IMPLEMENTING EMPLOYEE OWNER STATUS

Analysis by/response from Thompsons Solicitors

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About Thompsons

Thompsons is the most experienced trade union, employment rights and personal injury law firm in the country with 28 offices across the UK. On employment and industrial relations issues, it acts only for trade unions and their members.

Thompsons represents the majority of UK trade unions and advises on the full range of employment rights issues through its specialist employment rights department.

Foreword

As an Investor in People Thompsons recognises the benefit to businesses of a workforce which is fully engaged with the work they do. We accept that this engagement can be enhanced where employees feel that they have a stake in the business but that 'stake' can be emotional as well as monetary.

Employee share ownership is a form of 'Fair Share Capitalism' (FSC) and can be very effective in raising productivity but we are also aware of research (and of government research in particular) into the effectiveness of different scheme types which concluded[1]:

> • Although there was some variation across the three productivity measures used (a subjective measure of labour productivity relative to the industry average; sales per employee and value added per employee) there was a fairly consistently positive association of FSC with labour productivity.
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> • The productivity results differed by type of FSC scheme with share ownership schemes having the clearest positive association with productivity but only when those share ownership schemes were combined with profit-related pay (PRP) or group payments-by-results (PBR) schemes.
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> • **In isolation, share ownership was associated with lower productivity**, as were isolated PRP and group PBR schemes.
>
> • The positive links between FSC and labour productivity were much stronger in workplaces where employees had greater autonomy in decision-making.
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> • The productivity results differed by employee coverage of FSC schemes. The positive association between share ownership and productivity was most pronounced when all non-managerial employees were covered by the scheme. Schemes just covering managerial staff were found to have little impact on workplace productivity."

Thompsons is also aware of the recent report by Graeme Nuttall and the various recommendations which are made within it to promote the benefits of employee ownership.[2]

Thompsons is not aware of any study, research or literature that indicates that the success of such initiatives is either dependent upon, or enhanced by, the removal of employment rights at work.

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[1] DTi Employment Relations Research Series No. 81, *Doing the right thing? Does fair share capitalism improve workplace performance?* 2007, page 2 [emphasis added]
[2] *Sharing Success, The Nuttall Review of Employee Ownership*, July 2012

Nothing in the consultation seeks views about whether the proposal is a good one or not, and significantly there are hardly any questions about possible disadvantages.

The fact that the enabling powers in the *Growth and Infrastructure Bill* and this consultation were published on the same day (18 October 2012) as well as the extremely tight timescale to respond shows utter disregard for the principle of transparent government and due process.

For the record Thompsons deplores linking FSC with the surrender of rights in the manner proposed, considers that it goes against the very essence of FSC and the employee engagement that it seeks to achieve and believes that removing workers rights in this way will:

- **Have no positive impact on growth.**
- **Alienate rather than engage workers**
- **Leave workers with shares of questionable and invariably no value**

We note that 80% of the public do not support the proposal.[3] Even the CBI has been lukewarm in its support, describing it as a '*niche idea not relevant to all businesses'*.[4]

Q1. How can the government help businesses get most out of the flexibility offered and the different types of employment status?

The employee-owner proposals will not apply to 'businesses' per se, just those with limited liability. There are no equivalent proposals for employees to acquire an equity stake in partnerships for instance. It will also be of no application to emanations of the state such as local government or the NHS.

If the employee-owner scheme does carry the benefits which the government hopes (an outcome we doubt), it will be interesting to see the extent to which non-incorporated businesses are adversely affected. If their decision to remain incorporated represents a commercial disadvantage then these measures will adversely affect some businesses.

As Q21 makes clear, flexibility is often used as a euphemism for the ability of employer's to fire staff.

Q2. Do businesses feel able to use all three employment statuses? If not, what restricts the use of different statuses?

This question is a little hard to fathom. Of all working arrangements, employment is the most common and therefore it is clear that businesses feel able to use it. The engagement of workers is also extremely common and the same point applies. Employee-owner does not exist as a status and so no one is in a position to say that they feel able to use it.

Q3. What restrictions, if any, do you think should be attached to the issue of shares or types of shares?

