Winners and Losers in the Permanent Health Insurance Game

By Linda Goldman and David Brook

Financial protection

1. Permanent health insurance (PHI), also and probably more accurately known or described as Income Protection Insurance (IPI), can solve the problem of income protection when an employee is ill for a period beyond that where income is directly maintained by the employer. The employee has time to recover and the employer is relieved of the expense of paying the non-productive employee. But it is not always a Win-Win situation, particularly where there comes a parting of the ways between employer and employee.

2. Where an individual is employed in a particular job and becomes incapacitated through illness or injury, the employer might contractually provide for sick pay at or about the salary rate, or it might exercise discretion to pay whilst the employee is off work.

3. Either the employee will recover or inevitably termination of employment will be in the air. It might be that the employee can return to the original role, perhaps with reasonable adjustments (see Equality Act 2010) or he might be suitable for other, perhaps less congenial or less skilled, employment if he becomes permanently disabled. In general, the aim of PHI

is that, where periods of extended absence through ill health or disability arise, the employee's income is substantially protected.

4. The terms under which PHI is paid will be contained in the contract of employment, the employee handbook or a specific benefits leaflet. This will set out the level of income, usually 50-75% of wages, to be paid after exhaustion of a specified period or any contractual sick pay. PHI income will cease or vary on recovery but is otherwise designed to end with death in service or retirement. It is tax efficient for employers to provide PHI rather than employees who otherwise pay premiums out of taxed income. However, an employee who provides his/her own cover has the certainty of continued income protection regardless of continuation of an employment contract or solvency of the employer. Case law has been much concerned with the cessation of PHI benefit to the incapacitated employee on termination of employment.

NHS v. private medical treatment

5. Many employers offer insurance schemes which cover private medical expenses throughout the course of an employee's illness. As with PHI, the fundamental ingredient is employee status. Payment of medical bills is a separate matter from that of income protection. An employee might well be covered for private medical care whilst absent from work albeit that his income is derived solely from statutory sick pay.

6. The effect of termination of employment will generally mean the cessation of private medical cover unless the employer prolongs the employee's employment until a particular course of treatment is finished, or the insurer accepts the employee as an individual customer rather than part of the

corporate scheme which had hitherto provided the cover. Private medical insurance cover is often a benefit that is highly regarded by employees, the more so by those actually in receipt of the same. Thus it should be made clear to employees that where the benefit is offered it exists only in the course of employment and will cease on termination. This would only be avoided if there is specific contractual provision for continuance of cover or more probably for a course of treatment already in train (or imminent) to continue until completed or to allow for pre-planned medical procedures to be carried out. Private medical insurance is expensive to purchase out of taxed income but the fact of continuing benefit independent of employment with a particular employer is an option which may be worth the employee exploring. It is this area and loss of PHI/IPI benefit that has given rise to litigation.

NHS v. private medical treatment

7. The insurer dictates eligibility for PHI and how much benefit will be paid, with periodical review of the receiving employee on his fitness to work. Partial recovery invokes proportionately reduced payments since, sometimes with reasonable adjustments, the employee may be able to return to the original role or otherwise achieve a degree of independent income. Where capability changes occur in the course of a deteriorating condition, terms and conditions may expressly provide for fewer hours, or lower pay grade, superseding those envisaged by the original policy, and the amount of benefit can be commensurately reduced. Thus the swings and roundabouts can over time slowly grind to a halt even with PHI. Much depends on the policy terms and conditions.

Parting of the ways – not always such sweet sorrow

8. PHI envisages eventual full or partial recovery and there might come a time when there is no prospect of the employee returning to the original role or at all. But what if the employer falls on hard times, perhaps even going into liquidation? An employee's income could cease if premiums are not maintained. The employee needs to know whom the insurer pays. If the employer is the initial recipient on condition that it pays the absent employee then, if no company, no benefit. Even if the employee's job goes on the grounds of redundancy, through no fault of the employee, he will no longer be employed and PHI benefits can cease unless there is a specific contractual provision for continuing cover in such eventualities. Though something to approach with caution, a permanently incapacitated employee may still lawfully be dismissed on fair grounds, though before embarking on dismissal the employer should consider the effect on PHI. Whilst it might be lawful to dismiss the employee on (or about to receive) PHI benefit, there might still be a claim against the employer in relation to PHI benefit lost.

9. In relatively rare circumstances incapacity can cause frustration of a contract of employment if the employee's inability to work is by reason of an unforeseen event. Where frustration applies then no action (by dismissal or resignation) need be taken when performance of the contract becomes impossible. In ***Egg Stores v Leibowici***[1] frustration was described as occurring where an employee suffers "a catastrophic accident with effects that are so dramatic and shattering that it is obvious to all concerned that for all intents and purposes, the contract must be regarded as at an end …

[1] *Egg Stores (Stamford Hill) Ltd v Leibowici* [1977] ICR 260

[but] where an employee suffers a prolonged illness with an uncertain outcome, one of the factors [in determining whether the contract has been frustrated] is whether the employee continues to be paid." In practice the doctrine of frustration is unlikely to be found if benefit has already been and continues to be paid to the employee.

10. ***Villella v MFI***[2] held that income protection for long-term incapacity means that protection is for a foreseeable event. Given that the point in the doctrine of frustration is that the event in issue must be unforeseeable, where a contract incorporates PHI it is arguable that the contract of employment cannot be frustrated precisely because it was, however remotely, contractually foreseen.

