

**PERMANENT HEALTH INSURANCE –
WHEN AN EMPLOYMENT BENEFIT BECOMES A CAUSE FOR
DISPUTE**

OLIVER SEGAL

Old Square Chambers

Introduction

1. Permanent health insurance (PHI) is a fairly common insurance product offered to employers by, in particular, two or three of the big insurers and which many employers in turn ‘offer’ (in some sense or another) to their employees as an inducement and/or the better to protect them.
2. Lawyers typically become involved when an employee (or ex-employee) asserts that he/she ought to become, or to remain entitled to PHI benefits, while an insurer asserts that no such entitlement exists or that if it once existed it has ceased. Those claims often turn into quasi-personal injury claims, with the parties and their experts disputing whether the employee is ‘disabled’ (or whatever the necessary precondition is) within the terms of the PHI Scheme/policy.
3. It is most unlikely that the employee will ever have a right of action against the insurer directly:
 - (1) An insurer does not owe a duty of care to an employee claiming benefits in assessing the validity of the claim (*Briscoe v Lubrizol Ltd & anor.* [2000] ICR 694); and
 - (2) Any rights under the Contracts (Rights of Third Parties) Act 1999 will, in practice, be expressly excluded in the contract of insurance.

4. Thus the alternatives for litigation are:
 - (1) For the employer to sue the insurer; or
 - (2) For the employee to sue the employer (who can of course then bring a Part 20 claim against the insurer).
5. In passing, it is to be noted that the employee/employer can also challenge a decision of the insurer not to pay or not to continue paying benefits by applying to the insurance ombudsman (also some insurance policies contain a provision requiring disputes to be referred to arbitration).

Claims brought by the employer

6. Claims brought by the employee against the employer are by far the most common; but it is worth remembering that a sympathetic employer might well be better placed - forensically and/or in terms of controlling its costs exposure in any litigation - by suing the insurer without forcing its employee to sue it first, particularly if it can procure a partial or total indemnity from the employee, or even simply oblige the employee to cooperate with it in the conduct of the litigation (e.g. by having to take the employer's lawyers' advice as to settlement).
7. This option should be seriously considered if you are acting for an employer, particularly if the employer has genuinely supported its employee's claim to be entitled to benefits under the policy (as is often the case); in those circumstances, if the employer resists the employee's call to take legal action against the insurer and therefore the employee is forced to sue the employer, the employer will have little option but to bring a third party claim against the insurer in any event and may well have no defence to the employee's claim that it was obliged to take such action pursuant to its obligations to the employee under the contract of employment.

Claims brought by the employee

8. The employee can bring, potentially, two types of claim:

- (1) A claim for monies owed/damages for breach of contract for the benefits which should have been paid to him/her by the employer;
- (2) A claim for damages for breach of the employer's implied duty to compel the insurer to honour its obligation to pay benefits in respect of the employee - generally by taking legal action against the insurer.

Does the employer have a contractual obligation to pay benefits to the employee?

9. The first (legal) issue for any employee or employer if a dispute about PHI entitlement looms is to establish whether :-

- (1) The employer has obliged itself to pay benefits to qualifying staff (in which case the employee can sue the employer for monies owed); or
- (2) The employer has rather undertaken more limited obligations to:
 - (a) ensure that a contract of PHI is entered into by it with an insurer under which the employee may become eligible to receive benefits; and
 - (b) pass on all benefits received pursuant to that insurance contract in respect of the employee;

(in which case the employee will have to rely on breach of the implied duties of the employer to take action to recover benefits from the insurer in appropriate cases).

