

“The reformation of TUPE Regulations in 2006 sought to reinforce previous UK regulations by implementing the Amended Acquired Rights Directive. Provide a critique of the domestic legislation.”

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Introduction

The Transfer of Undertakings (Protection of Employment) TUPE (2006) Regulations is widely regarded as some of the most complex employment law legislation within the Human Resources and Legal sectors. The aim of this script is to provide a review of this notorious legislation; to assess its success in terms of efficacy of transfer, missed opportunities, new problems and legal loopholes that have been created. Due to the constrictions on the document's length, it is not possible to encompass all aspects of 2006 Regulations. As such, we shall focus some of the more forward thinking and intriguing angles of this multifaceted legislation.

The TUPE Regulations are the domestic implementation of the European Acquired Rights Directives (ARD). In this implementation, the UK Government had some flexibility in its design. We shall examine the success of this design in terms of business and employees.

In this text we shall also discuss the Directives, and how these have shaped or domestic legislation in terms of their original construction and subsequent interpretation through the European Court of Justice's judgements. It is important to discuss the evolution of the TUPE Regulations in order to assess the success and failures of TUPE 2006 and any possible future developments.

TUPE (2006) had a lot of ground to make up. For example, its predecessor – TUPE (1981) – was designed at a time when service transfers were far less common and as such TUPE (1981) did not legislate for actions. Tribunals attempted to deal with this deficiency, and this spawned a raft of conflicting legal precedence. As such, one of the main aspects of TUPE (2006) was to provide legislation to deal with service transfers. Interestingly, TUPE (2006) removed the requirement for the retention of identity for service transfers. This provision was to combat a practice known as 'innovative bidding' where an employer tenders for a contract and includes scope for the service to be carried out in a different manner, thereby altering the identity and removing the TUPE Regulations being triggered. We shall consider the success of the Government's strategy to close this and other loopholes to ensure the Regulation's efficiency.

The Regulations were also severely delayed, with consultation starting 2001. This was due to the UK Government's attempt to include legislations for the transfer of pensions. However, and somewhat perversely, the Regulations only provided for a diminished right to transfer pensions: encompassing only a fraction of what the UK Government aspired. The script will analyse the Government's attempts to improve TUPE to facilitate pension transfers and the success and these attempts.

Varying the terms and conditions of employees' contracts is not easy at the best of times, however in a TUPE scenario it is far more complex, with the new employer required to show an economical, technical, or organisational reason, and a reduction in the number of employees. The formation of the TUPE 2006 Regulations provided an opportunity to the Government to install the machinery to facilitate changing terms and conditions, however this was not taken. Instead, changing terms and conditions without dismissal was left to the extreme strategy of dismissal and re-engagement,

which has associated risks for the new employer. We shall discuss why this opportunity was not taken and the knock on effect on today's legal landscape.

Recently, the media has paid significant attention to so called 'pre-pack' insolvency procedures whereby a business can be sold prior to administration proceedings and where the company faces liquidation, the TUPE Regulations permit variations to the terms and conditions of employee contracts, dismissals, reduced redundancy payments and pensions and removal of potentially substantial debts. Moreover, 'phoenix deals' have blazed through the media, where the management of a financially struggling business resurrect the organisation via the TUPE Regulations, inciting public animosity. The Regulations' ability to facilitate this kind of action will be discussed in terms of fulfilling the ARD's purpose.

The TUPE Regulations have always been controversial and not easily understood. Since the inception of the original domestic legislation to the tumultuous formation of the 2006 Regulations, TUPE is one of the most intriguing aspects of UK employment law. This dissertation attempts to unwrap its success in meeting the needs of business and employees alike.

Background to the TUPE Regulations

The Transfer of Undertakings (Protection of Employment) (TUPE) Regulations 1981 were originally created in order to comply with the EU Acquired Rights Directive 1977. The Directive addressed the needs of the European business community; to encourage and facilitate mergers and acquisitions. The Directive was intended to address the needs of employees where the business in which they work is taken over by another. It was also aimed to provide benefits to employees to counteract those provided to business and at the same time allow employees to move into the hands of a new employer but maintain previous terms and conditions and hence minimise objections. When the Directive was constructed, the subcontracting of services between businesses was unusual, and hence no such provision was included. Today, the business world is very different and we shall look closer at the development of the TUPE (2006) Regulations later in this script. We shall now consider how the UK implemented Acquired Rights Directive and the subsequent reaction from the legal and business community.

