

## Service Provision Fragmentation and the Limits of TUPE Protection

### **Kimberley Group Housing Limited v Hambley; Angel Services (UK) Ltd v Hambley**

[2008] ICR 1030; [2008] IRLR 682 (EAT)

The Transfer of Undertakings (Protection of Employment) Regulations 2006 SI 2006/246 (TUPE 2006) made numerous changes to the domestic transfer of undertakings regime (see, for further commentary, 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: Oxford University Press, 2006)). One of the most significant of these amendments was the introduction, by Regulation 3(1)(b) of TUPE 2006, of the concept of a 'service provision change'. A service provision change engages the obligations and protections of TUPE 2006 as a form of 'relevant transfer' alternative to the pre-existing concept of a transfer of an undertaking (which is preserved by Regulation 3(1)(a) of TUPE 2006).

The service provision concept was introduced with the objective of making the application of the transfer of undertakings legislation more straightforward in relation to the transfer of labour-intensive activities, given the uncertainties presented by the relevant case law (see *Ayse Süzen* [1997] IRLR 255, ECJ and the ensuing case law). Rendering more certain and predictable the application of the transfer of undertakings legislation to the outsourcing, retendering and in-housing of service contracts was anticipated to create a 'level playing field' for contractors and was seen as helping to 'take the fear out of transfer' by smoothing the transfer process, thereby improving workplace relationships and partnership and promoting flexibility (see para 18 and Annex D para 3 of *TUPE, Draft Revised Regulations, Public Consultation Document*, DTI, March 2005, URN 05/926).

The key elements of a service provision change are, first, the existence prior to the putative transfer of an 'organised grouping of employees' whose principal purpose is the carrying out of the relevant activities for the client and, second, the cessation of the performance of the relevant functions by one person and their being performed by a replacement contractor. One-off or short-term contracts and those principally for the supply of goods are explicitly excluded from the scope of Regulation 3(1)(b) by Regulations 3(3)(b)(i) and 3(3)(a)(ii) of TUPE 2006, respectively. The application of Regulation 3(1)(b) is therefore materially more straightforward than the assessment which applies in relation to a Regulation 3(1)(a) transfer of an undertaking. The various factors prescribed by the ECJ in *Spijkers v Gebroeders Benedik Abbatoir* [1986] ECR 1119, ECJ as relevant to the consideration of whether there has been a transfer of an economic entity which retains its identity (including the type of undertaking or business concerned, whether assets and employees are transferred, whether customers are transferred and the degree of similarity of pre- and post-transfer activities) have no bearing on whether Regulation 3(1)(b) applies to a given situation.

*Hambley* is the first opportunity which the appellate courts have had to consider the operation of Regulation 3(1)(b). The claimants had been employed by an organisation,

Leena, which provided accommodation for asylum seekers pursuant to a Home Office contract. Leena provided some 140 properties in Middlesbrough and 50 in Stockton. On losing the relevant contract, the services in question were awarded to and conducted by two different organisations, Kimberley Group Housing and Angel Services. As between the two new providers, 97% of the operations in Stockton and 71% of the Middlesbrough function transferred to Kimberley and the balance to Angel Services.

Neither potential transferee organisation accepted that TUPE 2006 applied to their assumption of the relevant part of the functions previously conducted by Leena. The issues of particular interest which therefore arose were whether there was a service provision change in circumstances where the relevant functions are divided between new contractors and, if so, to which of the successor organisations the employees (or the liabilities associated with their transfer related dismissals) transferred.

The employment tribunal concluded that there was no transfer of undertaking for the purposes of Regulation 3(1)(a) of TUPE 2006 by virtue of the lack of asset transfer as between the outgoing and incoming service providers. However, the employment tribunal did hold that these circumstances did constitute service provision changes to the two new contractors. The activities in question were found to be 'the provision of suitable accommodation and related support to asylum seekers in Middlesbrough and separately in Stockton'. Comments in the EAT's judgment indicate that there might have been scope for greater argument over the identification of the relevant activities and indeed that the result might have been different had, for example, the relevant activities been described as 'maintenance functions'. However, this aspect of the employment tribunal's judgment was not challenged before the EAT, though the issue is likely to be productive of litigation in the future.

On appeal, the EAT, unsurprisingly, rejected the argument that Regulation 3(1)(b) can only apply where there is one transferee. By reference to the case law relating to transfer of undertakings (see, although not cited explicitly in *Hambley, Fairhurst Ward Abbotts Limited v Botes Building Limited and others* [2004] IRLR 304, CA) and s 6 Interpretation Act 1978 (which provides that in any Act, unless the contrary intention appears, words in the singular include the plural), the EAT held that there could be a service provision change where functions are divided to more than one transferee. It should be uncontroversial that a service provision change can arise on division of a service contract. To find otherwise would be inconsistent both with the prior case law in relation to transfers of undertakings and the Government's indication in its own guidance that Regulation 3(1)(b) applies where an original service contract is divided into two or more components. In *Employment Rights on the Transfer of an Undertaking, A Guide to the 2006 TUPE Regulations for employees, employers and representatives* (BERR, March 2007), it is explicitly stated (on p 7) that a service provision change would 'potentially cover situations ... where the original contract is split up into two or more components, each of which is assigned to a different contractor'.

