

IN FOCUS

Welcome

Welcome to the Winter edition of **In Focus**, our quarterly update keeping you informed of the latest developments in employment, pensions and incentives law.

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Best practice for best package

Updated ABI guidelines (www.ivis.co.uk) on executive pay say that companies should disclose clearly payments that replace pension scheme membership, and should exclude them from the salary used to calculate bonus entitlements and share scheme grants.

The other main changes are:

- as a performance criterion for share-based incentives, total shareholder return should reflect average share prices over a short period. This calls for a change in the current practice of using relatively long averaging periods in order to eliminate short term volatility in the price.
- the "expected value" of share-based incentive awards should be disclosed to shareholders even where this involves disclosing commercially sensitive financial performance conditions. Companies should now also disclose and justify any changes to award levels or structures.
- arrangements made to meet obligations under share-based incentive schemes should not only be prudent and appropriate, but should now also be disclosed to shareholders.
- a renewed emphasis that if awards vest on a change of control, the financial performance of the company should be the key determinant of the proportion of an award that vests. Vesting should also be proportionate to how much of the vesting period elapsed before the change of control.

The changes are not dramatic, but the attention they receive highlights the importance of the ABI guidelines as the "best practice" benchmark for good governance

over executive pay and the design of share-based incentives.

The guidelines have no legal force. Nevertheless, companies can face criticism if they do not comply. The Institutional Voting Information Service monitors and reports on compliance by all the companies in the UK FTSE All Share Index. Institutions use its reports to inform their voting and investment decisions.

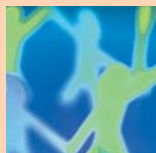
The guidance is intended for companies listed on the main markets. Companies on the Alternative Investment Market are increasingly seeking, and expected, to comply with the guidelines in order to attract institutional investors. Similarly, a private company looking to list or receive investment from listed companies can demonstrate good corporate governance by complying with the key principles.

In addition to detailed recommendations, the guidelines set broad principles for policies and practices on executive pay. Incentive arrangements should be justified by performance; service contracts should not expose companies to the risk of paying for failure; and bonuses and share-based incentives should be linked to the creation of shareholder value over the longer term. Finally, performance targets for incentives should be objective and stretching.

There are two core principles for the structure of share-based incentives – that options are not exercisable at a discount to the market value of shares at the date of grant, and that performance should be measured over a minimum period of three years.

For more, please contact James Dean on 0117 902 6693.





Pensions & incentives news in brief

As we have reported before, the European Court of Justice made a decision last year that investment trust companies are not liable to pay VAT on the investment management fees they pay. This prompted discussion of whether pension schemes were sufficiently similar to such companies to be entitled to the same treatment. The NAPF has now taken advice and believes that pension schemes have a "strong case". It is offering to co-ordinate a test case against HMRC if enough schemes come forward to fund it. See the press release on the NAPF website.

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Conflict of interest is a hot topic. Typically, a trustee who is also a director of the employer faces competing duties. Interestingly, the potential for conflict was the main reason that the Pensions Regulator moved to appoint independent trustees to the £2.75bn Telent pension scheme that has been "sold" to Pension Corporation LLP. Giving its reasons for the appointments, the Regulator's Determinations Panel said it did not think that Pension Corporation had sufficiently recognised the scope for conflict between the roles of trustee, investment manager and owner of the sponsoring employer that it might have taken in relation to the scheme. This is a high profile example, but in any scheme the consequences of not being alert to conflict can be significant.

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The Department of Work and Pensions has announced an extra £935m in net present value terms to fund FAS. It says this brings the total to £2.9bn in the same terms. The plan depends on £1.7bn worth of assets from the failed schemes being transferred to the Government. The revamped FAS will protect more people, and to a higher level than the original scheme.

Darling dallies

Chancellor Alistair Darling has delayed publishing draft legislation on the proposed changes to capital gains tax in order to give more consideration to the representations he has received.

The Pre-Budget Report proposed major changes from 6 April 2008:

- a flat rate tax of 18%, and
- taper relief to be abolished.

The proposed changes have implications for the tax treatment of share option and share-based incentives schemes, and for employees who participate in them.

Adverse reaction from business may mean that the proposals will change. The lack of transitional arrangements has drawn particular criticism. And there is speculation that, as a concession, a "retirement" relief for people selling their businesses will be re-introduced.

New Year, new Bill

A new Pensions Bill has started to go through Parliament. It deals mainly with the new system of pension saving known as Personal Accounts that will come into effect in 2012. It also covers other topics.

