SLAUGHTER AND MAY

Pensions and Employment: Employment/Employee Benefits Bulletin

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Legal and regulatory developments in Employment/Employee Benefits

In this issue

New Publication

Cases Round-up

Points in Practice

To access our Pensions Bulletin visit the Slaughter and May website.

Contents include:

- Contracting out – Government response
- PPF consultation on triennium starting 2018/19
- PPF long service cap – regulations and Government response
- Auto-enrolment consultation on new employers – response and regulations
- Auto-enrolment earnings trigger and qualifying earnings band
- Finance (No.2) Bill published
- Income tax and Class 1 NICs treatment of pensions advice
- Pension Advice Allowance authorised payment
- Overseas schemes requirements – regulations

Back issues

More about our pensions and employment practice

Details of our work in the pensions and employment field

For more information, or if you have a query in relation to any of the above items, please contact the person with whom your normally deal at Slaughter and May or Clare Fletcher

New Publication

Contractors: a European perspective

We attach a joint briefing which we have prepared with Bredin Prat, Hengeler Mueller and De Brauw Blackstone Westbroek on contractors. The briefing considers how contractors are distinguished from employees in the UK, France, Germany and the Netherlands. It also highlights the key rights and obligations of contractors, the risks and consequences of reclassification as an employee, and some topical developments in each jurisdiction.

Cases Round-up

Indirect discrimination: reason for disadvantage

Indirect discrimination occurs when an apparently neutral provision, criterion or practice (PCP) puts persons with a protected characteristic at a particular disadvantage, and is not objectively justified. The Supreme Court has now confirmed that it is not necessary to establish the reason for the particular disadvantage (or that that reason is related to the protected characteristic in question) (*Essop v Home Office (UK Border Agency)* and *Naeem v Secretary of State for Justice*).

BME employees fail test: *Essop* involved a group of employees of the Home Office (together E). They were required to pass a Core Skills Assessment (CSA) as a pre-requisite to promotion to certain civil service grades. They had all however failed the CSA. A report in 2010 established that black and minority ethnic (BME) candidates, and older candidates, had lower pass rates than white and younger candidates. No-one was able to identify why the pass rates were lower, although the 2010 report found that there was a 0.1% likelihood that this could happen by chance.

Claims: E issued claims alleging that the requirement to pass the CSA constituted indirect discrimination on the grounds of race or age. The claims were rejected on the basis that there could be no such discrimination unless E could establish that their race or age was the reason for the lower pass rate.

Muslim chaplain on lower pay: *Naeem* involved an imam (N) who works as a chaplain in the Prison Service. Before 2002 Muslim chaplains were engaged on a sessional basis only (unlike some Christian chaplains), but in 2004 N became a salaried employee. At this date the pay scheme for salaried chaplains incorporated pay progression over time. The average length of service of Christian chaplains was longer, which led to a higher average basic pay.

Claim: N argued that the incremental pay scheme was indirectly discriminatory against Muslim chaplains. N's claim was rejected on the basis that it was not enough to show that the length of service criterion had a disparate impact upon Muslim chaplains: it was also necessary to show that the reason for that disparate impact was something peculiar to the protected characteristic of religion.

Reason for disadvantage is not relevant: The Supreme Court held that there is no requirement for an explanation of the reasons why a particular PCP puts one group at a disadvantage when compared with others. It is simply enough that it does. It therefore did not matter that E could not show that they failed the CSA because of their race and/or age. It was sufficient that BME candidates failed the CSA disproportionately, and E suffered this disadvantage. Equally, it did not matter that the reason why the pay scale put Muslim chaplains at a disadvantage was their shorter lengths of service (on average) than Christian chaplains.

