

**Implementing employee owner  
status**

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## **Introduction**

In October 2012 the Chancellor of the Exchequer announced plans for the introduction of a new 'owner-employee' share ownership scheme.

On the basis of these plans the BIS launched a 'Consultation on implementing employee owner status' (18 Oct 2012). In summary, the proposal amounts to

*'creating a new employment status which will give businesses greater choice about the contracts they can offer to individuals, and ensure appropriate levels of protection are maintained. Under this new status, employee owners will receive shares between £2,000 and £50,000 which will be exempt from capital gains tax. Employee owners will have the same rights as current employees excluding unfair dismissal (except where this is automatically unfair or relates to anti-discrimination law), certain rights to request flexible working and training, and statutory redundancy pay. Individuals will also need to give longer notice to return from maternity leave or adoption leave'*

The paragraphs below seek to engage critically with the proposals and provide a set of responses to the consultation document and to the questions contained therein.

Our conclusions are that the new proposed status is unnecessary, harmful to workers and employers' interests alike, marred with legal pitfalls that could result in litigation costs, and possibly contrary to EU law. Ultimately it amounts to a socially regressive reform proposal, where workers will be bearing all the risks associated with the holding of shares without enjoying any of the benefits typically deriving from employment, self-employment, or share-ownership. It is hoped that the proposed reforms, completely divorced from the needs of British society, will never see the (legislative) light of day.

## **Response to questions**

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

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

At present, three different employment statuses (employee, worker, or independent contractor) are generally available in English law, with certain additional categories in areas such as anti-discrimination. While this broadly tri-partite setup may not sound too difficult, there is clear evidence that it provides a significant obstacle to companies who are *already* confused by the existing scheme and by the growing number of 'employee' or 'worker' contract typologies. A recent study by the CBI pointed out that, allegedly as a consequence of the introduction of the Agency Workers Regulations, businesses have chosen to hire a large number of workers through self-employed contracts. According to this report, this was not necessarily due to the rising costs of hiring better protected agency workers, 'but more importantly due [to] the considerable compliance burden and vastly increased risk of tribunal claims' (Facing the Future, 2012, p. 35).

Even before the implementation of the proposed reforms, businesses and workers are therefore facing a considerable degree of uncertainty, and as a direct result, considerable fears

about potential litigation: many an employment tribunal claim needs to go through a complete round of hearings (including appeals) simply in order to determine the preliminary question as to the claimant's status before the tribunal can turn to the merits of the claim. The introduction of a new, fourth category, will add considerable confusion; not just by virtue of having an additional category but also because it is difficult to see how the proposed employee-owner regime would map onto the current system of common-law based categories which serve as gateways to an array of statutory rights. In addition to this it is foreseeable that employee owners whose contracts were terminated would engage in strategic litigation by alleging discriminatory dismissal in order to gain access to justice.

The recent decision by the Supreme Court in Autoclenz v Belcher [2011] UKSC 41 will exacerbate these problems dramatically: in that case, the court held that in determining a worker's employment status, the relevant evidence was not necessarily limited to the written contractual agreement between the parties. While the case was decided in a slightly different context, its arguments could easily be translated across into the employee-owner scenario: if the individual continues to behave and be treated as an employee on a daily basis, with weak or no evidence of ownership (e.g. because of the low value his or her shares, or a lack of voting rights attached to them), the courts are likely to disregard the employee-owner contract in favour of more traditional classifications. This would be the case especially if the transition to employee-owner contracts (or their being offered to new joiners) becomes an automatic standard practice, along the lines of the now near-universal opt-out employees are asked to sign in order to waive their rights under the provisions of the Working Time Regulations 1998.