Personal Accounts

- An employer will be obliged to enrol employees automatically in the new trust-based system, though employees will be able to opt out. But if an employer has a scheme of its own of high enough quality, it need not put employees into the new system.
- The quality test for an employer's scheme is:
 - in a defined contribution scheme, the employer pays at least 3% of earnings between about £5,000 and £33,500, and that total contributions from the employer and the employee are at least 8% of those earnings. The test for a personal pension scheme is similar; and
 - a defined benefit scheme must provide benefits at least as good as a benchmark

scheme providing 1/120 of the same earnings for each year of service at an NRD of 65.

- There are high level provisions about the governance of the new system.
- The Pensions Regulator will oversee compliance and have enforcement powers, including the ability to impose fixed and escalating monetary penalties. Criminal sanctions (fines and, in the extreme, prison sentences) will be available where employers wilfully fail to comply with the rules on enrolment.
- In an anti-avoidance measure, employees will not normally be allowed to give up their rights to be involved in the new system; agreements purporting to do this will be void.

Deregulation

The revaluation of deferred pensions will be capped at 2.5% (today 5%), but only in relation to benefits earned after this new cap is introduced.

Sharing PPF compensation

It will be possible to share PPF compensation rights on a divorce.

Exceptional actuary

The court has held that the wording of a scheme rule about setting a special contribution rate to pay off a deficit meant that the company had less control over its ordinary funding rate than it thought.

The general rule under the Pensions Act is that the company and the trustees must agree the schedule of contributions (with the Regulator as tie-breaker if there is deadlock). But this changes if the balance of power in the scheme contribution rule favours the members. One example is where the rule gives the actuary power to decide the funding rate without the company's agreement. Here, the Act reflects the scheme rule by underpinning the rate the company and the trustees agree; it cannot be below what the actuary would have decided had he been the sole decision-maker.

The Allied Domecq scheme was in deficit. A special scheme rule about making up a deficit required the employers to "pay such an amount... as ...will in the opinion of the Actuary restore the solvency of the Fund; such amount to be paid by the [employers]... within such period as the Trustees... agree with the

Principal Company."

The company argued that its right under this rule to agree the catch-up period meant that the actuary did not have power to set the recovery contribution rate without its agreement, and so the underpin did not apply.

But the judge held that the rule was in two independent parts. The first part about who sets the rate was what mattered; the part about the length of the catch-up period was a separate and secondary decision.

So the underpin applied and, because of the wording of the legislation, it applied to the setting of the ongoing funding rate too.

This case turns on the wording of the particular scheme rule. But it illustrates that it will not always be straightforward to decide whether the particular balance of power in a scheme contribution rule means that the Pensions Act applies in a modified form. The case also shows the need to consider contribution rules that apply in special circumstances, and not just the normal rule about ongoing funding.

Flexible working - whatever!

Those who want to spend more time with their teenagers will be pleased to hear that the Government has announced that it intends to extend the right to request flexible working to parents of older children. Currently the right to request flexible working applies to parents of children under the age of six, parents of disabled children under the age of 18 and carers of adults.

The Department for Business Enterprise and Regulatory Reform (DBERR) has asked Sainsbury's Human Resources Director, Imelda Walsh, to undertake an independent review to determine how the current right to request flexible working can be

extended to parents of older children and the upper age limit of a child to which it should apply. It has been stressed that the review is of how, and not whether, to extend the age range.

The review will involve business representatives, unions, parents' groups and other interested parties in considering the options and recommendations will be made to the Secretary of State for Business, Enterprise and Regulatory Reform in Spring 2008.

Once the results of the review are published, formal consultation will take place before the new legislation is introduced.



Employment news in brief

The Government has published the draft Conduct of Employment Agencies and Employment Businesses (Amendment) Regulations 2007, which aims to protect agency workers. The new legislation is due to come into force on 1 April 2008. The Regulations do not deal with the issue of agency workers receiving different rates of pay to permanent workers for the same work. Equal treatment for agency workers is being sought through a private members' bill entitled "Temporary and Agency Workers (Equal Treatment) Bill 2007-08". A similar private members' bill was introduced in the last Parliament, without success.

The Information and Consultation of Employees Regulations 2004 will cover employers with 50 or more employees from April 2008.

On 1 December 2007 the provisions of the Tribunals, Courts and Enforcement Act 2007 came into effect to create a new title of "Employment Judge", which will replace the title of "Chairman".

The Tribunals Service has issued a consultation paper entitled "Transforming Tribunals" which, amongst other things, seeks to make the enforcement of Tribunal awards and ACAS settlements easier.

The Department for Business, Enterprise and Regulatory Reform (DBERR) has announced that there is going to be a review of health and safety laws. The review will ask employers, workers and experts for their views on how the health and safety system can be revamped to make it easier to follow, focusing on small and low risk businesses. It will also examine how to improve public confidence in the health and safety system. The Health and Safety Executive (HSE) is also publishing its 2007 simplification plan, reducing the number of forms by 50%.