How the did the business / legal community react to TUPE (1981)?

When the Directive and Regulations were originally drafted they could not foresee the way the business community would react to them or evolve in itself. The TUPE Directive and Regulations were being applied to scenarios for which they were not designed. The two main areas that caused problems were contracting services and retention of identity.

We shall look at some of the landmark cases that defined not only the use of TUPE (1981) but the development of the Acquired Rights Directive (1998) and TUPE (2006).

Service transfers

The *Suzen*¹ case is pivotal in how the TUPE (1981) regulations were interpreted by creative lawyers to incorporate the contracting of services.

Suzen worked for a cleaning contractor cleaning a school. The contract was taken away from *Suzen*'s employer and awarded to another contractor. *Suzen*'s employer issued her with a termination of employment, however this was insufficient notice and *Suzen* claimed that her employment continued over to the new contractor.

The case was passed on the European Court of Justice (ECJ) for clarification. The ECJ set out the essential minimum content of the phrase "transfer of an undertaking" and for such a definition to fit with observations of the Members States.

The ECJ's definition was largely built on the *Spijkers*² case; a landmark case that defined "transfer of an undertaking" by whether the business retained its identity. This retention of identity was a major feature of the TUPE (1981) Regulations and will be discussed later in this text.

The ECJ held that, generally, there is no transfer of a service unless a substantial majority of staff were transferred from one business to another. Normally, a transfer would consist of staff and other factors (for example, property assets). However, if the business in question was labour intensive, a group or workers engaged on a permanent basis may constitute an economic entity capable of maintaining its identity post-transfer. The ECJ then left it to the National Courts to decide whether this scenario should be considered a transfer.

¹*Suzen v Zehnacker Gebaudereinigung G.m.b.H.Krankenhausservice* [1997] I.C.R 662

²*Spijkers v Gebroeders Benedik Abbattoir CV* [1986] ECR 1119

In the UK, cases followed that placed service transfers outside the TUPE Regulations. For example, *Betts v Brintel Helicopters*³, where *Brintel Helicopters* had a contract with *Betts* to provide services, the part of the contract was awarded to *KLM*. *Brintel* appealed against an EAT decision providing transfer rights to *Betts* and others. The appeal was allowed by the Court of Appeal, stating that whilst there was retention of identity no assets were transferred, only staff, and hence there was no transfer of undertakings.

As the case law progressed, it became clear that the *Suzen* case was too narrow and in 2000 the case of *RCO Support Service v UNISON*⁴ started to open up the interpretation of the domestic legislation to permit the transfer of a service to be covered by the TUPE Regulations. In the instant case, the ET and EAT ruled that a transfer of a cleaning contract, with no transfer of assets, did constitute a transfer of undertakings. The EAT ruled that the willingness of the transferee to re-employ workers after they resigned from their former positions was indicative of the retained identity of the undertaking.

Non-transfer of staff

The case of *ECM (Vehicle Delivery Service) Ltd v Cox*⁵ provides a good example of lawyers creating strategies to circumvent the TUPE (1981) Regulations. At this time, several case cases occurred where no staff were transferred – on the basis that if no staff were transferred, there could be no transfer of undertakings.

Cox and others were employed as van drivers and yardmen by *A*, who had a contract with *VAG* to deliver cars from *Grimsby docks* to location across the UK. The drivers spent 50 per cent of their time on the contract. *A* lost the contract to *EMC* who did not take on any of the staff, although significant assets were transferred and the business retained its identity. *Cox* believed that he and others should have transferred under TUPE and took action for automatic unfair dismissal against *EMC* as the transferee. The Tribunal held that the dismissal had been automatically unfair and that undertakings had been transferred. Appeals were made via the EAT and Court of Appeal based on the *Suzen* case that if the only remaining factors post transfer was the service then no undertaking could be transferred. Both appeals were held, stating the ET was correct in applying a broad approach to the case. The business was essentially a service and this was transferred, hence there was a transfer of undertakings.

Moreover, Tribunal found that *ECM* had not transferred redundant staff because they were contemplating claiming unfair dismissal. In addition, *ECM* claimed that if there was no transfer of staff there could be no transfer of undertaking. The Court of Appeal did not agree and stated that neither the Directive nor Regulations stated such a provision.

