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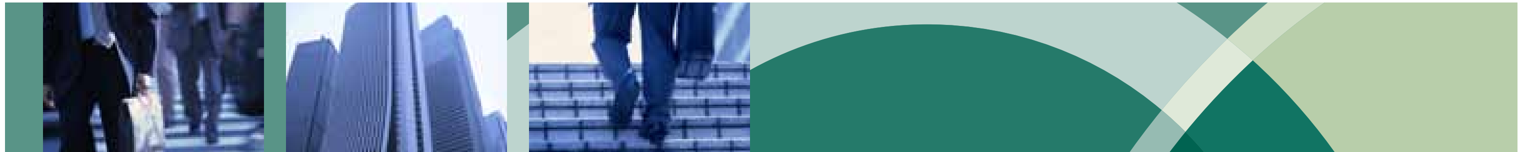
Law at work



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Features

A walk in the park? Practical implications of managing the role of non-executive directors if the Walker Review is adopted

Background

As the British Academy observes in its letter to The Queen of 22 July, the global financial crisis arose principally from "a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole". The Walker Review attempts to do two things: grapple with the Rumsfeldian desire to understand and adjust for the "unknown unknowns" while not resorting to a box ticking exercise or disadvantaging UK banks and other financial institutions ("BOFIs") against international competitors.

This means that to some degree, institutions wishing to adapt their processes for improved risk management will need to make up their own methods and devise their own resources. However, for those involved in responding to the Walker issues, there are a number of practical points.

Relevant Walker recommendations

A summary of the principal recommendations relevant to the management of the non-executive director (NED) function is:

1. NEDs must have enough knowledge and understanding of the business to help them contribute effectively. There should be thematic business awareness – and a personalised approach to induction, training and development.
2. The board must provide dedicated support for NEDs on any matter relevant to the business on which they require separate advice.
3. There is an increased expected time commitment of at least 30-36 days per annum.
4. The board should evaluate performance formally and rigorously at least every two or three years including a statement of its review in the annual report.
5. All BOFI board should establish a dedicated risk committee separate from the audit committee.
6. The remuneration committee should seek advice from the risk committee on specific risk adjustments to be applied to the performance objective in the context of remuneration packages.

The implications for the company secretariat or legal advisers if these recommendations are to be implemented include the following:

(a) Analyse the current board – review the competencies of non-executive members, how much time they can give and what their track record is in relation to the ability to understand and challenge the executive. Companies which do not retain board search consultants may want to think about appointing advisers on an exclusive basis to target what will be a narrow market of people with the required competencies.

(b) Having regard to the other part of the competency recommendation, external support in relation to training may also be required. The review is wary of suggesting that as part of the support available to NEDs on an ongoing basis, permanent external advisers be appointed to them because this may lead to friction and divisions. However, there is likely to be a well-defined role for consultants in bringing board members up to speed: inherently it must be undesirable for NEDs to be trained entirely by those they are there to review.

As to the question of who companies may be looking at (if one discounts John Kingman who is departing UKFI, at least on the basis that there is only one of him) clues may be found in the identity of members of risk committees among those BOFIs who already have them. For example, at Northern Rock, members of the risk committee include Laurie Adams, a City-trained lawyer latterly of ABN Amro and Kent Atkinson, a former director of Lloyds TSB. Partners in larger city law firms and particularly those in the investment management and risk practices of the large accountants, may finally find their entry route into a board portfolio beyond their partnership career. For a long time lawyers in particular have been unattractive to boards on the basis of their risk aversion. This may be their time.

There will be obvious consequences for the contractual arrangements on which non-executives are appointed. As a checklist:

- review the time commitment and see if the minimum must be increased;
- review the terms of reference for the role, perhaps amending any terms which copy the Combined Code descriptions to include a more obvious reference to the requirements to challenge where appropriate. Specific committee duties may also be expanded to include the risk committee, perhaps a beefed up nominations committee responsible for reviewing performance of the board in line with the fourth recommendation referred to above, and remuneration committee duties expanded to take account of liaison with the risk committee;
- consider setting out a commitment to undergo training as well as an obligation on the company to provide training and other resources (including the process required to take external advice on risks similar to that required when taking legal advice);
- consider whether the NED needs to be paid more for his/her time (perhaps particularly likely in the case of "professional" NEDs coming from law firms or multidisciplinary practices).