Justification: The Supreme Court noted that it is always open to an employer to show that the PCP is justified, as there may well be a good reason for it. The Court stressed that there is no shame in justifying a PCP; it should not be seen as casting some shadow or stigma on the employer. On the facts, E's case had not got as far as deciding justification, so must be remitted. The Court however upheld the decision in N's case that the pay scheme was justified by the desire to reward length of service and increasing experience, while at the same time managing an orderly and structured

transition over a period of time to a shorter, single pay scale. N's claim therefore failed.

Lessons for employers: This case illustrates that employers must always consider whether their policies and practices, while applied neutrally, may put employees of a particular age, sex, race or other protected characteristic at a disadvantage (whatever the actual reason for that disadvantage may be). The first step should then be to see if those policies which do have a disparate impact can be modified to remove that impact, while still achieving the desired result. If not, the employer can (and should) seek to justify its stance.

TUPE: ELI does not include contractual status of remuneration terms

On a TUPE transfer, the transferor must provide employee liability information (ELI) to the transferee. ELI includes all the terms which must be included in an employee's statement of particulars under section 1 of the Employment Rights Act 1996, which includes terms as to remuneration. However, ELI does not require the transferor to specify whether any particular aspect of remuneration was contractual or not, according to a recent judgment of the EAT. The transferor therefore could not be held liable for failure to provide accurate ELI which stated that a Christmas bonus was non-contractual, when in fact it was contractual (*Born London Limited v Spire Production Services Limited*).

Christmas bonus: Sotheby's auctioneers outsourced the printing of their catalogues to SPS. The contract ended in 2015, and Sotheby's then contracted with BLL to do the work. This resulted in 32 print finishing employees transferring from SPS to BLL under TUPE. Prior to the transfer, SPS provided BLL with ELI. Under the heading "non-contractual", it was said that each employee was entitled to a Christmas bonus of one week's pay, plus £7.50 per year of service, payable each November.

Contractual: After the transfer, it emerged that the Christmas bonus was in fact contractual, either as an express term or implied through custom and practice. BLL brought proceedings against SPS for failure to provide accurate ELI. It sought compensation of over £100,000, representing the bonus amounts for all 32 employees for the lifetime of the contract.

ELI doesn't require this: The EAT dismissed the claim, finding that TUPE did not require a transferor to say whether or not a term was contractual. It noted that TUPE requires the transferor to provide ELI which includes "*the scale or rate of remuneration or the method of calculating remuneration*", but says nothing about whether terms should be identified as contractual or not. The "*method of calculation*" was not the same thing.

Contractual status is not always clear: The EAT accepted SPS's argument that it would create real difficulties if a transferor was required to specify whether terms were contractual or not, given that this would depend on the particular context and thus could be difficult to determine. It would also require employers to ascertain and be alive to a shift from non-contractual to contractual, for example via custom and practice, and to issue a new section 1 statement accordingly. The EAT was therefore satisfied that the obligation under TUPE is to provide details of both contractual and non-contractual terms, but not to distinguish between them.

Points for transferees: Thorough due diligence is important to establish the rights and liabilities which will transfer. There are limitations to relying on ELI, as this case illustrates (it seems that the transferee here did not receive the statements of particulars or details of past bonuses until after the transfer). Warranties and indemnities are vital tools to support the findings of due diligence, and again should avoid the need to rely on the provision of ELI.

Points for transferors: Transferors should avoid labelling terms as contractual or otherwise when providing ELI. Although the use of such labels may not give rise to a claim under the ELI provisions, it could be actionable under the terms of the sale agreement, and potentially under common law (for example in misrepresentation).

Redundancy: offer of suitable alternative employment

If a redundant employee unreasonably refuses an offer of suitable alternative employment, he

may forfeit his entitlement to statutory redundancy pay (SRP). However, this is a two stage test, which must take account of the employee's reasons for refusing the offer, even if these are not communicated to the employer at the time. This test is also not determinative of whether the employee's dismissal is unfair, according to a recent judgment of the EAT (*Dunne v Colin & Avril Ltd t/a Card Outlet*).

