PRIVITY OF CONTRACT, EMPLOYERS' LIABILITY INSURANCE AND THE TUPE REGULATIONS

By Gary Freer

Ever since the Transfer of Undertakings (Protection of Employment) Regulations 1981 ("TUPE") came into force, there has been uncertainty and speculation about their effect on liability for personal injury claims brought by workers against their employers and on the practical implications for the employers' insurers. There have been a few County Court judgments dealing directly with the point, notably *Taylor v Serviceteam*, which was reported at [1998] PIQR 201 - but employees, employers and insurers now have to deal with two decisions which are inconsistent with each other, which have potentially important consequences, and which contained a surprising twist for insurers.

The issue

The key statutory provision is Regulation 5 of TUPE, which provides that:

"(2) On the completion of a relevant transfer -

(a) all the transferor's rights, powers, duties and liabilities under or in connection with any such contract, shall be transferred to the transferee; and

(b) anything done before the transfer is completed by or in relation to the transferor in respect of that contract or a person employed in that undertaking or part shall be deemed to have been done by or in relation to the transfer."

Take a common factual example. A worker suffers a personal injury at work due to his employer's negligence. Shortly afterwards, the undertaking or the part of the undertaking in which he is employed is transferred to a "new" employer and Regulation 5 of TUPE takes effect. The question about which employer he sues arises. Should he sue his old employer or does his new employer now have legal responsibility for the old employer's negligent act which led to the personal injury?

Martin v Lancashire County Council

This issue arose in this High Court decision in which judgment was given on 11 February 1999 by His Honour Judge Fawcus QC sitting as a Deputy Judge of the High Court.

When interpreting Regulation 5 of TUPE, the judge took particular account of TUPE's progenitor, the 1977 Acquired Rights Directive. He had to interpret TUPE to accord where possible with the express purpose of the Directive, which is the safeguarding of workers' rights.

The claimant's leading counsel argued that the personal injury claim (which both sides and the judge appear to have assumed arose in the law of *tort*) should *not* transfer to the new employer because, if it did, he would suffer potentially significant prejudice, particularly in the context of insurance cover. The judge said that:

> "prejudice lies in the fact that in this situation the transferor's insurer becomes "off risk" as at transfer, whereas the transferee's insurer will not be on risk as to matters arising before the date of transfer."

(Nowhere in the judgment was the insurance position examined in any depth. It appears to have simply been assumed that this would be the position.)

It followed that, far from safeguarding employees' rights, to regard the personal injury liability as having transferred would defeat the purpose of the Directive and the regime of compulsory employer's liability insurance introduced by the Employers' Liability (Compulsory Insurance) Act 1969.

The judge regarded this as the decisive point. He found that the liability did not pass to the transferee under Regulation 5.

***Bernadone v Pall Mall Services Group and Others* [1999] IRLR 616**

The claim arose out of a similar set of facts. The claimant argued that her claim should be met by her "old" employer and that Regulation 5 of TUPE did not pass responsibility to the new employer. The claimant and the old employer each joined the old employer's employers' liability insurers (Independent Insurance) to the proceedings and argued that, if the old employer was liable, then those insurers should pay.

The judge, Mr Justice Blofeld, recognised that this was a test case. However, the *Martin v Lancashire County Council* decision was never cited to him or taken into account in reaching his decision.

Do personal injury liabilities transfer under TUPE?

The claimant put the case on the basis that liabilities in tort do not transfer under TUPE and that an employer's duty to take reasonable care for the safety of its employees does not arise out of a contract of employment.

The judge, however, decided otherwise. While the duty is owed under the law of tort, it is also owed as an implied term of a contract of employment.[1] The fact that the claimant had chosen to bring her claim in tort and not contract was irrelevant.

[1] Although the judge did not cite any decided authority, it is there in abundance to support the proposition that such a duty is implied into an employment contract, often in cases when employees have resigned over health and safety issues and claimed to have been constructively dismissed. See, for a recent example, *Waltons & Morse v Dorrington* [1997] IRLR 488; *British Aircraft Corporation v Austin* [1978] IRLR 332; *Keys v Shoefayre Ltd* [1978] IRLR 476; *Jagdeo v Smiths Industries* [1982] ICR 47.

When looking at the wording of Regulation 5 (see above), which was intended to be interpreted widely, it was clear that such liabilities do transfer to the new employer.

The position of the transferor's insurers

Whereas, in the *Martin v Lancashire* case, it appears to have been assumed that upon transfer the old employer's insurers would go off risk, in this case it was argued that they would remain liable even after the transfer.