The proposals are also premised on the assumption that the labour rights and entitlements that will be denied to 'employee owners' are outside the scope and competence of EU law, and within the exclusive competence of domestic law. This assumption is premised, first, on the belief that 'employee owners' would be missing out exclusively on rights that are not protected by EU labour law Directives, and, second, on the assumption that even where they exists, EU labour law directives tend not to engage robustly with the personal scope question. We strongly disagree with both assumptions. As we suggest below, a number of these rights are directly or indirectly covered by EU law. Moreover, in recent years EU law has moved beyond its initial deferent approach in respect of the national definitions of 'worker' and the personal scope of application of EU labour law instruments. In our view, the Court of Justice would be reluctant to accept that the UK status of 'employee owner' is genuinely separate from the EU notion of 'worker' (as developed in its equal pay, health and safety, and pregnancy case law) when the alleged distinctive features are merely notional and simply disguise an employment relationship within the 'worker' meaning.

The proposals, finally, are very unclear as regards their application in the *collective dimension*, most importantly workers' rights to organise, bargain collectively and consult with their employers on certain topics. None of the relevant provisions are listed in the indicative table of employment rights in the consultation document. Should this be interpreted as an assumption that the rights will be available to employee-owners? Or is the opposite the case? Without specific legislative amendments to key statutes such as TULRCA 1992, it is difficult to see how the proposed scheme could operate within the current tripartite classification, thus leaving employee-owners outside the scope of collective rights. Such an exclusion would open the entire scheme to challenge under the Human Rights Act 1998, given the European Court of Human Rights' recent emphasis on strengthening Article 11 of the European Convention of Human Rights (freedom of association): in Demir v Turkey

[2008] ECHR 1345 the court explicitly recognized workers' fundamental right to collective bargaining and industrial action.

Overall, therefore, businesses and indeed the government itself would face significant uncertainty and the threat both of long classification arguments in employment tribunals, even where an explicit employee-owner contract has been signed, and larger challenges both in domestic courts and international law.

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

Regulations on share issues would need to ensure that worker's entitlements reflect the fundamentals of the legal and economic position of company owners, most importantly by including both control (voting) rights and an entitlement (however residual) to the company's economic surplus. If the regulations were to allow issues structured in a way that denies some of these features (for example, by restricting voting rights, or classifying employees as a distinct group of shareholders), additional safeguards need to be put in place to ensure that other aspects (e.g. preference shares with guaranteed dividends) are sufficient compensation. This would likely involve external valuation and the resulting complications, however (see further our answer to Q5).

**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?**

The idea of share forfeiture sits very uneasily with the overall employee-owner scheme. Generally speaking, companies have no powers to force shareholders into buy-backs without further agreements (e.g. a specifically designed option); so it is likely that any such provision would be used in demonstrating to an employment tribunal that there is little genuine about the 'ownership' aspect of the status (see further answer to Q2).

Should the forfeiture scheme go ahead regardless, it would raise several serious concerns: by definition, the buyback of an employee-owner's shares following termination of the employment relationship will happen at the very moment the worker will be at his or her most vulnerable, and in need of financial support. If valuation were at market value, or even below that (with a 'fractional' amount) this raises an additional problem: structurally, most layoffs will happen in periods of depressed company performance, and thus reduced valuations. The danger is that employees would receive very little, if any, meaningful value in return for their loss of employment rights. The only way to avoid this would be to set a minimum strike price for the employer's repurchase option at the original issue value; leaving employees to capture any potential economic upside, but not exposing them to the risk of serious drops in the stock-market. This approach would also have the benefit for company's treasuries of facilitating the valuation of outstanding liabilities.

**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?**

The biggest problem in valuation would be raised by non-traded employers generally, and dynamic, fast-growing companies in particular. Whilst fairly sophisticated models have been developed by private-market (pre-IPO) funds dealing in shares of non-listed companies, the administration of such schemes could easily become very complex (for example as regards dilution of previously-issued shares). Overall, the effect would be considerably off-putting to most companies: external third-party valuation will be intrusive and expensive, but without it, employers would open themselves up to the full range of claims and challenges that the employee ownership is not genuine, as discussed in our answer to Question 2.

**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.**

We suggest that individuals and businesses would in practice need a very high level of advice and guidance about the implications of taking on employee-owner status, so much so as to render the taking on of this status a seriously risky and potentially costly decision on the part both of individuals and businesses.

