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The End of the Opportunistic Breach of Contract! The Elective Theory of Repudiatory Breach Prevails: *Societe Generale, London Branch v Geys* [2012] UKSC 63

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SUMMARY

On the 19th December 2012 the Supreme Court provided an answer to the long-standing question as to the consequences of a wrongfully repudiated contract of employment. Was it for the innocent party to elect to accept the repudiation to bring the contract to an end? Or, was the contract automatically ended upon the wrongful repudiation? Previous authorities had moved between these elective and automatic theories. The elective theory held that a wrongful repudiation only became effective where the innocent party elected to accept the repudiation. Conversely, the automatic theory considered that the contract ended automatically upon the repudiation. Whilst in traditional contract law, the elective theory had been established as effective, this was not decided with authority in contracts of employment. In *Geys*, the Supreme Court had the opportunity to consider which was the applicable theory in relation to an employer's use of a payment-in-lieu of notice (PILON) clause. The Court resolved the conflict (4-1 with Lord Sumption dissenting) by holding that the elective theory was preferred in instances of wrongful repudiation of a contract of employment. This judgment has significant implications for employers, but also for employees who wrongfully terminate the contract.

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BACKGROUND

Contract law had a settled principle whereby on the event of a repudiatory breach of contract the innocent party was entitled to choose to either accept the repudiation (within a reasonable time) or to affirm the contract. This, however, was not a simple matter when the contract in question related to an employment relationship. The debate was whether the automatic or elective theory prevailed. The elective theory required the innocent party to accept the repudiation before the contract was terminated. However, the automatic theory held that upon the repudiation, albeit that it was wrongful, the contract was brought to an end automatically and the innocent party would seek damages as way of compensation. The elective theory was the most 'fair' and in line with traditional contract orthodoxy, but of course, traditional contract law was developed on a commercial bias which, naturally, is not so applicable in employment contracts (so-called relational contracts – see Brodie 2011).

In the case before the Supreme Court, the employee, Mr Geys, had been dismissed without notice from his employment. If his employment was terminated in 2007 he would have been entitled to a termination payment of €7m, if his employment was terminated in 2008, that figure would have amounted to €12.5m. As such the arguments presented by the parties amounted to when the employment contract was effectively terminated. The contract of employment included a PILON clause, and the Court had to determine when and how such a clause could be applied and be relied upon. In so doing, this led to a resolution of the conflict between the automatic and elective theories of termination of the contract of employment.

THE FACTS

Societe Generale, London Branch had, since 9th February 2005, employed Raphael Geys, a Belgian national, as its managing director of its European Fixed Income Sales, Financial Institutions Division. Geys' contract included typical written

particulars such as job title, working hours, a three months' written notice period applicable to both parties, a PILON clause, details of his duties and remuneration etc. Further, it also included at paragraph 5 some eleven pages detailing Mr Geys' entitlement to participate in bonuses under the employer's Fixed Income Sales Scheme. The contract of employment left Geys with little job security. There were two main sources for his dismissal – the contract and the staff handbook.

Paragraph 17 of the Contract permitted the employer to terminate the contract of employment on three months' notice. The handbook provided the employer with the right to terminate the contract at any time and with immediate effect by making a payment in lieu of notice. The contract was clear that despite any real job security for this well paid position, proper notice had to be provided for its termination.

On 29th November 2007, Mr Geys was called into a meeting with the employer where he was handed a letter informing him that the employer was terminating Geys' employment at the bank with immediate effect. At the conclusion of the meeting, Geys was escorted from the building and he did not return. Mr Geys, having obtained legal advice, wrote to the employer on the 7th December 2007 requesting information regarding the sums the bank was offering to pay following the termination of his employment (but also outlining that Geys reserved all his rights). On 10th December 2007 the employer sent to Geys a severance agreement in accordance with the contract he signed at the commencement of his employment. Mr Geys did not sign and return this letter of severance. On 18th December 2007 the employer paid a sum of £31,899.29 into Geys' bank account as an equivalent amount for his three-month's salary. Geys became aware of the payment before 2nd January 2008. The employer then sent to Geys a P45 (identifying the payment of the 18th December 2007 including in lieu payment of £37,500 before deductions). Mr Geys saw the P45 on his return to London from Belgium on the 7th or 8th January 2008. In evidence, Geys said he did not know the reason for the payment, but 'guessed' it could have been a payment-in-lieu of notice.

