EMPLOYMENT AND PENSIONS UPDATE

Recent key developments in UK employment and pensions law - Winter 2007

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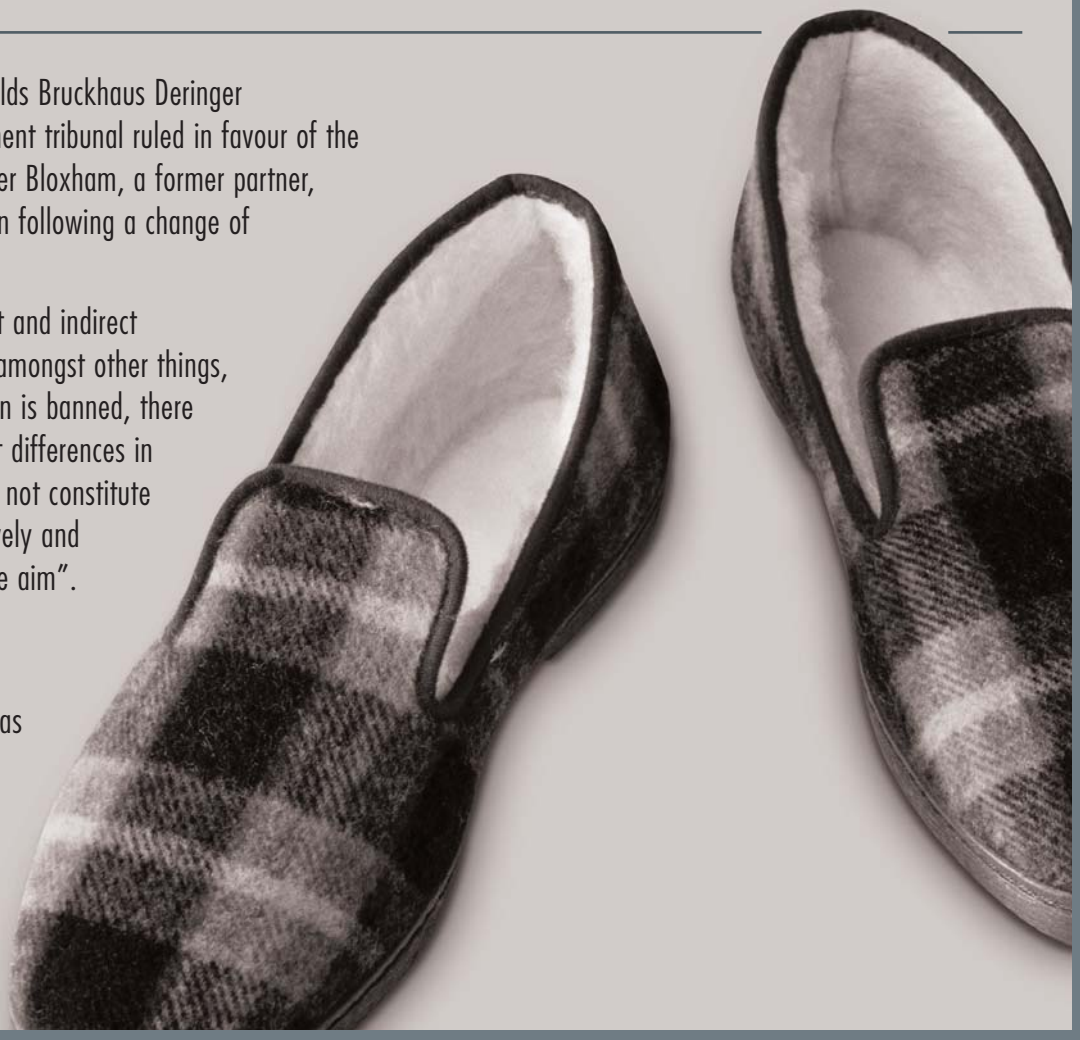
AGE OF ENLIGHTENMENT?

Judgment has been passed on the first major age discrimination case to be brought to tribunal since the law came into force in October 2006.