There are many kinds of difficulty and uncertainty involved, but they can usefully be reduced to two main types:-

- a) uncertainties about the application of statutory provisions, and
- b) uncertainties about employee-owner status as a common-law contract type.

We comment on these in turn.

- a) Uncertainties about the application of statutory provisions.

The main focus of the proposals is upon the positioning of the proposed employee-owner status in relation to the principal statutory employment protections which are currently applicable to ‘employees’, and, to a lesser degree, to ‘workers’, the basic idea being to limit some of those protections for ‘employee-owners’ on the footing that they will enjoy a compensating set of advantages deriving from their ownership of shares in the employing company.

However, although the proposals purport comprehensively to have clarified the position of employee-owners in this respect, we think that serious uncertainties would still arise. Arguments might for example arise as to whether a given individual had *genuinely* been accorded ‘employee-owner’ status, the mere assertion of that on the face of the contract not in itself being decisive if the individual could show that he or she had not properly understood what was involved.

Moreover, we think that rather elaborate advice-taking would be needed to enable both individuals and businesses to decide whether contracting on the ‘employee-owner’ footing was really to the benefit of the respective parties to the arrangement. So the transaction costs

of entering into such contracts could be very considerably greater than for conventional contracts of employment or even for ‘worker’ contracts.

b) Uncertainties about ‘employee-owner status’ as a common-law contract type

We think that the above-mentioned uncertainties are enormously multiplied by an even greater set of difficulties, to which the proposals do not refer, about how the ‘employee-owner status’ would operate as a common-law contract type. The crucial question here is whether and how far the common law of the contract of employment would apply to it, and if so with what if any modifications.

Individuals and businesses would need to know from the outset and during the continuance and upon the termination of such contracts whether the central implied terms of the contract of employment, such as that obligation of mutual trust and confidence, applied to ‘employee-owner’ contracts, and whether the doctrines prescribing the remedies for breach and wrongful termination of the contract of employment applied equally or differently to these contracts. This is a matter of the utmost consequence which the proposals do not seem to address.

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

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

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

**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?**

The Consultation Document takes the view that maternity leave notice periods for ‘employee owners’ could be increased above the equivalent notice periods presently required from employees. The underlying assumption is that EU law does not cover these matters, and therefore domestic law is free to discriminate between the parental and maternity entitlements of ‘employees’ and those of other workers.

We suggest that this is a risky if not altogether wrong assumption. Parental Leave in general is of course covered by EU secondary legislation (Directive 2010/18). EU law does not systematically defer to domestic law when it comes to defining the personal scope of application of the rights contained in EU labour and equality directives. Some of the areas in which the ECJ has forcefully asserted that the concept of ‘worker’ to which these rights apply must have an autonomous and EU-wide definition are the areas of equal pay, pregnancy rights, and health and safety legislation (broadly understood). While the Court has not yet had an opportunity to pronounce itself in respect of the personal scope of application of the Parental Leave Directive, it is plausible to assume that, should it be asked to decide whether it is possible for Member States to attribute different sets of rights to groups of employees that fall within the EU concept of ‘worker’, it would take a very critical view of any national measure seeking to do that. It is our firm belief that both ‘employees’ and ‘employee-owners’ would be seen as falling within the EU concept of ‘worker’ as developed by the Court of Justice of the EU in its more recent jurisprudence since the case of *Allonby*. As a consequence, provisions such as those suggested in Part 3 of the Consultation document

would be found to be in breach of EU law, in spite of the fact that the EU Parental Leave Directive does not explicitly cover notice periods.

**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 would like to start by reiterating the point made above. Even where a specific right or entitlement is not expressly covered by EU Law (e.g. notice periods or the right to request flexible working), and as long as that right is strictly connected with the enjoyment of a right provided or protected by an EU instrument (as in the case of parental leave), EU law may not allow Member States to create two tiers of rights and entitlements for different (national) categories of employees that the ECJ would see as falling within the broad and autonomous EU notion of ‘worker’.