One area of focus for any NED evaluating the risk and rewards to himself for taking up such a role will be the protections in place. The review comes out against capping liabilities of NEDs, referring to the adequacy of directors' and officers' insurance provisions. Arriving NEDs are likely to be particularly interested in the levels of cover and their provisions. Conventionally, D&O terms are not held for display as part of directors' engagement letters or contracts. This may need to be reviewed.

Company secretariats may also need to consider in relation to the Articles of Association of their BOFI:

- amending any cap on the aggregate of directors' remuneration if headroom needs expanding to take account of increased fees associated with increased time commitments for the role;
- reviewing the provisions of the Articles which may limit reappointments of directors to three times three year periods of appointments (the review suggests that the practice of retiring directors after a maximum of nine years may need to be relaxed in the case of complex or high risk businesses where time needs to be taken in order to fully understand the challenges such a company faces).

The Walker review notes at 3.6 that the greater the prospective risk appetite of a company and the greater the complexity of the instruments at the heart of its business, the higher the need for financial industry expertise among NEDs. But the report also notes that in order to avoid the dangers of "group think", a core component of any board will be the inclusion of non-financial industry specialists with sufficient strength of character and independence to be able to challenge precepts of the executive. Therefore, a review of the current board composition may be required.

Finally, the company secretariat will need to review the strength of the nominations committee and its competencies to assess the performance of board members. Committees may need to meet more frequently than twice annually and may themselves require external support in evaluating performance. If the concept of the review is to be honoured, a sensible suggestion would be to review performance in "off periods" adequately in advance of renewal of appointments so as to enable departures or arrivals to be managed smoothly and allow enough lead-in training during the induction period of a new appointee. The terms of appointment of NEDs who may not easily be removed might require review, and businesses which do not have a performance criterion to enable an early exit might wish to consider that. Whether this will assist in attracting NEDs from the professions is a separate question.

Sean Nesbitt **and** ***Paul Callaghan***
(*This article was first published in Pay Magazine)*

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Age Rage: In the clash of policy and legal challenges, are employers being treated fairly?

Employers continue to be buffeted by two strands of legal and policy development on age discrimination.

At the legal level, Heyday's challenge to the retirement age of 65 was heard in the High Court last week and long running litigation brought by a former partner in a law firm, Leslie Seldon, has reached the Court of Appeal. Mr Seldon challenges his forced retirement at 65 from the partnership (which cannot rely on the permitted mandatory retirement age set out in the Age Regulations, because those only apply to employees). His challenge raises important issues about the ability of the courts to intervene in businesses' assessment of their own needs; and the policy purposes of the age laws. No decision has yet been published, but the fact that the Department for Business, Innovation and Skills appointed an eminent QC to make representations in this case, which is also backed by the Equality & Human Rights Commission, is a straw in the wind as to the State's approach to revising the age laws.

The UK had committed to review the operation of the default retirement age in 2011. However, it has voluntarily accelerated its review and announced on 13 July 2009 that it will conduct a review in 2010. This is referred to in this month's Hot Topics section. In a statement, the Prime Minister said:

> "*Evidence suggests that allowing older people to continue working, unfettered by negative views about ageing, could be a big factor in the success of Britain's businesses and our future economic growth.*"

In a prolonged recession, economists will inevitably worry about labour market participation and the dangers created by the long-term exclusion of groups of workers from access to work. Also, at a point where many private sector employers have been revising their pension arrangements, and where the State has limited resources to fund its pension commitments, one can see the superficial attraction in revising the age laws so that older workers have greater ability to challenge the termination of their employment. Taking away the permitted age 65 mandatory retirement date would help them do this.

But is this sensible?

Employers are already wrestling with measures that affect labour market participation for other classes of worker and revising the age laws may have an adverse effect on them. Many employers have had a historic antipathy towards flexible working requests, being concerned about reaching a tipping point or managing the perceptions of "normal" workers. The recession has arguably had some positive impact on those attitudes, as employers have adopted patterns of atypical working for large numbers of their employees with a view to saving jobs – for example the KPMG flexible working scheme. However, there is anecdotal evidence (and a stream of training conferences for employment lawyers) supporting the proposition that women are more likely to bear the brunt of cost cutting measures in a recessionary environment. It is easy to anticipate that increased rights for one section of the workforce may exacerbate the environment for women and lead to increased legal claims.

