonable.

Planning for succession or ensuring the company does not become too dependent on one individual, for example, could potentially amount to justification, if there was clear evidence that uncertainty over the future of the business might significantly undermine the share value or damage shareholder confidence.

But consideration would still need to be given by the board as to whether there would be another way of providing such certainty and minimising the impact of age discrimination – for example with a properly managed later retirement age of 62 or 63; a period of phased handover; a joint appointment; or promotion to chairman. Such options would inevitably raise

issues under the Combined Code that would have to be addressed; how much sympathy the tribunal would show to such recommendations remains to be seen.

Pre-retirement notification procedures

The company will also need to adopt retirement notification procedures required by the new regulations. The company must notify the executive in writing of the proposed retirement date and his/her right to request to continue working beyond that date. That notice must be given between six and twelve months before the intended retirement date. If the executive makes such a request, a meeting and appeal process ensues. Failure to follow this notification process will be taken into account by tribunals in deciding whether the forced retirement at 60 was justifiable and fair.

The response of businesses to the new rules

A survey recently conducted of human resources directors, in-house lawyers and board directors by our firm revealed that companies are likely to start putting directors through formal performance and dismissal procedures, and documenting the true reasons for the director's departure, to help defend against potential age discrimination claims. Even though most companies would still prefer a quiet departure, it was felt that this would signal the possible decline of 'cosy deals in smoke-filled rooms' for departing directors.

Over two thirds (67%) of respondents to the survey considered that there would be significant corporate governance concerns regarding negotiated director exit packages inflated by age discrimination compensation. They believed this would result in more 'reward for failure' stories in the press.

Respondents considered that companies will need to:

- Plan and communicate more clearly and carefully before dismissing a director;
- Document the reasons for a director's departure and collate supporting evidence in advance of approaching a director about departure;

- Adopt an approach that is broadly consistent with that applied to other employees regardless of seniority, otherwise such inconsistency could, without justification, in itself amount to age discrimination.

Some respondents felt that the age discrimination rules are likely to make companies slower to remove failing directors for fear of claims and that there will be cynical use of the age discrimination legislation by directors to seek more generous exit packages.

The way forward

A better documented, more procedural and better planned and justified approach to director departures is therefore likely to emerge. Board and individual member evaluations, as recommended by the Combined Code, are likely to form a good starting point for discussions regarding director underperformance; ideally they should be followed

up with formal, documented performance management procedures, led most likely by the chairman of the board.

Where personality conflict is the real reason for departure, again it would be advisable to document such reasons and collate supporting evidence in advance, to show that the reason for the director's departure is not related to age. As unpalatable as this may seem, to leave a vacuum of evidence would make it very difficult for the company to prove that age played no part in the decision to remove the director.

And finally, a note about language: companies should try to avoid expressions such as 'the need for fresh blood,' 'next generation,' 'more energetic' or 'more dynamic' leadership. They all carry connotations of age and could place the company on the wrong end of a multi-million pound discrimination claim. As they used to say in the Navy: loose lips sink ships...

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