10. The leading authorities on this issue are the judgments of Ward LJ in ***Briscoe v Lubrizol Ltd*** [2002] IRLR 607¹, albeit the material parts (paras. 102-104 and 119-134) are obiter; and the judgment of Sedley LJ in ***Jowitt v Pioneer Technology (UK) Ltd*** [2003] IRLR 356.
11. The issue in each case is to be determined by examination of the terms of the contract of employment, which may in turn reflect or incorporate the terms of the insurance policy.
12. If, on analysis, the PHI scheme is offered by the employer to the employee as, say, a form of sick pay scheme, with benefits payable by the employer, then the employee can recover those benefits as monies owed by the employer. This was the case, for instance, in:-
- (1) ***Bainbridge v Circuit Foil (UK) Ltd*** [1997] IRLR 305, in which the rules of the long-term ill health scheme formed part of the contract of employment; in which disability benefit was defined as “*the amount of benefit payable by the employer in accordance with the ... rules*”; and in which it was provided that those benefits were to be paid “*as a continuation of salary*”.
 - (2) ***Earl v Cantor Fitzgerald International*** (26 May 2000), an unreported decision of Moore-Bick J (as he was then), in which the Rules of the PHI Scheme were incorporated into the contract of employment including that “*Payments of benefit made to a member under the scheme ... are a continuance of salary or earnings and although benefits are insured by the employer they are not insurance benefits to the member*”.
 - (3) ***Jowitt***, in which an employee handbook, incorporated into the contract of employment, provided “*The company runs a scheme that is designed to provide an income during lengthy periods of absence due to prolonged sickness or injury. ... members of staff are entitled to two-thirds of normal pay ... after 26 weeks’ continuous absence ...*” - which contrasted with the provisions in relation to

¹Not to be confused with the earlier decision in the same litigation referred to above!

personal accident insurance (which referred to an insurance policy) and pensions schemes (which were available on request).

13. However, in **Briscoe** the contract provided for the employer to pay sick pay for up to 26 weeks' ill health absence and (in an employees' handbook) made reference to "*a disability scheme*" in respect of any further period of enforced ill health absence, entry to which was "*subject to acceptance by the insurers*", and which (in so far as it was set out in the handbook) provided that "*The insurers will pay the benefit to Lubrizol, who will pay an equivalent amount to the member, after deduction of income tax, if any.*"

14. On that basis Ward LJ held that "*there can be no doubt but that the employer is obliged to pay sickness benefits for the first six months but then his liability ends and the disability scheme kicks into place. ... what the employer is doing is provide the scheme which provides the benefits. The cost of the scheme is met by the employer and that constitutes the employer's obligation; the employer must keep up payment of the premiums. There is no provision making the payment of benefits a continuation of salary so as to impose a primary obligation on the employer to pay them. The employer does not promise to do so. What the employer does promise is to make provision at its expense for employees to become members of the company scheme. Under the scheme the benefits are paid to the company and when received by the company it is obliged to pay them over to the employee. At that stage and only in those circumstances are the benefits treated as akin to remuneration requiring the deduction of tax. I would be satisfied that the company was under no contractual obligation to pay benefits which had not been received from the insurers.*" (paras. 126-127, 133).

15. In **Jowitt** (see above) Sedley LJ dealt shortly with the point (paras. 12-13) commenting that the decision in **Briscoe** reached a different result "*on the facts*" and that it was "*wholly consonant in its principles*" with the conclusion he had reached in **Jowitt**.

16. In some cases the proper analysis is not obvious² and claims may have to be brought in the alternative; but the issue is critical when advising employer or employee:

- (1) From the employee's perspective, if the employer does not have the primary obligation to pay benefits:-
 - (a) It may not be easy to demonstrate a breach of the employer's implied duty in pursuing the insurer, even if the employee was - on an objective analysis - entitled to benefits under the insurance policy; and
 - (b) It might be that the employee has duties to cooperate with, assist, even indemnify the employer, with which he/she must have complied/comply before the employer becomes obliged to take legal action against the insurer.
- (2) From the employer's perspective, the decision how to defend the claim, whether to bring a Part 20 claim against the insurer, what offers of settlement to make, etc., are all heavily influenced by whether it had that primary obligation to pay the benefits, or only the secondary obligations discussed above.

Scope of the employer's implied duties

17. There are two sorts of implied duties in relation to PHI claims which the courts have had to consider, the second of which is really an example of the first:

- (1) The duty to procure for the employee benefits to which he/she is entitled by reference to the insurance contract;

²In *Villella v MFI Furniture Centres Ltd* [1999] IRLR 468, Judge Green QC sitting as a judge of the High Court held the employer to have undertaken the primary obligation to pay in a case where, it is respectfully suggested, the contrary finding was arguably correct in light of *Briscoe*, etc. (though the result would have been the same).

