SLAUGHTER AND MAY

Pensions and Employment: Employment/Employee Benefits Bulletin

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Stop press

Brexit implications for employment law

On 23 June 2016 the UK voted to leave the European Union. As the UK enters a period of political and economic uncertainty, employers are asking whether there will be changes to UK employment laws, and if there are, how these changes are likely to affect their businesses. One of the most significant and pressing concerns for employers is likely to be the impact of Brexit upon the free movement of workers as employers consider whether EU employees will be able to come and go from the UK and whether the employees of UK companies will be able to travel and work within the EU. In this context there may be important differences in the long term position of EU citizens in the UK depending on whether they arrived before or after 23 June 2016.

1. Current position following the UK referendum to leave the EU

The referendum vote to leave the EU does not in itself change the rights of EEA or Swiss nationals (or nationals of other countries) to live and work in the UK. For the time being, the UK remains a member of the EU and still benefits from, and is subject to, the terms of EU membership despite the referendum result to leave the EU.

The formal process of leaving the EU is triggered only when the UK delivers its Article 50 notice to the European Council. Delivery of the notice starts a two-year period of negotiations to exit, which can only be extended with the unanimous agreement of the European Council.

It is not yet clear when the Government will trigger Article 50 and despite the fact that 'nothing has changed', the immediate impact of the vote to leave has been economic and political uncertainty which has affected confidence in the markets and led employers to consider their position.

Once Article 50 has been triggered no one knows how long it will take to exit the EU; according to David Cameron it could take up to 10 years but according to the Vote Leave campaign, an exit could be negotiated in less than two years. It is possible, however, that protracted negotiations will take place between the UK and the EU and, until the terms of Brexit have been negotiated and agreed, this uncertainty is likely to continue and any advice about the changes to employment laws and freedom of movement of workers can only be based on speculation. It must also be remembered that – although it is to be hoped that this is not the case given some of the uncertainties it would lead to – it remains possible that the UK will exit the EU at the expiry of the two year Article 50 period before a long term replacement trade (or broader association) agreement has been finalised.

It is unlikely that we will see any significant changes to employment laws during the period of negotiations as the priority will be to negotiate the exit of the UK and put in place alternative agreements rather than on amending, repealing or replacing employment laws already in place. Furthermore, repealing or ignoring EU legislation during the period that the UK is still a member would be in breach of Treaty obligations. However, the political upheaval could delay the timing of legislation in the pipeline such as the gender pay gap reporting and shared parental leave for grandparents.

2. Position from the effective date of Brexit

Most commentators are not expecting a significant repeal of employment laws following Brexit at least in the short term for the following reasons:

- A significant repeal of all employment laws originating from the EU is likely to be disruptive and many laws originating from the EU are now entrenched in our society and enshrined into the day-to-day business culture in the UK.

- Contrary to popular belief, many employment rights in the UK such as unfair dismissal, statutory redundancy pay, union legislation, national minimum and living wage are purely domestic and will not be affected by leaving the EU.

- UK laws such as those relating to equal pay and race discrimination originate prior to the UK's membership of the EU (For example; the Equal Pay Act 1970 and the Race Relations Act 1965). These laws (although subsequently amended) are enshrined in the day-to-day business culture of the UK and there is no significant political impetus to change them.

- If the UK wishes to remain part of the EEA single market then the EU would probably require the UK to be bound by European Directives to ensure the UK does not 'undercut' EU countries which have more onerous employment laws. Therefore, the UK may continue to be bound by EU Directives depending on the future Brexit model that is adopted.

For these reasons, it is unlikely that we will see any immediate changes to UK employment laws. Any change is likely to be dictated by the political aims of the party in power.

2.1 What are the potential areas of employment law that may be affected by Brexit?

In recent years the Government has been trying to remove those employee protections that go further than the basic objectives required by the original EU Directives, many of which were implemented by previous administrations. For example, the Working Time Directive gives full time workers 20 days of paid annual leave but the UK Working Time Regulations provide for 28 days of paid annual leave. We may see a drive to remove any 'gold plated' legislation that goes beyond that required by the EU and some modification or a potential 'watering down' of some of the more restrictive legislation originating from the EU that has been unpopular with businesses. Any changes will be dictated by the Government in power at the time and at this stage, any suggestions can only be based on educated guesses. Subject to that caveat, the most likely 'targets' for changes to employment laws following Brexit may be:

Discrimination laws: Discrimination laws are deeply enshrined in UK law and are unlikely to change. However, in 2011 the coalition government commissioned a report by Adrian Beecroft (Chief Investment Officer of the private equity group Apax) and asked him to provide his thoughts on areas of employment law that he considered may have potential for further improvement or simplification to help business. There is currently no upper limit on compensation for loss suffered as a result of discrimination and he advised introducing a fixed cap on the level of compensation for loss of earnings that could be awarded in discrimination claims. However, BIS stated in its Employment Law Review – Annual Update 2012: '*As discrimination legislation derives from European legislation it is precluded to set a fixed cap on discrimination awards, which effectively restricts the policy options available to address concerns in this area*'. If the UK leaves the EU there may be an appetite to attempt to introduce a fixed cap which could be attractive to businesses who may consider discrimination claims financially less risky and a cap could potentially deter employees from bringing discrimination claims given that the recovery of their losses would no longer be unlimited.