In the case of Bloxham v. Freshfields Bruckhaus Deringer ("Bloxham"), an English employment tribunal ruled in favour of the law firm, Freshfields, after Mr Peter Bloxham, a former partner, accused them of age discrimination following a change of pension provisions.

The Age Regulations prohibit direct and indirect discrimination on the grounds of, amongst other things, age. However, whilst discrimination is banned, there are exemptions which provide that differences in treatment on grounds of age shall not constitute discrimination if they are "objectively and reasonably justified by a legitimate aim".

This ruling helps to clarify the interpretation of the law and has implications for the legal industry as a whole and other partnerships.



AGE OF ENLIGHTENMENT?

CONTINUED

Details of the Bloxham case

Freshfields had historically provided retirement benefits to former partners by paying a share of partnership profits. If a partner retired before their 55th birthday a reduction was applied to the benefit that would otherwise be payable. By 2002 it was accepted that the current retirement arrangements could not continue indefinitely as younger partners would, in effect, be supporting a much greater number of retired partners. The partnership then engaged in considerable debate about alternative options and engaged professional consultants to advise them.

In August 2005, consultation papers were sent to partners for consideration and extensive discussion took place about the proposals to terminate the arrangement. In March 2006, after consideration of the proposals and modification options, the final reform proposal was put to a vote. 87% of the partners agreed the final proposal, which terminated the existing retirement arrangements but permitted partners over the age of 50 to retire on three months' notice, on or before 31 October 2006, and receive benefits under the pre-existing retirement arrangement.

Partners who elected to retire could, in certain circumstances, be offered continuing consultancy arrangements with the firm.

Mr Bloxham, who was 54, requested consent to retire in July 2006 and duly retired on October 31 2006. He then brought a claim under the Age Regulations that he had suffered discrimination on the basis he had to retire to get benefits under the existing arrangements and he received a reduced retirement allowance compared to older partners. He argued that Freshfields could not show that his treatment was a proportionate means of achieving a legitimate aim.

The Employment Tribunal agreed that the closure of the retirement arrangement, and the treatment applied to Mr Bloxham, compared to an individual of 55 or older, was discriminatory. However, the Tribunal found that the discrimination was justified i.e. the treatment was a proportionate means of achieving a legitimate aim.

Importantly, they noted that "it is an error of law to focus solely upon the treatment and not consider the context in which the treatment occurs". They further stated: "It seems to the Tribunal that this will be particularly necessary in cases of age discrimination because of the need to recognise that changes to the treatment of persons of one particular age or age group may, as in this case, directly affect to some extent the treatment of persons in a different age group." The Tribunal accepted that the reform of the retirement arrangements was legitimate and necessary and that no alternative less-discriminatory solution could be conceived.

What does this judgment mean?

Firstly, just because there is discrimination because of a person's age, it does not mean the discrimination must be eliminated if the employer can show that the reason, practice or treatment is a proportionate means of achieving a legitimate aim.

Secondly, tribunals will almost invariably look more favourably upon cases where the employer can demonstrate it has thought through all of the possible alternatives to try and eliminate the discrimination, and cannot sensibly propose a better alternative in the circumstances.

Thirdly, it is desirable for the employer to have provided information to employees, consulted with them about the proposals, and to have considered any alternatives that have been suggested.

PROPOSED AMENDMENTS TO THE EMPLOYER DEBT REGULATIONS 2005



In August of this year, the Department of Work and Pensions ("DWP") published draft regulations amending the Occupational Pension Schemes (Employer Debt) Regulations 2005.

The proposed changes envisage there being five ways of apportioning the statutory debt that is triggered when an employer ceases to participate in a defined benefit pension scheme which is in deficit on a buy-out basis.

The main issue relates to a proposed amendment to the definition of "employer cessation event" for multi-employer schemes. As originally drafted, if all employers ceased to employ active members in a scheme simultaneously, a statutory debt would have been triggered regardless of whether the employers continued to fund the scheme. This would have had serious consequences for companies contemplating scheme mergers or intending to freeze their schemes by terminating future accrual.