- (2) The duty not to dismiss the employee if so doing would dis-entitle the employee to claim benefits or further benefits.

The general duty to procure benefits for the employee

18. This is not an entirely straightforward area of the law.
19. The overall extent of the duty may be stated with fair confidence: As part of the duty of trust and confidence, there is an implied duty on the employer to 'take all reasonable steps' to obtain the benefits (see *Briscoe* [2003] para. 135); or to claim against the insurer in respect of a valid claim by the employee 'if it became necessary to do so' (see *Earl* para. 30); - but what are 'all reasonable steps'; and when does it 'become necessary' to claim against the insurer?
20. Perhaps surprisingly³, there has been little need thus far in the cases for more exact analysis of these questions; and thus the only real authority directly on the point is *Marlow v East Thames Housing Group Limited and Norwich Union* [2002] IRLR 798, a decision of Cooke J. This case needs to be approached with caution:

- (1) First, the issues were (unusually and perhaps in the event unhelpfully) divided up, such that the employer's liability to the claimant was considered at a preliminary hearing, without determination of whether the claimant was entitled to benefits under the policy (i.e. whether she was sufficiently disabled) and thus without determination of whether the insurer was liable to the employer (even though the insurer had been joined into the action). The insurer therefore played no part in the hearing and, having found the employer liable to some extent to take action against the insurer, the court had to go on to consider how and on what basis the

³The reason is that nearly all of the cases have involved either situations where the employer was found to have undertaken the primary obligation to pay benefits (see above) and/or where the employer had dismissed the employee, making it impossible thereafter - pursuant to the terms of the insurance policy at issue in those cases - for the employer to pursue the insurer.

employer was obliged to take that action (i.e. prosecute the Part 20 claim against the insurer). (See paras. 1-8 of the judgment.)

- (2) Secondly, though not of central relevance, the PHI scheme in that case was held to have been discretionary or ex gratia and the employer's liability founded on an agreement made between employee and employer after the employee became ill, to the effect that she would waive any rights against the employer at such time as her eligibility to claim benefits and her employment subsequently ceased, in return for the promise of the application of the PHI scheme to her. (See paras. 45-53 of the judgment.)

21. In any event, the relevant part of the judgment in this context is paras. 54-58. After commenting on the dearth of direct authority, the Judge held as follows (paras. 56-58):-

“... if the employee has no other form of redress in respect of an incorrect assessment made by an insurer as to his/her medical incapacity to work, and the employer is contractually obliged to provide PHI benefits from an insurer, as part of a PHI scheme with the employee, it is a necessary incident of the contract between employer and employee, that the employer take all reasonable steps to obtain the benefit of the policy from the insurer. This may or may not involve litigation depending on all the circumstances, the apparent validity of the employee's position and indeed the reasonable assessment by the employer of the prospects of success.

“The claimant would have to require such action to be taken ...

*“It is not possible for me to form a view as to whether or not it would be reasonable for the defendant to pursue Norwich Union in litigation to seek to procure the payment of benefits, because I have not seen evidence relating to the medical condition of the claimant. If an indemnity against costs were offered by the claimant or her union, then it would be hard to see that the pursuit of litigation would not be a reasonable step to take, unless the prospects of success were very poor indeed. In circumstances where it seems [as it did in **Marlow**] that the defendant considers that the claimant's position is correct, or may well be correct, an indemnity against costs would, it seems to me, make the*

refusal to pursue litigation ... unreasonable. In the absence of an indemnity however, I am unable to form a view on this.”

