

Where are we now?

David Gallagher of
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recent European
Court of Justice
decisions and how
they might affect
transactions governed
by TUPE

Two major European Court cases have ruled that TUPE has a wide application to a number of benefits payable under UK pension schemes. The cases –

Beckmann v Dynamco Whicheloe Macfarlane Ltd [2002] and *Martin v South Bank University* [2004] – specifically deal with public sector schemes which often include automatic entitlements for members to retire early without showing any ill-health.

Public sector schemes can be different to private sector schemes in their legal structure, as they are often established by the state under legislation and may be run directly by employers. But the Court's logic does not rest on these factors and appears to apply to public and private sector schemes alike.

Many early retirement benefits are now known to transfer to become obligations of the new employer when employment transfers under TUPE. As the Court has been interpreting UK legislation which is

already in force, the judgments have a retrospective element, so employees who transferred years ago can still claim if they remain with the transferred business.

What we know

TUPE is the UK implementation of the European Union Acquired Rights Directive (ARD). TUPE and the ARD provide that, when a business or similar operation is transferred from one organisation (the old employer) to another (the new employer), the employees in the business have protected employment rights. Rights and obligations of the old employer become rights and obligations of the new employer.

Each of TUPE and the ARD includes a pensions exception. In TUPE, the only rights excluded are those accruing post-transfer under occupational pension schemes, not personal or stakeholder pensions or health insurance schemes. The ARD permits states to exclude from transfer any employee's right to build up certain benefits, namely: 'old-age, invalidity or survivors' benefits' in the national laws which implement it. Since

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1993, that phrase has been echoed in TUPE. In addition, TUPE must be interpreted consistently with the ARD, and so the TUPE exception cannot be wider than is permitted by the ARD.

The Court ruled that the TUPE and the ARD exceptions for occupational pension schemes are strictly limited. In *Beckmann*, the Court decided that redundancy pensions would transfer to the new employer, and in *Martin* it decided that early retirement benefits transferred. In *Beckmann*, the Court set its test for deciding whether a benefit fell within the ARD exception:

It is only benefits paid from the time when an employee reaches the end of his normal working life as laid down by the general structure of the pension scheme in question, and not benefits such as those [payable on] dismissal for redundancy that can be classified as old-age benefits.

This test has now been applied in *Martin*.

Which benefits transfer?

Employees have a wide range of benefits potentially available under a pension scheme. The most obvious is a pension payable on a normal retirement date,

usually at 60 years of age in the public sector. Benefits payable before that retirement date appear to transfer.

But will schemes always have normal retirement ages? The government now

advocates flexible retirement and it is expected to feature in public sector schemes. How will the test apply in a scheme with a range of permitted retirement ages? Is there then a range of dates, each of which is 'the end of the [member's] normal working life as laid down by the general structure of the pension scheme in question'? If not, which date in a range is to be chosen: the beginning, the middle, the end or a date

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chosen by reference to statistical analysis of actual practice? Arguably there is no date, as a scheme with a range of retirement ages does not 'lay down by general structure' any date.

The most satisfactory option, we suggest, is for the scheme to include a statement in its governing instrument (regulations for statutory schemes, and the trust deed and rules for private schemes) declaring the date that is the end of the members' normal working lives as laid down by the scheme's general structure. Provided such a date is clear and objectively defensible, it should be treated as the appropriate date.

Without such a date in the relevant scheme, the risk must be that the court will take the statistical approach as showing the end of normal working lives for that employer. This will not be helpful for establishing whether a benefit transfers at the time when the undertaking transfers.

What entitlement transfers?

Many public sector schemes provide absolute entitlements to benefits payable to a scheme member who meets a prescribed objective test. For instance, Mrs Beckmann was aged over 50 and was made redundant, and so met the test for entitlement to a redundancy pension in the NHS Superannuation Scheme.

But many occupational scheme benefits are not absolute entitlements based on prescribed objective tests. For example:

- entitlement to early retirement benefit may require employer consent to the retirement; or
- an early retirement pension could be lower than a 60-year-old's pension 'by

such rate as the trustees determine on actuarial advice'.

In such circumstances, what is the new employer's obligation under TUPE? In *Martin*, the Court held that benefits payable on early retirement with employer consent had transferred.

The new employer does not have to pay for retirement benefits promised by the old employer if the transferred employee stops working at 'the end of his normal working life as laid down by the general structure of the pension scheme in question'. But can the new employer refuse to consent to all early retirements which trigger transferred benefits, so that everybody retires at normal retirement age?

We expect that a court would hold that:

- the new employer is under a duty to consider the transferred employee for early retirement;
- if an employee is considered fairly and then rejected for early retirement there will not be grounds for a claim; and
- for a discretionary benefit, transferred employees have a right to be considered openly for the award of the benefit. If the benefit is awarded, the new employer must fund it.

We expect this area to be tested by litigation.

Whose obligations transfer?