During these communications from the employer, Geys' solicitors wrote to the employer on the 2nd January 2008 informing them that Geys did not accept the repudiation and was affirming his contract. On the 4th January 2008, the employer's Human Resources Director wrote to Geys confirming the meeting of the 29th November 2007, identifying that Geys had been dismissed, stating that the payment into his bank account of 18th December was a payment in lieu of notice, and confirming his notice of dismissal. In accordance with the employer's staff handbook, this letter was identified as having the effect of being received by Geys on 6th January 2008.

SUMMARY OF THE PARTIES' POSITION

Geys argued that he was dismissed on receipt of the letter of the 6th January 2008. The contract allowed the employer to unilaterally terminate the contract of employment by use of the PILON clause, but to do so there had to be express

notice of the application of this clause. Geys became aware of the payment in lieu of notice in the letter received on the 6th January 2008. Consequently he was entitled to damages for breach of contract and (an increased) termination payment of €12.5m.

The employer contended that Mr Geys was dismissed on the 29th November 2007 (or at the latest on 8th December 2007) and his termination payment was limited to €7m with no right to claim damages. They purported that upon the employer's (albeit wrongful) repudiation of the contract, Mr Geys had been dismissed. They argued that it was not open for him to choose to accept the termination of the contract of employment. Rather due to the peculiarities of employment relationships, the automatic theory of termination applied. Therefore his remedy for damages and termination payments were limited.

THE HIGH COURT

Mr. George Leggatt QC found that Geys had been dismissed on the 6th January 2008 as this being the first occasion when the employer notified Geys that it had exercised its contractual right to terminate the employment. He awarded 'a payment on account by 1st April 2010 of €11m, less tax and national insurance contributions, together with interest on all sums due at 1% above base rate from 3 February 2008' ([2010] EWHC 648 (Ch)).

Societe Generale, London Branch appealed this decision on the following bases:

- 1) That a repudiatory dismissal of an employee by itself terminates the contract of employment even where the employee does not accept the repudiation;
- 2) They raised a question as to when, having regard to the contractual provisions, the right to terminate was validly exercised;
- 3) The construction of the paragraph in Mr Geys' contract which obliged Societe Generale, London Branch to ensure that any bonus awarded to him was made in as tax efficient manner as possible; and
- 4 and 5) Both relating to the construction of contractual provisions regarding Mr Geys entering into an agreement in the event of the termination, by his employer, of his contract of employment. This, argued the employer, resulted in a 'clean break' clause with the subsequent restriction of Mr Geys' claim for a damages payment.

THE COURT OF APPEAL

Arden, Rimer and Pitchford LJ dismissed the employer's appeal on the first and fifth grounds. They allowed the appeal to proceed on the second, third and fourth grounds and subsequently held Mr Geys to have been dismissed on the 18th December 2007 ([2011] EWCA Civ 307) when the payment of his three months' salary was made. In so doing, the Court rejected the employer's argument that the employment was terminated on the 29th November 2007 when Mr Geys was summarily dismissed.

The Court of Appeal considered it bound by previous authorities (*Gunton v Richmond-upon-Thames London Borough Council* [1981] Ch 448 and *Boyo v Lambeth London Borough Council* [1994] ICR 727) to the effect that a repudiatory breach of contract had to be accepted by the innocent party before it was effective. The Court further held that this was a principle which was to be applied to contracts of employment, but (per Rimer LJ at para 18), an appeal was permitted solely to allow the Supreme Court to reconsider this area of law.

Mr Geys' appeal to the Supreme Court was on the basis of the second and third grounds, and by the employer on the first ground (above).

THE SUPREME COURT

The Supreme Court had four issues to consider. The first two were matters of general importance whilst the latter two were to do with the construction of the provisions within the contract of employment.