22. As noted above, the situation was unusual because the court had not reviewed in detail or heard any medical evidence. In practice, such tripartite claims will more generally be dealt with by the courts at a single hearing at which the judge will be able to make his/her mind up as to the “*validity of the employee’s position and indeed the reasonable assessment by the employer of the prospects of success*”; in which case the ultimate liability of the insurer will be determined and the issue of an indemnity from the employee will probably be academic (save perhaps in relation to apportioning the costs of the action).
23. Note that, despite some employers’ subsequent attempts to claim differently, *Marlow* is not authority that, without the employee’s offer of an indemnity, the employer is free not to take legal action against the insurer – indeed it seems to the authors of this paper that such a proposition would so undermine the effect of the material implied term as to render it valueless in many cases (it is difficult to escape the impression that the whole issue of an indemnity might have been approached differently, or perhaps not at all, had it not been known in *Marlow* that the claim was union-funded). However, as the extract from the judgment in *Marlow* sets out above, the implied duty to take ‘all reasonable steps’ including legal action only comes into play “*if action has been requested by the employee ... the [employer] would not be obliged to take the initiative*” (para.135).
24. As we see it, the main relevance of *Marlow* is likely to be (and has been in practice) in the context of pre-action manoeuvring. An employer in any case where it is disputing a primary contractual obligation to pay benefits will be well advised to request an indemnity as to costs from the employee (which, if the employee’s legal advice is that he/she has a good claim, can presumably be provided in the form of a legal costs insurance contract) and may choose to insist on such an indemnity if its own position is that the fate of a claim against the insurer is unpredictable (or worse). The employee may not be in a (financial) position to offer that indemnity and, if so, must make that clear to the employer, but may be able to offer to repay the employer any of its irrecoverable costs out of damages or settlement sums recovered.

25. There is one other incident of the general implied duty to obtain benefits for the incapacitated employee which has featured in some of the cases: namely, the employer's duty to process the claim properly with the insurer – there are always obligations in the insurance contract on the employer to notify promptly and/or before the end of the 'deferred period' (usually 26 weeks), to provide evidence, etc.
26. It is uncontroversial that if an employee cannot obtain benefits because the employer has failed to take the necessary steps to activate or prosecute a claim to the insurer, the employer will be liable to the employee in damages for breach of contract (that was the situation in *Earl*, for instance). However, there is no obligation on the employer to do more than the insurance policy requires in terms of notifying the insurer, etc., and in any event any obligations of this sort do not survive the termination of the employment of the employee.
27. Thus an employee whose employment was terminated for redundancy when he had been off sick for just over three months (particularly where an early recovery was thought at the time not unlikely - though he in fact remained incapacitated indefinitely) did not succeed in his claims that the employer should have notified the insurer before termination (the policy only required notification after 5 months), or that it should have notified the insurer after termination: *Forbes v Cawdor Estate Trustees* [1999] Scots Law Times 1283, Ct Sess., Outer House.

The duty not to dismiss

28. There have been several cases dealing with this point, all in the context (which normally applies) that the insurer's obligation to pay benefits ceases with the termination of the employee's employment with the employer.
29. There is a general implied obligation - as an incident of the duty of trust and confidence and/or to reflect the obvious intentions of the parties and/or to give business efficacy to the material parts of the contract of employment - on an employer not to dismiss an employee who becomes entitled to claim benefits under a PHI scheme, so as to dis-entitle the employee to those benefits: that implied obligation was first articulated by Sedley J. in *Aspden v Webbs Poultry & Meat Group (Holdings) Ltd* [1996] IRLR 521 and has been approved by the

Court of Appeal both in *Briscoe* and, *obiter*, in *Brompton v AOC International Ltd and UNUM Ltd* [1997] IRLR 639.