The EAT reviewed a number of possible approaches which had been considered by the employment tribunal as to the proper resolution of the issue of how employment liabilities should be allocated when a service provision change divides activities between more than one transferee. One approach identified by the employment tribunal was to allocate the affected employees arbitrarily as between the two potential transferees. The employment

tribunal (understandably) considered this approach to be absurd, a view with which the EAT tended to agree, although the argument was not pursued on appeal. Another possible analysis was that the party which took over the greater part of the transferor's activities could be held to be responsible for all the employees in question. The employment tribunal considered this to be an unfair approach which would be stifling of competition and enterprise as well as only being operable retrospectively. The analysis which the employment tribunal did actually adopt was to the effect that, while the employees and their contracts of employment could not be 'split', the associated liabilities with regard to their dismissals could be divided on a percentage basis by reference to the proportion of the relevant functions which each new contractor took over.

In allowing an appeal against this finding, the EAT noted uncontroversially that, in determining the application of Regulation 3(1)(b), the relevant activity or activities must first be identified and then it must be considered whether the activities in question ceased to be conducted by a contractor on a client's behalf and were carried out instead by another person on the client's behalf. More importantly, the EAT gave short shrift to what it described as the employment tribunal's 'creative option', intended to achieve an equitable distribution of liabilities, of allocating dismissal-related liabilities on a percentage basis as between the new operators of the relevant functions. The EAT viewed this 'proportionate' approach as 'truly novel', unwarranted in statute and common law terms and without precedent. In its view there could be no justification for treating the application of Regulation 3(1)(b) to liabilities for transfer-related dismissals differently from its application to employees who were retained by the transferee or transferees. The employment tribunal's analysis was viewed as entirely inconsistent with the established principle (see *SO Bernicia* [1989] 1 AC 643) that an employee cannot be the servant of two masters at the same time, especially where those employers are in competition. Just as employees cannot be split between transferee employers, dismissal-related liabilities cannot be so divided.

The EAT concluded that, once a service provision change has been established to have taken place, the proper approach is to apply the well-established test of assignment in order to establish to which of the contractors who had assumed the relevant activities employees should transfer. The guidance provided by the ECJ in *Botzen v Rotterdamsche Droogdok Maatschappij B.V.* [1985] ECR 519, ECJ (as applied in *Duncan Web Offset (Maidstone) Ltd v Cooper* [1995] IRLR 633, EAT and subsequent cases) might be difficult to apply in particular cases but provided the basis for establishing which transferee would inherit the relevant employees and/or liabilities. The EAT considered the overall principle to be clear—what is to be focused upon is essentially the link between the employee and the work or activities which are to be performed. Had this approach been adopted, the relevant employees would have been found to have transferred to Kimberley Group Housing on the basis of the relevant percentages. The EAT accordingly substituted a finding to this effect.

In reaching these conclusions, the EAT considered that for the employment tribunal to have criticised the assignment approach on grounds of unfairness, in terms of its effect on competition and enterprise, was erroneously to focus on the effect of the legislation on employers, as opposed to on employees, and to fail to recognise the protective nature of the legislation. Also, to argue that the test could only be applied with hindsight was

also seen as untenable given, as was the case in these proceedings, the fact that specific functional responsibilities are often allocated as between particular successful contractors at the point of contracting.

To the extent, therefore, that *Hambley* focuses attention on the central issue of assignment as the basis upon which employees fall within scope for the purposes of TUPE 2006, the decision reflects an orthodox interpretation of Regulation 3(1)(b). It nonetheless signals the limits of the protection which TUPE 2006 can provide where service functions are divided on contract awards. Even though in *Hambley* the majority of the relevant functions passed to one transferee enabling it to be determined to whom the employees should have transferred, uncertainty will remain as to how the tribunals will approach more fragmented divisions of services. The more diffuse the division of functions on an outsourcing or retendering, the greater will presumably be the risk of employees falling outside the protective scope of the service provision change regime by virtue of their being unable to demonstrate that the assignment test is satisfied in order to transfer their employment (or associated dismissal liabilities) to a particular transferee.

The limitations of the scope of Regulation 3(1)(b) which the *Hambley* decision demonstrates go further, however, than highlighting the difficulties which can arise in relation to the application of the assignment test. It appears that the division of services on an outsourcing or retendering may even cause the transfer of services to new contractors to fall outside the scope of Regulation 3(1)(b) altogether. The EAT opined that there may be circumstances in which a service is 'in the event so fragmented that nothing which one can properly determine as a service provision change has taken place' (para 35). In that regard, the EAT also indicated that any difficulties in determining who should take responsibility for employees would appear to be potentially relevant to the issue of whether there is a service provision change at all.