The insurers argued that it could and would not be right to transfer to the transferee a contractual right enjoyed by the transferor, not under the contract of employment, but under a quite different contract entered into by the old employer with a third party (the insurer).

The judge found against the insurers, and said:

> "In the present case there was an implied term in the contract of employment that each individual employee would be protected by the appropriate insurance policy taken out under the 1969 Act by his employers. There was an implied term *in consequence* [our emphasis] that if he had an accident which was the employers' fault, he would be liable to be recompensed through *his* [our emphasis] insurance policy.
>
> The right to an indemnity of the employee is incorporated in the words of Reg. 5(2)(a), 'all the transferor's duties and liabilities under or in connection with any such contract'.
>
> The rights of the First Defendants for indemnity in respect of its insurance are transferred to the Second Defendant by virtue of TUPE."

Furthermore, in the judge's view this was the fair result:

> "The insurance company here has accepted the risk and taken the premium. I would not consider it just for an insurance company in this position to be able to walk away from its obligations."

The judge's finding was that the rights of the old employer for indemnity in respect of its insurance had been transferred to the new employer by virtue of the TUPE Regulations.

Comment

It was said in the *Martin v Lancashire County Council* case that an appeal to the Court of Appeal was likely, and the insurers in *Bernadone* have also appealed.

These two High Court decisions are inconsistent, but we suspect that until the appeals are heard the *Bernadone v Pall Mall* decision is more likely to be followed. Mr Justice Blofeld did not make the same critical assumptions made by Judge

Fawcus - that the liability arose in tort only and that the old employer's insurers would come off risk upon transfer. His decision is therefore likely to be given greater weight.

Mr Justice Blofeld was plainly right to decide that the personal injury liability passes under TUPE to the new employer. Once he grasped and accepted the fact that personal injury liabilities to employees arise in contract as well as in tort his decision was inevitable.

However, his reasoning on the transfer of insurance rights appears both wrong in itself and contrary to other decided and recent authority.

The effect of the judge's reasoning is to outflank the doctrine of privity of contract which underpins the general rule that, except when the Third Parties (Rights against Insurers) Act 1930 is triggered by the insured's insolvency, only the insured, and not any uninsured third party, has a directly enforceable contractual right against an insurer.

The judge's reasoning - which is set out in full above - appears muddled.

In particular, what did the judge mean when referring to *his* (ie the employee's) insurance policy?

Into what contract is the second of the judge's two implied terms to be implied? It surely cannot be the contract between the insured employer and its insurer, because the employee is not a party to that contract. The judge could perhaps have had in mind some different, collateral, contract between the insurer and the employee - but he did not say so. What would the other terms of such a contract be, and would it be supported by any consideration?

The confusion is compounded by his finding that it was the right of the *first defendants* - ie the employer - to an indemnity from its insurer which was transferred to the second defendant (the "new" employer), for if there was indeed a contractual right to an indemnity enforceable by the employee against the insurer directly, this would surely be entirely independent of and unaffected by any change of employer.

The employee's right to an indemnity *from whom* is incorporated in the words of Regulation 5(2)(a)? From the insurer or from the employer? The judge does not specify.

Why does it follow from the fact that the *employee's* right to an indemnity (from whom?) is incorporated in the words of Regulation 5(2)(a) that the rights of the *employer* against the insurer are transferred by virtue of TUPE?

Mr Justice Blofeld does not in this brief part of his judgment give any clear answer to these questions and it appears that he may have confused the respective

contractual rights of the employee against his employer and the quite distinct rights, under a separate contract, of the employer against its insurer.

Furthermore, the judge's approach to the privity of contract issue runs contrary to the approach taken in other decided authorities of which there is a very recent example.

Villella v MFI Furniture Centres [1999] IRLR 474

Mr Villella was employed by MFI as a forklift truck driver. He became ill and went on long-term sick leave.

During the course of his employment MFI had notified Mr Villella by letter that a new Permanent Health Insurance (PHI) Scheme was to be introduced. In an accompanying memo, said to contain "full details" of the Scheme, he was informed that he would, provided certain conditions were met, be entitled to receive benefits in the event of incapacity for work through illness. He was informed that the Scheme was underwritten by insurers, but no details of the terms of the insurance policy were set out in the memorandum or elsewhere.

