

## Notes

# The Ongoing Saga of TUPE and Contractual Variations

### **Power v Regent Security Services Limited** [2007] IRLR 226, EAT

*Power v Regent Security Services Limited* addresses a short point—the validity of a change agreed to the contract of employment of an employee in connection with a relevant transfer for the purposes of the transfer of undertakings legislation and which was to the advantage of that employee. The contractual amendment in question was held to be binding on the employer, notwithstanding the prohibition on transfer-related contract variations established by the case law on what is now the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE 2006) and its parent, the Acquired Rights Directive 2001/23 (the Directive). What this note seeks to argue is that the issue raised in *Power* and its resolution, while of themselves relatively straightforward, nonetheless highlight the difficulties still at the heart of the protection of employee rights under European and domestic transfers of undertakings legislation.

The transfer of undertakings legislation confers mandatory protection on the terms and conditions of employment of the employees who are the subject of a relevant transfer, such that those employees cannot validly and effectively agree diminutions to their contractual rights in circumstances where the changes in question are connected with the relevant transfer. This principle is established by the well-known line of authority comprising, inter alia, *Daddy's Dance Hall* [1998] IRLR 315, ECJ, *Wilson v St. Helen's Borough Council* [1998] IRLR 706, HL, and *Martin v South Bank University* [2004] IRLR 74, ECJ. The foundation of this principle was the statement in *Daddy's Dance Hall* that '... the [employment] relationship may be altered with regard to the transferee to the same extent as it could have been with regard to the transferor, provided that the transfer of the undertaking itself may never constitute the reason for that amendment'.

To this extent, therefore, the common law ability of employers and employees consensually to agree contract changes is nullified by the mandatory protection of the transfer of undertakings legislation. This principle is potentially damaging to the viability of transactions whose feasibility and/or perceived value may to a greater or lesser extent

be predicated on making contract amendments, not least by way of harmonisation of the terms of employment of the employees whom the transferee inherits on a TUPE transfer with those of its existing workforce. The potentially problematic operation of the *Daddy's Dance Hall* principle is demonstrated by *Credit Suisse First Boston (Europe) Limited v Lister* [1998] IRLR 700, CA. An employee who agreed new post-employment restrictive covenants pursuant to retention arrangements put in place in connection with a relevant transfer successfully argued that he was not bound by those covenants. This was the case even though on a fair view of the revised arrangements he was on the whole better off under his revised contract arrangements with the transferee than under his pre-transfer contract. For those who wish to effect post-transfer contract changes this principle can be an ongoing concern—a contract variation can be invalid even if effected a considerable time after the transfer, provided that the requisite connection with it is demonstrated. This point is demonstrated by *Taylor v Connex South Eastern Limited* EAT/1243/99, in which a dismissal for refusal to accept new terms of employment was considered to be transfer related (and therefore automatically unfair) some two years after the transfer. This raises the prospect of retrospective claims brought by employees seeking to recover benefits or other payments as part of a transfer-related renegotiation of terms.

Leaving aside its specific provisions relating to insolvency situations (which are outside the scope of this note), the reform of the domestic transfer of undertakings legislation effected by TUPE 2006 sought to clarify the operation of the mandatory protection of employment terms. TUPE 2006 established the following categorisation of permissible and impermissible contractual variations (for further commentary, see McMullen, *An Analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006* (2006) 35 ILJ 113, and Wynn-Evans, *Blackstone's Guide to the New Transfer of Undertakings Legislation* (Oxford University Press, 2006), Ch 6). Contractual variations for which the sole or principal reason is 'the transfer itself' (regulation 4(4)(a)) or 'a reason connected with the transfer that is not an "economic, technical or organisational reason entailing changes in the workforce"' (regulation 4(4)(b)) are void (as is consistent with *Daddy's Dance Hall*). Contractual variations the sole or principal reason for which is unconnected with the transfer (and which therefore do not fall within the ambit of the *Daddy's Dance Hall* principle) are valid (regulation 4(5)(b)). Under regulation 4(5)(a), variations for which the sole or principal reason is 'a reason connected with the transfer that is an economic, technical or organisational reason entailing changes in the workforce' (an 'ETO reason') are valid.

