

Changes to Terms and Conditions

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1. This paper considers some common pitfalls in effecting changes to contracts of employment in the light of recent case law. For the more than 2,500 employers now regulated by the FSA's Remuneration Code, changes to terms and conditions concerning remuneration may be required which will require particular care.

2. The following issues are considered below -
 - (a) Identifying the changes to terms and conditions
 - (b) How to effect the changes
 - (c) Variation clauses
 - (d) Express and implied acceptance/variation
 - (e) Dismissal and re-engagement
 - (f) Unfair dismissal/redundancy consultation
 - (g) Update on FSA Remuneration Code

(a) Identifying the terms to be changed – what is contractual?

3. Not all terms of the contract may be set out in a written contract of employment. A benefit provided to employees over many years may be a benefit to which the employees have become contractually entitled through custom and practice even though there is no reference to the benefit in the contract; see, for example, the implication of a condition that a departing employee signs a compromise agreement in order to be entitled to an enhanced redundancy payment in Garratt v MGN Ltd [2011] EWCA Civ 425. Once it has acquired contractual effect, the employer cannot simply remove such a benefit unilaterally without risking claims for breach of contract, constructive or unfair dismissal.

4. Some benefits on the other hand may properly be considered to be entirely discretionary and in respect of which no contractual entitlement arises. However, even in such cases the employer will be obliged to act, in relation to the benefit, in a way that does not undermine trust and confidence. Simply removing such a benefit or

ceasing to apply it in the manner that the employees have come to expect, could give rise to claims. Equally, offering a new contractual benefit to most but not all staff could give rise to a claim for breach of the implied duty of trust and confidence; Transco v O'Brien [2002] IRLR 444.

5. Then there are those terms that are incorporated into the contract from another source. This could be a staff handbook or collective agreement. Once again, such terms, if truly incorporated into the individual contract of employment, cannot simply be removed or changed unilaterally.
6. The source of the contractual entitlement need not be reduced to writing at all. The Court of Appeal has recently dismissed an appeal against a strike out of claims brought by former-Dresdner employees relying on an announcement at a (virtual) "Town Hall meeting" of the minimum size of a bonus pool as having contractual force. The announcement concerned only the size of the total bonus pool and not the entitlement of any individual employees to a particular share. Nevertheless, the Court of Appeal held that the announcement was intended to retain staff and was not informal in the sense of being casual and so the claim for contractual effect was sufficiently arguable to survive a strike out application; see Anar v Dresdner Kleinwort Ltd. [2011] EWCA Civ 229 (11 March 2011).
7. Thus, it is important to pause before any changes are introduced, and consider whether the change is trivial or non-contractual, such that the employee cannot complain about it, or whether the employer is in fact seeking to interfere with a contractual entitlement. If it is the latter, then the employer will have to go about the implementing the change lawfully.

(b) How to effect the changes

8. Express mutual consent is the clearest and simplest way to effect change. In the absence of such consent the following means may be available:
 - (a) There may be a variation clause in the contract itself which entitles the employer to make changes;
 - (b) The employee consents to the change by his actions. In other words, there is acquiescence;

- (c) There are changes to the collective agreement or other source of incorporated terms which vary the contract;
- (d) If all else fails, there is the option of dismissing the employee and re-engaging him or her on the revised terms.

(c) Variation Clauses

9. Employers may expressly reserve to themselves the right to vary the contract of employment. However, the Court will generally take a strict approach to the interpretation of such variation clauses. The right to vary unilaterally will have to be in clear terms such that there is no doubt that the intention of the parties was to confer the right of variation. Even if it is found that the right exists, the scope of the right will usually be quite limited:

"The general position is that contracts of employment can only be varied by agreement. However, in the employment field an employer or for that matter an employee can reserve the ability to change a particular aspect of the contract unilaterally by notifying the other party as part of the contract that this is the situation. However, clear language is required to reserve to one party an unusual power of this sort. In addition, the court is unlikely to favour an interpretation which does more than enable a party to vary contractual provisions with which that party is required to comply. If, therefore the provisions of the code which the council were seeking to amend in this case were of a contractual nature, then they could well be capable of unilateral variation as the counsel contends. In relation to the provisions as to appeals the position would be likely to be different. To apply a power of unilateral variation to the rights which an employee is given under this part of the code could produce an unreasonable result and the courts in construing a contract of employment will seek to avoid such a result."

