ALERT MEMORANDUM

Brexit: Implications for Employers

July 2016

On 23 June 2016, the UK public voted to leave the EU, sending shockwaves throughout Europe. After a period of political upheaval, Theresa May succeeded David Cameron on 13 July 2016 as the UK's 76th Prime Minister, with the task of negotiating the terms of the UK's exit from, and future relationship with, the EU. As the media feeding frenzy continues, we consider the key practical implications of Brexit for employers and, in particular:

1. What should employers be doing in the short term to address the impact of the referendum result?
2. What should employers do over the course of the two-year negotiation period to prepare for Brexit?
3. How is UK employment law likely to change as a result of Brexit?
4. How will Brexit affect employment litigation?
5. How will Brexit affect internationally mobile workers?
6. How will Brexit impact remuneration structures and incentive schemes?

If you have any questions concerning the UK's vote to leave the EU, please reach out to your regular firm contact or the following authors:

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The UK referendum is advisory in nature and the result, in itself, has no legal effect on employees, employment rights or employment laws. However, in light of Theresa May's speech to launch her leadership campaign on 11 July that "Brexit means Brexit", the UK's exit from the EU now seems a political certainty. Recent reports indicate that Mrs May intends to deliver the Article 50 notice triggering formal exit negotiations with the EU at the start of next year, which will then start the clock on a two-year negotiation period leading to the UK's eventual exit from the EU in early 2019. Negotiations will encompass the terms both of the UK's exit and of its on-going relationship with the EU.

There has been much speculation amongst commentators as to the model of the UK's future relationship with the EU; whether it will join the European Economic Area (the "EEA") or, instead, negotiate a bespoke arrangement analogous to Switzerland's partnership with the EU on the basis of a series of bilateral agreements. It is important to note, however, that the UK's move to leave the EU is unprecedented, and the terms of the UK's future relationship with the EU may well differ significantly from either of these models. In the meantime, the UK remains subject to EU law and the UK courts and employment tribunals remain bound by the jurisprudence of the European Court of Justice ("ECJ"), with no change from the current position.

1. What should employers be doing in the short term to address the impact of the referendum result?

With emotions running high in the wake of the UK public's vote to leave the EU, there are a number of things for employers to consider in the short term in light of employees' reactions to the result.

Reassure the workforce. Whilst not legally required, in the current environment of political uncertainty and economic volatility, employers should initially consider taking steps to reassure the workforce that it is 'business as usual' and there is no immediate impact, either on their rights to work in the UK or elsewhere, or on their employment terms or rights.

To prevent a potential loss of key staff, businesses that rely heavily on EU market access may also wish to address speculation by employees as to possible restructuring measures or a relocation of operations out of the UK.

In each case, email communications or town hall meetings may be advisable, though employers should take care not to step beyond the known facts.

Be alive to discriminatory harassment. There have been increased reports of xenophobic abuse since the referendum result became known. In the workplace this has, in some cases, involved the making of offensive comments to colleagues who are EEA nationals. There have also been accounts of altercations between 'remain' and 'leave' voters which, because of the reported average demographic differences between the two categories of voters, have brought into play issues of age in addition to political opinions and beliefs.

Such behaviour can constitute bullying and unlawful discriminatory harassment, which may result in poor workforce morale, a loss of productivity, an increase in absences and resignations, damage to an employer's reputation, and may also expose an employer to legal risks. This is because, unless an employer can show that it took all reasonable steps to prevent their employees from taking the relevant action, they can be vicariously liable under the Equality Act 2010 (the "Equality Act") for anything done by their employees in the course of their employment, regardless of whether the relevant action was taken with the employer's knowledge or approval.

Whether or not comments are made by employees maliciously, they may amount to discriminatory harassment under the Equality Act if:

— The comments (or other conduct) are *unwanted*;

— They *relate to a protected characteristic*, which include, among others, race, nationality, age and philosophical belief; and

— They have the purpose *or effect* of violating another person's dignity or creating an intimidating, hostile, degrading, humiliating or offensive environment.

To ensure employers are able to avail themselves of the statutory defence:

— As part of any general communications to reassure employees following the referendum, employers should remind employees of the company's applicable policies (including anti-bullying, discrimination and harassment policies);

— Such policies should be reviewed to see whether they require updating to address these specific risks; and

— Employers should consider carrying out a risk assessment based on the composition of their workforce, and take steps to address areas of particular concern through additional staff training.

