Employment Legal Update

Contents

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WELCOME TO OUR SPRING ISSUE OF THE UPDATE

In light of the current global economic downturn, we thought it would be appropriate to address some of the key issues currently facing employers in this issue of the Update.

Our feature article in particular, looks at cross-border redundancies. This offers practical tips for those involved in project managing or implementing cross-border redundancies, and includes key points to note for those looking to effect redundancies in the UK, France, Italy, Germany and Spain.

Continuing with the economic downturn theme, our dilemma section explores some interesting issues that can arise where employees are made redundant while on maternity leave. We then go on to explore issues that can arise on making a severance payment and how to make the most out of some tax concessions which are available.

Since our last Update, employers have also had to start grappling with the repeal of the statutory dispute resolution procedures and the reversion to the pre-2004 position, in the form of the Acas Code of Practice. It will be some time yet though before we are able to wash our hands of the legislation completely, as it will apply to certain ongoing disputes.

Our news section looks at recent changes affecting bonuses and the financial sector, the UK's success in retaining the working time opt-out, and the extension of maternity and paternity rights. There have also been a couple of significant European Court of Justice cases decided. This includes the *Heyday* case, which held that a compulsory retirement age of 65 is, in theory, capable of being justified. The other is that of *Stringer* (formerly known as *Ainsworth*). In this case it was determined that workers on long-term sick leave still have the right to paid annual leave and this should either be paid during sick leave or accrued and taken on their return to work. Where employees do not have the opportunity to take paid holiday then they should be paid in lieu at the end of their employment.

Looking to the future, employers will continue to face an ever-changing landscape for employment law. One significant change in the offing is the new Equality Bill which was published on 27 April 2009. The Bill is intended to amalgamate all the various pieces of anti-discrimination legislation into one single statute with the aim of simplifying and harmonising the law. There will also be new types of disability discrimination claims for employers to contend with, including claims for direct discrimination and harassment based on association and perception, and claims for gender pay discrimination based on hypothetical comparators. It will also be possible for Employment Tribunals to order large employers to report on their gender pay gap and make recommendations that benefit the whole workforce. The former has already proved to be highly controversial. The bill is expected to come into force in Autumn 2010.

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NEWS

Bonuses and the financial services sector

As a direct consequence of the current economic climate there has been much interest and, in some cases, anger about bonus awards in the UK financial services sector. This has led to numerous committees, inquiries and reviews being established at a national and international level into what went wrong. This is likely to lead to increased regulation in the industry, with a view to aligning pay with performance. Some of the most recent developments in this area are worthy of particular note.

Firstly, Gordon Brown has announced that those financial institutions which have benefited from rescue packages, will have to abide by four key points. These are that:

- banks should not reward those who are associated with a loss;
- banks should be able to claw back bonuses if performance turns out to be worse than expected;
- bonuses should be based on long-term, sustainable performance; and
- the regulator should consider pay and bonus structures as part of its supervisory role.

At the moment, no sanctions may be imposed on self-supporting financial institutions who refuse to follow these principles. It seems only a matter of time before these principles become a matter of regulation.

Separately, the Financial Services Authority has published a draft code of practice and consultation paper on remuneration policies, which will apply to larger banks, building societies and broker dealers. It may also be extended to other FSA authorised firms. This will aim to link remuneration policies to sound risk management systems. Pending the outcome of the consultation process, the FSA is urging firms to benchmark their remuneration policies against the draft code.

With even more pressure for reform coming from Brussels, including two new recommendations on directors' remuneration and remuneration in the financial services sector, the landscape for financial services remuneration will undoubtedly change. We are planning a seminar in September, as the new landscape becomes clearer, to brief all clients on the issues and changes.

Update on the working time opt-out

The European Parliament's attempts to end Member States' ability to opt-out of the 48 hour working week has suffered a crashing blow. Discussions surrounding the opt-out have broken down between the European Parliament, the Commission and the Council. The effect of this is that the UK will continue to be able to rely on the opt-out for the forseeable future.

Statutory holiday for employees on long-term sick leave

As reported in our email alert of 12 March 2009, many employers struggle with the idea of allowing absent employees to take holiday during sick leave. If employees are not at work due to ill-health, particularly if they are on long-term sick leave, employers might be forgiven for assuming that these employees are unable to take holiday.