Redundancy and alternative employment: D was employed by CAL as a book-keeper. D worked a 24-hour week, ostensibly for health reasons (she had leukaemia which it seems prevented her from working longer hours). Discussions took place about D's position. She was initially offered a 16-hour per week contract, which was not financially acceptable to her. She was then offered a 24-hour contract involving 16 hours' book-keeping and 8 hours of other work, including working in the warehouse. D declined that offer, contending that it was inconsistent with her book-keeping skills and experience and would not be cost-effective for the business. D was therefore dismissed.

Effect of refusal: The Tribunal found that there was a redundancy situation, but that D was not entitled to SRP, as she had been offered an office-based position on the same pay. This resulted in the 'inevitable' conclusions that the offer was suitable and D's refusal was unreasonable. Although the Tribunal found that D could not tolerate working in the cold environment of the warehouse because of her leukaemia, it did not take this into account since D had not relied on this as part of her refusal. The Tribunal concluded that the unreasonable refusal of the offer of suitable alternative employment resulted in D's dismissal being fair.

Two-stage test: The EAT allowed D's appeal, remitting both claims back to a different tribunal for re-hearing. It found that in order to deny SRP to a redundant employee, the Tribunal must first decide the objective question: was the alternative employment suitable? If so, it must decide the subjective question: was this employee's refusal of the offer unreasonable? The onus lies on the employer to show both suitability and unreasonable refusal. In this case the Tribunal did not properly apply the two strands of the test.

Employee's reason: The EAT also criticised the Tribunal's conclusion that because D did not raise the effect of the cold warehouse environment on her medical condition prior to her dismissal, she could not rely on it as part of her reason for refusing the alternative employment offered. In the EAT's judgment, that approach was too prescriptive. The mere fact that the reason later relied on by D in her claim was not raised prior to dismissal did not mean that it could be wholly disregarded in deciding the unreasonable refusal question.
Unfairness is different: Finally, the EAT found that even if D had been disentitled to a redundancy payment on the basis that she had unreasonably refused an offer of suitable alternative employment, that does not necessarily mean the dismissal was fair. The Tribunal had been wrong to reach this conclusion without applying the correct unfair dismissal test, and its conclusion must be set aside.

Employers beware: The effect of this case is that it will be difficult for an employer to deny an employee SRP based on his or her unreasonable refusal of an offer of suitable alternative employment, given that the reasonableness of the refusal is judged subjectively (from the employee's perspective), and may be based on factors which the employee does not rely on or communicate to the employer at the time when the offer is refused. Employers should therefore exercise caution when denying a payment of SRP on this basis. They should also note that an unreasonable refusal of an offer of suitable alternative employment will not necessarily mean that the dismissal is fair; this must be achieved by following a fair redundancy process.

Points in Practice

Brexit: White Paper on the Great Repeal Bill

The government has published a White Paper: Legislating for the United Kingdom's withdrawal from the European Union. The White Paper follows the government's triggering of the exit procedure under Article 50 of the Treaty on European Union on 29th March 2017, and sets

out the government's legislative strategy for Brexit, via the Great Repeal Bill.
The White Paper reveals the government's intention that the Great Repeal Bill will:

- repeal the European Communities Act 1972, on the date on which the UK leaves the EU;

- convert EU law as it applies in the UK into domestic law, so that "*wherever practical and sensible*" the same rules and laws will apply in the UK immediately after it leaves the EU. The White Paper specifically cites the Equality Act 2010, confirming that the protections covered by that Act will continue to apply once the UK has left the EU. It also confirms that there are no plans to withdraw from the European Convention on Human Rights (ECHR) (there is no mention in the White Paper of the Conservative Manifesto pledge to replace the Human Rights Act 1998 with a British Bill of Rights);

- give the case law of the European Court of Justice (CJEU) (as it exists on the day we leave the EU) the same binding or precedent status in our courts as decisions of the UK Supreme Court. The White Paper specifically cites the CJEU's case law on the calculation of holiday pay entitlements as being preserved by the Bill. The White Paper is however clear that there will be no role in UK law for the CJEU's ongoing case law following our exit from the EU; and

- create powers for the government to make secondary legislation, in order to enable corrections to be made to the laws that would otherwise no longer operate once the UK has exited the EU, and in order to reflect the content of any withdrawal agreement under Article 50.