Beware of discrimination legislation in relation to recruitment practices. Employers may be tempted to pre-empt possible changes to UK immigration laws in their recruitment processes. For example, by rejecting applications from EEA citizens now to avoid having to deal with sponsorship or other formalities (or, although this currently seems extremely unlikely, having to recruit a replacement if it becomes illegal to employ EEA nationals who don't have a specific immigration permission) post-Brexit. However, employers should be aware that job applicants are protected against discrimination, victimisation and harassment under the Equality Act. In particular, an employer must not discriminate against a person:

— In the *arrangements it makes* for deciding who to offer employment to (for example, in the content of application forms or questions asked in interview);

— As to the *terms on which it offers* someone employment; and

— By *not offering* someone employment.

A recent Supreme Court decision held that immigration status is not, of itself, a protected characteristic under the Equality Act (nor is it indistinguishable from nationality or race, which are protected characteristics). Whilst this decision could potentially be helpful for employers choosing between two applicants from the same country where one of them has a UK visa or indefinite leave to remain in the UK and the other would require sponsorship or another relevant immigration permission, employers would be ill-advised to modify their recruitment practices now in reliance of the referendum result or this decision. This is because:

— EEA nationals continue to have the right to live and work in the UK and, unless and until such rights are taken away post-Brexit (and they may not be taken away) they are entitled to continue to exercise those rights;

— Under Regulation 492/2011 on the freedom of movement for workers, EEA nationals have directly enforceable rights not to be discriminated against in the course of exercising their treaty rights to live and work in the UK (or any other EEA country). Until an eventual Brexit takes effect, this Regulation provides directly enforceable rights for employees; and

— If the second applicant in this scenario held a different nationality or race, both the employer and its associated employees could find themselves exposed under the Equality Act.

As always, employers should continue to tread carefully when asking questions about immigration status in application forms or during interviews. To help employers navigate the path between illegal working, on the one hand, and risks arising under the Equality Act, on the other, the Government's code of practice for employers avoiding unlawful discrimination while preventing illegal working is a helpful resource (the "Code"). The Code reminds employers:

— *Not to make assumptions* about a person's right to work or immigration status on the basis of their colour, nationality, accent or the length of time they have been resident in the UK;

— That the best way to avoid discrimination is to treat all applicants fairly and in the *same way at each stage* of the recruitment process. For example, if you ask for documents from one applicant, you should make sure you ask for documents at that same stage from all applicants being considered;

— Once a person who has time-limited permission to stay in the UK has established their *initial and on-going entitlement to work*, they should not be treated less favourably; and

— You should only ask questions about an applicant's immigration status *where it is necessary to determine whether their status imposes limitations* on the number of hours they may work each week, the type of work they may carry out or on the length of time for which they are permitted to work.

These issues are particularly pertinent in light of the expansion, on 12 July 2016, of the existing offence of knowingly employing an illegal migrant, to include circumstances where an employer has *reasonable cause to believe* that the person has no right to do the work in question, and the introduction of greater penalties.

Key points:

- Reassure your workforce.
- Remind employees of respect at work policies, review those policies and conduct a risk assessment to identify additional training needs.
- No changes to recruitment practices should currently be made in light of the referendum result and, as always, tread carefully with job applicant questioning.

2. What should employers do over the course of the two-year negotiation period to prepare for Brexit?

Keep in close contact with advisers. There is a great deal of speculation as to the post-Brexit world, and currently very little concrete information available to allow employers to start actively preparing for Brexit. The key message is therefore to monitor new developments and stay in close contact with your advisors to keep abreast of developments as they are announced.

Conduct an internal immigration audit. In the meantime, to prepare for any change in immigration arrangements for EEA nationals, employers should consider conducting an internal audit to identify staff who are either (i) EEA nationals living and working in the UK, or (ii) UK nationals living and working in the EEA. Employees should be encouraged to formalise their immigration status by seeking permanent residency status or citizenship (if eligible), or applying for a Registration Certificate, which evidences that they are exercising their treaty rights to live and work in the UK.

If there is any doubt about the situation of key employees, the advice of immigration specialists should be sought as soon as possible. Employers may also wish to facilitate or make available consultations between key employees and such specialists.