The European Court of Justice has now had to consider this issue in two cases concerning the interpretation of the EC Working Time Directive: *Stringer v HMRC* (previously known as *Ainsworth v HMRC*) and *Schultz-Hoff v Deutsche Rentenversicherung Bund*.

The ECJ's decision, in essence, provides that:

- Workers on long-term sick leave should not be denied the right to paid annual leave. They should either be allowed to take paid holiday during sick leave or accrue holiday and be able to take it when they return to work;
- If these workers do not have the opportunity to take paid holiday during their employment, they should be paid it in lieu when they leave. There appears to be no limitation period for such a right, which means that a worker who is absent for several years, and who has accrued statutory holiday during that period, would be entitled to payment in lieu of all accrued holiday when they leave; and
- Member States can introduce conditions for when and how holiday can be taken. In the UK for instance, this might mean that the law could be changed to enable payment in lieu of statutory holiday during employment.

The ECJ's decision now needs to be considered by the House of Lords to establish how this applies to the Working Time Regulations. The consideration of whether the Regulations can be interpreted in line with the ECJ's decision or whether the Government needs to amend the Regulations will be considered in the House of Lords hearing on *Stringer* on 30 April.

Part of this article first appeared as an email alert. If you do not currently receive Employment Group email alerts and would like to, please contact us using the email address: businessdevelopment@mayerbrown.com. We have also done a survey on the impact across key European countries.

Extension of maternity and paternity rights

During this Parliamentary session, the Government proposes to introduce a new right of additional paternity leave of up to 26 weeks for employed fathers or partners (of either sex) of a mother or adopter following the birth or adoption of a child. The leave will be for the purpose of caring for a child after the mother or adopter has returned to work.

Those entitled to this additional paternity leave may also be entitled to additional statutory pay if the mother has not taken all of her Statutory Maternity Leave when she returns to work. Employees will need to have qualified for "ordinary" paternity leave and have been in continued employment with the same employer for a specified period to take advantage of the right. The earliest a father or partner will be able to take additional paternity leave is 20 weeks from the birth/adoption of the child.

At the same time, the Government plans to extend paid maternity leave from nine months to 12 months.

ECJ decision on Heyday challenge

In our email alert of 6 March 2009, we reported on the European Court of Justice's decision regarding whether employers can lawfully force people to retire at the age of 65.

The ECJ delivered its long-awaited ruling on the legality of the UK's default retirement age on 5 March. This essentially followed the Advocate General's opinion which was published last September. The ECJ held that a compulsory retirement age of 65 is, in theory, capable of being justified. Attempts by Age Concern to make it more difficult for the retirement age to be upheld were unsuccessful. However, it is for the UK courts to decide whether or not the compulsory retirement age is justified by a legitimate aim, and whether the means used to achieve that aim are appropriate and necessary.

The ECJ did comment on the need for the particular aim to be a social policy objective. There is a broad discretion given to Member States as to how they achieve their social policy objectives, provided this does not frustrate the principle of non-discrimination. However in order for the retirement age to be justified the Government would have to produce more than mere generalisations about the way the retirement age is intended to implement the relevant social policy.

So, as we anticipated, it remains a case of "wait and see" whilst the case is referred to the High Court for a decision on whether the retirement age is justified. There are already an estimated 800 age discrimination Employment Tribunal claims awaiting the final *Heyday* decision and, if the High Court comes to the conclusion that a compulsory retirement age is not justified, this could have a substantial financial impact on employers.

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Employee disputes and dismissals: the new regime

The long-awaited demise of the universally loathed statutory dispute resolution procedures came about on 6 April 2009. The procedures have now been replaced by a new Acas Code of Practice and a supporting guide, although certain transitional arrangements will apply.