Wandsworth London Borough Council v D'Silva [1998] IRLR 193 at [31]

10. In Bateman v Asda [2010] IRLR 270, Asda wished to ensure that their entire store staff were employed on the same pay and work structure and this meant that those on the old regime had to transfer to a new regime. Some 9,330 employees agreed, but some did not. So when the new regime was imposed on them, six test Claimants brought claims for unauthorised deductions from their wages. Asda contended that they were entitled to impose new conditions because the staff handbook stated that Asda "*reserved the right to review, revise, amend or replace the contents of this handbook, and introduce new policies from time to time reflecting the changing needs of the business...*" The handbook also provided details of pay and other conditions of employment. The conditions in the staff handbook were incorporated in the employees' contracts of employment. The Tribunal held that these conditions

permitted Asda to impose the new regime on its employees without obtaining their further consent. The Claimants appealed contending that Asda could not rely on the conditions in the staff handbook to justify imposing the new regime and they required the consent of all employees.

11. The employees' appeal was dismissed. It was held, applying Wandsworth v D'Silva, that the staff handbook did permit Asda to make the changes to the pay and work regimes without obtaining the further consent of the Claimants. It was further held that the particular wording in the staff handbook was wide enough to permit Asda to change matters set out in it and these included the pay and work structure with the result that Asda was entitled to impose the changes in the Claimants' pay and work provisions without the need to obtain the employees' express consent.
12. One of the difficulties for the employees was that no evidence had been adduced before the Tribunal to show that the employees did not intend or expect that their contracts could be amended in this way without their consent. It might be thought that it was obvious that none or hardly any of the employees would actually have given the matter any thought before agreeing to be bound but in the absence of evidence to that effect, the EAT found that there was nothing in the "relevant background" to the contract to show that the parties did not intend for the variation provisions to have the effect contended for by Asda.
13. Bateman emphasises that a contractual right to vary may be relied upon to introduce far-reaching changes in contracts across the whole workforce. No doubt in any such cases in the future, employees would be well-advised to adduce extensive evidence of the relevant background in order to establish that such wide variations were not countenanced when entering into the contract.
14. There may come a point whereby the proposed changes are so far-reaching that they amount to a fundamental change to the contract. In that case, the proper analysis may be that the old contract has in fact been terminated and replaced by a new contract on the changed terms. The question of whether or not a change to terms and conditions had the effect of replacing the old contract arose in Potter v North Cumbria Acute Hospitals NHS Trust [2009] IRLR 900.
15. It was held in Potter that the introduction of a new pay system in the NHS did not create new contracts of employment for its workers. The question to be considered

was whether the parties' intention was to terminate the old contracts and replace them with new ones or to vary them, Cumbria CC v Dow (No.2) [2008] I.R.L.R. 109 and Morris v Baron & Co [1918] A.C. Fundamental as well as minor contractual changes could be effected by consensual variation. Parties could agree both the content and the mechanism for effecting change. The EAT held that on the facts, the existing contracts did permit the degree of unilateral change introduced by the employer.

(d) Consent by acquiescence

16. The employer may decide to introduce changes to contracts in the hope or expectation that they will be accepted but without requiring express consent. If the employee continues to work under the new terms, will he or she be taken to have consented to the change by his conduct? Relying on consent by acquiescence is a risky strategy for an employer as it is inherently fact-sensitive; a Court or Tribunal could, months or years later, decide that the change had not been accepted by the employee(s), in particular in respect of changes which do not have an immediate practical effect such as changes to termination payments or post-termination restraints.
17. The fundamental question to be asked in determining whether an employee had accepted a change to the contract by his conduct, is whether such conduct was only referable to his having accepted the new terms:

“30 The fundamental question is this: is the employee's conduct, by continuing to work, only referable to his having accepted the new terms imposed by the employer? That may sometimes be the case. For example, if an employer varies the contractual terms by, for example, changing the wage or perhaps altering job duties and the employees go along with that without protest, then in those circumstances it may be possible to infer that they have by their conduct after a period of time accepted the change in terms and conditions. If they reject the change they must either refuse to implement it or make it plain that by acceding to it, they are doing so without prejudice to their contractual rights. But sometimes the alleged variation does not require any response from the employee at all. In such a case if the employee does nothing, his conduct is entirely consistent with the original contract continuing; it is not only referable to his having accepted the new terms. Accordingly, he cannot be taken to have accepted the variation by conduct.

