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Briefing Note – June/July 2018

UK: EMPLOYMENT UPDATE

This Briefing explores new reporting requirements in relation to Board engagement with employees and the 'Board-Employee Pay Gap'. Finally, this month's Briefing would not be complete without looking at the latest 'gig' economy developments; this month it is the Supreme Court's decision on the 'employment' status of a plumber.

Key issues

- New Board Pay Gap reporting obligations
- Engagement with employees: new reporting obligations
- Employment status: limited right of substitution and control are decisive factors

New Board Pay Gap reporting obligations

What?

New regulations laid before Parliament (the Reporting Regulations) will amend existing legislation to require listed companies with 250 or more employees to publish in the directors' report the pay ratio of the chief executive's single total figure of annual remuneration (STFR) to the 25th, 50th and 75th percentile full time equivalent remuneration for the company's UK employees.

Companies operating as a group must assess the number of UK employees across the group to determine whether the 250-employee threshold has been attained.

When?

The new obligation will apply in relation to financial years of companies beginning on or after 1st January 2019 with the first reports being produced in 2020.

Going forward, companies pay ratio tables should cover a ten year pay reporting period, with the table building incrementally over time. The first reporting period will of course disclose only a single set of pay ratio figures.

What is pay for these purposes?

Employee 'pay and benefits' for the ratio calculation are made up of the same components as the pay and benefits of the CEO, including salary/wages, taxable benefits, pension benefits and performance related pay. However, the company does have the option of omitting any of the components other than salary from the calculation, but if it does so the report must explain why.

Although the company can omit components from the employee pay calculation, the equivalent component must still be included in the CEO's STFR calculation.

Whose pay?

It is only employee pay and benefits that are taken into account in the pay ratio calculation; if the company's workforce includes 'workers' their pay and benefits

are not taken into account as they are not strictly speaking engaged by the company under a contract of service. Similarly, the pay and benefits of self-employed contractors and consultants, and agency staff who do not contract directly with the company, but remain contracted with the agency are not relevant for pay ratio reporting purposes. Agency staff who do contract directly with the company will only be in scope if they contract as employees.

Methodology

Companies can use one of the three prescribed pay ratio calculation methodologies (Options A to C). However, the Government considers that Option A is the most statistically accurate way for a company to calculate the ratios and considers that companies should use it wherever reasonable and possible. Companies must explain why they have elected to use Option A, B or C. A company will not be bound by its choice for subsequent years but must provide an explanation for any change.

In essence, Option A requires the company to:

- Identify the full time equivalent (FTE) remuneration of all its UK employees for the relevant financial year;
- Rank the employees based on the FTE remuneration from low to high;
- Identify the employees whose remuneration places them at the 25th, 50th and 75th percentile point of this ranking.

Options B and C provide some limited flexibility for companies who may experience difficulties applying the methodology of Option A; they allow companies to identify on an indicative basis the employees at the 25th, 50th and 75th percentiles.

Explanatory statement

The company will have to include an explanatory statement alongside the pay ratio table which must, amongst other matters, explain:

- Any increase or reduction in the financial year's pay ratio compared to the ratio of the preceding financial year;
- Whether the change is attributable to changes in CEO remuneration or that of the UK employees, changes in employment models or the use of a different Option to calculate the pay ratio.

Guidance

BEIS has produces an FAQ document on the Reporting Regulations which can be found here.

The GC 100 Investor Group is expected to update its Executive Remuneration Guidance; this will no doubt address the new Board Pay Ratio reporting obligation.

The policy intention is to give shareholders a new tool to assess whether, and how, pay at board level is consistent with pay and incentives throughout the company rather than to compare pay ratios across companies. In any event, in practice it is likely to be difficult for meaningful comparisons to be made across different sectors. Financial services companies are likely to have large numbers of highly skilled, highly paid individuals below board level rendering the pay ratios smaller, by comparison retail sector companies will have large workforces that are paid at national minimum/living wage rates and the Board pay ratio will invariably be much larger.

[The Companies (Miscellaneous Reporting) Regulations 2018]

Engagement with employees: new reporting obligations

Section 172 of the Companies Act 2006 requires directors to act in the best interests of the company's members but also to have regard to the interest of stakeholders, including its employees. The Reporting Regulations will require companies to include in their strategic report a Section 172 statement setting out how directors have had regard to the matters set out in section 172. The Financial Reporting Council (FRC) is going to publish a revised version of its Guidance on the Strategic Report that will include guidance for companies on how to make a section 172 statement.