We therefore believe that that the Consultation paper may be mistaken in suggesting that the ‘only’ EU right at stake is paid parental leave (para 41). Other rights and matters that may trigger EU/ECJ competence in respect of the right to request flexible work range from pregnancy to disability discrimination, including discrimination by association. In all these cases EU law would most likely prohibit the attribution of lesser rights to ‘employee-owners’ if the latter were to be seen as falling within the EU/ECJ notion of ‘worker’.

We also note that as presently drafted the proposals contained in paragraphs 42-44 may fall short of the right to fair trial, which is clearly protected under both EU law and the European Convention on Human Rights.

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

The employee-owner scheme can probably be accommodated under the current company law regime strictly speaking. Employee’s share ownership would however throw open a series of unanswered questions in closely related fields. Would shareholders under the scheme have to comply with securities market regulation, for example when a trade union co-ordinates its members’ vote and therefore acquires control over a substantial block of shares in a publicly listed company? Would employee-owners in the previous example be subject to competition law and related provisions?

A further issue not addressed in the proposal is that of complex corporate structures, such as corporate groups, holding companies, and companies that are held by outside investors such as Private Equity firms. In which entity would employee-owners be given shares? If shares will always be held in the immediate contractual counterparty, this raises a problematic issue: in a corporate group, for example, it could become very difficult to value the shares of a subsidiary given the group’s freedom to continuously readjust assets and liabilities within its structure to match evolving business needs.

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

Any ‘automatic’ or boilerplate employee-owner terms need to be automatically invalidated under the statutory regime. Where employees do not have free choice in negotiating the



arrangement, the very point of the scheme is threatened: the acquisition of ownership in a company is, after all, a voluntary act which usually happens at arms-length between parties of reasonably equal bargaining power.

The second main area of concern is in the valuation of shares at issue, and in the provisions surrounding buy-back. Strong safeguards would be necessary to ensure that the employee-ownership scheme would stand up to judicial scrutiny; if an employee can demonstrate that at the moment of termination he or she had none of the benefits of ownership, it is likely that the courts would classify the relationship under one of the existing categories (see our answer to Question 2).

Preliminary analyses suggest, finally, that the scheme could open up a serious loophole in the existing tax structure. Senior management in particular could easily opt to become employee-owners, receive the maximum amount of tax-free equity in return, and then contract back into the full range of employment rights (and indeed contract out of the buy-back regime to ensure a truly golden, completely tax-free, parachute).

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

Our view is that the economic evidence of the effects that deregulation may have over hiring and firing decisions by businesses is scant and contradictory. The OECD has noted in its Employment Outlook of 2010 that ‘...*theory* predicts that strict employment protection should reduce worker flows ... *although it is not always clear to what extent estimated effects are general and robust*’ (see pages 181-182 of the report; emphasis supplied), and that ‘the evidence presented in the chapter also suggests that reforms involving the relaxation of regulatory provisions on individual and collective dismissals are likely to increase the number of workers who are affected by labour mobility at the initiative of the employer’ (page 200).

In a way, one could therefore only answer this question on the basis of theoretical and ideological arguments and/or hypothetical speculation. What is certain, on the other hand, is that the introduction of a fourth (and less protected) employment status would further segment the British labour market (going against the clear advice of both the OECD and the European Commission), and have a disproportionate effect on the most vulnerable sectors of the labour market and society, and in particular younger workers and women.

**Q23. What are your views on the take-up of this policy by: a) companies? b) individuals?**

Overall, it is unlikely that this scheme would see enthusiastic take-up. Whilst the lack of employment rights, notably as regards unfair dismissal, might be superficially attractive from a company’s perspective, the inherent uncertainty and resulting threat of litigation as outlined in our response to earlier questions will significantly distract from any perceived benefits of the scheme. From the individual worker’s perspective, the policy constitutes a dangerous risk-reallocation, where cyclical business risk is shifted onto the worker who is arguably least able to bear that risk. It is therefore likely that the most significant impact of the proposed scheme will in the end be on HM Treasury, further stretching decreasing public resources to provide basic social support for redundant employee-owners.