The key changes can be summarised as follows:

- there will no longer be an "automatic unfair dismissal" for a failure to follow the statutory procedures. Employment Tribunals will instead be able to adjust any awards of compensation (up or down) by up to 25% for a failure to follow the Code;
- employers should involve employees in the development of rules and procedures on disciplinary and grievances. There may be litigation about the extent to which employees and their representatives should be involved in this. Acas is encouraging a level of involvement which reflects the size and resources of the employer but it will be left to the Employment Tribunals to spell out what this means in practice;
- the Code does not apply to redundancy dismissals or the non-renewal of fixed term contracts at the end of the fixed term. However this may leave employers open to risk if say, an Employment Tribunal determined the dismissal was unfair. In practice therefore, it may be better to follow the Code;
- employees are no longer required to raise a grievance before lodging a claim in the Employment Tribunal;
- the Code does not apply to "collective grievances" (grievances raised on behalf of two or more employees).

Employers should postpone any celebratory cheers until the transitional arrangements expire. In terms of disciplinary or dismissal action if, on or before 6 April 2009, an employer has taken relevant action (for example by sending a step 1 letter to the employee, or by holding a step 2 meeting with the employee), the employer should continue to follow the statutory procedures throughout the disciplinary or dismissal process. Where the disciplinary or dismissal action commences on or after 6 April the new Code will apply.

For grievance procedures, if the action which the employee is complaining about takes place on or before 5 April 2009 and continues beyond that date, the employer should follow the statutory grievance procedure. However, this is subject to the requirement for the employee to submit a written grievance or Employment Tribunal claim on or before 4 July 2009 (or 4 October for equal pay and statutory redundancy pay claims). For action occurring on or after 6 April, the new Code will apply.

FEATURES

Managing cross-border redundancies in Europe

Shockwaves from the economic downturn have already had an impact on a large number of businesses. Employers are considering ways in which they could save costs and streamline their business. Redundancies and restructuring are high on the agenda for many. In a global business, any large-scale restructuring or cross-border redundancy programme can be a complex procedure. In order for the process to run as smoothly as possible, it is vital to have an effective central strategy and country specific plans for each of the jurisdictions which will be affected.

This article contains some practical tips for those involved in project managing or implementing cross-border redundancies and restructuring exercises generally, together with some points to note for a number of key European jurisdictions.

Practical tips in a cross-border redundancy

- Have an overall project plan, setting out your company's aims and milestones. Identify your key objectives, develop measures to ensure you have met those objectives and draw up a timeline.
- Identify and allocate individual responsibility for key aspects of the process. You will need to have people on the ground who can implement the plan locally. This can be useful to flag up potential problems that might arise. It might also be a helpful aid to communication to circulate a contacts list identifying any responsible parties.
- Develop country specific plans, addressing the procedures which will have to be followed in each affected jurisdiction. Whilst there are similarities across many European countries, there are key differences which need to be factored in, particularly in relation to the consultation process and timeline. Each plan needs to be considered in light of the overall project plan, to ensure that the relevant deadlines are met.
- Gather together key information, such as the number, categories and grades of workers in each location. If any employees are based abroad, particular attention should be paid to ensure the correct legal redundancy process is applied to them (for instance whether their home or host country process should apply). Collect details of any collective agreements negotiated with trade unions, works councils and any other relevant workplace representative bodies.
- It is important to try to maintain a good relationship with interested parties, including employee representatives, works council and trade unions. At this sensitive time, the way in which employees are kept informed is an important part of handling the process. This will be relevant not only to those employees who may be leaving but also to those who remain. Do not forget to include absent employees in the consultation process, such as those who are on maternity leave, long-term sick leave or secondment.

- Consider coordinating certain announcements so that they are made at the same time in each affected country. Bear in mind that once you announce in one country, the news will spread quickly. For large-scale projects, most clients will make a global announcement first, then start local consultation in stages, taking into account local timelines.
- Plan your corporate communication strategy. Employee consultation can be time-consuming but proactive and clear communication can be instrumental to the success of the project. Plan your announcements, prepare briefing documents, Q&A's and presentations. Consider what training you need for managers and employee representatives. You may also need to issue press releases, stock market announcements and notify Government bodies.

Below is a table which provides an overview of the key questions to think about for a number of European countries. This is a simple checklist for guidance only and it does not cover all situations. If you would like any further advice on the processes involved, please get in touch with your usual contact.