This final category of permissible variation was introduced by TUPE 2006 in an attempt to increase the ability of employers to agree valid transfer-related contract changes with transferring employees. This formulation is, however, not without its problems. The ability to agree transfer-related changes where justified by an ETO reason can cogently be argued not to be consistent with the Directive since *Daddy's Dance Hall* and its associated case law do not provide for an exception validating transfer-related changes for which there is an ETO reason. Also, the practical scope of this provision is arguably limited. To establish an ETO reason there must be a change in the workforce. This requires reductions in staff or (possibly) changes in roles (cf *Berriman v Delabole Slate* [1985] IRLR 305, CA). Transfer-related contract changes of the kind often envisaged post-transfer (in terms of benefit variations and harmonisation of terms) will therefore in many cases not be capable

of being validated by regulation 4(5)(a) of TUPE 2006 where they do not involve any workforce changes.

Against this background, *Power v Regent Securities Services Limited* addressed a specific aspect of the principle prohibiting transfer-related contract variations—whether transfer-related changes to the advantage of employees are unenforceable such that the employer can argue that those changes are void in the same way that employees can argue that detrimental changes cannot be enforced. The facts of the case were straightforward. The employee was employed to manage a particular estate under a contract of employment which provided for a retirement age of 60 years. After a relevant transfer for the purposes of what was then TUPE 1981, the employee agreed a contractual retirement age of 65 years. Whether this was a valid amendment was germane to the issue of whether the employee was able, when compelled to retire at 60, to claim unfair dismissal on the basis that he had not reached the normal retirement age for the purposes of the Employment Rights Act 1996, s 109 (which prevents unfair dismissal claims being brought in relation to dismissal after that normal retirement age).

The employment tribunal accepted the employer's argument that the variation to the employee's contractual retirement age was made by reason of the TUPE transfer and was therefore invalid. The tribunal considered the nullification of transfer-related changes pursuant to the *Daddy's Dance Hall* principle to be neutral as between employer and employee and to be limited to those changes which are detrimental to the employee. It was also heavily influenced by regulation 12 of what was TUPE 1981 which rendered unenforceable any attempt to contract out of its provisions. In reaching this conclusion, the employment tribunal was presumably influenced by the fact that the ECJ's comments in *Daddy's Dance Hall* referred ostensibly to all transfer-related variations and drew no distinction between variations which are to the advantage of employees and those which are to their detriment. The employee argued that nothing in the Directive sought to protect the interests of the employer (although this is questionable since the legislation operates to transfer powers and rights, as well as duties and obligations, from transferor to transferee). More pertinently, he argued that there was no reason why the employer should be able to resile from an agreement which it had reached and that the current case was distinguishable from decisions such as *Daddy's Dance Hall* and *Lister* in which employees sought to avoid detrimental (as opposed to favourable) variations even where they formed part of a package of changes to terms of conditions which were neutral or positive for the employee overall.

In allowing an appeal and upholding the validity of the advantageous contractual variation of a later retirement age, Elias P naturally focused on the purpose of the transfer of undertakings legislation. He referred to the recitals to the Directive and to comments in *P Bork v Foreningen af Arbejdslere* [2001] IRLR 51, ECJ confirming the objective of the legislation of safeguarding employees' rights in the event of a transfer and to Clarke LJ's observation in *Lister* (at para 16) that the relevant case law 'contain[s] many statements to the effect that the purpose of the Directive is to ensure that a transfer of a business "has no prejudicial effects" on the employees of the transferor and that it "does not subject them to less favourable treatment"'. Elias P's conclusion that favourable transfer-related variations are valid is understandable and policy driven—it would be inconsistent with the aim of protecting the workforce to refuse them benefits contractually conferred by the transferee' (at para 51).