This is a key area for the employee-owner proposals. An employer which wishes genuinely to engage with its workforce and reap the benefit of Fair Share Capitalism will want to ensure that the shares which it issues are perceived as a benefit by the workforce. The Nuttall report refers to research which emphasises that link and ascribes benefit arising from

[3] YouGov poll, 10th November 2012, available at http://research.yougov.co.uk/news/2012/10/11/employee-owners-scheme/
[4] John Cridland, CBI Director-General, 8th October 2012, available at http://www.cbi.org.uk/media-centre/press-releases/2012/10/cbi-responds-to-george-osbornes-speech-to-conservative-party-conference/

> "…enhanced engagement with management and that this sense of engagement is positively linked with well-being. Enhanced well-being is also more likely to be generated at employee owned companies which provide employees with a greater stake and involvement in long-term collaborative goals."[5]

However, where an employer is less interested in engagement, and more interested in being able to fire at will, it will want to establish a scheme which gives as little as possible in return for that. This will not enhance a feeling of well-being, empower staff or give them a greater stake in the business.

Thompsons would want to see a minimum set of standards applying to shares issued to employee-owners. These should be established in order to promote the sense of well-being and engagement for the employee-owners themselves, and to limit the impact of abuse by unscrupulous employers. At the very least we would want to see shares which carry voting rights and carry rights to dividends.

Q4. When an employer buys back forfeit shares, should this be at full market value or some other level (e.g. a fraction of market value) should some other level be allowed in certain circumstances?

Thompsons believes that the notion of forfeiture is an inappropriate one in the context of employee-owners.

An employee-owner will only be an owner in the narrowest of technical senses. They are highly unlikely to see any fundamental change in the existing employment relationships, or in the way in which management acts towards them. The consultation's view that employees will suddenly become empowered and have more influence will, for the most part, be naïve and misplaced.

It is important to remember that at work the power-relationship very much rests with the employer. It chooses who to hire, who to fire, who to favour, and who to hold back. As the Supreme Court put it recently:

> *"Employees as a class are in a more vulnerable position than employers. Protection of employees' rights has been the theme of legislation in this field for many years. The need for the protection and safeguarding of employees' rights provides the overarching backdrop to* [employment law]*"*[6]

It is common in employee share schemes to differentiate between 'good leavers' and 'bad leavers'. The former leave on good terms and are able to withdraw the value of their shares. The latter do not, and are not. They are usually the ones who are sacked for misconduct or incapability. Currently a 'bad leaver' may have the opportunity to argue unfair dismissal and seek an employment tribunal's view upon whether or not the employer was justified in applying that label. If not, then the leaver may use that to recover the value of the shares which was withheld.

That could not happen in most cases under the employee-owner proposals. An employer would be virtually unchallengeable in its ability to dismiss without cause or reason, apply any necessary label to attach 'bad leaver' status, and withhold payment of shares.

We consider that in recognition of the fact that an employee has surrendered many of their rights (and with them their ability to hold an employer to account) any shares should still receive their full value. We consider that it would be inappropriate to discount it in any way.

Q5. How should a company go about carrying out a valuation of the shares? What would the administrative and cost impact be for a company if an independent valuation was required?

This is not really an issue for publically listed companies. It is a major issue for private (i.e. unlisted) ones and this response addresses those companies.

The consultation notes that the Government "…is keen to ensure that this new employment status does not impose any valuation requirements beyond those that already exist when valuing companies for other tax

[5] Paragraph 2.31
[6] Per Lord Kerr in Gisda Cyf v Barratt [2010] UKSC 41, at paragraph 35

purposes."[7] We think however that this is unworkable.

An unlisted company will usually have no cause to engage in a valuation exercise more often than is required for the annual return to Companies House, or for tax purposes. This will be broadly annual, although it can be longer depending upon various factors. A year is a long time, and if there is to be just one valuation it is easy to envisage problems:

- The most recent valuation may be so out of date that it represents a significant under-valuation which causes the employee-owner to be significantly disadvantaged and short-changed;
- The most recent valuation may be so out of date that it represents a significant over-valuation which causes the company to be significantly disadvantaged and forced to pay out more than it would otherwise have done;
- Future valuations hold the same risks; and
- If an employee-owner has to wait up to a year or more to value their shares they risk the company ceasing to exist before the valuation compromise agreement be performed. If this is due to insolvency then they lose out on their entitlement because of that delay. If this is due to transfer then they will have no TUPE rights against the transferee and must hope that the transferor has assets.

