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Taking Stock

Winter 2016

Consumer Products Bulletin

Contents

Taking Stock

Welcome to the latest edition of Taking Stock, our consumer products and retail law bulletin. This publication explores recent legal developments in the consumer sector which should be of interest for in-house legal and business teams alike.

In this edition, we have four articles covering the following:

– The possibility of a sugar tax and the legal implications of such a proposal;

– The latest case law on penalty clauses and some drafting tips to increase the likelihood of them being enforceable;

– An update on the most recent developments in pensions law; and

– The Modern Slavery Act and the steps that businesses should be taking in response.

If you would like to discuss any of the issues in this edition of Taking Stock or wish to provide any feedback, please contact me, the author(s) of the relevant article or your usual contact at CMS.

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Will a spoonful of sugar help the medicine go down or the tax go up?

The debate over sugar and in particular its impact on childhood (and general) obesity continues to rage, with increased calls for the Government to introduce a sugar tax. The Government has said it has no current plans to introduce a sugar tax, but pressure to take some action is clearly mounting.

The Supporters' view

Supporters say a tax of just 7p per regular-sized can of soft drink with added sugar could generate £1 billion per year. This crucial revenue could be ring-fenced to support preventative strategies in the NHS and in schools around childhood obesity and diet-related disease.

The recent report by the Health Select Committee on childhood obesity calls for "brave", "bold and urgent action", with one of the nine areas highlighted for improvement being a "sugary drinks tax on full sugar soft drinks, in order to help change behaviour, with all proceeds targeted to help those children at greatest risk of obesity". The report also calls for greater powers for local authorities to tackle the environment leading to obesity, such as banning junk food outlets near schools.

An Obesity Stakeholder Group of 17 health related lobby groups (including the BMA, Diabetes UK and the Children's Food campaign) has emerged with a ten point action plan to tackle obesity. This includes a proposed 20% tax, the impact of which to be monitored and elevated annually, with the revenue raised to be reinvested in public health promotion.

A legislative view

The Sugar in Food and Drinks (Targets, Labelling and Advertising) Bill 2015, currently before Parliament (introduced as a Private Member's Bill) does not seek to provide for a sugar tax. Instead it aims to set targets for sugar consumption in the UK and proposes that the existing section 16 of the Food Safety Act 1990 should be amended to require labelling of sugar content in food, reflecting a new measure of "teaspoon units". (A teaspoon would equate to 4 grams.) The sugar content, by teaspoon measures, should also be declared in any advertising or promotional material.

The Bill further aims to prohibit companies from using language that "suggests" that a food is "healthy" or "low-fat" if the sugar content exceeds a 20% barrier.

Legal complications?

Quite apart from the difficulty of distinguishing between natural and processed sugars (a glass of fruit juice may contain just as much sugar as a soft drink with added sugar) or issues with defining a teaspoon as 4 grams of sugar, a sugar tax may potentially also be subject to various legal complications.

There is concern that the Sugar Bill, or indeed any legislation introducing a sugar tax, might even be in conflict with current EU law.

There are two main concerns here. First, the teaspoon measurement in itself may cause issues. National measures are only permitted under EU law to the extent that they do not impede or restrict the free movement of goods, save insofar as may be formally notified to the European Commission for reasons of health or the protection of consumers. It is questionable whether this provision would be accepted by the Commission.

‘A tax of just 7p per regular-sized can of soft drink with added sugar could generate £1 billion per year’

Also, the proposal to prohibit any food where the sugar content is over 20% from suggesting that it is healthy or low fat has caused concerns amongst sports food and drink and dairy companies in particular. These products may quite justifiably want to advance legitimate general health claims under the EU Nutrition and Health Claims Regulation. To prevent them from being able to do so, may again amount to a restriction to free trade and be illegal under EU law.