Agency workers: In October 2012 the CBI set out its analysis of the impact of the EU-derived Agency Workers Regulations. Neil Carberry, CBI Director of Employment & Skills, said in that report that '*one year on from the introduction of the regulations, the business verdict is that they are a drag on job creation in this vital sector. The regulations are thought to have cost businesses more than £1.5bn in their first year, but temps have not reaped the rewards - instead, the vast majority of this cost has*

paid for paper-pushing to ensure compliance. This has in turn led to a reduction in temps hired in eight out of nine months in 2012, despite a rise in permanent staff being hired'. The report also quoted a survey from TEAM research which found that 62% of agencies reported a negative experience of the regulations. In a report commissioned by the TUC Michael Ford QC states that '*any Government with a deregulation agenda would repeal or at least radically reduce the effect of the Agency Workers Regulations*'.

Holiday Pay: There is still uncertainty relating to the method of calculation of holiday pay such as how the reference period works and whether other forms of variable pay should be included. Litigation as to what should be included in the calculation continues in the UK courts with British Gas' appeal against Lock being heard in the Court of Appeal this month. Employers are left uncertain as to how to deal with holiday pay. Adam Marshall, Executive Director of Policy and Public Affairs at the British Chambers of Commerce said '*The pressure being placed on businesses by both the British tribunals and European courts on the issue of holiday pay is becoming unbearable*'. We may see an attempt to resolve the arguments on what is included in holiday pay and the introduction of a simpler calculation going forward (although the working assumption remains that claims for "back-pay" in respect of periods of time while the UK was a member of the EU would not be affected).

Working Time: Although the recent private members' Bill which sought to allow employers to opt out of working time rights has now been withdrawn, there does appear to be a political will review these provisions, in particular around employee opt outs.

TUPE: The Government may attempt to make it easier to harmonise terms and conditions following a TUPE transfer and reduce compensation for failure to consult. Parties to outsourcing agreements may wish to consider drafting express clauses to deal with a situation where there is a change in TUPE during the lifetime of the contract.

Any changes are unlikely to take place quickly and the Government may invite employers to take part in a consultation process if changes are to be introduced. It is only once the terms of the negotiated exit become clear that we will understand the true implications for UK employment law. In particular, there is likely to be a trade-off between the UK's wish to have continued access to the single market and the EU 27's desire to avoid "social dumping". The balance arrived at on these competing objectives will determine how far Brexit has a meaningful impact on UK employment laws. If the UK were to enter a Norway-style relationship with the EU, it would be subject to the EFTA court, bound by homogeneity rules (in the EEA agreement) to follow the rulings of the ECJ in all relevant cases.

2.2 Status of the European Court of Justice (ECJ) on UK courts

Depending on the Brexit model which emerges, it is possible that when the UK leaves the EU, the ECJ will no longer have jurisdiction over the UK courts. However, questions will arise over how far ECJ decisions will need to be taken into account when interpreting UK legislation which remains in force and which was initially implemented to give effect to EU law, the logical position would, presumably, be that Parliament's intention at the time of legislating should not be affected by a subsequent exit from the EU. That would imply that future ECJ judgments – even if unexpected – could still affect the interpretation of UK employment rights following Brexit regardless of the Brexit model which is pursued unless and until the relevant implementing legislation is repealed or amended. Given general presumptions against retrospective reductions in private law rights (and possible human rights issues), such amendment or repeal would be expected to apply only prospectively rather than retrospectively, which will have implications for any the interpretation of any

rights arising or relating to the period before amendment or repeal.

2.3 What might happen to nationals of EEA Member States and/or Switzerland in the UK after Brexit?

The answer to this question depends on the Brexit model that is adopted by the UK. The free movement of people is likely to be a significant issue for the EU if the UK is to continue to enjoy the benefits of free trade in goods and services. Whatever the outcome, given that restricting immigration was a key driver of the Vote Leave campaign, it may be hard for the UK Government to sign up for a post Brexit model which allows an automatic right of free movement for workers between the EU and the UK. The UK may enter into bilateral immigration treaties with EEA Member States and possibly Switzerland. It may become easier to hire non-EEA/Swiss nationals in an attempt to prevent a skills gap. The UK may allow the EEA and/or Swiss nationals to work in the UK to fill shortage occupation jobs via a sponsorship based visa system.

