SECOND DIVISION, INNER HOUSE, COURT OF SESSION

[2023] CSIH 32
XA61/22

Lord Justice Clerk
Lord Malcolm
Lady Wise

OPINION OF THE COURT

delivered by LADY WISE

in the Appeal by

by

PONTICELLI LIMITED

Appellant

against a decision of the Employment Appeal Tribunal

ANTHONY GALLAGHER

Respondent

Appellant: Napier KC; Brodies LLP
Respondent: Stobart advocate; Thompsons

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15 August 2023

[1] Mr Gallagher's contract of employment transferred to Ponticelli Limited by operation of the Transfer of Undertakings (Protection of Employment) Regulations 2006. Prior to the transfer he had participated in a Share Incentive Plan operated by his former employers. The question for determination in this appeal is whether his entitlements under that SIP were rights under or in connection with his contract of employment such that they, or broadly equivalent rights, transferred to his new employment. Are the TUPE regulations

apt to cover a situation where the relevant entitlement did not form part of the contract of employment but was detailed in a separate tripartite agreement to which the respondent was not a party? For convenience we will refer to the appellant as the employer and the respondent as the claimant.

The background circumstances

[2] The claimant was formally employed by Total Exploration and Production UK Limited. In 2018 he applied to join a SIP operated by that company. This was done by entering into a separate contract, a Partnership Share Agreement with his employers and the trustees of the SIP. Participation in the plan was voluntary and there was no reference to it in the claimant's contract of employment. When Ponticelli Limited acquired the company in which the claimant was employed his membership of the SIP ended and the shares then held on his behalf within the plan were transferred to him.

[3] On 10 June 2020 the new employer wrote to the claimant to advise him that he would receive a further one-off payment of £1,855 as compensation for the fact that the employer was not going to continue to provide a SIP. In an immediate response by email, the claimant asked the employer to refrain from making any such compensation payment to him while discussions were going on regarding the effect of the TUPE transfer on entitlement to a SIP.

[4] The claimant applied to the Employment Tribunal seeking a determination that he was entitled to be a member of a SIP equivalent to the Total plan. He argued that his right to participate in such a scheme had transferred to the new employer under Regulation 4(2)(a) of TUPE on 1 May 2020, the relevant date of transfer of his employment.

[5] The facts of the case were not in dispute before the ET or the Employment Appeal Tribunal. At first instance, the ET accepted the claimant's argument that he became entitled

to participate in a SIP of substantial equivalence or comparable value to the SIP operated by his former employers.

[6] On appeal by the employer, the EAT refused the appeal and upheld the first instance decision save for an amendment to reflect that the transferred obligation arose from the collateral partnership share agreement rather than from the contract of employment itself. At both first instance and before the EAT, the employer contended that the fact that the claimant's entitlement arose from a contract quite separate from the contract of employment meant that the rights and obligations thereunder did not arise either "under" the contract of employment or "in connection with" that contract. Accordingly it was argued that the TUPE regulation did not apply. Reliance was placed on the Court of Appeal decision in *Chapman* v *CPS Computer Group* [1987] IRLR 462 which was said to support such an argument.

The relevant legislation

[7] Regulation 4 of the Transfer of Undertakings (Protection of Employment) Regulations 2006 provides:

> "**Effect of relevant transfer on contracts of employment**
>
> 4.—(1) Except where objection is made under paragraph (7), a relevant transfer shall not operate so as to terminate the contract of employment of any person employed by the transferor and assigned to the organised grouping of resources or employees that is subject to the relevant transfer, which would otherwise be terminated by the transfer, but any such contract shall have the effect after the transfer as if originally made between the person so employed and the transferee.
>
> (2) Without prejudice to paragraph (1), but subject to paragraph (6), and regulations 8 and 15(9), 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 by virtue of this regulation to the transferee; and
>
> (b) any act or omission before the transfer is completed, of or in relation to the transferor in respect of that contract or a person assigned to

> that organised grouping of resources or employees, shall be deemed to have been an act or omission of or in relation to the transferee."

[8] The predecessor to the 2006 Regulations was the Transfer of Undertakings (Protection of Employment) Regulations 1981, Regulation 5(2)(a) of the 1981 Regulations was in the same terms as the current regulation 4(2)(a) of the 2006 Regulations. The 1981 Regulations had been introduced following the Council Directive 77/187/EEC of 14 February 1977, known as the Acquired Rights Directive. That Directive has now been replaced by Council Directive 2001/23/EC of 12 March 2001, which, insofar as relevant to this case is in identical terms. In particular Article 3 of the directive, which is concerned with the safeguarding of employees' rights provides:

> "1. The transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer within the meaning of Article 1(1) shall, by reason of such transfer, be transferred to the transferee.
>
> Member States may provide that, after the date of transfer, within the meaning of Article 1(1) and in addition to the transferee, the transferor shall continue to be liable in respect of obligations which arose from a contract of employment or an employment relationship."