30. That obligation can be triggered even before the right to claim benefits materialises, if it seems likely that the employee may be incapacitated from working for more than the necessary qualifying period: *Adin v Sedco Forex International Resources Ltd* [1997] IRLR 280, Ct. Sess., Outer House, where the employer terminated without cause (other than ill health) after about 4 months, during a period of contractual sick-pay and before entitlement to PHI benefits arose.
31. However, the obligation is not unqualified and in particular, the right to dismiss for repudiatory conduct (whether or not it is ‘gross misconduct’) remains: *Aspden* (*obiter*) and *Briscoe* (where the repudiatory conduct was the employee’s failure to cooperate or communicate with his employer in relation to establishing his (in)capacity for work) .
32. There is a little uncertainty whether an employer can also lawfully dismiss for a reason unconnected with the employee’s ill health, but not relating to repudiatory conduct. In *Hill v General Accident Fire and Life Assurance Corporation plc* [1998] IRLR 641, Ct Sess., Outer House, the point was directly in issue, since the employee was dismissed whilst off long-term sick by reason of redundancy (it was not alleged that he was selected for redundancy because he was off sick). The court, Lord Hamilton, held that the relevant implied term did not prevent an employer from dismissing for a reason other than repudiatory conduct, provided the reason was unconnected with the employee’s ill health and was not arbitrary.
33. The relevant parts of the judgment in *Hill* have been quoted with approval in inter alia *Villella* and *Briscoe*; but in the latter case, it is fair to say, all members of the Court of Appeal stop short of expressly endorsing the ratio of *Hill* (it not being necessary to consider the redundancy point in *Briscoe*): see in particular paras. 21-22, 64, 105-107 - in the last of which passages Ward LJ says, “*In my judgment, the principle to emerge from those cases [Aspden and Hill] is that the employer ought not to terminate the employment as a means to remove the employee’s entitlement to benefit but the employer can dismiss for good cause*

whether that be on the ground of gross misconduct or, more generally, for some repudiatory breach by the employee.”.

34. It is submitted that, although *Hill* is probably right (where limited to genuine redundancy situations where there is little or no suggestion that the reason for the employee’s selection has nothing to do with the sickness, e.g. large scale redundancy situations), given the Court of Appeal’s reference to dismissals for good cause being limited to repudiatory conduct, there may still be scope for arguing that the exception to the rule should be confined to such cases.
35. Finally, in this context, the employer has no duty to explain to an employee who wishes to terminate his employment on terms (in the instant case, to take early retirement) that he will or might be better off remaining in employment and claiming under a PHI scheme, or to explain that he will not be able to claim under such a scheme if his employment ends: *Crossley v Faithful & Gould Holdings Ltd* [2004] 4 All ER 447.

Did the employee qualify as sufficiently ill?

36. This is, in practice, the usual battle-ground, with the insurer (or employer) asserting its belief (or at least its purported belief) that the employee does not qualify. Where the issue is simply one of fact (as it sometimes is), the claim (as noted above) turns into a quasi-personal injury action where the issue is decided by the court on the basis of medical evidence, including expert medical opinion, (and not infrequently covertly obtained surveillance evidence), and little more need be said here.
37. However, there are two issues which arise that are specific to these types of claim:-
- (1) The proper construction of the qualifying condition in the contract/policy (the definition of ‘disablement’, ‘incapacity’, etc.); and
 - (2) The proper mechanism for establishing whether that condition is met.

The definition of 'disabled', etc.

38. Of course, this question turns on the material definition in the contract or policy, which must be construed alongside the other terms of the contract/policy; however certain themes emerge.
39. In ***Earl*** the requirement to qualify for benefits was that the employee should be “*totally unable by reason of sickness or accident to follow his Occupation [the job he was doing when he fell ill]*”. The court construed that as meaning that the employee “*is no longer capable of carrying out the duties which would enable him to be employed in his current position, whether full-time or part-time*”, though there was provision for a reduced benefit if inter alia the employee was (subsequently to going off sick in the first place, it was held) able to return to his job part-time only (para. 33).
40. In that case the court also had to deal with some ingenious arguments on behalf of the defendant that “*sickness*” did not include the deterioration of a condition and in any event did not include a state of health induced inter alia by alcohol dependence or personality disorder. The court rejected those arguments, interpreting “*sickness*” as simply describing a “*condition*” and referring to an “*absence of good health, without regard to the underlying cause of that condition*” and preferring the view that the scheme “*was intended to apply to all cases where a member is prevented by illness of any kind from carrying out his existing employment*” (para.35)
41. The phrase “*unable to work*”, however, whilst it “*cannot mean incapacitated from any and every purposeful activity*”, did not mean simply “*unable to do his previous job*”; rather it meant that “*there is no continuous full-time work which he can realistically be expected to do*”: ***Jowitt*** (*supra*) at para. 19.
42. ***Walton v Airtours plc and anor.*** [2003] IRLR 161, CA, had to construe a term including both the previous components: “*totally unable to follow the member’s own occupation and is not following any other. If incapacity shall have persisted for 24 months, incapacity shall be deemed to continue only if the member is unable to follow any occupation*”. The claimant

was an airline pilot who developed chronic fatigue syndrome; the issue was whether, after two years of being off sick, he was able to “*follow any occupation*”.