In terms of rendering this conclusion from public policy consistent with the case law, the gloss which Elias P effectively placed on *Daddy's Dance Hall* and *Lister* (and one which is consistent with how disputes arise in practice in this sort of situation) was to describe the invalidity of transfer-related contractual variations as optional on the part of the employee. In his view, *Daddy's Dance Hall* and *Lister* 'merely' established that '[i]f the employee wishes to rely upon a term originally found in the agreement with the transferor (but which will have transferred to the transferee) rather than relying upon a term in the varied or new agreement with the transferor or transferee, he will be entitled to do so. It is not a question whether objectively viewed the original term is beneficial or not. It is simply a question whether the employee wishes to rely on it, although no doubt he will only do so where he thinks it is beneficial.' This analysis allows favourable variations to stand if the employee so chooses without offending against the *Daddy's Dance Hall* principle. What Elias P described (at para 60) as 'compensating advantages' by way of new benefits do not save detrimental variations (as is consistent with cases such as *Lister*).

What this analysis leaves unresolved, however, is whether, if transfer-related contract changes are invalidated effectively at the employee's option, the employee can pick and choose between the pre- and post-transfer terms of employment and retain any compensating advantages received while avoiding detrimental variations. As Clarke noted in *Lister* (at para 39), although they did not fall to be decided in that particular case, a number of issues arise in relation to the situation where compensating advantages have been agreed in consideration for contractual variations which an employee subsequently avoids, including whether the new contract is void in its entirety and whether principles of estoppel or change of position can be relevant where the contract has been wholly or partly performed. In *Power*, Elias P gave (albeit fleeting and obiter) credence to the argument that employers can seek recompense for the compensating advantages rendered in return for detrimental changes which an employee subsequently avoids. He indicated (at para 60) that an employee who utilises his right to argue that detrimental transfer-related contractual variations are invalid may have to 'give up any benefits obtained under the varied contract as a condition of so doing' and (at para 53) there to be an 'powerful argument' that an employee should give credit for the benefits received in consideration for the detrimental transfer-related variation which the employee seeks to avoid. The idea that employers can reclaim benefits conferred on employees as consideration for the detrimental variations which they agree but subsequently seek to avoid not only lacks as yet a clear jurisprudential basis, although it is presumably based on unjust enrichment, but also raises potentially difficult issues of enforcement. Detrimental changes may be challenged a considerable period after the relevant transfer—for example as was the case in *Lister*, when restrictive covenants agreed in relation to a relevant transfer are sought to be enforced by the employer on eventual termination of employment. Recovery of the relevant benefits may well simply not be possible or equitable at that stage in terms of an employee's resources or change of position. Where the compensating advantages are not directly monetary, recompense may not actually be quantifiable.

That the issue of recoupment of compensating advantages has surfaced as a potential corollary of the rule against transfer-related contractual variations can be seen as a symptom of the problematic current state of the law. On one view, *Power* simply introduces welcome

clarity, making clear that favourable contract changes are valid despite the lack of any specific indication to that effect in the case law or indeed the categorisation of contractual variations adopted in TUPE 2006. On another, it reinforces how unsatisfactory a situation it is that employers and employees cannot negotiate freely contract changes which may overall be to their mutual advantage without the risk of detrimental changes being invalid and of attempts to recover the benefit of the relevant compensating advantages. In *Power* these issues did not have to be resolved. It remains unclear therefore whether recoupment by an employer would be permitted and in what circumstances or whether the employee could retain the compensating advantages while avoiding the detrimental changes.

Notwithstanding this uncertainty and the apparently firm foundations of the rule against transfer-related diminutions to employees' terms, there is a restrictive interpretation of the transfer of undertakings legislation which would resolve many of the concerns raised in this note about its operation. This approach argues that the objective of the legislation is to protect employees in their relationship with the transferee to the same extent as they were protected as regards the transferor under the relevant domestic law. Only at the point of transfer (or in relation to matters solely triggered by it) is specific provision above and beyond domestic employment law protection required to ensure that employees' rights are safeguarded. A detrimental change to terms of employment for no other reason than the transfer—for example changes required as a condition of the sale of a business—should, on that basis, be unenforceable. However, once an employee has transferred to the transferee with his terms and conditions of employment intact, it can be argued that his rights have been protected and he then, as regards his new employer, retains the usual domestic law protection in relation to the agreement or imposition of new terms. Subsequent contractual variations may be related to the transfer (in the sense that they would not have happened had the transfer not occurred) but there will often be some other reason or reasons for them (such as harmonisation of terms or required economies). On this analysis, these subsequent changes should be capable of being valid. The argument is that, in agreeing contractual changes after transfer, the employee is neither waiving the right to protection of employment terms on transfer nor is he agreeing the changes by reason of the transfer alone.

