You signed the contract...

The second in **Ian Smith's** two-part series on management myths that lawyers must work to debunk

- common employment disputes: bonuses, notice and contract terms
- the move away from classic contract law principles

In last month's employment law supplement, we dispelled three myths of modern employment law related to casual, fixed-term and agency workers (*NLJ*, p 1819, 5 December 2003). This month, we turn our attention to dismissing the myths of employment contracts that most commonly lead to disputes.

Myth 4: "I'm right—the contract says so"

Employment law evolved historically as simply one branch of contract law, so a natural assumption may well be that the manager can always insist on exercising a power or discretion that appears in black and white in the written contract of employment: the employee has agreed to it, and so must do it, end of argument. The problem has always been that UK contract law does not take into account inequalities of bargaining power (in contracts generally, let alone in employment contracts). Modern employment law is now moving away from classic contract law principles, and rules and approaches are being developed that may be used by a court or tribunal to limit, or even prevent altogether, unfair or unconscionable exercises of powers apparently unambiguously bestowed on employers by the contract.

Trust and respect

The first tranche of cases demonstrating these developments was concerned with the implied term of trust and respect—ie that the employer will not, without just cause, act in such a way as to destroy the trust and respect necessary for the continued functioning of the employment. This major limiting device, finally given the full approval of the House of Lords in *Malik v BCCI (in liquidation)* [1997] IRLR 462 HL, is of greatest legal significance where the employee, feeling that he cannot carry on in the light of the employer's behaviour, chooses the option of leaving and claiming constructive dismissal. However, in human resources (HR) circles the term is also well-known, and means that the HR professional has to try to pre-empt and prevent managerial actions that might lead to such a case.

The battleground in earlier case law revolved mainly around mobility clauses. These tend to be drafted in very wide terms, giving the employer the power to move the employee anywhere at any time. That power is clear, but what the implied term may do is place limits on *how* the employer exercises it. If the employee is told on a Friday afternoon in Newcastle that from 9am next Monday he is transferred to the Bristol office, that could be construed as breaching the implied term, leading to a constructive dismissal claim if the employee refuses (especially if a tribunal took the view that the real reason for the order was to provoke the employee to resign). In such a case, the employer's *power* is not being challenged; it is the unconscionable exercise of power that is subject to attack. While it is true that courts have baulked at developing this into one general principle that any contractual power must always be exercised reasonably, widespread use of the implied term (especially by ex-employees' lawyers) has produced a situation in practice that is not a million miles from such a principle.

Employer discretion: bonuses

More recent case law has opened up a new front, potentially going even further by attacking inequitable exercises of employer *discretions* granted by the contract of employment. The principal battleground here has been discretionary bonuses or commissions. Once again, the tendency has been to draft clauses in very wide terms, ostensibly giving the employer complete discretion as to what an individual receives in any given year. While we have seen attacks on employer practices in this area recently on the basis of patterns of fixing bonuses discriminating between male and female employees, ordinary employment law is starting to make inroads into this area in even more fundamental ways.

Take a high-ranking employee in a competitive field, who is appointed on the basis of a relatively low basic salary but the promise of huge annual bonuses or commission. For several years, very large amounts are awarded. When the employer and employee finally fall out and the latter is rapidly dispensed with (shortly before the end of the bonus year), the final bonus is fixed at nil. When the ex-employee complains about this, he is pointed towards his contract, the relevant clause of which says that the annual bonus shall be at the complete and unfettered discretion of the board (or its remuneration committee).

In two high-profile cases, the ex-employee in these circumstances successfully sued for the bonus he claimed he should have received. In *Clark v BET plc* [1997] IRLR 348 QBD, the judge made an award of damages on the basis of breach of the term of trust and respect, looking at the final bonus the employee would have received had his employment still been treated with proper trust and respect.

In *Clark v Nomura International plc* [2000] IRLR 766 QBD, a similar result was reached by the even more far-reaching route of striking down the employer's exercise of the bonus discretion on the ground of "perversity"—ie it was a decision that no reasonable employer could possibly have come to. This is cutting-edge law, and the argument will only succeed in certain cases.

In both *Clark* cases, the court was helped substantially by the fact that one could see how past bonuses had been calculated (either on the firm's performance or that of the individual employee), so that pattern could be used to quantify what should have been awarded instead of nil. Moreover, in both cases the employee had continued to perform his job well, until his sudden termination; declining performance possibly justifying a much lower bonus would be more difficult for the employee to win. Where the argument does succeed, the employee may win substantial damages. In the latter *Clark* case, the award was £1.35m; the earlier *Clark* case set the record for common law damages in this area, with an award in the region of £2.25m.

These developments have subsequently been approved and applied to another vital area by the Court of Appeal. In *Mallone v BPB Industries plc* [2002] IRLR 452 CA, a dismissed executive sought to exercise valuable stock options after his termination, only to be told that under his contract these could only be exercised to the extent permitted by the board of directors, who decided that the appropriate extent was nil. Following the

latter *Clark* case line, the Court of Appeal held that this (effectively punitive) decision was perverse, unlawfully interfering with the employee's interest in his vested share options, which was said to be akin to a property right. Damages were awarded for the loss of value of the options, fixed at £100,000.