11. In ***Aspden v Webbs***[3] A was dismissed while on long-term sick-leave. The employer was found to have breached the implied term in the employment contract that dismissal would not be effected so as to remove the employee's contractual entitlement to PHI benefit. Since that judgment the cautious employer, where there is no agreement with the insurer and employee, tends to keep the absent incapacitated employee "on the books" if dismissing him/her means cessation of PHI. The dismissal effect is not however written on tablets of stone. In *Lloyd v BCQ Ltd*[4], the EAT held there was no implied term (as found in Aspden) on loss of PHI in the event of dismissal. Most cases are terms and condition sensitive and, in Lloyd, the benefit of PHI was held not to be part of his employment contract. Procedural aspects play their part. In the case of redundancy, the employee should not be put to a disadvantage because of a current inability to perform particular work. In

[2] *Villella v MFI Furniture Centres Ltd* [1999] IRLR 468, QBD
[3] *Aspden v Webbs Poultry & Meat Group (Holdings) Ltd*, [1996] IRLR 521
[4] *Lloyd -v- BCQ Ltd UKEAT 0148/12 (unreported)*

Archibald v Fife Council[5] it was deemed a reasonable adjustment to transfer a disabled employee to another job, where such is available, when the employee is already receiving the income benefit of PHI.

If redundancy intervenes

12. Of course employment procedures should be carried out with scrupulous fairness. However, redundancy often carries with it particular difficulties as employees might not understand that business does not have to be bad for an employer to reduce the workforce lawfully. The employer is entitled to devise ways to bring in changes in technology, and/or changes in business needs or objectives, even if this means fewer employees. ***Kingswell and others v. Elizabeth Bradley Designs Ltd***[6] refers to business efficacy: "It appears that there is a fundamental misunderstanding about the question of redundancy, Redundancy does not only arise where there is a poor financial situation at the employer … It does not only arise where there is a diminution of work … It can occur where there is a successful employer with plenty of work but who, perfectly sensibly as far as commerce and economics are concerned, decides to re-organise his business because he considers that he is overstaffed … [therefore] the decision is taken that [a] lesser number of employees [is] required to perform the same function, that is redundancy."

13. However, things are not so simple when it comes to selection for redundancy. Survival of the fittest may be inherently discriminatory and, following Aspden, consideration should be given to whether a non-

[5] *Archibald v Fife Council* [2004] IRLR 651
[6] *Kingswell & Ors. V. Elizabeth Bradley Designs Ltd UKEAT 0661.02*

productive employee would be deprived of PHI benefit if he were to be selected for redundancy where one of the criteria for selection is poor attendance. When dealing with the sick employee, considerations of sympathy, tact and understanding will doubtless be in play, but it will also be necessary to make reasonable adjustments to the application of any attendance policy to avoid any element of disability discrimination. An assessment must not only cover the needs of the business but the risk of adverse impact on the sick employee who otherwise enters the selection pool. A simple but practical expedient is to adjust the absence score to take account of attendance prior to the long-term absence and the possibility of attendance (or skills deficit) improving had the employee not been absent by reason of ill health. The effect of Aspden is not a blanket prohibition on dismissal as the wording of the judgment makes clear the employer will not terminate the employment of an employee in receipt of PHI benefit without good cause. A genuine redundancy can amount to "good cause" but effectively places a high evidential and procedural burden on the employer to establish the same.

If redundancy intervenes

14. The general principle underlying the 2006 Transfer of Undertakings (Protection of Employment) Regulations is that where a business transfers to another employer, the employee transfers on the same terms and conditions as applicable to his original employment. Arguably this would extend to a contractual PHI benefit, whether operative in the sense of an employee's current ill health absence or where there is an imminent or foreseeable take up of benefit. That said, the effect of the decision in ***BT***

Managed Services Ltd v Edwards[7] is relevant to such circumstances. E was on long-term sick leave and had exhausted all his sickness absence benefits. There was no prospect of him returning to work. There came a time when, for administrative reasons, there was a transfer of that part of BT's business which employed E but E was not transferred. The question arose as to whether his continuing absence precluded him from being assigned to the organised group of transferring employees. The EAT held: "The question of whether or not an individual is "assigned" to the organised grouping of resources or employees that is subject to the relevant transfer, will generally require some level of participation or, in the case of temporary absence, an expectation of future participation, in carrying-out the relevant activities on behalf of the client, which was the principal purpose of the organised grouping." Accordingly E did not transfer and his employment terminated. This case is not, however, authority for the proposition that a permanently absent employee will never transfer. Each case will depend on its facts. Might this case have been decided differently if the employee's PHI benefits were capable of transfer with him? This question remains to be answered.

The benefit of clarity

15. Clarify from the outset the basis on which PHI benefits are paid and cease in the terms and conditions of the employment contract. If these appear in the employee handbook, make these contractual even where the employer unilaterally reserves some powers to vary or exercise discretion or distances itself from such powers. For example, by referring to cessation of payments in the event of the insurer refusing to pay and to any variation in benefits

[7] *BT Managed Services Ltd v Edwards UKEAT 0241/14 (unreported 2 September 2015)*

being the sole province of the insurer. The employer sued by an adversely affected employee can take some comfort from the procedure where, if the insurer refuses to pay, the employer can join the insurer as a third party to proceedings, asserting that the liability accrues to the insurer. However all could take more comfort in being contractually clear from the outset. In such things clarity is inevitably preferrable to clamity.

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This article is adapted from Linda Goldman's lecture on 7 March 2016 at the Health and Wellbeing @ Work Conference (NEC, Birmingham), the UK's leading event for HR and occupational health professionals, rehabilitation, therapy and behaviour specialists, ergonomists and other professionals responsible for the environment, health, safety and wellbeing of work-aged people. It has appeared in a shorter form in Corporate Livewire (www.corporatelivewire.com). Please note that the general use of "he/him" should be taken to mean "she/her" where appropriate.