Moreover, the recent European Court of Justice judgment on Scotland’s case for a minimum unit price for alcohol may have implications for a proposed sugar tax. The judgment considers what is the legitimate purpose of tax, whether measures to determine the pricing of goods and services are legitimate alternative means of achieving behavioural change, and whether such steps may be seen as a restriction on trade. The CJEU concluded that the Scottish legislation introducing a minimum price per unit of alcohol is contrary to EU law if other less restrictive tax options exist.

A different approach

New restrictions on the advertising of food and drink high in fat, salt and sugar were introduced for broadcast and non-broadcast advertising back in 2007. Recently the Advertising Standards Authority has been perceived as taking quite a strict line on such advertising, particularly where it considers there to be any targeting of children. On 1 October 2015 the Committee of Advertising Practice announced a public consultation on the introduction of new rules governing the advertising of food and soft drinks high in fat, salt or sugar to children. As well as proposing a 20 per cent tax on sugary drinks and sweets, the Health Select Committee also recommended the blanket ban of all advertising of junk food during family TV shows. So, for a Government famously averse to “nanny-state” solutions, this may be a different approach to the problem.

Do we need a sugar tax?

Since 2014, supermarkets have been taking voluntary steps, including helping to improve health through product reformulation and the education of young people and encouraging healthier lifestyles.

However the power to change attitudes often starts with the consumer and the most effective legislation tends to follows consensus rather than create it.

There are many who consider that the causes of obesity are far more complex than any single nutrient, food or drink. Globally it is argued that sugar and sweet products reflect a socio-economic divide – the option to select low sugar products is the prerogative of the rich or richer nations and communities.

So it seems that on both sides of the debate sugar remains a bitter sweet pill.

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Penalty clauses – who needs them?

It is commonly thought that the English are not very good at penalties, but during the last 100 years, English case law relating to penalty clauses has been regularly invoked or pleaded. The basic principle under English law is (or was) that a penalty clause in a contract cannot be enforced unless the damages or remedy imposed by the clause is considered a "genuine pre-estimate of loss" for the enforcing party. However, the case of *Cavendish v Makdessi* has significantly changed the landscape.

Many businesses in the consumer space are sold and purchased. Often the founder shareholders have all the contacts with the main customers, outlets, suppliers and key staff. A buyer of that business does not want the founder sellers setting up a "Mark 2" of the company and cannibalising the business. Therefore sellers are often required to provide a non-compete covenant. But how best to protect it?

Cavendish v Makdessi related to the sale of a PR and media business in the Middle East to a subsidiary of WPP, the global marketing communication services group. Mr Makdessi and a colleague sold 60% of the business, for which they received US$60m and based on the businesses performance over the next few years, were entitled to a maximum of US$147.5m.

Notwithstanding the business' performance, Mr Makdessi and colleague would not be entitled to a further payment if Mr Makdessi breached the non-compete covenants in the sale and purchase agreement. Furthermore, if he did commit such a breach, then the WPP subsidiary could force Mr Makdessi and colleagues to sell their remaining 40% for a much lower price.

Having breached them, Mr Makdessi claimed that these clauses were not enforceable because they represented "penalty clauses". The case ended up in the Supreme Court and the judges had some choice words about the law on penalty clauses in England describing it as "*an ancient haphazardly constructed edifice which has not weathered well….*".

The decision represents the triumph of common sense where business contracts are negotiated between parties with equal bargaining power. As one of the judges commented:

"*In a negotiated contract between properly advised parties of comparable bargaining power, a strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach*".

In fact the "real question" is disarmingly simple i.e. is the particular provision "penal"?

According to the Supreme Court, the true test for being a "penalty clause" is i.e. "*whether the clause is a secondary obligation which imposes a detriment on the contract breaker which is out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation*".

This raises issues as to what is a "legitimate" interest. There is no legitimate interest in simply punishing the contract breaker; it must be an interest in performance or an appropriate alternative, but may extend beyond an interest in receiving compensation for breach.

‘This decision represents the triumph of common sense’

So therefore in determining whether there is a risk of a penalty clause one needs to: (1) identify the innocent party’s legitimate interest in enforcing the contract; and (2) compare that to the detriment imposed on the contract breaker with a view to ensuring that it is proportionate.