Pay delay

It has been announced that the increase in the statutory maternity pay period from 39 to 52 weeks that was planned to apply to babies due in April 2009 or later, will be delayed. No firm timing decisions have yet been made but HM Revenue and Customs is currently planning implementation for babies due in April 2010 or later.

Similarly, the introduction of additional paternity leave and pay, enabling fathers to take up to 26 weeks' leave if the mother returns to work before the end of her maternity leave period, is now being planned for babies due in April 2010 or later.

Seeking closure

The Employment Appeals Tribunal ('EAT') has handed down an important decision relating to redundancy and collective consultation. Previous case law indicated that where a workplace was closing the obligation to consult did not extend to consultation over the business reasons for the closure. However, in *UK Coal Mining Ltd v National Union of Mineworkers (Northumberland Area) and anor*, the EAT found that legislative changes made in relation to the duty to consult collectively meant that this approach is no longer good law.

Departing from previous authorities on the scope of the duty to consult in a collective redundancy situation, the EAT held that there is an obligation to consult over the reasons for a workplace closure where the closure will inevitably, or almost inevitably, result in redundancies.

S.188 of the Trade Union and Labour Relations (Consolidation) Act 1992 specifically requires employers to consult with workforce representatives on a number of issues, including ways of avoiding dismissals in a collective redundancy situation. The EAT decided that "the obligation to consult over avoiding the proposed redundancies inevitably involves engaging with the reasons of the dismissals, and in turn [in the case of a proposed closure] requires consultation over the reasons for the closure". Whilst this decision does not necessarily require employers to consult if closure is a possibility, the obligation to



consult will apply where a closure is proposed, ie before any definitive decision is taken to close a workplace. Employers who fail to inform and consult in accordance with the legislation can be subject to protective awards of up to 90 days pay per employee.

If you are currently involved in a redundancy process you should consider whether changes to your consultation processes need to be made in order not to fall foul of this decision.

Waiting for Heyday

The President of the Employment Tribunals has issued a Practice Direction staying all current and future claims relating to Regulation 30 of the Employment Equality (Age) Regulations 2006. Regulation 30 provides for lawful retirement at or beyond 65 and this means any cases in which an employee claims compulsory retirement at 65 or over is unlawful, will be put on hold until the

outcome of the ECJ Decision in the *Heyday* case. This is not expected until early 2009. The Practice Direction was made as a result of the case of *Johns v Solent SD Ltd* and only applies to England and Wales. In the meantime, however, any employer who has a case brought against them will find themselves in a state of limbo.

In the office

Best wishes to **Tamsin James** who has decided not to return to work following the birth of her third child.

Check or cheque?



specified document checks at the point of recruitment and repeated the checks at least once every 12 months for those employees with limited leave to enter or remain in the UK.

Employers will be required to take reasonable steps to check the validity of the documents provided by the employee (eg their passport) by checking, for example, that the photograph resembles the employee and the date of birth contained in the document is consistent with the appearance of the employee. Copies of the documents will need to be kept securely by employers for not less than 2 years after the employment has come to an end.

The Government has published new measures to prevent illegal working following its consultation with businesses. Under the new system of civil penalties, which take effect in February 2008, employers who negligently hire illegal workers could face a maximum fine of £10,000 for each illegal worker. If an employer is found to have knowingly hired illegal workers they could incur an unlimited fine and a prison sentence.

Employers will be excused from paying the penalty if they can show that they have undertaken certain

The new civil penalties are part of a shake-up of the immigration system. Over the next 12 months, the Government will introduce a new points based system to ensure that only workers with skills to benefit the UK economy come to the UK. Under the new system, employers and educational establishments will need a licence in order to sponsor overseas nationals' visa applications. Employers will be able to apply for a licence from sometime in the first quarter of 2008.

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Stepping back in time

On 7 December, the Government published the Employment Bill which aims, amongst other things, to simplify the statutory dispute resolution procedures. The Bill follows a period of consultation by the Government that took place after the Gibbons review of the statutory dispute resolution procedures that were introduced by the Employment Act 2002.

The Bill will repeal the statutory dismissal and grievance procedures. ACAS will revise its statutory Code of Practice on Discipline and Grievance Procedures and tribunals will be able to take into account a failure of the parties to comply with the Code of Practice and adjust by any award it makes to an employee, by no more than 25%, if it considers it just and equitable in all the circumstances to do so.

The Bill also includes the following:

- The maximum penalty for underpayment of the National Minimum Wage or for employment agency offences will increase from a £5,000 fine to an unlimited fine.
- A fair method for dealing with National Minimum Wage arrears will be introduced so that workers do not lose out as a result of underpayment.
- The powers of the Employment Agency Standards Inspectorate will be strengthened, allowing them greater scope to access financial information to help them check whether a worker's complaint is an isolated incident or an example of widespread abuse.