

CAPPING PUBLIC SECTOR TERMINATION PAYMENTS - WHAT DOES IT MEAN FOR CONTRACTORS?

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Here, we outline the background to the proposed changes to termination payments for public sector employees and take a close look at what the Government's proposals to "rein in" such termination payments mean for contractors.

Background

Several high-profile cases of public sector employees being paid generous termination payments only to be re-employed in the public sector shortly afterwards led to a consultation in June 2014 about proposals to recover public sector exit payments in certain circumstances.

The result was section 154 of the Small Business, Enterprise and Employment Act 2015, which doesn't itself require exit payments to be repaid, but empowers the Treasury to make further Regulations requiring certain public sector workers to repay specified exit payments if they are re-engaged in the public sector within a prescribed period. The Government has indicated that it will make such regulations by April 2016.

These new Regulations will work alongside the existing provisions in Local Government which provide for repayment of certain termination payments if a recipient is re-employed within 4 weeks of finishing their previous role.

Continuing the theme, in May 2015 the Chancellor said he would bring an end to "six-figure settlements" for public sector workers. [A formal consultation on proposals to introduce a £95,000 cap on termination payments for public sector workers](#) was announced on 31 July and closed on 27 August 2015.

The proposed cap would apply directly to central and local government and some Government owned trading businesses, but the Government's consultation document states that it would expect bodies which are outside the direct application of the cap to come forward with their own, commensurate cap on exit payments. The cap would cover a wide range of termination payments, including enhanced pension provision on termination of employment. The capital value of any pension enhancements (such as an immediate unreduced pension on termination of employment) would therefore "count" towards the £95,000 limit.

If the actuarial value of an accrued pension enhancement exceeds the £95,000 cap (which would not be inconceivable for long-serving employees with a high pensionable salary) it's not yet clear how the cap would apply. The consultation states clearly that accrued pension rights will not be affected but there is no further indication of how this would be achieved, given that the capital cost of a pension enhancement is usually determined actuarially rather than directly controlled by the employer.

There would be an exception from the new cap for payments made "following litigation for breach of contract or unfair dismissal" but it's not yet clear whether this exception would be wide enough to cover payments made after litigation has started but before any judgment is issued. Depending on how widely this exception is framed in any final legislation, affected public bodies could therefore need to seek Treasury approval for termination payments.

What might all this mean for contractors?

These measures are likely to have a significant impact on people-management strategy for public sector employers (and indeed the consultations contain details of HM Treasury's assessment of the impact on public finances). But they are also likely to have a significant impact upon those service providers contracting with the public sector.

Repayment of exit payments

Until the Regulations setting out the detailed measures are published, it's not clear how wide the repayment mechanism will be. The Small Business, Enterprise and Employment Act 2015 stipulates exit payments may be repayable if the recipient "becomes an employee **or a contractor** of a prescribed public sector authority" (emphasis added).

The reference to a "contractor" would prevent the legislation being circumvented by the

use of different contractual models for engagement. But is there a risk that it could also catch the subsequent employment of a former public servant by a company which provides services to the public sector body?

Contractors sometimes employ individuals who have recently left public sector employment in order to benefit from their experience. If they do so, it would be the employee's liability (rather than their new employer's) to repay any exit payments, but contractors could find this possibility affects the timing of recruitment.

Cap on exit payments

One of the questions posed in the consultation is how the exit cap should apply in the case of public to private (or vice versa) TUPE transfers. The Government is concerned that staff transferring back to the public sector from the private sector ("in-sourcing") could be entitled to more generous termination benefits than their public sector counter-parts. This could also be the case where employees are transferring from the public sector to contractors. The consultation doesn't give any hints about the Government's preferred approach.

If the £95,000 cap is introduced as expected, there may be an argument for the cap to apply to **any** staff who transfer out of the public sector after it is introduced. If a public sector employee would only get a maximum pay-out of £95,000 while engaged in the public sector, it could seem unfair (and perhaps be a barrier to outsourcing) if a transferee were obliged to pay them higher benefits post-transfer.

It's less clear what should happen to staff who transferred in the past and whether the cap should be rolled out to them as well. Many contractors might argue for this, as it could reduce or provide greater certainty around termination costs, but it seems likely there would need to be some kind of statutory authority for this (in order to avoid breaches of the employment contract or TUPE).

On future in-sourcing or returns to the public sector, while the public sector contracting authorities might want the £95,000 cap to apply, there is a risk that certain employees might be more likely to resist a transfer back to the public sector if it would mean them losing out on uncapped termination benefits. There is also the question of what to do about existing legal and contractual entitlements.

Conclusions

This is a complex area and we will need to see how the Government implements its proposals, particularly with regard to the exit cap. However, at this point it is worth noting that the proposed cap could have an impact on how contractors cost bids and how they approach recruitment, especially at senior level.

There is potential for layers of indemnities and new contractual provisions to be factored into new arrangements.

Please contact Hannah Beacham, Paul Carberry or Mark Greenburgh if you require further information.

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