So what are the drafting tips?
To ensure that all parties recognise the importance of what might otherwise have been deemed a penalty clause, the following is recommended:

- Identify precisely the commercial interests that are being protected by the clause
- Try to ensure that the clause is drafted so as to highlight its importance to the overall package
- Expressly label the clause as a “primary” obligation
- Draft the clause so that it is conditional on performance rather than operating on breach
- Acknowledge the equal bargaining power of the parties and the fact each party has been fully advised

So is it as easy as that?
In most cases, yes. There will still be extreme cases. Suppliers may still seek to impose draconian provisions in supply contracts – and try to describe those provisions as “primary” obligations. For instance, if a supplier stipulated damages of £10 million for a breach of a minor obligation even where that obligation is identified as a “primary” obligation, the courts are still likely to look at substance rather than form. If the clause is in written terms and conditions where the innocent party is a consumer, then other legislation will assist the innocent party in not being “penalised” e.g. The Unfair Contract Terms Act. But it does seem that parties will not now be able to escape properly negotiated provisions, which properly and understandably have a serious commercial or financial impact in the event of their breach, by claiming “penalty!”.

The English may have been struggling with penalties for 100 years, but they seem to have finally worked out a way of dealing with them more effectively. Try to remove the goalposts altogether – or make the area between the goalposts very narrow to minimise the cases in which the rule against penalties could conceivably apply.

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A round-up of key pensions changes

The Government's new pensions freedoms have made headlines since they were first heralded in the 2014 Budget – but there are also plenty of other changes afoot. We take a look at some of the key changes that employers with occupational pension schemes should be aware of.

Abolition of contracting-out: increased costs for employers and members

From April 2016, a new single-tier state pension will be introduced. This replaces the existing basic state pension and earnings related state second pension. Historically, many occupational pension schemes "contracted out" of the second state pension, meaning the employer and member paid lower National Insurance contributions in exchange for the scheme providing certain benefits. As a result of the abolition of state second pension, defined benefit (DB) contracting-out will also end in April 2016.

For contracted-out schemes which have members accruing benefits, this means that both members and employers will pay higher NI contributions. This could equate to employers paying more than £1,000 extra per employee, per year. Members' take-home pay will also reduce.

There is no automatic reduction to the level of benefits that a scheme provides. So, on the face of it, the cost of providing DB accrual will increase.

Legislation gives employers a unilateral power to increase members' contributions or reduce future service pension benefits to offset this cost. The power is available until 4 April 2021.

Action Points

Employers should calculate their increased NI costs and decide if they want to make any changes to benefits or contributions going forward.

Pensions implications of shared parental leave

In April 2015, the new shared parental leave regime came into force. A child's parents can now share up to 50 weeks of parental leave.

Parents can continue to participate in their employer's pension scheme while taking SPL. Depending on their circumstances and the employer's policies some parents will receive full salary, some will be paid less and some will take the time unpaid.

The employee's pension contributions should be based on salary actually paid. However, the employer must pay contributions as if the member were earning their normal salary unless the leave is unpaid.

Action Points

Employers and trustees should ensure their scheme complies with the new provisions and any updated HR policies, and that scheme administrators are aware of them.

Postponement of changes to VAT arrangements

HMRC was due to change its approach to how employers can recover VAT on costs incurred running a pension scheme on 1 January 2016. However, there was concern about whether schemes and employers would be able to meet this deadline given the uncertainty over how the new requirements might work in practice.

‘there are plenty of changes afoot’

HMRC announced towards the end of 2015 that it is extending the transitional period before the new requirements come into force until 1 January 2017.

Action points
Employers and trustees may wish to continue their existing arrangements and keep a “watching brief” for future HMRC guidance before deciding how to deal with this issue.

Pensions for civil partners/same sex spouses
The Court of Appeal recently handed down its decision in *Walker v Innospec.*

The Equality Act provides that pensions for civil partners/same sex spouses need only take account of benefits accrued after the Civil Partnership Act came into force in December 2005. As a result, Mr Walker’s partner would receive a much lower pension than would have been payable to a wife.