And what about younger workers? Should the government not worry about the potential for increased workplace longevity for those already ensconced in a job to heighten the lack of opportunity for the younger population, creating political and social risk of a marginalised generation? Undermining the ability of employers to plan for certainty and manage career development could have this unforeseen impact.

One wonders whether, in accelerating the review, the government is making a political calculation about the voting intentions of an organised older workforce, backed by groups such as Age Concern and Heyday, in preference to the already marginalised younger unemployed who are less likely to vote. And at the expense of employers.

Sean Nesbitt
(This article was first published in Pay Magazine)

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Case law update

EAT holds no requirement to set off higher temporary earnings following dismissal against future loss

Islam Channel Ltd v Ms V Ridley (2009) UKEAT/0083/09

Why care?

The level of a claimant's compensatory award following unfair dismissal, is such amount as the tribunal considers "just and equitable in all the circumstances having regard to the loss sustained by the complainant in consequence of the dismissal in so far as that loss is attributable to action taken by the employer". At a time when the market is unsettled and a claimant may be dismissed, find temporary work, and then be made redundant again, this decision is relevant to employers.

The case

Ms Ridley, a TV journalist, was unfairly dismissed by Islam Channel Ltd (the "Company"). After her dismissal she found temporary freelance work for 30 weeks which paid more than her previous earnings with the Company. For an additional 19 weeks her earnings reduced and at the time of the Tribunal remedy hearing she earned less than she had with the Company. Combining the different incomes she earned £5,000 more during the period between dismissal and the remedy hearing than she would have earned working for the Company in the same period.

The Tribunal found that it was not required to set off the excess past earnings. It effectively ignored those and awarded her a sum for direct sex discrimination, harassment and unfair dismissal to reflect both past and future loss due to her lower earnings post dismissal plus a costs award of £5,000 against the Respondent.

The assessment of the future one year's worth of earnings was disputed on appeal, and it was argued that in essence the employee was receiving a bonus. The EAT, however, accepted that her role was insecure, uncertain and unemployment rates were high in the field. It reviewed a number of cases in this area and considered prior legal guidance:

(a) Assessment of loss must be judged on the facts as they appear at the assessment date;

(b) Where the employee has been unemployed from dismissal, subject to the duty to mitigate, loss will be judged on earnings at pre-dismissal rate;

(c) If he finds permanent alternative employment paid at a lower level, compensation will be based on the difference between pre-dismissal earnings and those paid in the new employment;

(d) Taking alternative employment does not preclude an applicant from claiming loss to the assessment date, giving credit for those earnings;

(e) If an employee obtains higher paid alternative employment his loss attributable to the employer ceases and cannot be revived *but* that this would not always be the case as such an approach could, in some cases, lead to an award which is not just and equitable.

In Ms Ridley's case the EAT concluded that under (e) there must be some flexibility depending on what is just and equitable. There was no automatic "guillotine" on continued losses once a former employee took on new work. The tribunal was entitled to view Ms Ridley's temporary higher-earning work as not breaking the chain of causation, and therefore to award compensation for ongoing future losses. They found no error of law in the Tribunal's approach and therefore upheld their decision.

What to take away

This was a somewhat unusual case in which, although the dismissed employee had initially found replacement income which was greater than her earnings with the former employer it was from insecure, freelance work. By the time of the remedies hearing, it had dropped to below her salary with her dismissing employer. Where an employee has found alternative, and better paid employment after termination, this does not necessarily mean that the former employer's duty to pay compensation will come to an end. Each case will be fact specific – for example whether such employment was temporary or the stability of the particular working environment.

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Where an employer has knowledge of facts on which it later relies as grounds for summary dismissal, it should have clearly reserved its position in that regard

Cook v MSHK Limited and Ministry of Sound Recordings Limited [2009] EWCA Civ 624

Why care?

Ordinarily, it is employees who seek to rely on the implied duty of mutual trust and confidence between themselves and their employer. In this case it was the employer, and the Court had to consider whether the employer had affirmed the contract, or whether it could argue that it had accepted the employee’s repudiatory breach.