The possibility that service fragmentation may lead to there being no service provision change is further supported by the decision in *Thomas-James v Cornwall County Council* ET1701021-22, 1701230-31, 1701051 and 1701059/07. In this case, 17 contractors provided free legal advice to telephone callers under contracts awarded by the Legal Services Commission. On a retendering exercise, the number of contractors was reduced to nine. The issue before the employment tribunal was whether any of the employees who were engaged by a contractor whose services were dispensed with transferred to one of the remaining contractors pursuant to Regulation 3(1)(b). Although an organised grouping of employees was held to have existed for the purposes of Regulation 3(1)(b) pre-transfer, the employment tribunal considered that there was no service provision change because it was not possible to identify to which service providers specific functions conducted by predecessor contractors had transferred.

It has to be said that this first instance decision reflects a materially different situation to that in *Hambley* where it was clear that the major proportion of work had transferred to Kimberley Group Housing, thereby enabling the proper transferee to be identified and the assignment test to be operated. By contrast, in *Thomas-James*, there was, as the employment tribunal put it, no nexus between any of the transferors and any particular transferee. Factors indicating this lack of connection to a particular transferee included the facts that telephone calls were allocated randomly between contractors, the percentage of the service provided

pre- and post-transfer could not be compared directly due to the change in number of contractors and the allocation of hours was not uniform among the outgoing and incoming contractors. As the employment tribunal put it, had the activities been defined by location or alphabetically or in some other way and been allocated to the new contractors according to that definition, then the answer might have been different.

The analysis which requires, for there to be a service provision change, a clear link between the activities conducted by the outgoing contractors and by the incoming contractors does not by itself introduce into Regulation 3(1)(b) a requirement of retention of identity post-transfer (as applies in relation to Regulation 3(1)(a)). After all (as indicated at para 27 of *TUPE, Draft Revised Regulations, Government Response to the Public Consultation*, DTI February 2006), the view of the Government in introducing Regulation 3(1)(b) was that '[t]here is no implied requirement for activities to be carried out by the transferee in an identical manner'. However, to the extent that the relevant functions are fragmented between suppliers (as distinct from changes made to the method of delivery of the services themselves), changes in the nature of the provision of a service (and therefore in a sense its identity) can, it would appear, take an outsourcing or retendering outside the scope of Regulation 3(1)(b).

For all the simplicity of the formulation of Regulation 3(1)(b) and the expansion of the scope of the transfer of undertakings legislation which it effects, *Hambley* and *Thomas-Jones* demonstrate that the application of the concept of the service provision change in cases where services are retendered to multiple transferees can be far from straightforward. Quite apart from the fact that the identification and description of the transferring services may be crucial to the outcome of litigation, for employees to establish that they are assigned to the particular activities now undertaken by a specific new contractor among a number of new service providers may be problematic. Fragmentation of services may even evade the scope of Regulation 3(1)(b) altogether if an employment tribunal accepts that no nexus between the transferor and a particular transferee can be demonstrated such that no service provision change can be said to have occurred.

Concern has inevitably been expressed that these decisions will present opportunities for the avoidance of the transfer legislation which undermine not only the protection which the legislation provides for those affected by outsourcings and retenderings but also the certainty with which contracting parties can approach such transactions. The possibility of evading Regulation 3(1)(b) may encourage those awarding contracts to split services on their outsourcing or retendering in order to seek to prevent employees from being able either to identify a transferee in respect of the activities to which they were dedicated or to establish that they were assigned to the functions taken on by a particular transferee. This concern is presumably heightened by the fact that the motive of the parties to the relevant arrangements would appear not to be relevant to the application of Regulation 3(1)(b). This is in contrast to the position under Regulation 3(1)(a) in relation to the issue of whether a transfer of labour-intensive activities can constitute a transfer of an undertaking. In that context, an intention to evade the legislation may be relevant (see *Astle v Cheshire County Council (1) Omnisure Property Management (2)* [2005] IRLR 12, EAT and the preceding jurisprudence).

Such concerns can be argued, however, possibly to be overstated. It would not be unreasonable to assume that the circumstances in which it would be practicable or commercially viable to structure an outsourcing or retendering in such a way as to evade Regulation 3(1)(b) along the lines discussed will be relatively rare, not least given the flexibility and fact sensitivity of the assignment test (which after all applied to transfer employment liabilities in *Hambley* where only 71% of the activities were assumed by the transferee in respect of one of the locations in question). Also, it can be argued to be inevitable that there will be circumstances where the legitimate division of services atomises the service functions in question such that it is not practicable or fair or commercially appropriate to allocate affected employees or associated liabilities to particular transferees. There is, as the EAT observed, no jurisprudential basis for allocating liabilities between contractors on a percentage (or other) basis where transfer of employment or liabilities to a specific transferee cannot be established. Indeed for an approach to be adopted which disconnected the liabilities inherited by contractors from the employees assigned to the activities which they assume would fairly attract the criticisms levelled at the assignment test by the employment tribunal in *Hambley* in terms of the potential damage to competitive tendering processes. It is where service activities are most fragmented on transfer that the unavoidable outer limits of TUPE protection are to be located.

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