The two questions considered in this case summary are what Lord Wilson referred to as the 'conflict issue'; and the second was what he termed the 'repudiation issue.' The questions were summarised in para 14 of the judgment:

QUESTION 3:

'Is there any conflict, within the meaning of paragraph 17 of the Contract, between the provision for termination on three months' notice in paragraph 13 of the Contract and the provision in paragraph 8.3 of the Handbook which gives the Bank the right to terminate the employment at any time with immediate effect by making a payment in lieu of notice? [the conflict issue].'

Lord Wilson considered that the use of either the three-months' notice of termination or the PILON clause where the contract could be terminated with immediate effect were not mutually exclusive and could co-exist. However, it was the application of this PILON clause which caused problems, namely the notification of its use. Commenting on the execution of the clause, Lady Hale remarked '(The payment of £31,899.29) says nothing about whether and how the employee is to be notified that his employment is at an end. Is it enough that the payment in lieu is actually made? Or is something more than that required? And if so, what?' (para 50). This was devastating to the employer's argument that the dismissal had occurred in 2007, not 2008.

At para 51, Lady Hale continued to explain why the dismissal, using the PILON clause, was effective in January 2008, and not when the meeting was held in November or when the payment into the employee's bank account in December:

'Payment into the bank account was not enough, because it was not accompanied by notification in writing that the Bank was terminating his employment by making a payment in lieu of the notice period. The letter of 29 November was not enough to cure that omission, because it did not notify the appellant that that was what the Bank intended to do... In any event, it could not put the burden upon him of checking whether and when the money had reached his bank account. It had a duty to notify him at that time. The first proper notification which the Bank

gave him was the letter of 4 January 2008.’

Here the Supreme Court ensured that employee’s were not placed under the obligation of checking their bank accounts for unusual payments from their employer and having to determine what they were for or what such a payment could mean. It is not uncommon for an employee to find an erroneous sum of money paid into his/her account due to some accounting error of the employer. An employee should not be placed in the position of questioning whether this is indeed an error or the application of a PILON clause (or whatever other reason could have led to the payment). To ensure the correct application of a PILON clause requires express notification by the employer to that effect. This removes any misunderstanding on the part of the parties.

The first question identified by Lord Wilson was the more significant as it was regarding the automatic and elective theories of acceptance of repudiatory breach of contracts of employment:

QUESTION 1:

‘Does a repudiation of a contract of employment by the employer which takes the form of an express and immediate dismissal automatically terminate the contract or – as was held in *Gunton v Richmond-upon-Thames London Borough Council* [1981] and *Boyo v Lambeth London Borough* [1994] – does the normal contractual rule that the repudiation must be accepted by the other party apply equally to that case? [the repudiation issue].’

The Court held that adhering to the terms of the contract, the employer had not provided Mr Geys with proper notice of the termination of his contract until January 2008, when the Human Resources Director provided confirmation that the payment in December 2007 was a payment-in-lieu of notice. Consequently, per the terms of the contract, Geys was entitled to a higher termination payment.

IMPLICATIONS OF THE JUDGMENT

QUESTION 3

The Court was clear that to be effective, a PILON clause required express notification of its use to be made to the employee. Where notice is provided before payment is made, the contract will be deemed to be terminated on the date that payment is made. Where notice is provided *after* payment has been made (as with Geys), the termination is effective when the notice has been received (or, if applicable, where the contract deems the notice to have been received).

QUESTION 1

The elective v automatic theories of termination of contracts of employment had been argued, considered and pronounced upon for nearly 40 years.

(1) In contract law, the elective theory has dominated. The different camps,(2) in supporting their ‘champion’, provided credible reasons for the preference of each theory (see Cabrelli and Zahn 2012).