Fortunately, the DWP has recognised the problem and said that this drafting will be revised. The intention is to prevent companies from leaving a scheme without any real means of funding and not to curb legitimate activities such as scheme mergers.

Consultation on the draft regulations ended on 1 October 2007

ECJ UPHOLDS COMPULSORY RETIREMENT AGE

In the same week as the Bloxham judgment, the European Court of Justice ruled on a case considering compulsory retirement ages. The court has held that, although forced retirement at a selected age is considered discriminatory, in this case it was justified because it helps to stablise the workforce by promoting employment across generations.

The Palacios de la Villa v Cortefiel Servicios SA ("Palacios") case concerns compulsory retirement ages under applicable collective bargaining arrangements.

As noted in the Bloxham case, in general, age discrimination is prohibited. However, under the Equal Treatment Directive, Member States may continue to have national provisions laying down retirement ages. They can also permit age qualifications, without this constituting discrimination, for joining or starting to receive benefits from "occupational social security schemes".

Member States must take measures to ensure that laws and other administrative provisions contrary to the principal of equal treatment are abolished and provisions in other areas such as collective agreements which "offend the principal of equal treatment" are amended or invalidated.

Different treatment on grounds of age may continue if it is objectively and reasonably justified by a legitimate aim.

Until 2001, compulsory retirement was used as a mechanism to regulate the Spanish labour market. In 2005, the Spanish Parliament amended legislation to provide that collective agreements could continue to contain clauses permitting termination of contracts on the grounds of age, provided that the measure was linked to objectives which were consistent with "employment policy" and the justification was set out in the collective agreement. In addition, any worker whose contract was terminated must be of an age and qualify for a retirement pension under the relevant contribution regime. Crucially, the 2005 legislation provided that where a collective bargaining agreement was already in force there was no requirement to amend it to refer to the "objective justification" qualification. The only requirement was that the individual must have the age and service qualification to start receiving pension benefits.

Details of the Palacios case

Señor Félix Palacios de la Villa, an employee of Cortefiel Servicios SA, was notified that his employment would end under the terms of the collective bargaining agreement on his 65th birthday. Señor Palacios objected to this on the grounds of age discrimination. The applicable agreement was in place before 2005. The Spanish courts sought clarification as to whether Spanish law, as it applied to pre-2005 collective agreements, had properly implemented the Directive, i.e. should pre-2005 collective agreements be declared invalid because they did not explicitly refer to the "objective justification" provisions and/or were the provisions of Spanish law permitting compulsory retirement compatible with the Directive?

The European Court of Justice held that as the law had been implemented with the aim of promoting employment it remained valid, as did the provisions of the collective agreement even though it did not explicitly refer to the aim of promoting employment.

What does this mean for the UK?

In the UK, retirement age is usually set by the employer or, in certain industries, with some trade union involvement. Contracts do not contain or refer to reasons for selecting a particular age. Under English law the government has set a "default" retirement age of 65. If an employee wishes to work beyond this age he or she may make a request which an employer has to consider. If the request is not agreed the employee may be dismissed without this constituting unfair dismissal by reason of age. It is important to note that employers may select an earlier retirement age but would need an objective justification for the selected age.

It is possible to infer from the Palacios decision that the need to have new and younger employees coming through the work force may be an acceptable justification for setting a retirement age.

This may be a factor that is considered in the upcoming "Heyday" case. This high-profile case sees Heyday, an organisation backed by Age Concern, challenge the UK government on their decision to include a default retirement age which employers may adopt in the Age Regulations. So, while currently employers may be able to simply rely on the "default" age of 65 without any separate justification, it may not be possible if the government loses this case. The implications for employers will be discussed as the case progresses.