	UK	France	Italy	Germany	Spain
Does the concept of redundancy exist?	✓	✓	✓	x [1]	✓
Is there a requirement for individual consultation?	✓	✓ [2]	x	x	x
Is there a collective consultation procedure?	✓	✓	✓	✓ [3]	✓
Are there prescribed selection criteria?	x	✓	✓	✓	x
Is there a fixed time period for consultation?	✓	✓/x [4]	✓	x	✓
Is there a statutory right to a severance payment?	✓ [5]	✓ [6]	✓ [7]	x [8]	✓
Are there penalties for failure to comply with information/consultation obligations?	✓	✓	✓	✓	✓

1 There is no statutory definition of redundancy.
2 Individual meetings are required for redundancies of less than 10 people.
3 There is a collective consultation procedure, but only if there is a works council.
4 There is a fixed time period for social consultation, but not for economic consultation.
5 If the employee has two years' service.
6 If the employee has two years' service.
7 A redundant employee is entitled to a severance payment on termination, but this is not a redundancy specific payment.
8 There is no statutory right to a severance payment, but an employee will be entitled to a severance payment if this is set out in the social plan or collective bargaining agreement.

Points to consider if you are contemplating a cross-border redundancy:

UK

1. Focus on the number of employees being made redundant. If there are 20-99 employees affected from an establishment, the consultation process must begin 30 days before notice of dismissal takes effect. If there are 100 or more employees affected, consultation must begin 90 days before notice of dismissal takes effect.

2. Even if only one person is being made redundant, there is still an obligation on the employer to consult. If an employer does not consult the individual, the employee could bring a claim for unfair dismissal.

3. The collective consultation process is triggered if employees' contracts are re-negotiated by being terminated and the employees are then offered re-engagement.

4. It is common for employers to offer enhanced redundancy pay, particularly professional services companies. Employers often use the length of employees' service to calculate the amount of redundancy pay. There is some concern that this could be discriminatory on the grounds of age.

France

1. The procedure required depends on whether more or less than 10 employees are affected over a 30-day period and whether the employer employs more or less than 50 employees. Below these thresholds, an employer does not need to implement a social plan and so the dismissal procedure is more straight forward. Where a social plan is required, the procedure will take a minimum of two months, depending on the scale of the redundancies.

2. Employees can only be made redundant after the employer has made every possible effort to find alternative employment within the company or within the group worldwide.

3. Failure to consult properly with the workers' council constitutes an offence which is punishable by one year of imprisonment and/or a EUR 3,750 fine, and may lead a judge to consider the dismissals as null and void. Employees may then claim for reinstatement or may be granted a minimum of 12 months' damages.

4. Notice periods are determined either by statute, the collective bargaining agreement applicable to the employer or the employment contract (whichever is most favourable to the employee). The notice period starts on the day the employee receives the dismissal letter.

5. In addition to legal or collective severance pay, a social plan must contain measures to help an employee to find alternative employment within or outside the group.

Italy

1. If an employer employs more than 15 people and intends to effect at least five dismissals in 120 days, it must carry out collective consultation.

2. The redundancy procedure is divided into two phases. Phase one starts with a mandatory communication to trade unions and governmental bodies (stating the reasons for the dismissals as well as the roles to be dismissed), and must be completed within 45 days (23 days if the number of employees concerned is fewer than 10). If no agreement can be reached after 45 days, the employer will need to enter into final negotiations with the Employment Office, which can take up to 30 days (15 days if fewer than 10 employees).

3. After the end of negotiations, the Employment Office must be given a written list of all the employees who have been made redundant. This should include the employee's name, address, job description, age and family situation and a detailed description of the selection criteria applied.

4. Collective consultation does not apply to managers and executives that are qualified as "Dirigenti" under a separate collective agreement. They are governed by different rules of law.

5. The dismissal of disabled employees as part of a collective redundancy process will not be valid if the number of disabled employees in the workplace falls below the minimum required by law.

Germany

1. There is no statutory definition of redundancy, but any substantial re-organisation of a business with more than 20 employees will require consultation. Consultation is triggered if there is a proposed "mass dismissal". This will occur on the dismissal within 30 days of more than five employees of businesses with regularly more than 20 and fewer than 60 employees; 10% of the regularly employed workforce or more than 25 employees in businesses with at least 60 and fewer than 500 employees; or 30 or more employees in businesses with regularly at least 500 employees. There are no required time limits for consultation but the entire process can take as little as a day or as long as six months or more.