In addition, listed companies with 250 or more employees will have a new obligation to include in the directors' report a statement summarising how the directors have engaged with UK employees and how they have had regard to employees' interests and the effect of that regard on the principal decisions taken during the financial year. This obligation will also apply in relation to financial years of companies beginning on or after 1 January 2019.

Again, the obligation is in relation to employees not 'workers'; however, given the modern nature of the workplace and the composition of the workforce there must be merit in having regard to the wider workforce interests.

This reporting obligation will sit alongside anticipated changes to the UK Corporate Governance Code due to be published by the FRC shortly; the revised Code is expected to include new provisions requiring companies to include on a comply or explain basis one of three employee engagement mechanisms: a designated non-executive director, a formal employee advisory council or a director from the workforce. It remains to be seen whether the revised Code will adopt a broader approach and suggest engagement with the wider workforce, i.e. employees and workers or simply engagement with employees. If the former approach is adopted it may give rise to practical issues in some cases where the workforce is composed of large populations of workers on short term contracts with a high turnover.

The draft Wates Corporate Governance Principles for Large Private Companies that are currently the subject of consultation echo the need for workforce engagement recommending that companies should develop methods that enable them to engage meaningfully with their workforce and utilise such forms of engagement when taking decisions.

[The Companies (Miscellaneous Reporting) Regulations 2018]

Employment status: limited right of substitution and control are decisive factors

The Supreme Court has handed down the latest decision in relation to the employment status of 'gig' workers; in this case the 'gig' in question was plumbing work. The Court had to consider the appropriate approach to determining whether, S, a plumber working for Pimlico Plumbers (PP) was a 'worker (as opposed to self-employed contractor) for the purposes of pursuing claims for unlawful deduction from wages, holiday pay and disability discrimination. It should be noted that S lost his claim that he was an employee.

The Supreme Court upheld the Employment Tribunal (ET) decision that S was a worker. In order to qualify as a worker, S had to perform the work for PP personally. There was however a right of substitution in S' contract. The Court scrutinised the extent to which this right of substitution meant that S did not provide personal performance. The right of substitution was, on the facts, very limited. S was only permitted to provide a substitute who was also a PP plumber subject to PP contractual terms. It was not an unfettered right of substitution with PP only concerned that the work was done and not with the identity of the individual performing it.

Even if S provided his services personally he would not qualify as a worker if PP was a client or customer of his. The Supreme Court considered what factors might be relevant when assessing whether a contracting party has the status of client or customer. It acknowledged that there was no 'single key' but referred to dicta in two cases that could be of assistance. In these cases, factors identified as relevant included:

- Whether the individual actively marketed his services to the world in general;
- Whether the individual is recruited to form an integral part of the recruiter's organisation;
- Whether the individual performs services for and under the direction of another for remuneration;
- Whether the individual is an independent provider of services who is not in a relationship of subordination with the person receiving the services.

The Supreme Court held that the ET had been entitled, by some margin, to conclude that PP was not a client or customer of S. Although S had been free to reject any particular piece of work (subject to his overriding obligation to make himself available for up to 40 hours a week), could take outside work, was subject to financial risks if customers did not pay and was not supervised by PP in the way in which he performed his work, there were features of his contract which indicated a high degree of control over S not consistent with PP being a customer or client. S had to wear a branded PP uniform, drive a PP branded van which was tracked and had to closely follow the instructions of the PP control room. All these factors suggested subordination and/or integration which was not consistent with PP being a client. In addition, the 'severe terms' on when and how much PP had to pay S, the Court clearly considered to be inconsistent with S being an independent contractor.

This decision was based on a very specific factual matrix. Accordingly, it does not provide a definitive checklist by which to determine whether an individual is a worker. However, the following points can be extrapolated:

- The terms of contracts must be consistent with the intended status. The Supreme Court commented on the references in the PP contract to: 'wages', 'gross misconduct' and 'dismissal' querying whether they were 'ill-considered lapses' that shed light on the true nature of the arrangement.
- What is the reality of the relationship in terms of how much control it is necessary to have over the individual? The contract should reflect that reality because the courts and tribunals will scrutinise the contract to assess whether it reflects the reality of what happens in practice.
- A substitution clause in the contract will not act as a magic bullet destroying any argument that the individual is a worker. The nature of the right (rigid or relaxed) and how it operates in practice will all be relevant factors.

[*Pimlico Plumbers v Smith]*

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