The Government plans to introduce the Great Repeal Bill in the next Parliamentary session, and its passage through Parliament will run alongside the UK's negotiations with the EU and other legislation associated with the UK's withdrawal.

Gender pay gap reporting: final form guidance

ACAS and the Government Equalities Office (GEO) have published the final version of their guidance on gender pay gap reporting: Managing gender pay gap reporting (March 2017).

The final version incorporates a number of changes since the draft version published in February (see our Employment Bulletin dated 10th February 2017). The key changes are:

- **Pensions**: the guidance now states that where employee contributions to a pension scheme are made by salary sacrifice, these should be excluded from the pay figures (so the salary after the sacrifice should be used in the calculations). This brings pension contributions into line with how other salary sacrifice benefits are treated under the regulations, but creates a disparity where employee pension contributions are not made via salary sacrifice (in which case they would be included in the figures because the salary would be greater).

- **Groups of employers**: there is a new section to clarify that each separate legal entity within a group must calculate and publish separate reports (if they have 250 or more employees). However the section goes on to suggest that:

  - larger employers may find it useful to break their calculations down further, for example where they are operating in a number of completely different employment sectors, or where the jobs and levels of pay and bonuses are not obviously comparable;

  - a group of employers who have all provided separate reports may wish to give an indication of the gender pay gap within their overall group; and

  - provided that the legally required calculations are clearly provided, employers can enhance their reports as they wish on a voluntary basis where they consider this informative and appropriate. In most cases, this will be through supplying additional information in the voluntary narrative that accompanies a published report.

- **Full-pay relevant employees**: the guidance continues to make it clear that if employees are being paid at a reduced or nil rate during the relevant pay period as a result of being on leave, they are not a 'full pay relevant employee'. It now clarifies that it does not matter whether the leave is taken during the relevant pay period – what matters is whether the pay is reduced during that relevant pay period due to the leave. It also states that employees who receive no pay at all during the relevant pay period, whether or not this is as a result of being on leave, should be excluded from the gender pay gap calculations. This last statement does not in fact reflect the Regulations, but it represents a common sense solution, since otherwise the figures could be skewed.

- **Overseas employees:** this section now includes a statement that where an employee is employed by an overseas entity and seconded to work for an organisation in GB, the GB organisation will need to consider whether that person is their employee within the meaning of the regulations. It also states that where currency needs to be converted to carry out relevant calculations, an employer should generally use the exchange rate that applied at the date of payment (that is, the payroll date which corresponds to the relevant pay period).

- **Allowances**: the list of examples now includes on-call allowances. This section now also states that where payments for recruitment and retention are 'one off' incentive payments made at the start of employment, or are more in the nature of a bonus than an ongoing allowance, they should be treated as incentive payments falling within bonus pay, rather than as allowances falling within ordinary pay.

- **Backdated pay awards**: the guidance still states that any ordinary pay received in the relevant pay period that would normally be received in a different pay period (such as a payment to remedy an accidental underpayment for the previous period) should be excluded. However, it now clarifies that if an employee receives a pay award or allowance in the relevant pay period backdated to January, only the amount attributable to the relevant pay period should be included.

- **Bonuses**: this section now states that long service awards with a monetary value (cash, vouchers or securities) are included within the definition of "bonus", but any other type of non-monetary award under this category, such as extra annual leave, should instead be treated as a benefit in kind and excluded. It also states that while bonus pay does not include pay related to overtime, it may be difficult to distinguish whether a bonus (or part of a bonus) relates to overtime hours. In cases where it is unclear that an element of bonus pay relates to overtime, it should be included in bonus pay.