COMPANIES ACT 2006 - INDEMNITIES FOR DIRECTORS OF TRUSTEE COMPANIES

The Companies Act 1985 (as amended) contained a section which rendered void any provision that purported to exempt a director from liability in connection with negligence, default, or breach of trust or duty. However, companies were able to obtain insurance for directors against such liabilities and directors were able to benefit from a "qualifying third party indemnity".

Good News for Trustee Company Directors

The Companies Act 2006 adds a third form of indemnification to the benefit of directors of pension scheme trustee companies: the Qualifying Pension Scheme Indemnity. Under Section 235, a director of a company, which is trustee of a pension scheme, can be indemnified against liabilities incurred in connection with the company's activities as trustee of the pension scheme. However, the indemnity cannot extend to:

- any liability of the director to pay a fine imposed in criminal proceedings;
- any liability of the director to pay a fine to a regulatory authority by way of penalty for non-compliance with a regulatory requirement; and
- any liability incurred by the director in defending criminal proceedings in which they are convicted.

The introduction of the qualifying pension scheme indemnity provision is good news for a trustee company director. It will permit indemnification against costs incurred by the director in defending civil proceedings brought by the company (or an associated company) in which judgment is given against him, and against liabilities incurred by him in connection with an application for relief which the court refuses to grant to him. Neither of these protections is available under a qualifying third party.

THE PENSIONS REGULATOR PROPOSES CHANGES TO GUIDANCE ON CLEARANCE



More than two years have passed since the original guidance was issued in April 2005, and the Regulator considers that it is time to focus again on its expectations of professional advisers working with trustees and employers in relation to events that may have a detrimental impact on a pension scheme.

The Regulator has been consulting on the proposed changes which are intended to move away from prescriptive tests towards a more principled approach. This is to provide greater clarity in relation to both the risk assessment that pension scheme trustees should undertake, and the level of mitigation that they should seek. The changes also clarify that where there is a "Type A" event (i.e. one in respect of which clearance may be sought), trustees may trigger a scheme valuation and renegotiate an existing recovery plan.

Under existing legislation, the Pensions Regulator is able to give clearance statements in advance of corporate transactions. A clearance statement is confirmation that the Regulator will not use its powers to require the applicant to make a financial contribution or to give other support to a pension scheme as a result of a proposed transaction where the transaction is detrimental to the employer's covenant to the scheme.

Assuming that the proposed changes to the guidance remain largely in their current form, their impact should be fairly limited. Ultimately clearance is a voluntary process and if the transaction will not give rise to circumstances in which a financial support direction or contribution notice could be issued, parties to corporate transactions may choose not to apply for clearance. For trustees, the revised guidance will serve as a reminder that, where a transaction will lead to a reduction in the strength of the employer's covenant to the pension scheme, they should look for the increased risk to the scheme to be mitigated in some way.

The consultation period on these changes closed on 2 November 2007.

CORPORATE MANSLAUGHTER ACT TO COME INTO FORCE IN APRIL 2008

The Corporate Manslaughter and Corporate Homicide Act 2007 applies to companies (whether incorporated in the UK or overseas), public bodies, partnerships, limited liability partnerships, Crown bodies and the police force.

Recently, the Ministry of Justice published its guide to the new Act, the main points of which are summarised below.

- For the new offence to apply, the organisation must have owed a "relevant duty of care" to the victim. For example, an employer has an existing duty to ensure that worksites are safe and that health and safety procedures are followed. The Act does not create any new obligations.
- It will be possible to secure a conviction if an offence takes place where there has been a gross breach of a relevant duty of care, and where this lay in the way the organisation's activities were managed or organised.
- The offences of corporate manslaughter and corporate homicide are intended to be reserved for the very worst cases of corporate mismanagement which lead to death.
- A substantial part of the failing must have occurred at a senior management level and the mismanagement must have fallen far below the level of management that could have reasonably been expected. "Senior management" are those people who make significant decisions about the organisation or substantial parts of it.
- Penalties for those organisations convicted of this offence will be:
  - a fine for which there is no upper limit. Fines will reflect the size of the offender and scale of the offence;
  - a publicity order requiring the organisation to publicise its conviction and certain details of the offence; and
  - a remedial order requiring the organisation to address the cause of the fatal injury.

