

Pension protection in sight for transferred employees

Changes to the Transfer of Undertakings (Protection of Employment) Regulations 1981 SI 1981/1794 have been a long time coming. For those of you who remember, a number of amendments to the original EC Acquired Rights Directive (No.77/187) were made way back in 1998, and Member States were given until 17 July 2001 to implement the changes into domestic law. Now, nearly four years on from that deadline, we are still awaiting revised TUPE rules. As we pointed out in our editorial in Brief 772, the latest position is that the Department of Trade and Industry plans to publish a consultation document this February, with revised Regulations coming into force on 1 October.

Solid legislative progress has been made, however, in the realm of pension protection on a transfer with the enactment of the Pensions Act 2004. The new provisions on pensions and transfers are designed to bring UK law into line with the revised Acquired Rights Directive, which gives Member States the option of protecting employees' occupational pension provision in the event of a transfer. Currently, new (transferee) employers are not obliged to maintain the level of future payments into pensions or make any pension provision at all.

A consultation period on accompanying draft regulations closes on 21 January 2005, and the Regulations are due to come into force in April, along with the relevant sections of the Pensions Act. The underlying theme of the changes is to protect the pension rights of transferred employees without placing excessive burdens on employers.

Under S.258 of the new Pensions Act, when a TUPE transfer occurs from a transferor employer who provides a pension scheme, the transferee employer must make arrangements to provide for the continuation of pension benefits. The changes, however, will give new employers a fair degree of leeway in that they are not obliged to replicate the pension arrangements offered by their predecessors. Accordingly, the new scheme can be a defined benefit (i.e. final salary) scheme, a defined contribution (i.e. money purchase) scheme (DC), or a stakeholder arrangement, to which the employer must make contributions.

The Act and accompanying draft regulations provide that where the new employer opts to provide a final salary scheme, that scheme must either satisfy the statutory standard set out in S.12A of the Pension Schemes Act 1993 or, alternatively, provide benefits which are of

overall equivalent value to those of the pre-transfer scheme. Therefore, where the transferor employer's scheme exceeds the S.12A standard, the transferee employer can provide – as a minimum – a scheme that fulfils that standard. Alternatively, if the transferor's scheme is below the S.12A standard, the transferee employer need only provide a scheme that provides benefits of equivalent overall value to the pre-transfer scheme.

The draft regulations also set the level of employer contributions where the transferee employer chooses to provide either a DC or a stakeholder scheme. In either case, the employer will have to match transferred employees' contributions up to 6 per cent of an employee's basic pay.

Assuming the draft regulations are not amended once the consultation period closes, it will follow that in many situations the obligation to provide a 'worthwhile' pension could amount to no more than matching employee contributions up to 6 per cent into a stakeholder pension scheme, with the result that employees lose valuable retirement benefits, such as membership of a final salary scheme, making them worse off than they were before. Additionally, even where new employers operate final salary schemes, it is very likely that we will see a growth in two-tier workforces, with newly recruited (transferred) employees denied entry into such schemes and therefore forced to accept less favourable pension terms than those made available to the existing workforce.

Increased protection for public sector employees

Finally, we should mention the position of public sector transfers. The new rules will apply to all employees who are transferred – whether from the private or public sector. Currently, public sector employees enjoy a measure of pension protection in the event of a transfer as a result of a Cabinet Office statement of practice, which requires public sector organisations to achieve 'broad comparability' in pension schemes when staff transfer to another employer as a result of competitive tendering or outsourcing of services.

If a new employer does not honour this statement of practice, employees currently have no redress. Under the new arrangements, employers will be expected to continue to honour the policy on pension protection in public sector transfers. If this does not happen, the new legislation will provide a minimum fallback level of protection. It will be interesting to see what happens in practice and we will keep subscribers informed on the new law when it comes into force.

Case Law Developments

In the absence of the new TUPE Regulations, case law has been developing at a pace, with various cases on different aspects of TUPE being decided during 2004. A significant proportion of these resulted from disputes over whether or not there had been a TUPE transfer. TUPE applies in circumstances where (1) there is a 'stable economic entity' capable of being transferred, and (2) there is evidence that the stable economic entity retained its identity after the transfer.

Economic entity - In *Fairhurst Ward Abbotts Ltd v Botes Building Ltd* the Court of Appeal held that the TUPE Regulations applied to a transfer of part of an undertaking, even though the part transferred had not been an identifiable, stable economic entity prior to the transfer. The Court stated that TUPE can apply where a part of a stable economic entity becomes identifiable as an entity in its own right for the first time 'on the occasion of the transfer separating a part from the whole'.

Retention of identity – case law is divided on this issue, the European courts favouring one approach, and the UK courts preferring another. European case law draws a distinction between asset reliant and labour intensive undertakings. If an undertaking is asset reliant, there must be a transfer of significant assets for TUPE to apply. In labour intensive undertakings, the issue is whether or not a major part of the workforce transferred. The test is whether or not something of substance is actually transferred.

Abler v Sodexho MM Catering Gesellschaft was a decision of the European Court of Justice ('ECJ'). The case concerned a contract for catering in an Austrian hospital, and whether the undertaking was asset-reliant or labour intensive. The ECJ concluded that catering is an activity based essentially on equipment. It was therefore an asset-reliant undertaking and the failure of the incoming contractor to take on the outgoing contractor's employees did not preclude the existence of a transfer.

The UK courts are concerned that transferees may attempt to avoid the application of TUPE by refusing to employ or transfer any of the transferor's workforce or assets. With this in mind, they have adopted a more 'multi-factorial' test requiring the courts to examine all of the relevant factors available. The Court of Appeal has in past cases decided that there can be a TUPE transfer even though there is no transfer of significant assets and none of the relevant employees were taken on by the new employer.