The Vote Leave Campaign has said that it favours an Australian style Points-Based System for all non-UK workers. The Australian system is based on a system awarding points to reflect personal attributes (e.g. age, language ability, qualifications) and ability to contribute to Australian society – most obviously, through their occupational status (e.g. accountants receive more points than youth workers). However, we do not know what system the Government will adopt and how long it will take to implement. A similar system based on "tiers" currently exists in the UK for non-EU immigrants, and may provide a framework for a future immigration system for EU immigration as well.

As negotiations progress, the UK immigration framework will become apparent. It is hoped that employers will have prior warning of any immigration laws that may negatively impact on businesses thereby giving employers time to adapt and to put in place measures to deal with the new system. It should be noted that Theresa May has argued that "reform" of free movement is required, given that immigration was a salient concern during the referendum campaign.

Cases round-up

Early termination payments to Tottenham Hotspur players were not 'from' employment and therefore not subject to National Insurance Contributions

A First Tier Tax Tribunal (FTT) found that payments made by Tottenham Hotspur to two of its players which formed part of an agreement to leave the club prior to the expiry of their fixed term contracts did not derive 'from' the players' employment and therefore were not subject to income tax and national insurance contributions (NICs). (*Tottenham Hotspur Limited v HMRC*)

Transfer of Peter Crouch and Wilson Palacios: Tottenham Hotspur was looking to transfer Peter Crouch and Wilson Palacios to another club in an attempt to reduce its wage bill. The players eventually moved to Stoke City Football Club after the terms for their exit were agreed.

Crouch and Palacios' termination payments subject to tax: HMRC considered that the payments made to the players were earnings 'from' the players' employments and therefore liable to income tax and NICs. HMRC reasoned that the players' contracts provided for termination of employment by mutual consent and therefore the termination payments flowed 'from' the players' employment contracts. HMRC argued that there would have to be a breach of contract by Tottenham Hotspur if it were not to flow 'from' employment and in these circumstances there was no such breach.

Tottenham argues the termination payments are not taxable: Tottenham Hotspur argued that the payments were in return for the players giving up their contractual rights to be employed until the

expiry of their fixed term contracts and were not made pursuant to any term of the players' contracts.

Dispute taken to the FTT: The dispute about income tax related to whether the first £30,000 of the payments was taxable or not but the NIC dispute concerned whether the whole payment was subject to NIC which concerned considerable sums and therefore the FTT focussed on the NIC position.

Important to look at why the payments were made: Relying on the case of *Kuehne and Nagel Drinks Logistics Limited v HMRC* the FTT emphasised the importance of focussing on why the payments were made. The FTT stressed that a payment would be 'from' the employments (and therefore taxable) provided that there was a '*sufficiently substantial*' employment-related reason for making the payments and this was even the case where the employer and/or employees have substantial reasons not connected with the employment for making/receiving the payments.

Receipt of remuneration in respect of the office? The FTT relied on the test established in *Henley v Martin* namely; had there been '*receipt of remuneration in respect of the office*' or '*sums paid in consideration of the surrender by the recipient of rights in respect of the office*'? The Court of Appeal held in the *Henley* case that the termination payment made to the employee was not taxable because the payment '*was consideration for the total abandonment of all the contractual rights' held by the employee*'.

FTT finds payments in return for the surrender of players' contractual rights: Applying the principle established in *Henley*, the FTT accepted that both players had provisions in their contacts providing for early termination if certain circumstances arose, but held that none of those early termination provisions were engaged and therefore neither the players nor Tottenham Hotspur had any contractual right of termination. The FTT held that the payments were in return for the surrender of the players' contractual rights and therefore were not taxable. A spokesperson for HMRC said they are considering the judgment; it is not clear whether this case will be appealed.

Caution for employers: A termination payment will either be wholly subject to NIC or completely exempt. Only the first £30,000 of a termination payment can potentially be paid exempt from income tax but the whole termination payment could be subject to NICs. NIC considerations are often overshadowed by the income tax position of employment-related matters. Where payments are substantial, the income tax 'saved' on the first £30,000 can be relatively trivial compared with the NIC 'saved' where the payment is deemed not to be 'from' the employment. It is important always to consider the NIC position when negotiating settlement agreements because employers could be faced with a large employer NIC bill that cannot be covered by an indemnity in the settlement agreement.

Change expected: The government announced at Budget 2016 that it intends to consult during the summer on the taxation of termination payments including the alignment of income tax and NIC rules so we may see some changes in the future.

