TUPE and employee share schemes: an update in light of Ponticelli

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In the May 2020 ELA Briefing, the authors set out a summary of the law relating to TUPE and employee share schemes. In light of the recent IHCS decision in Ponticelli, they have revisited some of the major themes in that article to assess what has changed.

The IHCS decision in Ponticelli

In the February 2023 edition of *ELA Briefing,* we reported on the factual background to *Ponticelli* and the EAT decision. As briefly also noted in the September/October 2023 edition of *ELA Briefing*, Ponticelli appealed the decision to the IHCS. The IHCS dismissed the appeal, holding that both the employment tribunal and EAT had been entitled to find that the individual's right to participate in the transferor's Share Incentive Plan (SIP) transferred under TUPE on the basis that such participation, although it did not arise 'under' the employment contract, clearly still arose 'in connection with' it and was therefore within the scope of reg 4(2)(a) TUPE. It did not accept Ponticelli's argument that the Court of Appeal decision in *Chapman* (in which the court had indicated that TUPE may not apply to a share option contract which was separate from the employment contract) should be followed, saying that *Chapman* was only concerned with the interpretation of a specific rule under the relevant share option contract and had not considered the application of reg 4(2)(a). Accordingly, *Chapman* did not apply.

The IHCS also noted that other cases subsequent to *Chapman* (in particular *Martin*) had shown the wide scope of what is covered by reg 4(2)(a). As such, the obligations of the transferor under the partnership share agreement (ie the document which implemented the employee's participation in the SIP) fell within the scope of reg 4(2)(a) and Ponticelli was under an obligation to provide the employee with a scheme of substantial equivalence under the principles established in the *Mitie* decision. It is not known whether Ponticelli will appeal to the Supreme Court.

The effect of TUPE on existing share incentive awards

As noted in the May 2020 article, the issue of what effect TUPE may have on existing awards is a relatively straightforward question and it is common for share schemes to provide for what happens on a TUPE transfer. In many cases, particularly tax-advantaged schemes, it is a statutory requirement for the scheme to provide for what happens on such a transfer. For example, in sharesave schemes, the scheme must provide that, in the event of a TUPE transfer to a company outside the relevant group, the participant will have a period of six months after the transfer to exercise any options that they hold (using the savings accrued up until the point of exercise).

In *Ponticelli*, the SIP provided (as it is required to do under the relevant SIP legislation) for what happens to existing awards on a TUPE transfer outside of the group. It provided that, in that event, the participant's shares must be sold or transferred to the participant within 90 days of cessation of employment, with no income tax or national insurance to pay. One of the arguments put forward by Ponticelli at the employment tribunal level was that, since the rules of the SIP set out what happens to awards on the TUPE transfer, those provisions effectively terminated any entitlement the employee had to participate in the SIP and therefore, as at the moment of transfer, the employee had no rights under the SIP which were capable of transferring.

The tribunal did not address this argument explicitly in its judgment (and the point was not pursued on appeal). That may be because it implicitly accepted that, due to the nature of the particular SIP arrangement and in addition to the shares already sitting in the SIP trust, the employee had ongoing rights to acquire shares using further salary deductions made and therefore this argument only dealt with his historic awards, not his future rights to deductions/share purchases (see below).

Does TUPE require the transferee to replicate the transferor's share scheme?

As mentioned in the May 2020 article, many lawyers previously took the view that, if the transferring employee did not have a right under the employment contract to participate

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in the share scheme (which is usually the case), there would be no obligation on the transferee to replicate the scheme. This was largely based on a combination of the decisions in *Mitie* (in which the Court of Appeal held that the transferee was obliged to provide a substantially equivalent scheme but, in that case, there was an express ongoing right under the employment contract to participate in the relevant scheme) and *Chapman* (under which the Court of Appeal had indicated that TUPE may not apply to share option arrangements set out in collateral contracts).

Ponticelli has made this view more difficult to argue. It is clear from *Ponticelli* that, even where the employment contract makes no reference to the share scheme, and the rights and obligations arise solely from entirely separate contractual documentation, the obligation to provide a scheme of substantial equivalence may be triggered.

The key point when considering how to apply the *Ponticelli* decision in practice is how widely does the decision apply in the context of participation in share schemes on a TUPE transfer?

At first glance, it might be assumed that the practical implication of *Ponticelli* is that, where a transferring employee was participating in a SIP (or, for that matter, any other type of share-based incentive arrangement) on a TUPE transfer, the transferee will be now be effectively obliged to put in place a substantially equivalent replacement in order to continue such participation right.

However, the alternative view is that it is arguable that both *Mitie* and *Ponticelli* should be confined to their own particular facts. Our understanding is that the SIP in *Ponticelli* was an 'evergreen' SIP and was somewhat unusual in the way in which it operated in that the right relating to monthly salary deductions and share purchases made (as set out in the partnership share agreement) was an *ongoing* and *continuous* right (subject to the transferor not exercising its power of termination under the SIP).

With that in mind, one can see why it is correct that, in addition to the shares which the employee already had in the SIP trust as at the transfer date, there was an ongoing right to further share purchases that needed to be replicated under TUPE. It is worth speculating as to whether the ruling in *Ponticelli* would have been different if the SIP had been structured differently (or if the employee had been given a different form of share incentive).