2. The employer must inform and negotiate with the relevant works council to prepare a reconciliation of interests agreement and a social plan. If the planned re-organisation consists solely of a layoff of employees and no other operational changes will be implemented a social plan is only mandatory in certain circumstances.

3. The employer has to justify that there is no longer a need to employ the individual. The employer must dismiss those employees who will be least socially affected by the termination. Criteria include age, length of service, disability and family obligations.

4. Where an employer proposes to carry out a collective redundancy exercise, it must issue a notice of proposed redundancies to the employment office before serving any notices of termination.

5. In relation to individual redundancies, the employer must still consult with the works council prior to giving notice to dismiss.

6. Under German law there is no obligation to pay severance if the dismissal is valid. If the dismissal is not valid, the employer is obliged to retain the employee. However, the employer is certainly free to offer a severance payment so as to reach an agreement on the mutual termination of the employment. Generally employees are only entitled to receive a redundancy payment if the employer and the works council have agreed on a social plan or the applicable collective bargaining agreements provide for such payment.

Spain

1. Collective consultation is required where redundancies are proposed in the following circumstances:

   (a) 10 employees in a company employing up to 100 persons;

   (b) 10% of employees in a company employing between 100 and 300 persons;

   (c) 30 employees in a company employing more than 300 persons; or

   (d) All the employees in companies of more than five employees.

   The consultation must last for at least 30 days where the company has more than 50 employees, or 15 days if the company has less than 50 employees.

2. There is no obligation to consult where individual redundancies are proposed. The individual must be informed of the decision in writing and given a 30-day notice period. The employee is also entitled to 20 days' salary for each year of service, up to a maximum of 12 months' salary.

3. A decision to make collective redundancies must be authorised by the labour authority. If the labour authority approve the dismissals, the employees have one month to challenge the administrative resolution. Alternatively, the employees can challenge the dismissal itself, which they are likely to do if the administrative resolution approves the redundancies. Employees have 20 working days to do this. This process should therefore be factored into any proposed redundancy timeline.

4. It is common for employers to pay more than statutory redundancy pay. Often redundancy pay will be 40, 50 or 60 days' salary for each year of service.

With thanks to Bjorn Vollmuth, associate in our Frankfurt office; Sophie Thomas, associate in our Paris office; Andrea Patrizi Montoro, partner at our associated firm Tonucci & Partners, Italy and Fatima Vera Cabrero, associate at our associated firm Ramon Cajal, Spain for their contributions to this article.

EMPLOYMENT DILEMMAS

In this edition, we are focusing on the issue of redundancy which, unsurprisingly, has given rise to a lot of queries lately. If you have any questions for the editorial team, please forward them to Michelle Last (mlast@mayerbrown.com).

Redundancy and parental rights

Q. We have an employee who is being made redundant, whose wife is pregnant. Will he be entitled to statutory paternity pay if his termination date is before the date of the birth?

A. No. In order to qualify for statutory paternity pay, a man must remain in continuous employment with the employer up to the date of the birth of the child. This is different to the position in relation to statutory maternity pay, which is dealt with below.

Q. We have an employee who was made redundant two months before the birth of her baby. She is claiming that she is entitled to statutory maternity pay from us even though she is no longer on our payroll. Can this be correct?

A. Yes, this is correct if the employee met the qualifying criteria for statutory maternity pay when her employment was terminated. To qualify, she must have been employed for at least 26 weeks into the 15th week before the week the baby is expected and earn at least enough to be relevant for National Insurance purposes (presently £95 a week).

Q. I have an employee who is on maternity leave but is in a redundancy pool of four people. There are two suitable alternative vacancies available. Does she get preferential treatment as she is on maternity leave?

A. Yes, she does get preferential treatment. She must be offered the alternative employment if the work is suitable and appropriate and the terms and conditions under which it is offered are no less favourable to her. If you do not do this, the employee would have a claim for automatic unfair dismissal and probably a sex discrimination claim.

Severance payments

Q. When making a severance payment, what is the significance of making it after the termination of employment and after the issue of the P45?