In *Beckmann*, the old employer was an NHS organisation and the disputed benefits were provided under the statutory NHS Superannuation Scheme. In *Martin*, all lecturers at Redwood College (a specialist medical training facility) had their employment transferred from the NHS to South Bank University. The benefits in dispute were again under the NHS Superannuation Scheme.

Will there be a different outcome where the pension is payable by separate trustees? TUPE and the ARD transfer the obligations of employers, not of third parties. While some public sector schemes have third-party trustees, this point is more likely to be the subject of case law arising out of a private sector transfer. We suspect that the ECJ (or a UK court or tribunal applying the ARD) will favour an analysis that extends *Beckmann* and *Martin* to benefits in such schemes. The basis we expect to be used is that the old employer is obliged to supply and fund the benefits payable by the third-party trustees. A similar analysis was used when the equalisation of pension benefits was considered by the ECJ in the 1990s.

Varying the benefits

Well-established case law holds that TUPE and the ARD restrict the new employer's ability to vary employer obligations transferred from the old employer. If the material reason for the variation is the transfer of employment, then public policy requires that the variation is void even if the employee consented to it and/or received valuable benefits in exchange.

A number of consensual variation arguments arose in *Martin* and the ECJ made it clear that the restrictions on variation apply to pension-related early retirement benefits. The fact that some of the employees had agreed to change their benefits as part of transferring past service rights from one pension scheme to another still fell within this 'anti-avoidance' jurisprudence.

Some room for manoeuvre may exist in the Court's clarification that the ARD:

... precludes the transferee from offering the employees of a transferred entity terms *less favourable* than those offered to them by the transferor in respect of early retirement. (Our emphasis.)

If new terms are demonstrably more favourable, perhaps the employee and new employer can agree to them. But showing that one defined benefit pension is more favourable than another will not be easy.

Procurement guidance

Public sector outsourcing is also affected by procurement guidance and legislation.

Central government contracts which provide for staff to transfer employment should comply with the Cabinet Office Statement of Practice 'Staff Transfers in the Public Sector'. Normally, the new employer must provide a pension scheme which is broadly comparable with the employee's pre-transfer scheme. 'Broad comparability' is

determined by reference to and certification by the Government Actuary's Department. Employees with a defined benefit scheme pre-transfer should be offered a defined benefit scheme post-transfer.

A very similar test must be applied where local government work is transferred to the private sector under a best value arrangement. This is now in the Local Government Act 2003, ss101-102, which replaced the 'two-tier workforce' non-legislative guidance.

A crucial difference in local government is that the Local Government Pension Scheme Regulations 1997 (as amended in December 2003) permit private sector companies to participate in the funded scheme so that benefits can be replicated. The Principal Civil Service Pension Scheme, which is unfunded, does not allow private sector participation.

Future changes

The Pensions Bill published in February 2004 will, if passed by parliament,

Beckmann v Dynamco Whicheloe Macfarlane Ltd
(ECJ Case C-164/00) [2002] IRLR 578

Martin v South Bank University
(ECJ Case C-4/01) [2004] IRLR 74

introduce limited protection for pensions in all public and private sector TUPE transfers. This is increased protection for private sector transferred employees but is at a lower threshold than currently applies in public sector transfers.

The new 'protected level' of pension benefit will not directly address the issues created by *Beckmann* and *Martin*. Early retirement benefits which transfer under TUPE, interpreted in accordance with *Beckmann*, are not normally part of the 'broad comparability' analysis. It is assumed that the new employer will comply with its duty to replicate them.

But the Pensions Bill and these cases combine to provide a pensions focus in TUPE transfers; pension schemes and the benefits under them cannot be ignored. Practical problems may arise with new small employers who can comply with the new statutory duty by using a stakeholder scheme. They will not be able to match pension-related benefits on redundancy etc, which transfer with such a scheme. This may frustrate attempts to broaden public sector procurement to involve smaller private sector employers.

There is no doubt that public sector outsourcing and public-private partnerships continue at great pace. The pension schemes of the staff involved are now perceived as one of their most valuable benefits. So, the application of *Beckmann* and *Martin* in practice will continue to exercise the minds of all parties involved in such transactions.

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DIFFERENCES BETWEEN PUBLIC AND PRIVATE SECTORS

Scheme constitution

Public sector schemes are often created under legislation, for which the UK government is responsible under EU law. Private sector schemes will normally be created under private trust deeds and rules.

Scheme management

Public sector schemes are often operated directly by the employer (usually through a central pay and benefits department). Private sector schemes will normally be under the control of trustees who are legally separate from the employer.

Early termination benefits

In public sector schemes these are normally entitlements based on years of service, age or a combination. In private sector schemes they are far more likely to be discretionary and decided upon either by the trustees or the employer.

Case law

Beckmann and *Martin* involved public sector plans.

Transfer practice

Procurement rules and guidance mean that most public sector outsourcing and PFI contracts require the new employer to provide broadly comparable ongoing benefits for transferring employees. In recent years private sector transactions have tended to allow lower value pensions to be provided by the new employer.