Begin reviewing relevant documents. Additionally, employers could start thinking about conducting a review of their employment arrangements, contractual documentation and policies and procedures to identify clauses with a geographic scope defined by reference to the EU (for example, mobility clauses and post-termination restrictions).

In relation to any employees working on a temporary basis in another EEA member state, employers should assess repatriation obligations and overseas assignment policies.

However, in both cases, to avoid incurring unnecessary costs, it is not advisable to give effect to any amendments identified as being necessary, until the post-Brexit position becomes clearer.

Key points:

- Keep in close contact with your advisers.
- Conduct an immigration audit and encourage key employees to formalise their immigration status.
- Review employment documentation to identify provisions that may require amendment.

3. How is UK employment law likely to change as a result of Brexit?

Over the life of the UK's membership of the EU, EU legislation has become the source of a significant proportion of the UK's employment laws, including discrimination and family-friendly rights legislation, working time and holiday rights, employee rights on a business transfer, collective bargaining rights and atypical workers' rights. In addition to the direct impact of EU law-making on the UK's legal framework, UK courts are bound to interpret domestic laws in accordance with EU legislation and are bound by the jurisprudence of the ECJ. In theory, the UK parliament is at liberty to repeal these laws in full upon the implementation of Brexit. In practice, however, we are unlikely to see wholesale repeals or significant changes to our employment laws in the short or even medium term, for several reasons:

— Many employment rights that originate from the EU have become ingrained in modern day British employment practices and are now taken for granted by employers and employees alike; significant changes would likely meet with resistance from relevant stakeholders, including trade unions;

— The two-year exit negotiation will absorb much of the Government's resources and significant legislative reform in the employment domain is unlikely to be seen as a priority; and

— Many UK employment laws (including the Equality Act), although having developed over the years to reflect EU jurisprudence, have domestic origins, or were implemented in the

UK with more stringent requirements than EU law (so-called "gold-plating").

However, there is broad consensus that we may expect a degree of 'tinkering around the edges'. Speculation as to what this might entail, includes:

— The introduction of a cap on compensation in discrimination, victimisation and harassment claims under the Equality Act;

— Amendments to elements of the Working Time Regulations dealing with the carry-over of holiday by workers on long-term sick leave, and legislation to displace recent ECJ decisions on holiday pay calculation;

— The repeal of the Agency Workers Regulations, which grant employee-like rights to qualifying agency workers;

— Small amendments to TUPE to permit the harmonisation of employment terms and conditions following a relevant transfer;

— An increase in the threshold for collective consultation in redundancy situations;

— In light of the Government's prior legal challenge, a repeal of the bonus cap under CRD IV (but see below Theresa May's areas of focus); and

— A repeal of legislation implementing the European Works Councils Directive.

In truth, however, these speculations are merely that, and it will be some time until there is any real clarity as to the Government's legislative agenda. Theresa May, in her 11 July speech, gave an early indication of her initial areas of focus:

— *Corporate governance*: Mrs May commented that non-executive directors are, in practice, "*drawn from the same, narrow social and professional circles as the executive team*". She specifically mentioned the introduction of employee representation on corporate boards, but may also be thinking about imposing women on boards targets;

— *Executive pay levels*: Mrs May condemned the trebling of FTSE executive pay in the last 18 years and the "*irrational, unhealthy and growing gap between what these companies pay their workers and what they pay their bosses*", and so may be looking to introduce caps on executive pay that go beyond the CRD IV bonus cap;

— *Say on pay*: Mrs May wishes to make binding, the annual advisory shareholder vote on the directors' remuneration report, which is required by quoted companies. This vote currently relates to directors' remuneration paid in the financial year the subject of the report and how the company's remuneration policy will be implemented in the year of the vote. It's not clear how a binding vote in respect of remuneration already paid would work in practice and, in particular, whether directors would need to repay amounts already received if shareholder approval were not obtained. Since 30 September 2013, quoted companies' remuneration policies have been subject to a binding shareholder vote at least every three years, or earlier to approve changes or because the advisory vote was not passed;

— *Remuneration disclosure*: Mrs May also spoke about increased disclosure of executive remuneration, including full disclosure of bonus targets and the publication of the ratio between CEO pay and the average company worker's pay;