Mr Walker argued at the Employment Tribunal that this was illegal direct discrimination. The Tribunal agreed but the employer successfully appealed. Mr Walker, in turn, appealed to the Court of Appeal.

The Court of Appeal dismissed his appeal, on the basis that when Mr Walker was earning his pension, the discriminatory treatment was lawful.

Whether or not there is a further appeal, this may not be the end. The Marriage (Same Sex Couples) Act required the Government to review survivors’ benefits in pension schemes. Its report, in 2014, did not draw firm conclusions. It will be interesting to see if the new decision prompts further response from the Government.

Action points
For now, the decision provides legal certainty. Employers and trustees can make an informed decision whether to rely on the 2005 cut-off.

Lifetime allowance changes
The lifetime allowance for pension savings will fall to £1million in April 2016. There will be significant tax charges for anyone who goes over this limit.

Members will be able to apply for two types of protection against this fall. There is no application deadline but individuals may need to think about how they will stop accruing benefits before 6 April 2016.

Action points
Employers and trustees may wish to communicate the changes to members.

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Anti-slavery and human trafficking statement – is your business ready?

Section 54 of the Modern Slavery Act, which came into force on 29 October last year, obliges certain commercial organisations to produce an anti-slavery and human trafficking statement. Depending on the nature of the organisation, this may require significant auditing of its global supply chains and business.

The obligation will apply to organisations in all sectors, and issues which section 54 is intended to address are likely to be particularly prevalent in the consumer products and retail sector.

Transitional provisions apply which provide that businesses with a financial year-end between 29 October and 30 March 2016 will not be required to produce a statement for their current financial year. Relevant businesses with a financial year-end on or after 31 March 2016 will however need to produce a statement within six months of their current financial year-end.

Is my organisation caught?

The obligation applies to corporates, partnerships and limited liability partnerships, whether incorporated in the UK or not, that have turnover of £36 million or more and which are carrying on business or part of their business in the UK. Turnover is determined on a global scale, and for a parent company will include the turnover of its subsidiaries. Turnover is calculated on the basis of all revenue derived from the provision of goods and services after the deduction of trade discounts, VAT and other applicable taxes.

Unlike a similar law in California, the UK law does not require any level of footprint in the UK for an organisation to be caught. It is estimated that the total number of UK active organisations falling within the scope of the legislation may be as high as 12,250.

What do organisations need to do to comply?

A relevant commercial organisation will need to produce a statement of the steps it has taken during the financial year to ensure that slavery and human trafficking is not taking place in any of its supply chain or any part of its business. Alternatively, an organisation can choose to produce a statement that states that it has taken no such steps. Although the former is likely to require significant auditing of an organisation's global supply chain and business the latter is likely to carry the risk of reputational damage.

If an organisation has a website it must publish the statement on that website and include a link to the statement in a prominent place on the homepage of that website. If the organisation does not have a website it must provide a copy of the statement within 30 days of receiving a request for it.

The government has indicated that while it will not be prescriptive with regard to the content of a statement relating to the steps an organisation has taken, and that it expects the contents to vary from business to business, the core elements may include:

‘Organisations should be considering now how they are going to respond’

— an outline of the organisation’s business model, structure and supply chain relationships;

— the organisation’s policies relating to modern slavery, including the due diligence and auditing processes implemented;

— details of the training available and provided to members of the organisation;

— the principal risks related to slavery and human trafficking including how the organisation evaluates and manages those risks in their organisation and supply chain; and

— relevant performance indicators to gauge the organisation’s progress on the above from year to year.

Whilst there is no financial penalty for an organisation which fails to publish the annual statement it may be compelled to do so by the Secretary of State.

What next?
Organisations should be considering now how they are going to respond to this requirement, including putting in place appropriate practices, policies and training relating to slavery and human trafficking. As part of such preparations, reference should be made to the new government guidance which provides extra context and explanatory notes to assist relevant businesses in complying with their Section 54 obligation.

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