A. If the severance payment is made well in advance of the employee's termination date (and issue of the P45), there may be a suggestion that the payment is employment income, which should be taxed in the normal way. We would therefore recommend making the payment as close as possible to the termination date. This can be before the termination date, provided it can be demonstrated that the payment is not related to the employment.

If the severance payment is made after termination of employment this suggests it relates to the termination of employment for the purposes of Section 401 of ITEPA 2003 (and so benefits from the first £30,000 exemption). If the payment is made after termination but before the P45 has been issued, the employer should deduct tax at the employee's normal rate to the extent that the payment exceeds £30,000. If the payment is made after termination and after issue of the P45, only basic rate tax should be applied to the balance. The employee will then need to account directly to HMRC for any further tax due. This gives the employee a cash flow advantage as it means that tax is likely to be payable at some future date rather than at the time the payment is made. No National Insurance is payable on any part of the severance payment that exceeds £30,000. The P45, on termination, will reflect the payments made at the termination date in the normal course of employment but not the severance payment. This would normally be subject to a separate letter from the employer to HMRC.

Q. What is the significance of keeping legal and outplacement costs payments separate from the severance payment in a compromise agreement?

A. If the employer pays the employee's legal costs, these are exempt from tax under the HMRC concession. However, they need to meet certain conditions: they must be paid directly to the solicitor (pursuant to an invoice in the employee's name but marked payable by the employer); the costs incurred must be in connection with the termination of employment; and the payment must be made under the terms of a compromise or severance agreement. A tax exemption also applies for outplacement costs if: the outplacement is to enable the employee to adjust to the termination of employment or find new employment; the counselling consists of advice, guidance or training; the employee has two years or more service; and the outplacement service is part of arrangements generally available to employees or former employees. Therefore, these payments must be kept separate to ensure their tax-free status is maintained. It can often be more tax efficient for the employee to allocate some of the agreed severance payment to discharging legal fees in excess of an employer contribution.

Alternatives to redundancy

Q. Instead of making redundancies, we are considering making changes to the terms and conditions of employment. We anticipate that these will not be agreed and therefore intend to impose them on our employees. What are the risks?

A. If you unilaterally impose new terms and conditions on your employees, you will normally be in breach of contract unless the amendment is minor and there is a right to alter terms and conditions expressly in the contract. The employee may, by their conduct, be taken to having impliedly agreed to the variation, i.e. if the employee continues to work under the changed rules you could argue that the employee had, by his/her conduct, agreed to the variation. However, this would not be case if the employee indicated that they would work to the new terms but only under protest and reserved the right to sue you for breach of contract. This is called "standing and suing". Proceedings would need to be brought by the employee in the County or High Court, not the Employment Tribunal. The employee has six years in which to bring such a claim.

If the changes to terms and conditions are significant, they may constitute a repudiatory breach of the employee's contract of employment, entitling an employee to resign and claim constructive dismissal (in the Employment Tribunal). A repudiatory breach of contract would generally cover cuts in pay, hours or benefits if imposed unilaterally.

Another option is for the employer to dismiss and re-engage the employees on the new terms and conditions. The employer would need to show a potentially fair reason for the dismissal, that it had acted reasonably in treating that reason as a sufficient reason for dismissal, and that the dismissal was fair in all the circumstances. If the employer can show that the company had sound business reasons for the dismissal and re-engagement (e.g. to avoid making redundancies), this ought to be deemed to be a fair reason. The employer would also need to consult employee representatives about the dismissals where 20 or more employees will be affected. Failure to do so carries a penalty of up to 90 days' pay per affected employee.

Insolvency

Q. We are buying an insolvent company. The liquidator has already made all the employees redundant. Will we be liable for redundancy payments that are owed to the employees?

A. If the business cannot be continued and is to be wound up, the employment of all of the employees will be terminated and the employees do not get normal TUPE protection from the buyer of that company. They will not be eligible to receive any redundancy payments. However, if the business is not to be wound up but is subject to "relevant insolvency proceedings" (for example administration) the responsibilities for redundancy payments, payments in lieu of notice and unpaid holiday pay transfer to the National Insurance Fund rather than the transferee.