The employer's arguments on appeal

[9] Senior counsel for the employer emphasised that the particular scheme set up by the claimant's previous employer was open not just to employees but to others who were not employees but had been employed for at least 3 months in the same group of companies as the claimant's former employer and were also resident for tax purposes. In essence the argument was that the claimant's rights in this case arose from his choice to enter into the scheme which was a separate, discrete contract and not part of his employment. As properly construed, Regulation 4(2)(a) did not apply to such rights. The SIP scheme was a contractual one but not by reference to the contract of employment.

[10] The first main contention was that the EAT had erred in failing to apply the decision in *Chapman* v *CPS Computer Group* [1987] IRLR 462. Mr Napier submitted that the decision of the Court of Appeal in that case was in point in answering the question of construction of Regulation 4(2)(a), albeit dealing with that provision's predecessor in the 1981 Regulations. That case had involved a relevant transfer under TUPE where the claimant employees had been holding options to purchase shares in the transferor company under its stock option scheme. After the transfer and the cessation of their employment with the transferor group company the employees sought to exercise their options in terms of a provision of the contract that permitted them to do so within six months of the termination of their employment by reason of, amongst other things, redundancy. The transferor employer argued that they were not entitled to do so because the TUPE transfer ended their employment but not in a way that constituted redundancy in terms of the stock option scheme. The Court of Appeal rejected the argument that the TUPE transfer meant that employment with the transferor had not terminated by reason of redundancy for the purposes of the option scheme.

[11] The court in *Chapman* expressed the view that the TUPE regulations had no relevance to the question of whether the employees' employment with the transferor did or did not cease by reason of redundancy under the schemes rules. However, Mr Napier contended that the ratio of the decision in that case was that where there was a lack of connection between what was transferred under TUPE and the content of a share option scheme contained in a contract separate from the contract of employment, the rights under the share option contract did not transfer. It was submitted that the EAT had been wrong to reject *Chapman* as a relevant authority on the point simply because there was no reference in the decision to the wording of Regulation 4(2)(a) or its predecessor. The comments in the EAT

decision in the present case that *Chapman* had been the subject of academic criticism was also an error as while there had been differing views as to whether the decision was correct it had never been the subject of judicial criticism or doubt. It was also contended that the EAT's reliance on differences between the share option scheme in *Chapman* and the SIP in this case was misconceived. What was important was that the employees' right to participate in both *Chapman* and the present case did not form part of the relevant contracts of employment. In essence, *Chapman* stood as sound authority for the proposition that benefits available to employees under contractual arrangements that were wholly distinct from and collateral to the contract of employment do not transfer under Regulation 4(2)(a) of the 2006 Regulations.

[12] The second ground of appeal related to the EAT's acceptance of the decision in *Mitie Managed Services Limited* v *French and others* [2002] ICR 1395. In the *Mitie* case there had been a contractual right that transferred because the profit sharing scheme offered by the transferor employer, Sainsbury's, formed part of the employees' contractual rights under TUPE. The decision of the EAT was that the transferee employer required to provide a scheme of substantial equivalence to that operated by the previous employer. The ET had been wrong to regard *Mitie* as in point. However, in the course of his submissions counsel accepted that he was not contending that the decision in *Mitie* was wrong, simply that it was not in point in the present case. If his principal argument that the decision in *Chapman* was correct and in point failed, he would concede that there would be no difficulty in following the position in *Mitie* that a scheme of substantial equivalence should be provided.

[13] The final ground was that Regulation 4(2)(a) could not be interpreted in a way that extended the scope of what is transferred beyond what was envisaged by Article 3.1 of the Directive. The rights and obligations must exist at the point of transfer "in consequence of"

the contract of employment or employee relationship, whether or not those rights and obligations can be expressed as terms of the contract of employment itself. Accordingly, it was clear from the Directive that it operated only to transfer rights in the employment relationship. The point was said to be important because there could be situations where an employer would enter into agreements with an employee quite separate from their contract of employment and the employer was entitled to know that such separate contracts would not transfer. For example, an employer might make available to its employees an optional non-contractual benefit, such as subsidised gym membership. If this was created by a separate contract between the employer the employee and the gym, the rights under such a collateral agreement would not transfer under TUPE because it was not "connected with" the contract of employment.