- **Valuing bonuses paid in securities**: the guidance now confirms that where the securities provided to employees do not give rise to a charge to income tax at all (e.g. as part of a share incentive plan where shares are kept for a certain period of time), they will not be included in bonus pay.

- **Data protection**: the guidance now clarifies that only the calculation results and written statement should be published, which should not in itself raise employee data protection issues. However, it goes on to recommend that employees (query if this should have been a reference to employers) should bear in mind data protection principles when going through the whole process of gender pay reporting (including data gathering), since it may involve processing personal data.

In addition, a number of **errors** in the draft guidance relating to the hourly pay calculations have been corrected to accurately reflect the Regulations. There are however still no details of the **designated government website** where companies must publish their gender pay gap information (as well as their own websites).

Action point: Companies should use the guidance to begin compiling the necessary data for their gender pay calculations, using the snapshot date of 5th April (and the pay period within which that date falls). If you require any assistance in complying with your gender pay gap reporting obligations, please speak to your usual Slaughter and May contact.

Corporate Governance: BEIS Committee Report

The Business, Energy and Industrial Strategy (BEIS) Committee has published its Third Report of this session, Corporate Governance. The report makes some wide-ranging recommendations for reform, particularly as regards executive pay and board composition. The key points are:

- **Abolition of LTIPs**: these are seen as too complex and liable to create perverse incentives and short-term decisions. The report concludes that LTIPs should be phased out as soon as possible; no new LTIPs should be agreed from the start of 2018 and existing plans should not be renewed. Instead, the report recommends that the FRC should consult on amending the UK Corporate Governance Code (the Code) to establish a more simple pay structure, comprising salary, cash bonus relating to stretching targets, including those relating to wider performance criteria, and deferred stock to divest over a genuinely "long-term" period, normally at least five years.

- **Votes on remuneration**: the report recommends that a binding shareholder vote on executive pay awards should be triggered if there is a significant minority of opposition (of over 25 per cent of votes cast) to pay awards in the previous year.

- **Pay ratios**: the report calls for the Code to be amended to require the publication of pay ratios between the CEO and both senior executives and all UK employees.

- **Employees on boards**: although the report stops short of recommending a compulsory requirement for companies over a certain size to include a worker on their board, it does state that it should become the norm for workers to serve on boards. Employees appointed to boards should be directors in their own right, with the necessary skills and aptitudes to play a part as a full board member rather than a representative of the workforce. The report also recommends that the Code should include the option for employee representatives on remuneration committees, and it expects leading companies to adopt this approach.

- **Diversity**: the report calls on the Government to set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women. The Code should be amended to require all FTSE 350 listed companies to disclose in their annual report the reasons why they have failed to meet this target, and what steps they are taking to rectify the gender inequality on their Executive Committees. The report further recommends that the FRC embeds the promotion of the ethnic diversity of boards within its revised Code. At the very least, wherever there is a reference to gender, the FRC should include a reference to ethnicity, so that the issue of ethnic diversity on boards is made explicit in the revised Code, and is given as much prominence as gender diversity. Further, the Government should legislate to ensure that all FTSE 100 companies and businesses publish their workforce data, broken down by ethnicity and by pay band.

- **People policy**: the report recommends that companies should set out clearly their people policy, including the rationale for the employment model used, their overall approach to investing in and rewarding employees at all levels throughout the company, as well as reporting clearly on remuneration levels on a consistent basis. The FRC should consult with relevant bodies to work up guidance on implementing this recommendation for inclusion in the Code.

Implications: It is not clear at this stage how many (if any) of these recommendations will be taken forward. The Government is expected to take action based on its Green Paper on Corporate Governance within the coming months.

If you would like further information on these issues or to discuss their impact on your business, please speak to your usual Slaughter and May contact.

If you would like to find out more about our Pensions and Employment Group or require advice on a pensions, employment or employee benefits matters, please contact Jonathan Fenn or your usual Slaughter and May adviser.

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