KEY CASES

Controlling shareholder employees

Secretary of State for Business, Enterprise and Regulatory Reform v Neufeld

Employees are generally entitled to certain payments on the termination of their employment. But what should happen where those employees are controlling shareholders and directors of the company? Should they receive the same level of protection, even though they are in effect terminating themselves? In this case, the Court of Appeal has determined that they should.

Facts

This case concerned two conjoined appeals. Employee A owned 90% of his employer company and had provided personal loans and guarantees in respect of the company until it became insolvent. Employee B owned 100% of his employer company and gave personal guarantees in its favour until it went into voluntary liquidation.

Decision

The Court of Appeal confirmed that a shareholder and director of a company can be an employee of their company, even if their shareholding means they are in control of the company. Whether an individual is an employee is a question of fact. In determining that question, the relevant tribunal or court may first have to consider whether any alleged contract of employment is a sham. Where the tribunal or court finds that a contract is genuine, it should then go on to consider whether the contract is in fact a contract of employment or whether certain factors exist which prevent it from being a contract of employment. For example, if it was made in favour of an individual who was also the company's controlling shareholder, and who had personally invested in the business and assumed personal liabilities for it. The fact that the individual exercises control over the company as a shareholder does not of itself prevent the individual from being subject to the control of the company and therefore an employee.

Impact

This case has interesting implications for a purchaser of an insolvent business. If directors and shareholders are employees then they are capable of transferring to the new owner under the Transfer of Undertakings (Protection of Employment) Regulations 2006 together with associated liabilities. The new owner may then be liable for claims for unfair or wrongful dismissal arising from a dismissal before or after the transfer and for any award for a failure to inform and consult if that is relevant. One way to deal with this would be to require the relevant individuals to enter into a compromise agreement. Having said that, they may expect some form of compensation in return. On a wider note, readers should bear in mind that TUPE contains special provisions in relation to insolvent companies. These provide for some flexibility for purchasers but they may still be required to inform and consult affected employees and certain liabilities can still transfer.

How discretionary can a bonus scheme be?

Small and Others v The Boots Company plc

Bonuses and the "bonus culture" in the financial sector in particular are subject to ever closer scrutiny. There is increasing pressure on employers to withhold, defer or cut bonus payouts during the economic downturn. However, employers should exercise caution here, even where bonus schemes are labelled as "discretionary". This case highlights that simply describing a bonus scheme as discretionary does not necessarily give the employer an automatic right to pay no bonus or an unexpectedly small bonus to employees. If an employer does so, it risks breach of contract or unlawful deduction from wages claims from its employees.

Facts

Mr Small and the other claimants were employed by Boots as warehousemen. They took part in a performance related bonus scheme. The warehouse operations in which they were employed were transferred from Boots to Unipart under the TUPE Regulations. They did not then receive a bonus whilst employed by Unipart. Three years later, all the claimants were TUPE transferred back to Boots. Mr Small and the other claimants brought an Employment Tribunal claim for unlawful deduction from wages, claiming that they had a contractual entitlement to a bonus which transferred with their employment to Unipart and then back again to Boots. The Tribunal found that there was no unlawful deduction for wages since the performance related bonuses were discretionary. The claimants appealed.

Decision

The appeal was upheld, and the case remitted to a different tribunal to determine whether the bonus scheme had contractual effect. The EAT confirmed that labelling a bonus scheme as discretionary does not necessarily prevent it from having contractual status or certain elements that are contractual. The EAT emphasised that a tribunal should carefully analyse the bonus scheme wording to determine the extent of the discretion. The use of the term "discretionary" could relate to different aspects of the scheme: the discretion could apply to the actual provision of an overarching bonus scheme, the method of calculating the bonus, the threshold that triggers the payment, or what percentage of salary would be paid. In deciding if the discretion in the documentation was to be construed as having contractual effect, a tribunal should take account of all the relevant circumstances, including the practice of making payments over many years. The EAT made it clear that custom and practice can regulate the way in which a term of a contract is construed and is to be exercised. In this case Boots' practice of giving employees bonuses over a period of 40 years was a relevant factor when determining whether the scheme was genuinely discretionary and what the extent of that discretion was.