[14] It was noted that there was some provision in the Regulations to protect employees. Regulation 13(6) imposes a duty on an employer to consult with the relevant trade union on any relevant measures which would include the plan to discontinue the SIP. It was accepted that this was not as strong as bestowing a right, although if consultation is not carried out timeously it can lead to an award being made to the employee. There was authority to the effect that, in deciding what is transferred, the court can take the burden on the transferee into account (*ISS Facility Services NV* v *Govaerts and another* [2020] IRLR 639). That was a decision of the CJEU (Fourth Chamber) involving the transfer of employees to various different new employers. The court confirmed that the relevant Directive did not aim solely to safeguard the interests of employees in the event of transfer of an undertaking but sought to ensure a fair balance was struck between the interests of the employees on the one hand and the transferee on the other.

The submissions for the claimant

[15] Counsel for the claimant submitted that there had been no error of law made by the EAT. The obligations created by the Partnership Share Agreement were clearly obligations in connection with the claimant's contract of employment within the meaning of Regulation 4(2)(a). On the first ground Ms Stobart submitted that the case of *Chapman*, more properly understood, was concerned with the interpretation of the particular share option contract involved and what was meant by "redundancy" in the Employment Protection Consolidation Act 1978. What *Chapman* did not consider was the construction of Regulation 4(2)(a) or its predecessor and whether any obligation transferred. Accordingly the case of *Chapman* did not help and had in any event been regarded as deficient by academic writers. In any event there were other differences between the case of *Chapman* and the present one. In that case the employees were being given shares as opposed to a chance to buy shares. The central question in the case was the interpretation of a rule of the scheme and the meaning of redundancy. It had been agreed by parties that the case was not concerned with the provisions of the TUPE regulations. Accordingly the court in *Chapman* simply did not consider whether a right under a stock option scheme could arise in connection with the employee relationship.

[16] Authorities subsequent to the *Chapman* case have interpreted the "in connection with the contract of employment" part of Regulation 4(2)(a) widely. For example in *Martin* v *Lancashire County Council* [2001] ICR 197, the Court of Appeal rejected the contention that only contractual rights and liabilities transfer under the regulation. In that case, under the predecessor Regulation 5(2)(a), liability for negligence was found to be sufficiently connected to the employment contract as to be "in connection with" it so as to transfer a duty of care arising out of the relationship of employer and employee. Reference was made

also to *Alamo Group (Europe) Limited* v *Tucker* [2003] ICR 829 where the language of the regulation was said to be "very wide".

[17] In the present case the payment of shares arose directly from the claimant's status as an employee. There was no other reason an employee could have deductions made from his salary in return for shares than for it to arise from his employment relationship with his employer. It was part of his financial remuneration package and so clearly resulting from it. Deductions were made from his salary to reflect this aspect of the employment relationship and the separate contract enabled that to be done in a tax efficient way.

[18] On the second ground counsel argued that the case of *Mitie* was in point as it was also looking at a share scheme and whether the relevant rights transferred under the TUPE regulations. The issue in that case was whether, given that the scheme operated by the previous employers could not transfer in the same form, there was an obligation to produce a scheme of substantial equivalence and it was said that there was. The case of *Mitie* was consistent with the argument that so long as the scheme arose under or in connection with the contract of employment there was a duty to provide such a scheme.

[19] On the third ground, which had not been before the EAT judge, Ms Stobart submitted that the use of the wording in the Directive did not assist the employer in this case. Article 3 thereof refers not only to rights and obligations arising from the contract of employment but also to those arising from the employment relationship. This permissive wording clearly sought to extend the rights of employees. In *Martin* v *Lancashire County Council* [2001] ICR 197 the court had noted that the "obligations to be transferred are more rather than less comprehensive" (paragraph 34) when giving the predecessor to Regulation 4(2)(a) a wide construction. The employment contract and employment relationship were noted by the court to be plainly different. Ms Stobart submitted also that

the terms of the directive are if anything broader than the terms of the regulations and so there was no question of the proposed construction of the regulations going beyond the directive.

Analysis and decision

[20] The employer's primary argument rests on the submission that the case of *Chapman and Elkin* v *CPS Computer Group* is in point and should have been followed by the ET and EAT. However, the sole question for the court in that case was identified as *"... whether within the phraseology of rule 6.1(ii) the option holder has ceased to be an employee by reason of redundancy..."* (Glidewell LJ at para 25). It was a specific rule in the share option contract that required interpretation, not a provision of the TUPE Regulations. Accordingly, no consideration was given to whether the rights under the stock option contract were rights connected with the contract of employment within the meaning of what was then Regulation 5(2)(a). For this reason alone, we consider that the case of *Chapman* is of no assistance to the issue that arises in the present case. Neither is the fact that the decision has been the subject of some adverse academic commentary of relevance. It seems to us that the case of *Chapman* was decided simply by reference to the four corners of the separate contract creating the stock option because that is the way in which the argument was presented to the court. It was not necessary to consider the nature of the rights under the TUPE Regulations because the argument was restricted to the reason for the employees having ceased to be employed by the transferor company in the context of an alleged breach of contract by that company. The present case is concerned with an alleged failure of the transferee company, in breach of the TUPE Regulations, to transfer rights (or bestow equivalent rights) that formed part of the employee's contract or were connected with it.