The dispute between Mr Villella and MFI arose in the following way. The insurance policy between employer and insurer provided that benefits would cease to be paid to an employee upon his leaving the employer's service. The insurer told the employer that medical evidence no longer supported the continuation of benefits being paid to Mr Villella under the scheme and they would cease to make payments. Despite this, the employer continued to pay the benefits to Mr Villella for a short period from its own resources. His employment was then terminated on the grounds of ill-health.

The case concerned the correct interpretation of the employment contract between Mr Villella and MFI. It did not suit the employee in this case to sue the insurer or to argue that he was entitled to recover under the terms of the insurance policy - because if he had done so his claim would have been bound to fail. The policy wording was clear - benefits ceased to be payable when an employee left the employer's service.

The employee therefore sued his employer on the basis that the memorandum which it had sent to him with "full details" of the benefits payable did *not* provide for payment of the benefit to cease once his employment had ended. So far as he was concerned, the obligation to pay the benefits was that of the employer alone. The terms of the insurance policy between the employer and the insurer were irrelevant.

In other words, this was a case in which the employee argued for a rigid application of the conventional privity of contract doctrine to the agreements between employee, employer and insurer; and for precisely the approach which was implicitly rejected by Mr Justice Blofeld in *Bernadone*.

In fact, the employer did not disagree with this analysis of the structure of the contractual relationships between the three relevant parties. Its argument was rather that on the facts of the case the terms of the insurance policy were incorporated into and became part of the terms of the contract between itself and Mr Villella.

On the facts of the case, this argument failed. Judge Green QC (sitting as a High Court Judge) held that the arrangements between MFI and its insurers were "plainly irrelevant" and referred to previous decisions in which similar findings had been made.

So can *Villella* be reconciled with *Bernadone?* The types of insurance under consideration could be said to differ, but the essence of each was the same - financial support from an insurer which an employer had promised to the employee (impliedly in *Bernadone*, expressly in *Villella*) would be arranged.

The only possible distinction seems to lie in the fact that, in contrast to *Villella*, *Bernadone* was a case involving TUPE; but this could logically make a difference only if the reason for Blofeld J's decision was that Regulation 5(2)(a) incorporates the employee's right of some kind to an indemnity from the insurer direct and, as explained above, his judgment does not make it clear whether this is so.

Perhaps the main feature which these two cases have in common is the outcome. Two different judges reached, by different reasoning, an outcome whereby a sick employee was not left without the cushion of financial support. However, at least one of these two hard cases appears to have made bad law.

In my view, the conventional approach as applied in *Villella* is right and that part of the *Bernadone* judgment is wrong. The Court of Appeal's decision will be keenly awaited.

Could insurers validly exclude liabilities acquired under TUPE?

The effect of the judgment in *Bernadone* appears to be that the new employer is entitled to an indemnity under the terms of the old employer's employer's liability policy. Could insurers avoid liability by specifically and expressly excluding claims brought in these circumstances?

Mr Justice Blofeld did not expressly deal with the point (which suggests that no such exclusion appeared in the Independent Insurance wording) but there must be considerable doubt whether any such exclusion would be valid.

Regulation 12 of the TUPE Regulations provides that "any provision of any agreement (whether a contract of employment or not) shall be void in so far as it purports to exclude or limit the operation of Regulation 5...". Since it was under Regulation 5 that the judge found the liability under the insurance policy to have

been transferred, it seems clear that any purported exclusion would be void and therefore ineffective.

Conclusion

The outcome of the forthcoming Court of Appeal hearing in *Bernadone* will have important practical consequences. If the judge's findings on the transfer of personal injury liability from old employer to new are confirmed, but his findings on the transfer of rights to indemnity under insurance policies are overturned - in our submission the correct outcome - then the consequence which worried the judge in *Martin v Lancashire County Council* will indeed come about. It will not, however, be the first or last time that TUPE has had the (probably unintended) effect of undermining other UK legislation, in this case the 1969 Act.

If all the judges' decisions are upheld, then insurers will be faced with what may well be an unwelcome increase in uncertainty as to the nature of the risk which they may have to carry during the course of a policy year. Of course, there will be an element of swings and roundabouts involved as exposures are shed as well as inherited as incoming and outgoing TUPE transfers take place. The profile of an insured's workforce at the end of the year may be very different to that contained in the proposal or renewal form presented before inception.

Since TUPE is essentially EC legislation, drafted to implement the EC Acquired Rights Directive 1975, it is at least possible that this or a similar case may be referred to the European Court for guidance, in which case the present uncertainty may persist for some time to come.

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