Thompsons recognises however that preparing a valuation is a time consuming and expensive exercise. Businesses will not wish to be required to undertake one every time an employee leaves. We therefore see significant problems ascribing a fair and meaningful valuation upon an employee-owner's shareholding.

We are also concerned about the basis of valuation. A valuation for tax purposes is not necessarily the same as a valuation for other purposes. If shares have voting rights then their face value may be exceeded by their value as a means of securing majority control. We therefore have some difficulty in reconciling the Government's stated aims of limiting valuations to those undertaken for tax purposes, and ascribing an "unrestricted market value" to them.[8]

Q6. The Government would welcome views on the level of advice and guidance that individuals and businesses might need to be fully aware of the implications of taking on employee owner status.

There are two broad areas of advice here: financial and legal.

A potential employee-owner will need to be informed of the current value of the business, the debt gearing, the current finances, growth projections, and some indication of management competence to manage. They will also need to be able to get professional advice about that from an independent financial advisor. They will need a right to request that information as well as to see and receive it within a reasonable timeframe.

Currently s.203 *Employment Rights Act 1996* imposes minimum independent legal advice requirements upon the surrender of unfair dismissal rights. The shorthand for this is 'compromise agreement advice' and the key elements are a written agreement upon which the employee has received advice from an insured independent legal advisor. That advisor may only be a lawyer, certain trade union officials or certain advice centre workers. The Government rejected calls for that category to be extended. The Government has chosen not to amend s.203 as part of its changes to introduce settlement agreements. For that reason these will need to be observed.

Although the Treasury press release referred to becoming an employee-owner as being optional for existing staff[9] this is in fact not realistic. Employers regularly dismiss and re-engage staff to impose brand new terms and conditions upon them.[10] The proposals make it clear that employers can impose that status upon new starters.

[7] Paragraph 19
[8] Paragraph 19
[9] http://www.hm-treasury.gov.uk/press_91_12.htm
[10] For a current example see North Tees & Hartlepool NHS Foundation Trust which is currently looking to use this mechanism to impose new terms on 5,400 members of staff

Thompsons considers that there is an overwhelming case in favour of providing proper professional advice to the potential employee-owner before they give their agreement. This is a cost which it is reasonable to expect the business to bear. As such it represents a very real impediment to hiring new staff and could choke the very growth that these proposals, on their face, seek to stimulate.

We would also be concerned that employers might seek to use a compromise agreement format to exclude more than simply the unfair dismissal rights. It is human nature to use familiar documents and most compromise agreement precedents include provisions to exclude all possible claims. We foresee the situation where an individual is required to sign a compromise agreement, is told that it excludes the unfair dismissal required for employee-owner status, but actually goes further and excludes other claims too. This may not be deliberate, but would be an abuse.

Q7. What impact will allowing individuals limited unfair dismissal protection and equity shares have on employers' appetite for recruiting?

We believe that these measures will have no significant, measurable, positive impact upon employers' appetite for recruiting.

There is no hard evidence to show that employment rights are a genuine hindrance to hiring. Indeed Vince Cable acknowledged that recently in a speech to the EEF:

> *"A recent survey of SMEs, commissioned by BIS, revealed that the proportion regarding regulation, including employment regulation, as the main obstacle to business success was only 6% - and it has halved over the last two years."*[11]

We emphasise that all regulation (including taxation, export rules, money laundering etc) only accounted for 6%. It is therefore difficult to see how employee-owner measures, with all the regulations which must follow, will be any more attractive when as the Nuttall report highlighted:

> "*This review found a widespread perception amongst those not directly involved in the employee ownership sector that employee ownership is complex and difficult to set up.*"[12]

In our view the CBI was right to call this a niche idea not relevant to all businesses: the administrative, regulatory and valuation elements will be unattractive to many businesses; it fails to offer any protection from the overwhelming majority of potential employment tribunal claims; the two years continuous employment requirement for unfair dismissal means that new businesses have that protection already without the hassle; and it seeks to fix a problem that simply does not apply to most businesses by offering a solution to only some.

Q8. What benefits do you think introducing the employee owner status with limited unfair dismissal rights will have for companies?