[21] As the focus of the present case is the scope of Regulation 4(2)(a) of the 2006 Regulations, it is instructive to consider how that provision, or its predecessor, has been interpreted. In *Martin* v *Lancashire County Council* [2001] ICR 197 (heard together with *Bernadone* v *Pall Mall Services Group)*, the Court of Appeal considered whether the liability of a transferor employer to an employee in respect of two personal injury claims, accrued before the transfer, transferred under TUPE to the transferee. The court noted the width of the language used in Regulation 5(2)(a) and the absence of any suggestion in the language used that the rights and liabilities must be contractual. It determined that a liability in tort, while not arising "under" the contract of employment, clearly arose "from or in connection with the contract" for the purposes of the TUPE Regulation (Peter Gibson LJ, at paras 35-37). Unsurprisingly, the case of *Chapman* was not cited to the court.

[22] *Martin* and *Bernadone* have been relied on in subsequent decisions involving the construction of the provision under discussion in this case. In *Alamo Group (Europe) Ltd* v *Tucker* [2003] ICR 829, the "clearly very wide" language of Regulation 5(2)(a) was again emphasised. An attempt to rely on *Chapman* failed in that case as raising a different point from interpretation of the Regulations (para 15).

[23] The Partnership Share Agreement entered into by the claimant, the employer and the trustee company in the present case clarifies that contributions to the SIP were made through salary deduction, with contributions of up to 10% of basic salary each month in return for the allocation of shares being permitted. The attractiveness of the scheme included that, for each Partnership Share purchased by salary deduction, the employer contributed funds for the purchase of two further "Matching Shares". Other optional benefits included the opportunity to participate in the "Free Shares" part of the plan which linked the award of possible further shares to the employer's bonus scheme. All of this

illustrates that the ET was correct to find that the rights and obligations under the scheme formed an integral part of the claimant's overall financial package. Mr Napier was constrained to accept in the course of argument that the claimant would be disadvantaged financially if he was unable to participate in an equivalent scheme with the transferee employer. The example he offered of an analogy with gym membership is inapposite unless that membership was part of a range of benefits available to an employee as part of a financial package. If it was so part, it is difficult to understand why it would not fall within the definition of being a right (with corresponding obligation) " in connection with" the contract of employment or the employment relationship.

[24] We conclude that the EAT was correct to view *Chapman* as presenting no obstacle to the conclusion of the ET in this case that the obligations of the transferor in this case under the Partnership Share Agreement fell within the scope of Regulation 4(2)(a).

[25] So far as the second ground and the case of *Mitie* is concerned, the EAT there accepted an argument that where the specific scheme operated by the transferor employer cannot transfer directly because the transferor had no ability to control it, a substantially equivalent scheme must be implemented by the transferee employer. That case involved a profit sharing scheme that was the subject of a clause in the contract of employment. However, a purposive interpretation of the Regulations was again approved, such that the inability to transfer the rights and obligations in the same form as they were held prior to transfer did not present a barrier to achieving the objective of ensuring the protection of the employees' full range of remunerative benefits. As it was not suggested to us that *Mitie* was wrongly decided and in light of the view we have reached about the case of *Chapman* not being in point on the issue of interpretation, nothing more need be said about the second ground of appeal.

[26] Turning to the argument that the Regulations should not be construed more widely than the Directive, we consider that, for the reasons given, the words used in the Regulations are clearly wide enough to cover various obligations not contained within or "under" the contract of employment. Whether obligations outside the formal contract are regarded as arising "in connection with" that contract or "from the employment relationship", the outcome would be the same in the present case. No question of extending the scope of the Regulation arises. Nothing in the language used in either instrument would require the rights to be the product of the contract.

[27] In *ISS Facility Services NV* v *Govaerts and another* [2020] IRLR 639 the CJEU noted at para 25 that the 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".* The restrictive interpretation of the Regulation proposed by the employer in this case would enable employers to subvert the important protections the Directive and the Regulations are designed to bestow, simply by creating separate contracts to confer various benefits additional to basic salary. In any event, the reference to achieving a "fair balance" in *ISS Facility Services* arose in the context of distributing transferred obligations in an appropriate manner between two transferees. There was no suggestion that the employee's rights under the Directive should be diluted in favour of a transferee's interests (para 34).

[28] For all these reasons, we consider that neither the ET nor the EAT fell into error in relation to interpretation of Regulation 4(2)(a) in this case. The appeal is refused.