³*Betts v Brintel Helicopters* [1997] 2 All E.R 840

⁴*RCO Support Service v UNISON* [2000] IRLR 401

⁵*ECM (Vehicle Delivery Service) Ltd v Cox* [1999] 4 All E.R 669

The instant case is a good example of organisations transferring factors other than staff to try to side step the TUPE regulations and hence test it's strength. However, the courts made several judgements that demonstrated that if the only reason staff weren't transferred was to avoid a transfer of undertakings, then TUPE regulations would still apply. This demonstrates the Tribunal systems ability to interpret the TUPE Regulations to maintain their stability and obtain an outcome in line with the ARD's purpose.

Another good example of testing the TUPE Regulation's strength is the case of *ADI (UK) v Firm Security Group Ltd*⁶. The Firm Security Group Ltd (FSG) took over a contract supplied by ADI and carried out the work from the same premises using the same equipment but where no staff transferred. The Court of Appeal stated that in its opinion there had not been a transfer of an economic entity and, moreover, as the nature of employment was labour intensive any finding that the employees were not taken on in order to circumvent the Regulations would suggest that there had been the transfer of undertaking.

The afore mentioned cases shaped lawyers interpretation and strategy of the TUPE (1981) Regulations, however this was a side effect of the Regulations construction – unforeseeable at the time of their writing. The impact of this case law can be seen in the development of the updated Acquired Rights Directive and TUPE (2006), where this legislation has attempted to close such loopholes.

The question of identity retention, stated in the *Suzen* case, has been very important in interpreting the domestic UK regulations. We shall now examine how case law has evolved in this area in order to understand the construction of TUPE 2006.

Defining an economic entity/ retention of identity

An early important ruling from the ECJ was that of *Schmidt*⁷, where the ECJ ruled that the contracting out of a single cleaner came with the scope of the ARD and so constituted a transfer. Notably, the ECJ concluded that the retention of the company's identity is the decisive criteria for established whether a business transfer has occurred.

The *Spijkers* case followed on from this case in the sense that the ECJ set out an early list of a factors that should be considered when defining economic entity post transfer and hence whether identity was retained. The list is as shown:

- The type of business or undertaking concerned
- Whether the intangible assets are transferred
- The value of the intangible assets at the time of transfer
- Whether or not the majority of the employees are transferred over

⁶*ADI (UK) v Firm Security Group Ltd* [2001] 3 C.M.L.R. 8

⁷*Schmidt v Spar-und Leikhasse der fruheren Amter Borrdesholm* [1994] IRLR 302 ECJ

- Whether the customers are transferred
- The degree of similarity of the between the activities before and after the transfer
- The period for, in any, for which those activities are suspended.

This *Spijkers* ‘shopping list’ remains good law today when identifying an economic entity post-transfer. It became a hot topic in case law, as creative lawyers sought to alter organisations’ functions and circumvent the Regulations. Let us now look at some example of how the Regulations were manipulated.

In order for a transfer to be confirmed, the pre-transfer economic entity must be identified post-transfer. Once the type of business has been identified before the transfer, the activity can be identified and also the key requirements of the business. Although a business is more than an activity – and must include a structure, resources, assets and staff – unless the activity transfers then there can be no transfer.

If the new owner does not operate the old business, but instead changes it, then no transfer of undertakings takes place. We shall now discuss how Tribunals view identity retention.

In *Crook v H Fairman Ltd*⁸, the owner of a dress shop sold the lease to Fairman and sold all the stock to the public in final sale. The owner then paid off all the staff and handed them their P45s. Fairman then opened a new dress shop, which targeted a different market and different branding. Although the staff from the old shop were taken on, they were then dismissed after seven months as they were seen not be suitable for the new customer base. The EAT held that this was not a transfer of economic entity, the new business had a new identity, different customers and new brand and logo.

In *Mathieson and Cheyne v United News Shops*⁹, the EAT reached a similar decision. Mathieson and Cheyne had been employed in a shop in an NHS establishment. The shop was purchased by United News and renovated. Whereas the old shop sold newspapers, confectionary and flowers, the new shop had a wider range of products to include clothes, toys, sandwiches etc. The EAT deemed that the new shop had a different identity. Notably, it found too many differences between the old and new shops including opening hours, stock and commercial setup.