31 So, where the employer purports unilaterally to change terms of the contract which do not immediately impinge on the employee at all — and changes in redundancy terms will be an example because they do not impinge until an employee is in fact made redundant — then the fact that the employee continues to work knowing that the employer is asserting that that is the term for

compensation on redundancies, does not mean that the employee can be taken to have accepted that variation in the contract.”

per Elias J (as he then was) in Solectron Scotland v Roper [2004] IRLR 4.

18. The "only referable" test has twice been considered by the Court of Appeal in (a) Khatri v Cooperative Centrale Raiffeisen-Boerenleenbank BA [2010] EWCA Civ 397 and (b) Anar v Dresdner (*supra*).
19. In Khatri, the appellant former employee (K) appealed against a decision refusing his application for summary judgment against the respondent bank. K was a derivatives trader and was entitled to a discretionary bonus. K signed a new contract which entitled him to a performance-related bonus, calculated according to a set formula. The contract stated that the bank "maintains the right to review or remove this formula-linked bonus arrangement at any time". Several months later K was told that he was at risk of redundancy. The bank offered him a suitable alternative position for a trial period of three months. It sent him a letter informing him that under his new terms and conditions he would be entitled to an annual discretionary bonus. The letter stated that K should sign to indicate his acceptance of the offer. K did not sign the letter. He continued to carry out the same work and received the same salary, but reported to a different person. Shortly before the end of the trial period, K indicated that he did not accept the new terms and wished to be paid his performance-related bonus. He was later dismissed on the grounds of redundancy but did not receive the performance-related bonus. The bank argued that under the old contract it was entitled to remove the performance-related bonus at any time and the bonus had been varied by K's subsequent acceptance by conduct of the new terms.
20. As to the question of acceptance of the variation by conduct, the Court of Appeal in Khatri applied the "only referable" test set out in Solectron Scotland Ltd v Roper and held that it was clear that it would be quite wrong to infer from all the circumstances that K had accepted changes to his contract, changes which were wholly to his disadvantage. In reality he had carried on doing the old job for the same pay. The only difference was in reporting to a different superior. That was a trivial difference and miles away from a clear unequivocal act from which one could infer that K accepted the new terms. It was particularly striking that K had not signed the offer letter and the bank had not required K to sign or even queried why he had not signed.

21. In Anar v Dresdner, the Claimants argued that, when considering the test for acceptance of contractual changes, a distinction should be drawn between changes which are wholly advantageous to the employee, as in Dresdner, and those which are not, as in Solectron and Khatri. The Court of Appeal held that the issue of acceptance was not suitable for summary judgment and this part of the claim was sent back for trial.
22. These cases highlight the importance of obtaining written confirmation that an employee has consented to variations in his or her contract. It will rarely be sufficient that the employee has continued to work after the change of contract was introduced, particularly where the change has no immediate effect to the employee's day to day working experience. Restrictive covenants, which would only apply after termination, are a good example of contractual provisions that would not have any immediate effect on an employee's day-to-day work experience and where it would be difficult to say that the continuation of work was only referable to the employee having accepted the new terms.
23. The other risk of the acquiescence route is that once the period for objection has passed, and the new terms take effect, some employees might assert that the changes have been imposed on them by way of a dismissal from the old contract and immediate re-employment under the new terms with the difficulty that the employer will not have followed a fair process: Hogg v Dover College [1990] ICR 39.
24. What if the employee simply refuses to recognise the new terms, while continuing to work under the old terms? If the new terms involved, for instance, a reduction in pay and benefits, then this option would not arise. But if the new terms required the employee to perform additional duties then he might refuse to do so, while continuing to perform his previous duties. The choice for the employer would then be whether to dismiss the employee for refusing to accept the new terms: the same issues would arise as were discussed above. Finally, the employee might work under the new terms, while making it clear that he did so under protest. This would defeat any argument that there had been a consensual variation of the contract. It would leave open for the employee the possibility of claiming damages for breach of contract arising out of the failure to honour the old contractual terms: see Rigby v Ferodo [1988] ICR 29.

25. However, the exercise of this right to “stand and sue” can involve pitfalls for the employee. In Robinson v Tescom [2008] IRLR 408 the employee indicated that he would accept the new terms under protest. Subsequently he refused to work under them and was dismissed. His claim for unfair dismissal failed. The employer having indicated that he would work under the new terms (even if under protest) his subsequent refusal to do so was misconduct, to which dismissal was a reasonable response.

