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UK: Employment Update

This edition of Employment Update considers the new concept of the employee-owner contract announced at the Conservative Party conference. In addition we review two decisions in relation to redundancy: addressing whether a reduction in hours can give rise to a redundancy and whether it is reasonable for an employer to choose a redundancy pool of one. Finally this Briefing examines the Government's consultation on settlement agreements and a High Court decision on the point in time at which the enforceability of a restrictive covenant must be considered.

Key issues

- CGT exemption in exchange for employment rights
- Redundancy: Triggered by a reduction in hours
- Redundancy: When is a pool of one acceptable?
- Restrictive covenants: An employee's promotion does not enhance or restore enforceability
- BIS consultation on settlement agreements

CGT exemption in exchange for employment rights

At the Conservative Party conference the Chancellor of the Exchequer announced a rather novel idea of employees exchanging some of their employment rights for rights of ownership in the form of shares in the business they work for with any gains on those shares being exempt from Capital Gains Tax (CGT).

The idea is that companies of any size will be able to use a new kind of contract under which employees will be given between £2,000 and £50,000 of shares that are exempt from CGT. In exchange, they will give up their rights on unfair dismissal, statutory redundancy payments, the right to request flexible working and time off for training, and will be required to provide 16 weeks' notice of a firm date of return from maternity leave instead of the current requirement to give 8 weeks' notice if the employee intends to return to work early.

Employee-owner status will be optional for existing employees but both established companies and new start-ups can choose to offer only this new type of contract for new hires. Companies recruiting employee-owners will continue to have the option of inserting more generous employment conditions into the employment contract if they want to.

It is intended that the new legislation bringing in the new employee-owner contract will be published this year so that companies can use the new type of contract from April 2013. The Government proposes to consult on the details of these contracts later this month. It is hoped that the consultation will address some obvious questions. For example: will the employee be liable to income tax on the shares? Will it be permissible for employees to be offered such contracts after a TUPE transfer?

Redundancy: Triggered by a reduction in hours

When an employee is dismissed by reason of redundancy, he or she will be entitled to a statutory redundancy payment (subject to having two years' service) and potentially a contractual redundancy payment if the employer operates a contractual redundancy scheme. Accordingly, it is important for an employer to understand when a termination situation amounts to a "redundancy". Bizarrely, there has been some doubt about whether there can be a redundancy if an employer

deals with a downturn in business by decreasing the workload of the employees rather than reducing the number of employees.

In the past, the Employment Appeal Tribunal (EAT) has ruled that there can only be a redundancy if there is an actual reduction in the numbers employed. More recently, the President of the EAT considered a case where the number of book keeping hours required by a business reduced as a result of a combination of economic circumstances and new software. The book keeper's employer attempted to address this by reducing her contracted hours but she refused to have her hours reduced and as a consequence was dismissed.

The EAT held that this dismissal was by reason of redundancy: a reduction in hours (as well as a reduction in the number of employees) is a redundancy for the purposes of the legislation.

This decision means that there are now competing EAT authorities on whether it is necessary to have a reduction in the number of employees in order to trigger a statutory redundancy situation. In light of the fact that the most recent decision was handed down by the President of the EAT, employers would be advised to adopt the cautious approach of assuming that a reduction in hours arising from business or economic needs that then results in a dismissal will give rise to a statutory redundancy situation triggering an entitlement to a statutory redundancy payment where the qualifying conditions are met. The terms of any contractual redundancy pay scheme would also have to be examined to assess whether any payment is due.

[*Packman v Fauchon*]

Redundancy selection pool: When is a pool of one acceptable?

In recent months, there have been a number of EAT decisions focusing on whether a redundancy dismissal has been rendered unfair as a consequence of the employer's decision to adopt a redundancy pool of one.

The most recent decision addressing the size of a redundancy selection pool looked at the situation where C was the steward at W Golf Club. As a consequence of the Golf Club's need to save money, C was dismissed by reason of redundancy after the Golf Club identified a selection pool of one, i.e. C.

The Employment Tribunal held that the dismissal was unfair because the Golf Club had not acted within the range of reasonable responses of a reasonable employer in choosing to make C redundant because it had not turned its mind to any sort of selection pool and had simply decided that the steward's role would be extinguished.

This decision was overturned on appeal by the EAT which held that there was no rule that there must be a pool; an employer could, if it had good reason for doing so, consider a single employee for redundancy. There had been no criticism of the Golf Club's conclusion that it no longer needed a club steward. Accordingly, it was within the range of responses to focus on the holder of the role that was to be extinguished without also considering other staff such as the bar staff. This issue had not been explored by the Tribunal and therefore the case was remitted for consideration.

It is apparent from the case law that there is perhaps a variety of judicial approaches to the issue of whether an employer is under an absolute obligation to consider a redundancy selection pool failing which the redundancy will be deemed unfair. In practice, an employer is advised to turn its mind to the question of what is the correct selection pool, particularly in the context of employees performing the same or similar roles.

There is a risk that if an employee is dismissed by reason of redundancy without any consideration being given to the selection pool the dismissal will be held to be unfair. If there is no customary arrangement or agreed procedure that specifies a particular selection pool, a Tribunal will not generally challenge an employer's choice of pool as long as the employer has genuinely applied its mind to the issues and acted reasonably. It is therefore advisable to document the thought-making process clearly.