Construed in this way, it is argued that the transfer of undertakings legislation would remain consistent with its objective of the protection of employees against the transferee to the same extent as applied in respect of the transferor as noted by the comment in *Ny Mølle Kro* [1989] IRLR 37, ECJ (at para 25), that '[t]he purpose of the Directive is to ensure, as far as possible, that the contract of employment or employment relationship continues unchanged with the transferee, in order to prevent the workers concerned from being placed in a less favourable position solely as a result of the transfer'. This interpretation also reflects some of the domestic judicial comment on the still vexed question of the degree of connection required between a contract variation and the relevant transfer for that variation to be invalidated. In *Wilson*, Lord Slynn referred to contractual changes being invalid if 'due to the transfer and no other reason'. In *Ralton v Havering College of Further Education* [2001] IRLR 738, EAT, the test was considered to be whether the transfer was the *sole cause* of the change. It can also arguably be reconciled with the ECJ authorities. In *Daddy's Dance Hall* and *Martin*, the employees did not transfer to the transferee on their existing terms and

conditions only for changes subsequently to be implemented. Rather, the rights conferred by the Directive were sought to be waived at the point of transfer. Those decisions do not address the situation where employees' rights are respected on transfer and consensual variations are subsequently agreed and in which it is argued that employees' rights as at transfer are preserved. That said, it must be admitted that this interpretation is difficult to reconcile with the comments of the Advocate General in *Martin* to the effect that a contract change would be valid if the reason or at least the main reason for the change was not the transfer and that the harmonisation of employees' terms would be invalid. It is also inconsistent with the reformulation of the transfer legislation in TUPE 2006 which brings within its scope changes 'connected with' the transfer rather than the narrower category of those agreed or effected solely by reason of and at the time of transfer.

*Power* is a sensible decision on its own facts. However, it does nothing to resolve the fact that in this context the operation of the transfer legislation is arguably unsatisfactory in three particular respects: the uncertainty over whether employers can recoup compensating advantages if employees treat detrimental changes as invalid, the inflexibility of the Directive so far as consensual changes are concerned and the fact that the provisions of TUPE 2006 seeking to render permissible contractual variations for which there is an ETO reason are of doubtful efficacy and practical value. When considering the way forward, one can have a degree of sympathy with the views which the DTI expressed in its deliberations over the reform of the transfer legislation which led to the introduction of TUPE 2006. While it considered that the introduction of an ability to agree transfer-related contract variations where justified by an ETO reason was valid and of value, the DTI took the view that reform of the Directive itself would be preferable (see TUPE, Draft Revised Regulations, Government Response to the Public Consultation, Department of Trade & Industry, February 2006, at paras 3.4–3.7), albeit reform based around harmonisation rather than more general renegotiation of terms. The DTI recognised what it saw as the damaging cost and human resources implications of groups of employees being on different sets of terms and conditions and therefore saw great merit in permitting agreement of variations to terms and conditions in order to achieve greater post-transfer harmonisation provided that the employees are no worse off overall (ie exactly the balancing exercise considered inappropriate in *Lister*). Accordingly, the DTI indicated that, while it considered that there would be 'a very serious risk that widening the ability of parties to agree to vary contracts for the express purpose of harmonisation would be incompatible with the Directive (as interpreted by the European Court of Justice)' (para 3.6), it would support and pursue an amendment to the Directive to enable a greater ability to effect transfer-related harmonisation. The decision in *Power* is consistent with the purpose of the Directive and holds employers to the bargains which they reach post-transfer. However, the problems that remain, both practical and analytical, indicate the desirability of a judicial or legislative reconsideration of the operation of the Directive in this area.