Note: A repudiatory breach is a breach of contract by one party that is sufficiently serious to entitle the other to treat the contract as terminated with immediate effect and sue for damages for breach of contract.

The case

Mr Cook was employed by and in charge of Ministry of Sound’s ("Ministry's") artist and repertoire team. He accepted employment from one of Ministry’s competitors, Warner Music UK Limited, and resigned by giving his contractual six months’ notice. Although Mr Cook’s contract contained various post-termination restrictions it did not contain a non-compete clause. During Mr Cook's notice period Ministry allegedly discovered that Mr Cook would be competing with them, and decided to remove him from commercially sensitive work and restrict his access to certain information. Mr Cook went off sick with stress after being shouted at during a confrontation. During his absence Ministry stayed in touch with Mr Cook and he later returned to work out the rest of his notice after being assured by the Ministry that the matter could be put behind him.

However, Mr Cook was subsequently dismissed for gross misconduct and breach of fiduciary duty. The Ministry sought damages for breach of fiduciary duties and a declaration that his dismissal was lawful as it believed that (a) Mr Cook had lied when asked what work he would be carrying out for Warner and therefore breached his fiduciary duties and (b) he had attempted to secure a company loan after he had resigned, putting his interests ahead of those of Ministry.

The High Court and the Court of Appeal held that:

- Ministry could not rely on Mr Cook's breach of contract to justify the dismissal. They had failed to reserve their position in relation to the allegation that Mr Cook had lied about his new role. They had known of Mr Cook's intentions for some time, gave no indication of the fact they were going to bring disciplinary proceedings against him for his alleged dishonesty. Conversely, they had reminded him of his confidentiality obligations during his notice period and expressed the hope that he would return to work shortly. The Ministry had affirmed his contract.
- by contrast the Ministry could rely on the allegation that Mr Cook accepted the company loan, putting his interests before those of his employer, because it had expressly reserved its position in this regard.

What to take away?

If acting in cases of suspected misconduct, it is important to act quickly upon learning of the breach, or otherwise an employer could risk affirming the employee’s conduct as Ministry did in this case. If immediate action is not possible, for example, due an employee's absence through illness, then an employer should reserve its position in this regard. However, in doing so, an employer should ensure that no damage is done to the relationship of mutual trust and confidence, and consequentially, to the enforceability of any restrictive covenants.

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Hot topics

Immigration Rules Changes: MAC Review of Points Based System

Throughout 2008 the UK Border Agency (the "UKBA") rolled out the Points Based System (PBS), the most radical change to UK immigration law for 40 years. The UKBA consolidated 80 immigration routes into five tiers. After a "bedding in" period of nearly a year, the UKBA commenced its first review of the new system through the Migration Advisory Committee (MAC). On 19 August the MAC issued a 193 page report. The report contains recommended changes to the PBS. The key recommendations (with our comments in bold) are listed in our recent client e-alert.

The Government has now indicated that it will adopt the recommendations, either at the end of October 2009 or early in 2010. This will make it harder for skilled foreign workers to take jobs in the UK under the points based system.

From 2010 all jobs will have to be advertised in a job centre for four weeks before employers look for staff from outside Europe. The minimum salary that will allow a worker to qualify as a skilled worker will also rise from £17,000 to £20,000. In addition, overseas workers who want to transfer to the UK base of their company will have to have worked for that company for a year, rather than just six months, prior to the move.

Government is to review default retirement age in 2010

The Government has launched a strategy document, "Building a society for all ages". This announced that its review of the default retirement age of 65, which had originally been planned for 2011, will be brought forward to 2010.

The consultation closes on 12 October 2009. The review, originally scheduled for 2011, is expected to result in either a higher default retirement age or its abolition altogether.

Guidance on the employment of children

The Department for Schools and Families has produced a guide to the types of work children can (and cannot) do, which includes guidance on age limits and hours they can be required to work and the implications for employers. The guidance can be obtained here.

The Supreme Court will replace the House of Lords in October 2009

The House of Lords is to be replaced by the Supreme Court as the highest appeal court in the UK at the start of the new legal year in October 2009. It will act as the final court of appeal in civil cases for the whole of the UK. The creation of the Supreme Court separates the judicial function carried out by the Law Lords from the rest of the parliamentary process.

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