Conflict between Statutory and Common Law Rights

In the case of a wrongful repudiation of a contract of employment the individual has two routes in which to seek a remedy (Ewing 1993). There exists the pure contract law claim of wrongful dismissal with its remedy of damages (and increasing, but also restrictive, use of equitable remedies such as injunctions and, arguably, specific performance – see Brodie 1998). There also exists, insofar as the qualifying criteria are satisfied, a claim under statute for unfair dismissal (see White 1997). The existence of these two routes can cause a problem when applying the elective and automatic theories. For example, the Employment Rights Act 1996, which governs much of the law relating to unfair dismissal, provides for the application of the automatic theory in relation to the effective date of termination (ss. 95 and 97). Further, the entire notion of ‘dismissal’ and an individual’s right not to be dismissed is problematic when applied to traditional contractual principles. Dismissal relates to a relationship between what used to be the ‘master and servant’ where more modern relationships are more likely to be based on contractual principles - with greater equality of bargaining positions (although admittedly still skewed in favour of an employer but with much greater protection by the courts - see *Autoclenz v Belcher* [2011] UKSC 41). Hence employment law has generally experienced conflict between the two theories.

Restriction of Available Remedies

Beginning with the automatic theory (see *Sanders v Ernest A Neale Ltd* [1974] 3 All ER 327 and *Denmark Productions Ltd v Boscobel Productions Ltd* [1969] 1 QB 699) it had been argued that this should have been the operative theory because of the restrictive application of equitable remedies. Whilst it is possible to obtain injunctions to prevent an employer’s wrongful repudiation of the contract in breach of contractual principles regarding disciplinary measures,⁽³⁾ and examples exist of courts awarding specific performance in very restrictive ways (see Brodie 1998), it remains a general principle that injunctive relief is not available to prevent a wrongful repudiation of the contract of employment in termination (*Wilson v St. Helen’s Borough Council* [1999] 2 AC 52). It is this lack of applicable remedies which led some members of the judiciary to argue that this gave credence to the automatic theory as the contract of employment could not survive an employer’s repudiatory breach.

Absence of Core Obligations

Beyond each of the competing theories and their justifications as to being the operative mechanism in determining the status of wrongful repudiation, there remains a practical dimension whereby wrongful repudiation effectively does terminate the contract of employment. How can an employment relationship exist where an employer no longer wishes to engage the individual? Indeed, it is quite probable in such circumstances, that the implied duty of trust and confidence must surely no longer exist. Indeed, as per Fry LJ in *De Francesco v Barnum* (1890) 45 Ch D 430, courts are ‘very unwilling to extend decisions the effect of which is to compel persons who are not desirous of maintaining continuous personal relations with one another to continue those personal relations.’ (at p. 438).

However, as provided by Hope LJ at para 17 ‘One must be careful not to assume

that, just because in practice the employee may have little choice but to accept the repudiation, he has in law no alternative but to do so'.

In his advancement of the automatic theory, Lord Sumption identified the 'core obligations' in contracts of employment. Namely:

'... core obligations are those which are fundamental to the continued existence of the employment relationship, essentially the obligation of the employee to work and the concomitant obligation of the employer to continue to employ and pay him.' (at para 120).

However, of course, there is no requirement for an employee to work. Mutuality of obligations merely requires that an employee is available for work. Whether the employer chooses to provide the employee with work is entirely his/her own business, save for certain occupations or contracts. Indeed, per Asquith J in *Collier v Sunday Referee Publishing Ltd* [1940] 2 KB 647 'Provided I pay my cook her wages regularly she cannot complain if I choose to take any or all of my meals out.'

ARGUMENTS FOR THE ELECTIVE THEORY

'Readily Inferred' is not Elective

The Court of Appeal was clear in its reasoning for allowing the appeal in *Geys*. It wished to allow the Supreme Court to finally resolve the problem in balancing the rights between parties in the event of wrongful repudiation of the contract of employment given the distinction between the approach taken in 'traditional' contracts and contracts of employment. In pursuing a 'third way' of resolving this conflict, the Court of Appeal held in *Gunton v Richmond Upon Thames* that whilst the elective theory was the 'correct' theory to apply, it would (per Buckley LJ) be 'readily inferred' in instances of an employer's wrongful dismissal and therefore require little, if any, action by the employee. But this inference could not possibly be considered an elective theory (in any meaningful application of the theory as we know it) as it works on the presumption that the employee would naturally accept the repudiation. This is the very point of the debate between the competing theories. This led to Ralph Gibson LJ's criticism of the 'readily inferred' approach in *Boyo v Lambeth London Borough Council*.