— *Incentive structures*: Mrs May wishes to "simplify" the way bonuses are paid "*so that the bosses' incentives are better aligned with the long-term interests of the company and its shareholders*". This statement echoes similar statements made by institutional shareholders, including the Local Authority Pension Fund Forum in its "Expectations for Executive Pay" (i.e., that FTSE350 companies should "*Phase out the use of long term incentive plans in favour of company-wide, long-term profit pools that use a straight-forward formula for calculating bonuses based on base salary and seniority*");

— *Equal pay*: Mrs May observed "*If you're a woman, you still earn less than a man*". As former Minister for Women and Equalities, Mrs May was a proponent of voluntary, rather than compulsory, gender equality reporting, but in light of this recent statement (and the apparent failure of the voluntary approach) it seems likely

that she intends to bring into force on 1 October 2016, as planned, the regulations that will place gender pay gap reporting for employers with 250 or more employees on a statutory footing. It is unclear whether Mrs May envisages taking other measures to address the gender pay gap; and

— *Anti-avoidance*: Finally, consistent with recent legislative trends, Mrs May spoke about introducing measures to tackle individual tax avoidance and evasion. This may mean that consultancy, dual contract, and LLP/partnership arrangements come under greater scrutiny.

Key points:

- Wholesale or significant change to UK employment law immediately post-Brexit is unlikely.
- Minor changes are predicted, but nobody currently knows for sure what will happen or when.
- The Government seems focused on strengthening corporate governance, limiting executive pay and tax avoidance.

4. How will Brexit affect employment litigation?

A further issue that has hitherto been governed by EU legislation is the question of where an employer can sue, or be sued by, its employees. For UK employees these questions are currently governed by the Recast Brussels Regulation (the "Brussels Regulation").

Under the Brussels Regulation, in matters relating to individual contracts of employment (and this phrase has been interpreted broadly by the ECJ to include, for example, standalone bonus and incentive schemes):

— An employer, whether domiciled in a Member State or not, may bring proceedings *only* in the courts of the Member State in which an *employee is domiciled*. In the UK, domiciliation is deemed to arise after 3 months of residence; and

— An employer domiciled in a Member State (including where deemed domiciled by virtue of a branch, agency or other establishment) may be sued in the courts of the Member State in which *it is domiciled*; or

— An employer, *whether domiciled in a Member State or not*, may be sued in the courts of the Member State: (a) where the employee *habitually carries out his work* (or last did so); or (b) if the employee does not habitually work in any one Member State, in the courts for the place where the *business that engaged the employee is situated.*

Asserting jurisdiction under the Brussels Regulation, the English courts have issued anti-suit injunctions to prevent proceedings from being tried against EU employees in US courts.

Further, within the EU, a court taking jurisdiction pursuant to the Brussels Regulation in one Member States automatically prevents another Member State court from hearing parallel proceedings on the same matter.

The Brussels Regulation will cease to apply post-Brexit, but the expectation is that it will be replaced with a similar or equivalent regime, such as the Lugano Convention, which currently governs the allocation of jurisdiction among EFTA states and broadly mirrors the original version of the Brussels Regulation enacted in 2001. One key difference, however, is that the Lugano Convention does not enable a third country employer to be sued by an employee in the courts of a contracting EFTA State because the employee habitually works there or the business that engaged the employee is situated there.

If the UK does not adopt equivalent regulations, the jurisdiction of employment disputes will be left to be determined by English common law rules, which broadly require the defendant to be served with proceedings while physically present in the UK, to have submitted to the jurisdiction of the UK courts or for permission to serve proceedings outside the UK to have been granted. There are no specific protections for UK employees under the common law rules that would prevent them from being sued by their employers outside of the UK, and this may bring welcome flexibility to multinational

employers, particularly those who operate cross-border incentive schemes.

Key points:

- Existing jurisdiction rules are likely to be replaced by a similar regime but, if not, we could see a relaxing of the rules in favour of employers.

5. How will Brexit impact internationally mobile workers?

Immigration uncertainties. The position of EEA workers currently living and working in the UK (and UK employees currently living and working in other EEA countries) is dependent on the deal eventually struck with the EU. The principle of freedom of movement is regarded as fundamental by even the more dovish of the EU leaders, who have indicated that it will be a condition of the UK retaining access to the single market going forward. However, with concerns over EU migration credited as the biggest contributor to the UK public's vote to leave the EU, it may be politically difficult for the incoming government to accept free movement in its current form.