This was the case in RCO Support Services v Unison which was reported in 2002. The case was appealed, but the parties settled in June 2004, shortly before the appeal hearing. The final decision was, therefore, that of the Court of Appeal. The Court of Appeal held that a new employer's unwillingness to take on an existing workforce may be a significant factor in deciding whether TUPE applies. This is, however, only one of the factors to consider in deciding whether TUPE applies. In this case, the Court held that there was a transfer of an undertaking in a contracting out situation, even though no assets had been transferred and none of the workforce had been taken on by the incoming contractor.

In *Astle and Others v Cheshire County Council*, in a labour intensive undertaking, the transferee chose not to take on any of the transferor's employees. The employees argued that the transferee intended to thwart TUPE and for that reason did not take them on. The EAT made it clear that in these circumstances the motive for not engaging employees must be carefully questioned – if the principal reason for not taking on employees is to avoid TUPE then it will be a factor to take into account in deciding whether there was a transfer.

The time of transfer - Later this year, we can expect the decision of the ECJ in *Celtec v Astley*. The question for the ECJ is whether the Acquired Rights Directive is sufficiently wide to embrace a transfer of a business which takes place over a period of time – three years, in this case.

Identifying which employees transfer - When only part of an undertaking is transferred difficulties often arise in identifying which employees belong to the part which transfers. In *Securiplan v Bademosi* the EAT held that an employee who had been temporarily assigned for one year to a part of the business which transferred was not truly assigned to that part for the purposes of TUPE. Although it had not been a factor in this case, the EAT acknowledged the scope for the 'industrial mischief' of cherry picking employees immediately prior to a transfer so that less satisfactory employees could be moved to the part of the undertaking which is being transferred. It emphasised that there must be a genuine assignment to the undertaking transferred and not an attempt to 'unload' an unwanted employee.

Fairhurst Ward Abbots Ltd v Botes Building Ltd was mentioned above. Part of the case concerned an employee who would have been

assigned to the part which transferred had he not been absent from work due to illness at the time of the transfer. The Court was asked to decide whether the employee had in fact been transferred. It concluded that the appropriate test was whether the employee would have been employed to work in the part transferred immediately before the transfer had he not been excused from attendance. The same test would apply to the employee on holiday, on study leave or on maternity leave.

Transfer of rights and liabilities - In *Martin v South Bank University* the ECJ were asked to consider the effect of an employee's voluntary acceptance of diminished terms for early retirement. The diminished terms had been offered by the new employer in order to harmonise terms across the workforce. The ECJ held that given the purpose of the Directive to safeguard employees' employment rights, any consent given by transferred employees to the unfavourable alteration of early retirement terms was invalid.

Compromise agreements - *Solectron Scotland Ltd v Roper* concerned the enforceability of compromise agreements signed by employees who were made redundant following a transfer. Case law is clear that an employer cannot vary the terms of an employee's contract after a transfer if the variation is solely by reason of the transfer. However, the agreement in the present case was not by reason of the transfer. Its effect was solely to compromise the financial claim that the employee had on the termination of his employment contract. It followed that there was no reason of principle or policy that should prevent the compromise agreements being enforceable. This case is helpful to employers relying upon a compromise agreement to settle employment claims after termination of employment following a TUPE transfer. It is also clear from this decision that an employer's use of a compromise agreement purportedly to vary existing terms and conditions of employment in the context of continuing employment would not be effective.

The New Regulations

The DTI has indicated that the publication of the new TUPE Regulations is imminent, and that the Regulations will come into force on 1 October this year. The changes we anticipate are based on the proposals which the Government set out in its 2001 consultation document. These include:

- More clarity over whether or not the TUPE Regulations apply to situations of 'contracting out' or analogous situations.

- New provisions creating an obligation on the transferor prior to transfer to notify the transferee of all the rights and obligations in relation to employees that will be transferred.
- Greater clarity on the provisions which apply to dismissals made by reason of a transfer of an undertaking, and further explanation with regard to the application of the ETO (economic, technical or organisational) defence.
- More detail on the circumstances in which changes to terms and conditions of employment can be made after a TUPE transfer.
- Changes to the provisions which apply where the transferor is subject to insolvency proceedings.
- Provisions to ensure continuity of employee representation after a TUPE transfer.
- Minor changes to employers' information and consultation obligations.
- Provision that the transferor and transferee are jointly and severally liable for liabilities to employees for injury or disease arising from their pre-transfer employment in those cases where the transferor was a public sector employer exempt from employers' liability compulsory insurance.
- Amendments and more clarity on provisions relating to territorial extent. Unfortunately, the consultation paper is silent on the extent of the regulations to offshore work.

Pensions and TUPE

When employees transfer following the change in ownership of an undertaking, the general rule is that the existing terms and conditions of employment transfer over with them. The current law provides for one exception to this rule – occupational pension rights relating to old age, invalidity and survivors are excluded from the contractual rights that transfer under TUPE. This exclusion will no longer apply with effect from 6 April 2005, when the new Pensions Act 2004 comes into force.

Under the new Pensions Act, when a TUPE transfer occurs from a transferor employer who provides a pension scheme, the transferee

employer must make arrangements to provide for the continuation of pension benefits. New employers will have a certain degree of flexibility in that they are not obliged to replicate the pension arrangements offered by their predecessors. They will have the option of offering transferred employees either a defined benefit (final salary) scheme, a defined contribution (money purchase) scheme, or a stakeholder pension scheme. Where the transferee employer chooses to provide either a money purchase or stakeholder pension scheme they will have to match employees` contributions up to 6%.

For any further information in relation to this, or any other employment law matter, please contact a member of the Paull & Williamsons [Employment Law Unit](#)