We have already noted the potential benefit to business of FSC, and that there is no research which we are aware of that links its success to limiting employment rights. We refer again to the summary of the research at the top of this document and its focus on employee buy-in. We believe that employee buy-in will be undermined where the business asks it to make a greater commitment to it but without the commitment to rights that balance that equation.

We also note the finding that in isolation, share ownership was associated with lower productivity. These employee-owner proposals are just that – an example of isolated share ownership. Even without the loss of rights this proposal is likely to under-achieve.

There is the potential for a tax-dodging benefit for companies. A sole trader, or partnership, need only

[11] 23rd November 2011, available at news.bis.gov.uk/imagelibrary/downloadmedia. Presumably referring to the *SME Business Barometer*, August 2011, Table 4a
[12] Paragraph 4.17

incorporate, make themselves employees, grant themselves £50,000 of shares and enjoy the tax breaks which accompany that move. As 'proper' owners they could not sack themselves anyway and so this is win-win for them.

The consultation says it is keen to avoid unintended consequences. One may well be that there is limited uptake for the employee-owner proposals and that the job market moves against those which go down that route. Businesses can offer share schemes without the loss of rights. Doing so nevertheless gives a clear message to the market about how you value staff. Those businesses may well find that they lose staff to competitors who leave rights intact, and cannot recruit replacements where it would involve giving up existing rights. To some extent this is already a feature of the continuous employment requirement for such rights, but the employee-owner proposals perpetuate that indefinitely beyond the two year period.

Another unintended consequence may relate to a change in position. A business may try the employee-owner model, find it does not work for them, and may wish to revert back to a 'full-rights' model. The proposals, and the Bill, are currently silent about how such a move could be achieved. There is no mechanism currently in existence which could allow the reinstatement of rights by an employer. Unfair dismissal rights cannot be granted by employers as they are a statutory right independent of individuals. Continuous employment for unfair dismissal purposes cannot be backdated and clarity would need to be given about what periods, if any, counted to any reinstated right.

Q9. Do you think these benefits will be greater for larger, smaller or start-up businesses?

We have no observations to make in respect of this question.

Q10. What impact, if any, do you think the employee owner status will have on employment tribunal claims, e.g. for discrimination?

As there is no way of reversing the loss of the unfair dismissal right there would be a reduction in unfair dismissal claims. As we believe that the take up would be very limited, and because of the impact of the two year continuous employment requirement, we think that this reduction would be likely to be negligible.

It is likely that attempts would be made to use other jurisdictions where unfair dismissal was unavailable. This might be one of the specie of unfair dismissal claims that remains intact, or discrimination. The extent of this would depend on the take-up of employee-owner schemes, and the way in which businesses conducted dismissals. We are not able to hazard an assessment of either at this stage.

Q11. What impact do you think introducing the employee owner status with no statutory redundancy pay will have for businesses, in particular, smaller businesses and start-up businesses? What negative impacts do you anticipate and how might these be mitigated?

We repeat our observations in Question 10. it is difficult to see how the statutory redundancy payment is a major issue for small firms. No-one acquires the right until they have two years continuous employment so new start-ups will not have that problem for several years. Even after two years the payment due is between one and three weeks wages capped at £430. These are small sums compared to other business costs. While multiple redundancies would increase that cost, smaller businesses by definition have fewer staff and are less likely to face that issue to any significant degree.

Q12. What impact will this change to maternity notice period have on employers?

We have no observations to make in respect of this question.

Q13. What, in your view, would employers do if employees wish to return early without giving 16 weeks' notice?

We have no observations to make in respect of this question.

Q14. How will these changes impact on a company's payroll provisions?

We have no observations to make in respect of this question.

Q15. What effect will a compulsory 16 weeks' early return notice period have on the length of maternity leave that mothers take or adoption leave that parents take?

We have no observations to make in respect of this question.

Q16. Do you think 4 weeks is the right period? If not, why not? What would be the impact of a shorter or longer period?

We do not see the need to alter this time limit at all.

Q17. What impact do you think this proposal would have on the ability of employee owners to access support for training?

We consider that it is likely to be reduced because employee owners will not have the right to request it.

Q18. Do you have any comments on the Government's intention not to amend Company Law to implement the employee owner proposal?