For example, rather than an evergreen SIP, it is possible to structure a SIP so there is a one-off award or opportunity to purchase partnership shares (with or without an 'accumulation period' – being a period of up to 12 months during which deductions are made from the employee's salary and then used to buy shares for the employee shortly after the end of the accumulation period). In addition, the employer can choose to make SIP offers subject to a maximum number of shares available for purchase/award.

If the SIP in *Ponticelli* had been structured in this way, then it would seem more arguable that (i) the rules of the SIP dealt with what happens to existing awards in the SIP trust on the TUPE transfer; and (ii) since there were no ongoing rights to any further deductions/share purchases/awards, there was nothing capable of being transferred under TUPE and nothing to which the principle of substantial equivalence could apply.

The *Mitie* case itself was also one in which, somewhat unusually, the employees had an ongoing and indefinite right (in their employment contracts) to participate in the relevant Sainsbury's profit sharing scheme. As such, it can be seen why the principle of substantial equivalence should have been applied in that case also, given that they had potential future rights to profit sharing that needed to be replicated.

If it is right that *Mitie* and *Ponticelli* should, in fact, be confined to those limited circumstances in which a participant may have an ongoing right (whether in the employment contract or separate documentation) to future share purchases/awards, then it may be the case that the *Mitie/Ponticelli* principle does not carry across in many other situations of participation in employee share schemes.

So, for example, if employees of a transferor have, prior to transfer, been granted an award of options under a company share option plan (with no contractual right to any future awards), it may be the case that (i) in respect of the award granted to them prior to transfer, the scheme rules will entirely address what will happen to that award on the TUPE transfer (for example, there will be a limited period following transfer in which to exercise any vested awards with any unvested award lapsing without compensation); and (ii) there is no ongoing right that is capable of being transferred to which the principle of substantial equivalence can apply.

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Termination rights in share schemes

It is also worth noting that, at the employment tribunal level in *Ponticelli*, the tribunal accepted that, if the transferor's SIP contained a unilateral power of termination by the company, the transferee's equivalent replacement scheme should also contain such a termination right (although this was not commented on further at the EAT and IHCS levels). If that is correct, then, in principle, the transferee should be free to exercise such a unilateral right to terminate the replacement scheme on transfer (and it is common for share schemes to contain exclusion of liability clauses on such termination which, provided that they are drafted widely enough, will be valid to exclude (contractual) liabilities (see *Micklefield* and *Levett*)).

This may mean that, even if *Ponticelli* is not confined to its particular facts and is capable of a wider application, a participant's rights may be relatively worthless – a pyrrhic victory of sorts (the issue for Ponticelli was that it maintained the position that the SIP had not transferred and that it was not obliged to provide a replacement, and so it was inconsistent with that position to terminate a scheme which they did not recognise as having transferred).

Share scheme rights in other group companies/collateral contract arguments

In the May 2020 article, we noted there might be an argument that, where the share scheme relates to shares in a group company that is not the transferor, this might fall outside the scope of reg 4(2)(a) (on the basis that reg 4(2)(a) relates only to the 'transferor's' rights, powers, duties etc and not those relating to other group companies), but noted that the chances of it succeeding were uncertain. Since *Ponticelli*, this seems even less likely to succeed, not least because this was the position in *Ponticelli* itself, where the SIP (although established by the transferor) related to a different group entity's (ie the parent company's) shares. It is perhaps debatable whether the argument might have more chance of success if the scheme not only relates to shares of an entity other than the transferor but was also established by such different entity (as in *Tomlin*), but even then, *Ponticelli* would seem to make that an unlikely argument to succeed.

Employees with contractual rights: the scope of the transferee's duty

As noted in the May 2020 article, there is virtually no case law on what is meant by 'substantial equivalence'. Unfortunately, *Ponticelli* gives no further guidance on the question also, as neither the tribunal, EAT nor the IHCS was required to decide on that issue. Therefore, all of the uncertainties we outlined in the May 2020 article about what may be needed to meet the substantial equivalence test remain valid.

Final thoughts

The EAT and IHCS decisions in *Ponticelli* have been widely reported as effectively meaning that, where a transferring employee participates in an SIP (or other type of share scheme), a transferee on a TUPE transfer may need to establish a substantially equivalent replacement scheme. However, for the reasons set out above, the practical implications of *Ponticelli* (and *Mitie*) may arguably be significantly narrower than that and the obligation to establish a scheme of substantial equivalence may be confined to situations in which there is some ongoing right of the transferring employee to further awards/share purchases, which in many transactions will not be the case.

KEY:

Ponticelli	*Ponticelli Ltd v Gallagher* [2023] CSIH 32
IHCS	Inner House of the Court of Session
TUPE	Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246)
Chapman	*Chapman v CPS Computer Group* [1987] IRLR 462
Martin	*Martin v Lancashire CC* [2001] ICR 197
Mitie	*Mitie Managed Services Ltd v French* [2002] ICR 1395
Micklefield	*Micklefield v SAC Technology Ltd* [1990] IRLR 218
Levett	*Levett v Biotrace International Plc* [1999] IRLR 375
Tomlin	*Tomlin v EDS* ET Case 2702211/07