Changes to Collective Agreements

26. Bateman v Asda was an example of a case where contractual variations were introduced as a result of changes to the staff handbook. In Malone v British Airways [2010] IRLR 431, the employees sought to rely upon a provision in a collective agreement providing for minimum crew complements on various flights. When British Airways sought to reduce the cabin crew complements on some of those flights, employees claimed that the term as to cabin crew complements in the collective agreement was incorporated into their individual contracts of employment and that therefore the airline was in breach by not complying with those complements.
27. The High Court rejected the employees’ claim. It was held that the parties at no stage expressed an intention that the terms of the collective agreement, in relation to crew complements, would be legally binding either between themselves, under the Trade Union and Labour Relations (Consolidation) Act 1992 s.179, or as incorporated in the respective employment contracts. There was no sufficient objective evidence of a mutual intention to give the terms of the collective agreement in relation to crew complements legal enforceability at the behest of any individual crew member. Further, the provisions were not apt for incorporation into the employees’ contracts. The collective agreement was a negotiated fleet collective agreement apt to cover planning for, and deployment of, 11,500 employees; it was not 11,500 individual contracts. Accordingly, there was no material incorporation into M’s contract and hence no breach.
28. Malone is a reminder that if reliance is placed upon the provisions of a collective agreement, whether by the employer or the employees, a key question will always be whether the particular provision relied upon is in fact apt for incorporation into individual contracts of employment.

(e) Dismissing and reengaging employees on new terms.

29. The position is straightforward when there is one employee concerned and he or she agrees to a proposed change in the contract. What happens when the changes are applied across the workforce and most accept but some continue to resist? In those circumstances, the employer does have the option of dismissing those who refuse to agree to the variation. If lawful notice is given, the dismissal will be lawful but whether or not such a dismissal is fair would depend on whether the dismissal was for “some other substantial reason” within s.98(1)(b) of ERA 1996; and, if so, whether the employer acted reasonably in treating it as a sufficient reason to dismiss.

(f) unfair dismissal/redundancy consultation

30. It is well-established that where a substantial proportion of employees have accepted the change and there is a sound business reason for its introduction, the dismissal of those that do not accept may be fair: St John of God (Care Services) Ltd v Brooks [1992] ICR 715. See also Willow Oak Developments Ltd v Silverwood [2006] ICR 1552 in the context of a change to introduce restrictive covenants into the contract. Of course, in order to be fair, any such dismissal would also have to comply with procedural requirements.
31. Where very few or none of the workforce are willing to accept the changes, and the change is considered sufficiently important, the employer may have to consider the more drastic route of dismissing and re-engaging the entire affected workforce on the new terms. As well as basic procedural considerations, if 20 or more employees are affected, the employer will be required to follow collective consultation procedures under s.188 Trade Union and Labour Relations (Consolidation) Act 1992.
32. As to when the obligation to consult collectively is triggered under TULRCA, the Court of Appeal in United States v Nolan [2010] EWCA Civ 1223; [2011] I.R.L.R. 40 has referred the issue of when consultation obligations are triggered to the ECJ. The Court of Appeal held that the ECJ's decision in Fujitsu, Middleborough BC v TGWU [2002] I.R.L.R. 332 had not clarified the issue of whether the consultation obligation under the Directive arose when the employer was proposing but had not yet made a strategic business or operational decision that would foreseeably or inevitably lead to collective redundancies, or only when that decision had actually been made and he was then proposing consequential redundancies (see also UK Coal Mining Ltd v

National Union of Mineworkers (Northumberland Area) [2008] I.C.R. 163 and R. v Secretary of State for Trade and Industry Ex p. Vardy [1993] 1 C.M.L.R. 721).

33. Changing terms and conditions in this way is not only administratively burdensome, but may have a detrimental effect on industrial relations. In order to avoid a mass of unfair dismissal complaints (even from those who accept the new terms: Hogg v Dover College [1990] 1 ICR 39), the securing of compromise agreements should be a key feature of any procedure involving dismissal and re-engagement. For an unsuccessful challenge to the requirement that a compromise agreement be concluded before an enhanced redundancy payment is made, see the decision of Underhill P in ABN Amro v Hogben [2009] UKEAT 0266_09_0111 at paragraph 45 where he concluded that the practice of requiring a compromise agreement in return for an enhanced redundancy payment involved a legitimate interest in achieving finality.