The EAT also confirmed that if employers are obliged to exercise their discretion on whether to provide a bonus, they must do so rationally and in good faith.

This case also raised some interesting TUPE-related points:

- If the Boots scheme was contractual, Unipart would have been required to apply the scheme, but if that had not been possible, they would have had to have put in place a "substantially equivalent scheme". However, any claim in relation to a "substantially equivalent scheme" would be for unquantified damages, and so would most likely need to be brought in the County Court or High Court as a breach of contract claim, rather than as an unlawful deduction from wages claim in an employment tribunal.
- Statements alleged to have been made about the bonus scheme in the course of the information and consultation process at the time of the TUPE transfer from Boots to Unipart were not contractual statements.

Impact

This case is a reminder to employers that care must be taken if they wish to establish discretionary bonus schemes or other benefit plans. Merely labelling a scheme as "discretionary" may not be enough. The wording in any scheme should be clear as to the extent of the employer's discretion. Employers are advised to review their bonus schemes to ensure that the terms are clear, transparent and that they reflect the current practice of the business. However, employers should also be aware that employees may still have a claim if a bonus has been paid consistently over a number of years.

Furthermore, a purchaser of a business should make full enquiries about any bonus schemes operated by the seller due to the obligation that may arise under TUPE to continue or replicate such schemes.

Second glance at dismissals

Kirklees Metropolitan Council v Radecki

The Court of Appeal has decided the effective date of dismissal of an employee who was removed from the payroll after a long period of suspension on the assumption that a compromise agreement would be signed, was the date the Council stopped paying salary to that employee. Establishing this date as the effective date of termination is key in determining whether or not a claim for unfair dismissal will be time barred.

Facts

The employee was suspended for a substantial period and settlement discussions subsequently commenced in August 2006. A compromise agreement was negotiated which was clearly expressed to be "without prejudice" and "subject to contract". The parties anticipated entering into a compromise agreement with a termination date of 31 October 2006 and the employee was removed from the payroll with effect from that day. However, as is often the case, those negotiations turned out to be protracted and the employee decided not to sign the agreement. The employee contacted the Council in February 2007 to ask for his outstanding salary. On 5 March 2007, the

Council wrote to the employee stating that employment had terminated on 31 October 2006. The employee claimed that this was the first he knew of his termination and presented a claim for unfair dismissal to the employment tribunal on 7 March 2006.

The tribunal found that the employee's effective date of termination was 31 October 2006 and that his claim was out of time. The EAT allowed the employee's appeal and subsequently found that the effective date of termination was 5 March 2007; the unfair dismissal claim was therefore within time. Whether or not this was the case was ultimately the question the Court of Appeal sought to solve.

Decision

By a majority, the Court of Appeal upheld the Council's appeal. The Court decided that the employee's effective date for termination was when the Council stopped paying him his salary. The Court held non-payment of salary in this case showed a clear intention to terminate the contract of employment and that the employee knew that his employment had terminated when he had ceased to be paid. His employment was therefore terminated on 31 October 2006, and the claim for unfair dismissal was out of time. The Court held that the EAT had been wrong to regard the non-payment of salary as merely consistent with an expectation that the execution of a compromise agreement was imminent. There was nothing to suggest that the suspension of salary was because the parties were in negotiations. Nevertheless, the EAT's insistence that there should be an actual, explicitly clear statement to terminate an employee's employment was considered to have great merit.

Impact

The one important message that employers might take from this decision, is that there must be an unequivocal termination of the employee's employment. The mere fact that the parties are intending to enter into a compromise agreement based on an agreed termination date will not be enough. It is often the case that an employer and an employee will agree on a termination date in advance and that date subsequently comes and goes as a result of negotiations and delays on both sides. Employers should, however, be conscious that the employee remains an employee until there is an effective termination of their employment. Where the parties are unable to conclude a settlement within a specified time, it would be prudent for the employer to consider commencing (or recommencing as is often the case), the appropriate disciplinary process. Employers are often reluctant to do this for fear of crystallising a claim for unfair dismissal. On the other hand, the very real threat that disciplinary proceedings will be commenced if a compromise agreement cannot be concluded within a set frame may itself focus the parties' minds on settlement.

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June 2009