With regard to the fourth myth, therefore, legal advisers should warn HR professionals to be wary of any simple assumptions that contract rights and discretions only mean what the words expressly say. Inequitable exercises of such rights and discretions are increasingly amenable to legal challenge, on grounds increasingly akin to those found in administrative law, particularly by ex-employees who have been deprived of valuable expectations on termination. Decisions such as the nil final bonus are so clearly meant to be punitive and retributive that it may not be difficult to establish the argument that they are perverse in law, in which case "I'm right—the contract says so" may be an increasingly plaintive cry.

Myth 5: "I can always just sack him by giving notice"

If all else fails, the manager knows, it is possible to be rid of the employee by giving the notice set out in the contract or, even better, by giving wages in lieu. Of course, you have to be careful with unfair dismissal (if the employee has over a year's service) and, increasingly, with disability discrimination. However, at least as far as the contract itself is concerned, it can always be ended (for good reason, bad reason or no reason) by proper notice. Even if you get it a bit wrong, the ex-employee can only sue for any unpaid notice money.

PHI cases

Even this nostrum is under attack. There may now be cases where the power to give notice may *not* be lawfully used, where the effect would be to negate other valuable employee rights or expectations. Once again, this is groundbreaking law, with uncertain parameters, but the case law is significant. Until recently, it has focused on one area—the so-called "PHI" cases. Permanent health insurance (PHI) schemes have enjoyed some popularity, especially when headhunting senior managers, and offer generous long-term sickness benefits in the case of permanent incapacity. They have, however, caused major legal problems (especially when not fully integrated into employment contracts), where either the employer or the backing insurance company seeks to renege on what the employee considers to be his rights under the scheme.

In *Aspden v Webbs Poultry Ltd* [1996] IRLR 521 QBD, a senior manager offered PHI protection at the time of his appointment became ill and expected to qualify for generous benefits—three-quarters of his salary to retirement age—after 26 weeks' illness, as set out in the scheme. However, his employer doubted his *bona fides* and tried to stop him qualifying. Unfortunately, the PHI scheme existed in separate documentation. His written contract (making no reference to the scheme) provided for an unrestricted power to terminate on three months' notice by either party. The employer gave this notice, to expire before the magic 26 weeks necessary to receive PHI. Under the traditional law on notice, the employer had acted lawfully, but the court held for the employee and awarded damages reflecting the loss of PHI rights. It held there was an implied term that (except for summary dismissal for cause and, according to a later case, redundancy) the employer could not terminate the contract in such a way as to deprive the employee of his PHI rights.

This novel approach by the English court has subsequently been followed in Scotland and approved, in principle, by the Court of Appeal in *Brompton v AOC International Ltd* [1997] IRLR 639 CA. Moreover, it has now been applied for the first time outside the PHI context. In *Jenvey v ABC* [2002] IRLR 520 QBD, an employee who was shortly to be made redundant under a generous contractual redundancy scheme was deprived of this by his employer who dismissed him on other grounds beforehand. He brought a successful action for unfair dismissal, but because the cap on compensation at that time was only £12,000 he could not recoup the loss of £58,000 under the redundancy scheme. Instead, he brought a breach of contract action and won. The judge found that there was an analogy with the PHI cases and held that there was an implied term that, where the employer has resolved to dismiss the employee by reason of redundancy, it will not (without good cause) dismiss him for some other reason and so deprive him of valuable redundancy rights.

With regard to this fifth myth, the law remains in a formative stage. Are the PHI and redundancy cases isolated examples, or might they be seen eventually as two species of a wider genus, namely a right not to be deprived of *any* valuable right by being unfairly given notice? Clearly, the right to give notice to the employee will remain a powerful one in most cases. However, even at this early stage, these judicial inroads into that right mean that the HR professional may need to be aware of possible arguments by a dismissed employee that he has suffered financial loss by the cynical and/or inequitable use of the otherwise unlimited power to dismiss on notice.

> *"Decisions such as the nil final bonus are so clearly meant to be punitive and retributive that it may not be difficult to establish that they are perverse"*

Myth 6: "You can request any changes you like, but the answer will be no"

This final myth has great topicality, and equal long-term significance. As with myths four and five, it starts with a solid base in traditional contract law. The contract of employment fixes the relationship between employer and employee and, being bilateral in nature, cannot be changed unilaterally by one party. Thus, an employee wanting to change any particular term has no common law right to do so. All the employee can do is propose or request a change; if the answer is "no", there is no contractual variation and that is the end of the matter. Of course, what makes this issue particularly important now is the government's flexibility at work and work/life balance policies. Requests for change in working patterns are likely to come, and the law is currently moving away from the purely contractual position.