We have no observations to make in respect of this question.

Q19. The Government welcomes views on particular safeguards that would need to be applied, in order to minimise opportunities for abuse.

We have commented on this earlier within this response.

Q20. The Government welcomes views on whether the existing tax rules which apply to share-for-share exchanges (such as might happen when a company is taken over) and schemes of reconstruction should apply where shares issued in return for taking up the new status are involved.

We have no observations to make in respect of this question.

Q21. What impact do you think the proposal will have on labour market flexibility – that is, in relation to hiring and letting people go?

We consider that it is likely to have a minimal positive impact, and that is unlikely to lead to an increase in recruitment.

Q22. Would you be likely to take up the new status? What would the impact of the status be on your business?

No.

Q23. What are your views on the take-up of this policy by:

a) companies?

b) individuals?

We do not anticipate take-up by either group to be significant for the reasons given earlier.

Q24. What are your views on the equality impact assessment? Are there other equality and wider considerations that need to be considered?

We consider that employee-owner statuses may be sought for workforces perceived to be 'high risk'. This might introduce discriminatory assessments. The impact assessment's assertion that such action would be actionable in discrimination law is not necessarily accurate. The decision to make all new starters adopt this status may be discriminatory in nature, but it is a decision that an individual new starter is unlikely to be able to challenge.

The rights relating to maternity leave obviously have a disparate impact upon women, as do the flexible working aspects. The assertion that "Employee owners will find it easier to discuss working patterns with their employer because they have a vested interest in the business" shows an astonishing lack of understanding about workplace dynamics.

Further comment

In our view it is important to point out and address fundamental issues which this consultation fails to address, something which suggests that the employee-owner proposal is a misguided one. We set these out below:

1. There is some possibility that the proposals could be deemed a breach of human rights law. Some of the statutory employment rights to be relinquished could be construed as "property" for the purposes of the right to property under Article 1 of the First Protocol of the European Convention of Human Rights (the "Convention").
2. There is also a chance that the fact that it favours only incorporated businesses places it in breach of competition law
3. How simple will it be for small to medium sized companies to value the shares?
4. How simple will it be for small to medium sized companies to issue or allot new shares if they do not have Companies Act 2006 Articles of Association?
5. What will be the administrative and legal costs of doing this, including the cost of amending any Articles where necessary?
6. What proportion of companies have these types of restrictions in their Articles as opposed to having Companies Act 2006 Articles?
7. What measures will be taken to prevent Articles of Association being used to restrict the pool of potential purchasers and preventing them from purchasing a 'bad leaver's' shares?
8. How far will the above costs need to be replicated for each and every employee participating in the Share Scheme, particularly if joining or leaving at different times?

9. Will small firms want to dilute share ownership in this way?
10. If employees leave, will companies have the cash to buy back shares? Alternatively, will companies be concerned about perhaps disgruntled employees remaining shareholders?
11. What liability might attach to a business in respect of representation which it makes to induce someone to become an employee-owner?
12. To what extent will these measures see a rise in associated disputes such as shareholder actions?
13. How will businesses view the risk of employee-owners acting collectively to assert control?
14. Will companies be worried about negative PR concerning employee treatment and potential redundancies if they adopt the Share Scheme?
15. What level of budget is apportioned by small to medium sized companies to compliance with unfair dismissal, redundancy and flexible working rights, together with associated claims?
16. Do the savings arising from reduction of these rights outweigh the various financial, reputational and administrative costs associated with the Share Scheme highlighted above?
17. What proportion of small to medium sized companies have been asked these questions?
18. What sort of administrative difficulties are posed to a business of having some staff opt into the employee-owner scheme, and others not?
19. What safeguards is the Government proposing to introduction to prevent abuse of the employee-owner scheme by businesses? We note that there is no protection for impropriety as suggested for the pre-settlement agreement negotiations.
20. Would employee-owners be able to cash in their shares during their employment?
21. What is to stop company owners diluting a shares worth by issuing shares to themselves or others prior to selling out the firm or before a mass 'redundancy' situation?
22. What is to stop company owners running a company into the ground in the knowledge that employees cannot come back against them?
23. What is to stop company owners using "protected conversations" or "pre-termination negotiations" to force employees to accept shares?

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