[*Wrexham Golf Club Company Limited v Ingham*]

Restrictive covenants: An employee's promotion does not enhance or restore enforceability

It can be tempting for an employer to adopt a blanket approach to the use of restrictive covenants in its employment contracts. This is inadvisable. The Court's approach to the enforcement of restrictive covenants such as covenants prohibiting competition, the solicitation of former colleagues or clients is that the covenant is *prima facie* void unless the employer can demonstrate that it has a legitimate interest to protect and the covenant goes no further than is necessary to protect that legitimate interest. The reasonableness of a covenant will be dictated by the nature of the employer's business and the individual's role within that business and is assessed by reference to the factual situation at the time the covenant is entered into, not when the employer wishes to enforce it.

It is important to keep covenants under review as an employee's career evolves and to tailor the covenant to the employee rather than adopting a boiler plate approach. In a case, the employee, N, started in a junior role and his contract contained restrictive covenants that were very broad in scope. By the time the employee left employment to join a competitor, he had risen to a very senior role. The employer argued that if the employee left, he would be in breach of the 12-month non-compete covenant in his contract.

The employer accepted that at the time N entered into his employment contract, the 12-month non-compete clause was too wide and therefore unenforceable, however, it tried to argue that the enforceability of the covenant should have been examined not at the date when N started employment but when he was promoted. It argued that his contract had effectively been varied at that stage when N was given a new job title reflecting enhanced responsibilities and a substantial increase in pay together with a longer notice period.

The Court rejected this argument as N had not, as part of the terms of his promotion, been asked to indicate afresh his acceptance of the original restrictive covenants either expressly or implicitly. The Court held that a general acknowledgement by N that his old terms remained unchanged upon his promotion did not amount to an agreement to reinstate the restrictive covenants which had been null and void at the time they were originally entered into.

The Court considered that it is important for an employee to know where he or she stands and it would be undesirable for the effectiveness of a restrictive covenant to vary over the lifetime of an employment relationship. It commented that employers would have to take more care in considering whether promotion or some other change in an employee's terms or circumstances requires an explicit reconsideration of what restrictive covenants are reasonable and that that was a healthy discipline to enter into.

Once again, this High Court decision illustrates how important it is to tailor restrictive covenants to the situation of the employer and employee at the time the employment contract is entered into and how covenants must be kept under review as both the employer's business evolves and the employee's role changes.

[*Pat Systems v Neilly*]

BIS consultation on settlement agreements

BIS have launched a consultation on the use of settlement agreements and the level of unfair dismissal compensatory awards. The Government hopes to make it easier for employers to part ways with employees by means of the use of a settlement discussion followed by a payment under a settlement agreement (the new name for compromise agreements).

The Government is making legislative changes so that offers of settlement by an employer will be inadmissible in unfair dismissal claims except where the employer has behaved improperly; at the same time, it proposes that a statutory code will underpin this process. The Code will be produced by ACAS and will explain how the settlement process operates in practice. Employment Tribunals will be required to take the Code into account in making a determination on a case. The Code will set out the principles of how employers/employees should make an offer of settlement under the new regime. The Government proposes that the Code will embody the following principles:

- the legislative protection (that is the inadmissibility of the offer of settlement in evidence in Employment Tribunal proceedings) will only apply in unfair dismissal cases
- employer and employee can propose a settlement
- the reason for people making a settlement offer should be clear
- the settlement offer should be made in writing and set out clearly what is being offered (e.g. the settlement sum and, if appropriate, the agreed reference) as well as what the next steps are if the individual chooses not to accept the offer
- no particular procedure needs to be followed by an employer prior to making a settlement offer
- if an employer handles settlement in the wrong way there is a risk that this will give rise to a breach of the implied term of trust and confidence and allow the employee to resign and claim constructive dismissal
- where an individual refuses settlement, the employer must go through a fair process before deciding whether to terminate the relationship
- individuals should be given a clear and reasonable period of time to respond to the settlement offer
- clear examples of what amounts to "improper behaviour" by the employer that will remove the exemption from the settlement discussion being admissible in evidence
- no undue pressure should be put on a party to accept the offer of settlement
- employers should not make discriminatory comments or act in a discriminatory way when making an offer of settlement

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The Government also proposes that the statutory Code will include draft letters that an employer can send to the employee when making an offer of settlement together with a template settlement agreement supported by guidance. The intention is that the provision of such templates will make it easier, cheaper and faster to agree settlement. Under the new regime employers will, however, be permitted to use their own forms of settlement agreement, for example where they wish to address issues that are perhaps not covered by the simple form of Government settlement agreement such as confidentiality, undertakings, reaffirmation of restrictive covenants and so on.

Employees will still be required to take independent legal advice in order to compromise statutory employment claims and the current practice of employers making a contribution to legal fees is likely to continue.

The Government is also consulting on whether it would be helpful if a guideline settlement tariff is established based either on a set figure or formula, for example, notice period salary + £x, or, a list of factors that the employer/employee should consider in deciding their own figure, for example, the reason for proposing settlement, the terms of the contract, notice period, length of time required to follow a full process for fair dismissal if the offer is refused, how difficult it would be to fill the post, the individual's perception of how long it will take them to find another job and/or perceived strength of any potential claim the employee may have in the Tribunal.

The consultation closes on 23rd November. At this stage, it is unclear when this new settlement agreement regime will come into effect, however, it is likely to be April or October 2013.

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