43. The trial judge had found that the claimant had at the material time been medically fit to undertake light sedentary work, but on a part-time basis only, and that in order for him to follow an occupation of that sort it would be necessary that he should have a programme of rehabilitation involving psychiatric support and the help of his employer. As to that, the Court of Appeal, upholding the judge’s view, held (paras. 15-16) that “... *the employee, to follow an occupation, must be able to do more than a minor part of an occupation and must be able to undertake more than a short-term job. ... To follow any occupation naturally connotes to be engaged in regular work, not temporarily but for a substantial or indefinite period. [It] also .. plainly implies an element of continuity.*”. Further, the judge’s finding that the claimant was not fit to start any work without a programme of rehabilitation, etc., meant that he was not yet able to follow any occupation.

44. In short, the courts tend to take a fairly robust and un-technical approach to these issues of construction, which might fairly be characterised as unsympathetic to insurers who seek to avoid liability in ‘deserving’ cases.

Whose decision as to incapacity, etc.?

45. What is now a fairly ‘dead horse’ is the argument featuring in several of the older cases, that if the insurer reserves to itself the right to determine entitlement to benefits on the basis of evidence sufficient to establish such entitlement being provided to it - or if the employer reserves that decision to the insurer - then the insurer’s decision is final.

46. That proposition has been rejected - by the courts being prepared to imply a further contractual term if required - in *inter alia Napier v UNUM Ltd* [1996] L1 LR Vol 2 550, *Marlow* paras. 50-53; *Earl* paras. 29-30.

47. In *Earl*, for instance, there was a term of the PHI Scheme that “*The Employer shall not be under any obligation to make any payment to an Incapacitated Member ... unless the Employer has first received such sum from the Insurer ...*”. As to that (not relied on in fact

by the defendant), the court held: “*I would, if necessary, hold that it was an implied term of the contract between [employer] and the employee that the insurance would cover any valid claim that might be made under the terms of the scheme ... Ultimately, therefore, it is for the court to decide whether [the employee] was and remains incapacitated.*” (para.30).

Damages and mitigation

48. If an entitlement to the benefits is established the starting point for the measurement of damages is the amount of benefit he/she would have received during the whole of the period of entitlement under the scheme, e.g. until incapacity ceased or would have ceased or the employee reached or would have reached the age of retirement (leaving aside for present purposes any possible arguments under the Employment Equality (Age) Regulations 2006). The employee would also be entitled to receive the amount of any incidental benefits which he/she would have been entitled to receive as an employee.
49. In *Earl* it was argued on behalf of the employer that the employee was under a duty to mitigate his losses by seeking alternative employment within his reduced working capacity. It was held, however, by reference to the rules of the scheme in that case, that an employee who was unable to do his ordinary occupation could find alternative work “*without losing his status as an Incapacitated Member, but there is nothing in the Rules which expressly requires him to seek alternative work*” (original emphasis) (para. 43), and there was no need to imply any such requirement into the Rules of the Scheme.
50. Thus, in *Earl*, once the employee became incapacitated or disabled within the terms of the scheme “*nothing further is required of him in return for his right to receive benefits under the scheme. At most he must hold himself available to return to work if and when he becomes fit to do so, but in the case of an employee who has become permanently incapacitated the relationship between the parties becomes virtually one of creditor and debtor*” (para.44). Further, although the point did not have to be decided in that case, the Judge went on to find that, where employment had terminated, there was a “*strong argument*” where an employee was entitled to benefits under that particular scheme, that he had no duty to mitigate his losses by seeking alternative employment within his reduced capability.

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