ACAS Code does not apply to dismissal for "some other substantial reason" where there is an irretrievable breakdown in the working relationship

The EAT held that the 25% uplift for non-compliance with the ACAS Code of Practice on Disciplinary and Grievance Procedures (the "Code") does not apply to dismissals for some other substantial reason (SOSR) where the dismissal is attributed to an irretrievable breakdown in the working relationship. The EAT also gave useful guidance setting out steps an employer should take when considering a dismissal on the grounds of a breakdown in a working relationship. (***Phoenix House Limited (PH) v Stockman and another (S)***)

Dismissal for SOSR: Following a restructure, S accepted another role but she felt that she

had been unfairly treated in the recruitment process by the Finance Director and she raised a grievance. S was then accused of alleged misconduct for confronting the Finance Director whilst he was in a meeting and S was asked to attend a disciplinary hearing which was to be heard at the same time as the grievance hearing. S's grievance was dismissed and she was given a 12 month written warning. S then went on sick leave. Following an unsuccessful internal appeal and unsuccessful mediation, S was invited to a formal meeting and told that her contract would be terminated for SOSR because the working relationship had irretrievably broken down. S did not agree that the working relationship had broken down and she said she was willing to return to work but PH disagreed and dismissed S for SOSR.

S claims unfair dismissal and compensation uplift of 25%: S lodged a claim in the Tribunal alleging, amongst other things, that she had been unfairly dismissed and that she should be awarded an uplift in any compensation because PH had failed to follow the Code. The Tribunal found that the dismissal was unfair and awarded a 25% uplift because PH had not complied with the Code.

EAT finds ACAS Code does not apply: The EAT upheld the Tribunal's finding of unfair dismissal but held that the Code did not apply. The EAT held that clear words were required to give effect to the uplift sanction. The EAT found that certain elements of the Code are capable of being, and should be applied because of 'common-sense fairness' and gave the example of giving an employee the opportunity to demonstrate that she can fit back into the workplace without disruption when a relationship has deteriorated. However, the EAT stated that to impose a sanction for failure to comply with the Code would go beyond what Parliament had intended.

EAT gives guidance to employers who wish to dismiss where a relationship breaks down: The EAT gave useful guidance in respect of the steps an employer should take when considering a dismissal on the grounds of a breakdown in a working relationship; namely:

- The employer should fairly consider whether or not the relationship has deteriorated to such an extent that the employee holding the position that she does can not be reincorporated into the workforce without unacceptable disruption;
- That '*is likely to involve a careful exploration by the decision maker of the employee's state of mind and future intentions judged again the background of what has happened*'; and
- The employee should be given '*the opportunity to demonstrate that she can fit back into the workplace without undue disruption*'.

Culpable conduct? The Code explicitly states that it applies to dismissals and poor performance and that it does not apply to dismissals for redundancy or where a fixed term contract expires without renewal but whether or not the Code applies to SOSR dismissals has never been determined. This case now makes clear that the Code does not apply to dismissals for some other substantial reason where the dismissal is attributed to an irretrievable breakdown in the working relationship. However, employers need to take care because the recent case of *Holmes v Qinetiq* confirmed that the Code applies where an employee faces a complaint or allegation that may lead to a disciplinary situation or action and there is 'culpable conduct' whether in the form of misconduct or poor performance which requires correction or punishment. Therefore, employers should note that if the EAT had found that S's conduct was the cause of the breakdown in the relationship then the Code is likely to have applied and an uplift given because there is likely to have been 'culpable conduct' by S. The safest option for employers is to assume the Code applies and to carefully follow internal policies and procedures.

Points in practice

Employment Tribunal fees

The House of Commons Justice Committee has found that '*the regime of employment Tribunal fees has had a significant adverse impact on access to justice for meritorious claims*'. In particular, the report (i) highlighted a 70% reduction in the number of cases brought to the employment Tribunals since the introduction of fees; (ii) dismissed as "superficial" the contention that the number of cases taken through early conciliation procedures without progressing to the employment Tribunals mitigated this drop and demonstrated access to justice; and (iii) stated that the adverse impact on access to Tribunals had disproportionately affected women, those from disadvantaged groups and claimants with low value claims.

The report found that significant change was necessary to reinstate an acceptable level of access to justice and made the following recommendations:

- the overall quantum of fees charged for bringing cases to employment Tribunals should be substantially reduced;
- the "simplistic" classification system used to determine the quantum of fees should be replaced;
- disposable capital and monthly income thresholds for fee remission should be increased; and
- special consideration should be given to women alleging maternity or pregnancy discrimination.

"Dying to Work" voluntary charter

The Trades Union Congress are continuing their "Dying to Work" campaign for terminal illness to be recognised as a protected characteristic. The campaign includes a voluntary charter for employers to set out an agreed way in which their employees will be "*supported, protected and guided throughout their employment following a terminal diagnosis*." If you wish to sign up to this voluntary charter then there is further information here (voluntary charter).

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.

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