(g) Update on FSA remuneration code

34. In December 2010, the FSA published its final Remuneration Code. A detailed examination is beyond the scope of this paper but in so far as it may affect the need to make changes to terms and conditions of employment, the following update is provided. Further analysis can be found in the papers for the 11KBW seminar on the draft FSA Code held on 17 November 2010 and available at www.11kbw.com. The final Code involved relatively few changes from the earlier draft but, in summary, the significant points to note are –
35. For Code Staff (defined as all staff who have a material impact on the firm’s risk profile) -
- (a) Bonuses - individual, business unit and firm wide performance must be taken into account;
 - (b) at least 40 per cent of any bonus must be deferred over at least three to five years;
 - (c) for Code Staff whose total remuneration is a “particularly high amount” (£500,000 is a particularly high amount but lower sums may also fall within this bracket) the deferral rate is 60 per cent;

- (d) at least 50 per cent of any bonus must be paid in shares, share-linked instruments or other equivalent non-cash instruments. This applies to both the deferred and undeferred portions of any bonus; and, significantly,
 - (e) Guaranteed bonuses must be exceptional and limited to new hires for the first year of service.
 - (f) Performance adjustment - unvested deferred bonuses must be reduced where the firm or the business unit suffers a material downturn in its financial performance or a failure of risk management, and in the case of misbehaviour or material error on the part of an employee.
 - (g) Termination payments - early-termination payments must reflect performance over time and must not “reward failure”.
36. NB the Code requires firms to apply the provisions on guaranteed bonuses on a firm-wide basis and not just to Code Staff. The implementation of the Code is subject to (a) the principle of proportionality (see the FSA’s Guidance at Appendix 2 to the Code for the tiered approach) and (b) the transitional provisions contained in the Code.
37. The Code now applies to a wider range of employers – all banks and building societies, investment banks, investment firms subject to the European Capital Adequacy Directive, most fund and asset managers, some brokers and some corporate finance and venture capital firms and to UK branches of equivalent firms headquartered outside the EEA. Over 2,500 firms will be subject to the Code. The Code also applies to all branches of a firm in any jurisdiction in the world and all members of a “UK consolidation group” and its “non-EEA sub-group.”
38. Remuneration is defined as “any form of remuneration, including salaries, discretionary pension benefits and benefits of any kind.”
39. Employers will clearly be required to effect contractual changes to comply with the Code; when are they required to do so? To which bonus years does the Code apply? To what extent is it retrospective? The Code provides as follows -

19A.1.3 R A firm must apply the remuneration requirements in SYSC 19A.3 in relation to:

(1) remuneration awarded, whether pursuant to a contract or otherwise, on or after 1 January 2011;

(2) remuneration due on the basis of contracts concluded before 1 January 2011 which is awarded or paid on or after 1 January 2011;

and

(3) remuneration awarded, but not yet paid, before 1 January 2011, for services provided in 2010.

19A.1.4 G Subject to the requirements of SYSC 19A.1.5R, in the FSA's view SYSC 19A.1.3R does not require a firm to breach requirements of applicable contract or employment law.

19A.1.5 R

(1) This rule applies to a firm that is unable to comply with the Remuneration Code because of an obligation it owes to a Remuneration Code staff member under a provision of an agreement made on or before 29 July 2010 (the "provision").

(2) A firm must take reasonable steps to amend or terminate the provision referred to in (1) in a way that enables it to comply with the Remuneration Code at the earliest opportunity.

(3) Until the provision referred to in (1) ceases to prevent the firm from complying with the Remuneration Code, the firm must adopt specific and effective arrangements, processes and mechanisms to manage the risks raised by the provision.

40. The effect of this is far from straightforward but appears to suggest that existing and accrued contractual rights to remuneration before 29 July 2010 will be enforceable but that an employer must take reasonable steps to vary the contract to ensure compliance with the Code at "the earliest opportunity". What does this mean? How will it affect employees on, say, three year fixed term contracts with guarantees in each year or a provision for a discretionary bonus to be paid in cash in each year? When is the 'earliest opportunity' for a variation in such a case? The practical impact of the requirement to effect a variation for existing staff promptly is compounded by the disapplication of the prohibition on guarantees and retention payments for new hires. Competitors may be able to offer better terms when current employers are being required to effect what will be seen as detrimental variations; see below.