The system of immigration restrictions and permissions that will apply to EEA nationals if the UK's future deal with the EEA does not allow free movement of EEA nationals into the UK, is currently uncertain. The Government could extend the existing points-based visa system to apply to EEA (and Swiss) nationals and, as part of this, could bring into force the existing, but inactive, tier 3 category for unskilled workers. Alternatively, we could see an entirely different regime.

We expect to see transitional arrangements in place to allow EEA nationals currently living and working in the UK to remain. Theresa May has recently made a statement indicating that the status of EEA workers currently in the UK is not guaranteed, but this could be viewed with a degree of scepticism as a potential gambit in anticipation of the EU exit negotiation.

EU Social Security Regulations. Following Brexit, the EU Social Security Regulations, which also by virtue of the EEA agreement apply to the EEA states and, since concluding its agreement on the free movement of persons with the EU, Switzerland, will cease to apply to the UK. These Regulations are crucial for ex-pat arrangements as they work to ensure that employees living and working in two or more relevant states:

— Are not required to make social security contributions (in the UK, National Insurance contributions) in more than one state at the same time; and

— Do not fall between multiple regimes and find themselves without any social security entitlements.

However, there is limited cause for alarm at this point: whatever form the future immigration arrangements between the UK and the EEA take, it is in all parties' interests to maintain an administratively workable framework for the payment and collection of social security charges in relation to cross-border workers. Certainly, any outcome involving the free movement of persons will inevitably involve coordination on social security matters. If the UK does not accede to the EEA agreement or, like Switzerland, negotiates its own agreement with the EU, it would still be open to the UK to negotiate bilateral state by state arrangements on social security matters similar to the reciprocal arrangement between the UK and the US or the double contribution convention between the UK and Canada.

Key points:

- There is no immediate impact on expatriate EEA and UK employees, but the future of freedom of movement is uncertain.
- Transitional provisions in favour of EEA nationals currently living and working in the UK are expected.
- Existing EU social security rules are likely to continue to apply in one form or another.

6. How will Brexit impact remuneration structures and incentive schemes?

Possible loss of passporting rights. Securities may currently be offered or allotted within the EEA to existing or former directors or employees by their employer (or by an affiliated undertaking), with the publication of an information document instead of a full blown prospectus, under the so called "employee share scheme" exemption deriving from the Prospectus Directive.

Where an employee share scheme involves participating employees across the EEA, securities can be offered or allotted without requiring separate authorisation in each EEA jurisdiction (the so called, "passport").

The position following Brexit will depend on the terms of the UK's post-exit relationship with the EU and, in particular, which of the three financial services sector access models is adopted. See question 7 of our Frequently Asked Questions.

If UK-headquartered multinational issuers were, post-Brexit, to lose the ability to passport their employee offerings within the EEA, the position will substantially be governed by the local requirements of the relevant EEA Member State, which will determine whether cross-border offerings may be made and, if so, to which categories of person and with which documentation. Other exemptions from the requirement to produce a prospectus may come into greater focus in structuring employee incentives, such as the *de minimis* exemption for offers made or directed at fewer than 150 people (other than qualified investors) in each EEA state, or where the aggregate consideration for the transferable securities being offered does not exceed €100,000.

Possible legislative reforms. As described in section 3 above, a number of legislative reforms that will impact remuneration structures and incentive schemes seem likely. While Mrs May's proposals are, at this stage, very high level, they broadly mirror positions previously taken by investor associations and shareholder advisory firms, which suggests that Mrs May can likely expect industry support for reform.

In addition, also as mentioned in section 3 (but perhaps in tension with the tenor of Mrs May's proposals) commentators have suggested that a new government may move to repeal the CRD IV bonus cap in an effort to bolster the UK's attractiveness to financial services firms.

Key points:

- The UK is likely, but not certain, to retain its passporting rights. If it does not, more in-depth local law advice will need to be sought in each relevant jurisdiction before offering or allotting securities to employees post-Brexit.
- Legislative changes affecting incentive schemes (including possible caps on FTSE executive remuneration, enhanced disclosure requirements and greater shareholder oversight) are politically in focus.

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