The Choice to Accept Repudiation Should Remain with the Innocent Party

It would seem 'reasonable' (4) to apply the elective theory as it should be for the innocent party to choose whether to accept a wrongful repudiation of the contract. Be that a traditional/commercial or a relational contract, it remains with the innocent party to make that choice. This has been the orthodox contract law position because, as per Hope LJ 'the automatic theory can operate to the disadvantage of the injured party in a way that enables the wrongdoer to benefit from his own wrong.' (Para 15). Indeed in the case of Mr Geys, the employer wished to pursue the automatic theory to save themselves a substantial additional payment had the dismissal taken effect in 2007, rather than in 2008 where Mr Geys 'accepted' the repudiation. As Lord Wilson agreed, application of the automatic theory '... is to reward the wrongful repudiator of a contract of employment with a date of termination which he has chosen, no doubt as being, in the light of the terms of the contract, most beneficial to him and,

correspondingly, most detrimental to the other, innocent, party to it.' (para 66).

IMPACT ON EMPLOYEES

Geys is of great significance to employers who may have opted to wrongfully terminate the contract of employment to avail themselves of some benefit such as avoiding a bonus payment, reducing a pension contribution, preventing the application of a wage increase etc. There is little doubt that this will be a major focus of this judgment. Lord Wilson's judgment should also be considered by employees as the judgment equally applies to them: 'It is common ground that, whichever theory be chosen, it should apply equally to wrongful repudiations by employers (i.e. wrongful dismissals) and wrongful repudiations by employees (i.e. wrongful resignations)' (para 63). Of course this point had been made by Sir Robert Megarry VC in *Thomas Marshall (Exports) Ltd v Guinle* [1979] Ch 227 where an employer sought use of an interlocutory injunction to restrain an employee who had wrongfully resigned in repudiation of the contract so that employee could neither solicit the employer's customers nor use the employer's confidential information. At p. 243 Megarry commented:

'I think the courts must be astute to prevent a wrongdoer from profiting too greatly from his wrong... [W]hy should the court's inability to make a servant work for his employer mean that as soon as the servant refuses to do so the court is forthwith disabled from restraining him from committing any breach, however flagrant, of his other obligations during the period of his contract? I would wholly reject the doctrine of automatic determination...'

CONCLUSIONS

The Supreme Court resolved the conflict between which theory was to prevail in cases of wrongful repudiation of the contract of employment. Lord Wilson was adamant that the automatic theory was incorrect and that contracts, be they commercial or relational in practice, should seek to protect the innocent party, as far as possible, from the negative effects of the other party's breach: '... proposing that the court should indorse the automatic theory... invites it to cause the law of England and Wales in relation to contracts of employment to set sail, unaccompanied, upon a journey for which I can discern no just purpose and can identify no final destination.' (at para 97).

As such, a contract of employment will remain in existence, despite an employer's wrongful repudiation, unless and until the employee accepts the breach or the employer adopts some lawful means of bringing the contract to an end. This brings us to the secondary issue of the case. Where an employer seeks to exercise a PILON clause (as are increasingly popular in contracts of employment), express and unequivocal notice of this should be made to the employee. Errors in this area of law can prove very expensive.

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(1) Per Hope LJ at para 16 'I find it hard to disagree with Buckley LJ's observation in *Gunton v Richmond-upon-Thames London Borough Council* [1981] Ch 448, 466 that *Sanders v Ernest A Neale Ltd* was the first case in which the automatic theory was part of the basis for the decision in an employment case.'

(2) In the Supreme Court Lord Wilson represented proponents of the elective theory and Lord Sumption for the automatic theory.

(3) See *Jones v Lee* [1980] ICR 310; *Irani v Southampton and South West Hampshire Health Authority* [1985] ICR 590; *Robb v Hammersmith and Fulham London Borough Council* [1991] ICR 514; and *Edwards v Chesterfield Royal Hospital NHS Foundation Trust* [2011] UKSC 58.

(4) See Sartor, G., Bongiovanni, G., and Valentini, C. (Eds) (2009) 'Reasonableness and Law' *Law and Philosophy Library* 86, Springer.