41. The Code came into effect on 1 January 2011 but, for those employers who fall within its scope for the first time, they must comply with the Code by 1 July 2011, and must take reasonable steps to comply as soon as reasonably practicable. In particular, transitional provisions are found in Rules 5 G and 6 R as follows –

(1) The FSA recognises that *firms* may require additional time to comply in full with the requirements of the *Remuneration Code* where they were not subject to the version of the *Remuneration Code* that applied before 1 January 2011. The FSA considers that a *firm* may be able to rely on the proportionality provisions in SYSC 4.1.2R and the

remuneration principles proportionality rule to justify not complying with the requirements of the *Remuneration Code* relating to *remuneration* structures by 1 January 2011 provided it takes reasonable steps to comply as soon as reasonably possible and in any event by 1 July 2011.

(2) On a similar basis and on the same timescales set out in (1), a *firm* which was subject to the previous version of the *Remuneration Code* may be able to justify not complying with the requirement to pay 50% of variable *remuneration* in *shares* or other non-cash instruments (SYSC 19A.3.47R).

6 R Until 1 January 2012, SYSC 19A.3.54R and SYSC 19A Annex 1 (on voiding and recovery) apply only in relation to a *firm* that was subject to the version of the *Remuneration Code* that applied before 1 January.

42. One of the most significant immediate practical consequences of the Code is likely to be the limits on guaranteed bonuses and retention payments where the Code provides as follows -

19A.3.40 R A *firm* must not award, pay or provide guaranteed variable *remuneration* unless it:

- (1) is exceptional;
- (2) occurs in the context of hiring new *Remuneration Code* staff; and
- (3) is limited to the first year of service.

19A.3.41 E (1) A *firm* should not award, pay or provide guaranteed variable *remuneration* in the context of hiring new *Remuneration Code* staff („X“) unless:

(a) it has taken reasonable steps to ensure that the *remuneration* is not more generous in either its amount or terms (including any deferral or retention periods) than the variable *remuneration* awarded or offered by X’s previous employer; and

(b) it is subject to appropriate performance adjustment requirements.

(2) Contravention of (1) may be relied on as tending to establish contravention of the *rule* on guaranteed variable *remuneration* (SYSC 19A.3.40R).

19A.3.42 G Guaranteed variable *remuneration* should be subject to the same deferral criteria as other forms of variable *remuneration* awarded by the *firm*.

19A.3.43 G In the FSA’s view, variable *remuneration* can be awarded to *Remuneration Code* staff in the form of retention awards where it is compatible with the *Remuneration Code* general requirement to do so. The FSA considers this is likely to be the case only where a *firm* is undergoing a major restructuring and a good case can be made for retention of particular key staff members on prudential grounds. Proposals to give retention awards should form part of any

notice of the restructuring proposals required in accordance with *Principle 11* and the general notification requirements in *SUP 15.3*.

43. The response to consultation on the earlier draft Code raised the threat of a “poacher’s paradise” due to the prohibition on guaranteed bonuses beyond the first year of service. This raises a real practical problem. If guaranteed bonuses cannot be used to ‘buy out’ an offer from a competitor (who can offer a guarantee, at least in the first year and subject to performance adjustments), this will inhibit retention of staff. Under the Code, retention payments are only permitted in exceptional circumstances – namely restructuring or “where a strong case can be made for the retention of key staff on prudential grounds”. However, this needs to be set against the effect of lengthy deferral periods in retaining employees during the vesting periods.

Voiding and recovery

44. The Code’s provisions on guaranteed and non-deferred remuneration are subject to detailed rules on voiding and recovery. Only agreements concluded after the new rules were made, or subsequently amended in a way which contravenes them, can be made void. The detailed rules are found in SYSC 19A Annex 1 which provides as follows -

19A Annex 1 Detailed provisions on voiding and recovery

Rendering contravening provisions of agreements void

1 R Any provision of an agreement that contravenes a prohibition on *persons* being *remunerated* in a way specified in a *rule* to which this annex applies (a “contravening provision”) is void.

2 R A contravening provision that, at the time a *rule* to which this annex applies was made, is contained in an agreement made before that time is not rendered void by 1R unless it is subsequently amended so as to contravene such a *rule*.