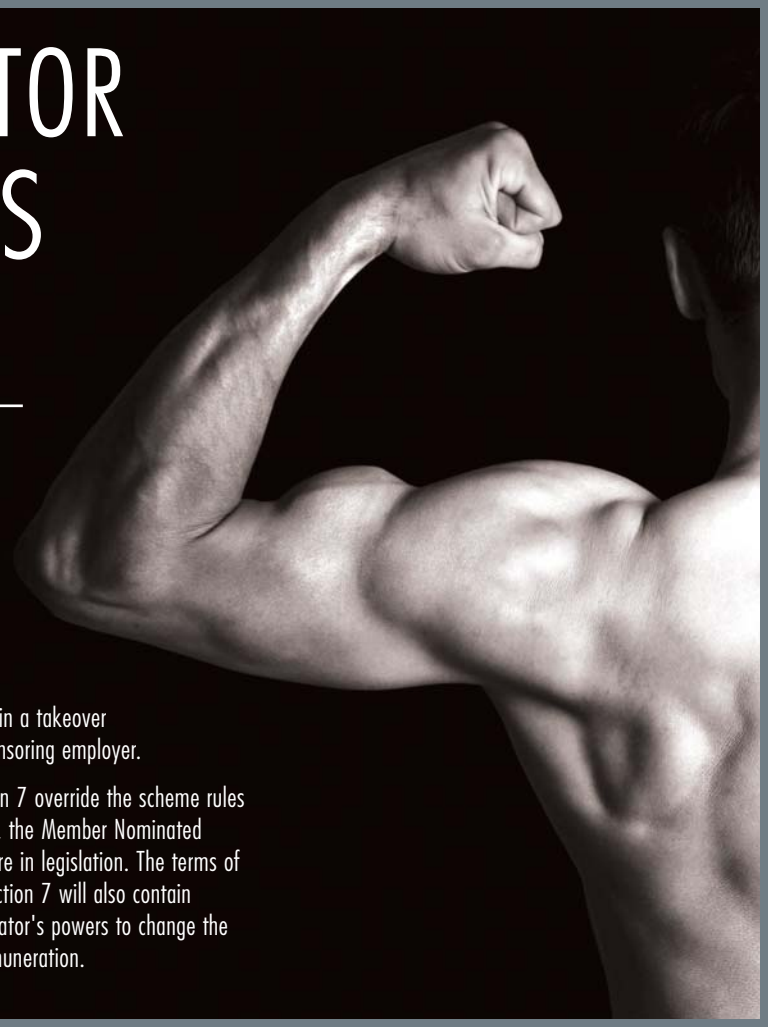
The Act was given Royal Assent on 26 July 2007 and the majority of its provisions will come into force on 6 April 2008.

REMINDER: SECTION 179 VALUATION DEADLINE APPROACHES

The risk-based element of the Pension Protection Fund (PPF) levy is calculated by reference to the extent to which a pension scheme is underfunded. The trustees of each defined benefit occupational pension scheme are required, under the Pensions Act 2004, to obtain a valuation for this purpose.

Any scheme registered prior to 6 April 2007 must submit its Section 179 valuation by 31 March 2008.

PENSIONS REGULATOR EXERCISES POWERS



The Pensions Regulator has exercised its powers under Section 7 of the Pensions Act 1995 to appoint three independent trustees to the Telent Pension Scheme. The power was exercised after the existing trustees approached the Regulator for assistance.

Section 7 permits the Regulator to make an appointment where it is necessary to "secure" that the trustees as a whole have or exercise the necessary skill or knowledge for the schemes proper administration; to secure the appropriate number of trustees; or to "secure the proper use or application of the assets of the scheme".

The power has generally been exercised to appoint trustees when there are governance issues in a scheme's operation, or, for some reason, there are no trustees and no other way of appointing than by application to the Courts.