Child-care changes

Such change has come about in two ways. The first has been through case law and, once again, employment lawyers making the most of the tools already to hand (though not necessarily designed for the job). The driving force has tended to be the desire of full-time employees taking maternity leave to come back to work on a part-time basis. Hitherto, there has been no statutory right to do so—the right to return from maternity leave has always been a right to return to the same job on the same terms, not different ones. However, as cases such as this involve an element of the highly protected areas of pregnancy and maternity, employees' lawyers have been advancing the argument that a refusal by the employer can constitute indirect sex discrimination. If correct, this puts the onus onto the employer to justify the refusal on objective grounds (ie by being able to present a business case for it). Thus, a straight "no"

has been legally dangerous for some time now (no matter how effective it may be in pure contract law), and legal advice has tended to make it "no, because…", setting out the reasoning for declining. Any element of the refusal constituting a predetermined response or a refusal to consider the request on its merits would be especially dangerous.

It is, however, the second change that really exposes the myth, going much further than just maternity returners. The Employment Act 2002 (EA 2002) gives a new right to any employee with a child under six (18 if disabled) to request a change in working arrangements, to be properly considered by the employer. The details of this are contained in the Flexible Working (Eligibility, Complaints and Remedies) Regulations 2002 (SI 2002/3236) and the Flexible Working (Procedural Requirements) Regulations 2002 (SI 2002/3207). This scheme came into force in April 2003.

There is a tendency to abbreviate this to "the right to request to go part-time and not be unreasonably refused", but this is inaccurate, understating the breadth of the new right from the employee's point of view. For one thing, it is not confined to a request to go part-time, it covers requests to change *any* terms relating to hours of work, times of work and where the work is to be performed. It thus covers matters such as requests to increase or decrease hours, to change working hours (eg shift patterns), to jobshare, and to change to home working. Moreover, the employer is not able to object on any 'reasonable' grounds; instead, the only grounds of refusal are set out in the statute itself, with *no* final catch-all similar to "some other substantial reason" in unfair dismissal law. Although the grounds are individually wide (eg "the burden of additional cost", "inability to recruit additional staff"), the point remains that the employer has to nail its colours to the mast at the early stage of any refusal, and be able, if necessary, to defend reliance on that ground before a tribunal later. The unthinking "no" by itself is not an option. Moreover, the new laws set out a detailed procedure to be followed (including time limits and written reasons), breach of which is specifically made a ground of complaint to a tribunal by the employee.

"Organisations interested in recruiting and retaining valuable staff will be looking at producing generous contractual schemes for flexible working"

Wider changes

The ground rules are clearly shifting in this area, and it is possible that this may only be a start. At present, the new statutory right is anchored in the area of maternity/parental rights, with its linkage to caring for a child under six. However, it is quite possible that it may be widened by dropping that childcare requirement. After all, employees will want flexibility for other reasons, such as caring for the elderly or simply to promote the much-discussed work-life balance. Moreover, such an extension could be used to defuse any reaction against improved maternity/parental rights by childless employees perceiving themselves as shouldering the burdens of work. Any such extension would show that, although this new right starts with its feet in family-friendly policies, it really belongs in the government's wider flexible working policies.

With this in mind, it may be that organisations with a particular interest in recruiting and retaining valuable staff will be looking not just at minimum compliance with the new law, but at making a virtue of a necessity by producing their own more generous contractual schemes for flexible working and advertising them positively. One obvious form of this would be to extend such schemes to all employees immediately. This is a matter that may well impact on HR practice sooner rather than later. In relation to this sixth and final myth, therefore, the role of HR may be not just the negative one of pointing out the legal dangers of an uncomplicated and unthinking reliance on the word "no", but the more positive one of promoting a culture change in relation to flexible working.

The move away from contract law

The pace of change in employment law shows no signs of slowing. EA 2002 is the most obvious cause of this, but only the most obvious cause. There are equally important developments in modern case law that are challenging some remarkably fundamental tenets and assumptions. What lies behind much of this is a continuation and recent acceleration of a major theme in employment law—namely, the movement away from reliance on traditional contract law to resolve employment disputes. While the individual contract of employment remains the cornerstone of employment law, we are seeing the development of ideas and judicial approaches that can be used to control or prevent the perceived abuse of employers' powers and discretions, even where apparently set out clearly in the contract. When this is added to the movement towards specific legislation on part-time working, fixed-term working (and possibly agency working), and the long-term effects of laws on flexible working, we see a picture of serious change within a short period.

In several of these developments the new legal position will be as reliant on ideas of 'best practice' and what lawyers refer to as 'soft law' (eg DTI guidance) as on traditional contractual principles, especially when it is the way in which employer powers and discretions are exercised that is under judicial scrutiny. The HR professional will be the key to ensuring any necessary procedures and practices are put into place to deal with the new challenges, and are complied with. There will be a major problem in ensuing that managers understand the nature of these changes. The purely educative function of HR managers and the employment lawyers advising them has never been more important.

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