3 G The effect of 2R, in accordance with section 139A(11) of the *Act*, is to prevent contravening provisions being rendered void retrospectively. Contravening provisions may however be rendered void if they are contained in an agreement made after the *rule* containing the prohibition is made by the *FSA* but before the *rule* comes into effect.

4 R For the purposes of this chapter it is immaterial whether the law which (apart from this annex) governs a contravening provision is the law of the *United Kingdom*, or of a part of the *United Kingdom*.

Recovery of payments made or property transferred pursuant to a void contravening provision

R In relation to any payment made or other property transferred in pursuance of a contravening provision, a *firm* must take reasonable steps to:

(1) recover any such payment made or other property transferred by the *firm*; and

(2) ensure that any other *person* (“P”) recovers any such payment made or other property transferred by that *person*.

6 G The *rule* in 5R(2) would, for example, apply in the context of a secondment. Where a *group* member secondes an individual to a *firm* and continues to be responsible for the individual’s *remuneration* in respect of services provided to the *firm*, the *firm* would need to take reasonable steps to ensure that the *group* member recovers from the secondee any *remuneration* paid in pursuance of a contravening provision.

Replacing payments recovered or property transferred

7 R (1) A *firm* must not award, pay or provide variable *remuneration* to a *person* whose *remuneration* has caused the *firm* to breach a contravening provision (the “contravening *remuneration*”) unless the *firm* has obtained a legal opinion stating that the award, payment or provision of the *remuneration* complies with the *Remuneration Code*.

(2) This *rule* applies only to variable *remuneration* relating to a performance year to which the contravening *remuneration* related.

(3) The legal opinion in (1) must be properly reasoned and be provided by an appropriately qualified independent individual.

45. What is the legal effect of these ‘voiding’ provisions?
46. The Code itself provides that “A contravention of a rule in SYSC 11 to SYSC 19 19A does not give rise to a right of action by a private person”.
47. However, the voiding mechanism does have statutory underpinning. Section 6 (9) of the Financial Services Act 2010 gives the FSA power to make rules prohibiting a firm from remunerating its staff in a specified way and to render void contractual provisions that contravene such prohibition (“the voiding power provides as follows as far as is relevant -

(9) *General rules may—*

(a) *prohibit persons (or persons of a specified description) from being remunerated in a specified way;*

(b) provide that any provision of an agreement that contravenes such a prohibition is void; and

(c) provide for the recovery of any payment made, or other property transferred, in pursuance of a provision that is void by virtue of paragraph (b).

48. The FSA has exercised that power in relation to guaranteed bonuses, lack of deferral and replacement payments. Employment lawyers will be familiar with statutory voiding mechanisms such as are found in section 203 ERA. However, this is a statutory prohibition found in primary legislation. It remains to be seen how 'illegality' arguments will fare when the prohibition is found in a Code issued by a regulatory body, albeit one with statutory support and where this prohibition conflicts with otherwise enforceable rights agreed between two private law contracting parties.
49. For those changes which are not subject to the voiding mechanism, what challenges are likely to be brought in respect of attempts to vary existing contractual rights in order to comply with the Code? In relation to provisions which are not void, employees will be able to invoke an express contractual right against the employer, even if performance by the employer places it in breach of the code.
50. Employers may argue that employees are required to accept a variation to such terms by the mutual duty of trust and confidence. In Fish v Dresdner Kleinwort [2009] IRLR 1035 the High Court gave summary judgment for contractual bonuses, rejecting arguments that, in the financial crisis which had arisen since the bonuses had been agreed, senior executives were in breach of the implied term of trust and confidence in not forgoing payment. The duty of trust and confidence did not impinge on the individual's rights to payment under a freely negotiated agreement. Will reliance on the need to comply with the FSA Code have more success?
51. Further, compliance with the Code and the general principles underpinning it will increasingly form part of an employer's 'reasonable and proper cause' under the implied duty of trust and confidence and constitute relevant factors in the rational exercise of a contractual discretion. For example, how will trust and confidence operate during the deferral period; if 40% of an award is deferred for 3-5 years and subject to potential ex-post risk adjustment during deferral for material downturn in the business unit, how far does the implied term of cooperation operate to preclude an employer from disbanding the business unit or ignoring the effect of it being disbanded?

52. The FSA Code will herald interesting times for all employment lawyers in this sector, not only those called upon to provide the “properly reasoned” legal opinion referred to in Rule 7R (1) (*supra*).

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