This is the first instance where the power has been exercised after an application by trustees in a takeover situation involving the sponsoring employer.

Appointments under Section 7 override the scheme rules and, to the extent needed, the Member Nominated Trustee provisions elsewhere in legislation. The terms of the appointment under Section 7 will also contain provisions about the Regulator's powers to change the new trustees and their remuneration.

PRE-BUDGET REPORT

Income Tax	The personal allowance increases from £5,225 to £5,435 from 6 April 2008 for individuals under the age of 65.
National Insurance	No change to contribution percentage rates.
Pension Scheme Allowances	The annual contribution allowance increases to £235,000 or 100% of income (if lower). This is the maximum amount, which can be contributed without triggering a tax charge. The Lifetime allowance increases from £1,600,000 to £1,650,000. This is the maximum amount which can be in the "pot" without triggering a tax charge. It is important to note that individuals who elected pre A-Day protection are subject to different "caps" on the amount of the Lifetime Allowance.
Capital Gains Tax	A proposed change to the Capital Gains Tax Regime to abolish "taper relief" and replace this with a flat rate change of 18% regardless of the length of time the asset is held.
Non-Domiciled Individuals	Under discussion: A proposal to impose a charge of £30,000 on non-domiciled individuals after they have been resident for seven years unless they choose to be taxed in the UK on world-wide income. It is suggested that the change may lead to individuals relocating from the UK.

POINTS TO NOTE
COMPANIES ACT 2006

Directors' Service Contracts

The Companies Act 2006 (the "2006 Act") introduces reforms which will affect directors, auditors, shareholders (stockholders) and company secretaries of UK private, public and quoted companies.

The 2006 Act is being implemented in phases. Many of the provisions do not come into force until October 2008, however, from 1 October 2007 a number of sections relating to directors are in force including changes relating to directors' contracts.

A summary of the most significant reforms concerning directors' service contracts are set out below.

Key Changes

Long-Term Service Contracts

Under the Companies Act 1985, shareholder approval was required for a director's long-term service contract. A long-term service contract is one where the fixed term exceeded five years during which the employment could not be terminated by the company by notice (except in specified circumstances) or where the notice period exceeded five years.

If a director's service contract is a long-term contract, and it is not approved by the shareholders, the notice provision is invalid and the contract is deemed to contain a term entitling the company to terminate at any time by 'reasonable notice'.

Now, under Section 188 of the 2006 Act, shareholder approval is required for a director's service contract in excess of two years or if the notice period in a contract is two years or more.

Shareholder approval is not required for a company which is either a non-UK registered company or a wholly-owned subsidiary of another company.

The provisions of the 2006 Act requiring shareholders' approval will apply to service contracts made on or after 1 October 2007, although approval obtained under the Companies Act 1985 will be effective for the purposes of the 2006 Act.

A company does not require shareholder approval before entering into a rolling contract with a director requiring no more than two years' notice of termination. However, in the case of UK-listed companies, the Combined Code on Corporate Governance recommends that notice or contract periods should be set at one year or less.

Definition "Service Contracts"

The definition of "service contract" has been widened to include letters of appointment, contracts for services (as director or otherwise) for the company or for a subsidiary of the company, including services made available to a company through a third party. Note that the contract must require the director to personally perform the services.

Retention of Service Contracts

A company must keep a copy of every directors' service contract open to inspection by shareholders without charge for a period of at least one year from the date of termination or expiry of the contract. Where there is no service contract, a memoranda of their terms must be available. This applies regardless of the length of any service contract and whether or not it is terminable within 12 months.

Right to Request

Shareholders have a new right to request a copy of a director's service contract on payment of a prescribed fee. If the contract is not in writing then a memorandum of its terms can be requested. On receipt of such a request, the company has seven days within which to provide a copy to the shareholders. The right to request a copy of a director's service contract is in addition to the existing right of a shareholder to inspect a copy or memorandum of the terms of a service contract held by the company.

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