This is a common angle taken by Tribunals; if there is more than one factor changed from the old entity to the new then the identity is deemed to have been altered. This highlights the sensitivity of the legislation and this was picked up lawyers in order to facilitate the purchase of business without transferring undertakings. Essentially, by changing two more factors in the new business can nullify TUPE action.

⁸ *Crook v H Fairman Ltd* EAT [1990] IDS 412

⁹ *Mathieson and Cheyne v United News Shops* [1995] IDS Brief 541 EAT

Purchasers of a business can take the strategy of claiming that they were purchasing the premises and some of the equipment of the old organisation, then setup a new business with a new identity from that premise. This is a weak point in the TUPE (1981) Regulations and this has been transposed to the 2006 Business Transfer legislation. The weakness is intrinsic to the transfer of a business. However, as will be discussed later the 2006 Regulations removed the requirement for service transfers to show retention of identity to trigger TUPE actions.

Defining ETO's

Dismissals related to the transfer of undertaking can be justified by using an economical, technical or organisation (ETO) reason. The provision for the ETO defence has been in existence for a substantial period prior to TUPE 2006. The Acquired Rights Directive (ARD) provides for dismissals related to the transfer of undertaking provided they are for an ETO reason (Article 4). This provision was transposed into the TUPE (1981) Regulations and again into TUPE (2006).

There is no statutory definition of ETOs however the BIS guidance notes of TUPE define ETOs in the following manner:

- Economical - a reason related to the profitability or the market performance of the new employer's business.
- Technical – a reason relating to the nature of the equipment or production processes which the new employer operates.
- Organisational – a reason relating to the management or organisational structure of the new employer's business¹⁰.

To date, the ETO defences have attracted little attention of the ECJ and EU Commission and as such it not a main focus of this script so will not be analysing case law to seek further definition clarification. We will, however, be discussing how the ETO defence can be used to vary contracts later in the text, hence it is important that the reader understands their definitions.

Formation of Acquired Rights Directive (ARD) (1998)

In 1994, following over 40 rulings from the ECJ on the ARD, the EU decided to amend the Directive. The European Commission tendered proposals for amendments to the 1977 Directive. The Amended Directive was adopted at the Cardiff Summit in June 1998, with Member States given three years to implement. Further updates were made in 2001.

We shall now consider the Directives Amendments in more detail. The main areas of focus were the service provision changes, employee liability information and pension rights. As such we shall look at the amendments to these areas before discussing how these were then integrated in the UK domestic legislation. The inclusion of insolvency legislation will be discussed in a later chapter because of its breadth.

¹⁰Department for Business Innovation and Skills, Employment Rights on the Transfer of an Undertaking, 2009

Service Provision Changes

As discussed, the European Commission original attempted to clarify the ARD's position on the contracting out of services by amending Article 1(1) to exclude a mere 'activity' and require an 'economic entity'. However, this was met with a fierce repulsion from the EP and was subsequently completely withdrawn. The amended script was based on a number of ECJ rulings and this really dampened the end results clarity. Article 1(b) states;

“where there is a transfer of an economic entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether that activity is central or ancillary”.

The definition provides little clarity and hence we are led back to case law. Intriguingly, the Amending Directive's Recital 4 states the amendment does not alter the meaning of the original Directive – which seems somewhat bizarre given that it was the lack of clarity that triggered the Amendment.

This leads us back to European case law for clarification and, somewhat predictably, to attempt to reconcile the *Schmidt* and *Suzen* cases. As discussed, the *Schmidt* case involved a first generation contracting out of a cleaning contract. Although only one member of staff was transferred and no tangible assets, this was deemed to be a transfer of undertakings. This approach contrasts that of *Suzen*, a second-generation contracting out service, where it was ruled that an activity in itself does not constitute an economic entity. ECJ stated that the fact that a similar activity is carried pre and post transfer does not confer a transfer of undertakings. In a labour-intensive scenario, (as per the *Suzen* case) there will only be a transfer if the new employer takes on the majority of the staff. This decision makes no attempt to reconcile with that of the *Schmidt* case, and, moreover, opened up an avenue for abuse where employers avoided transfer of undertakings by not transferring staff. In an organisation where the workforce is unskilled there is little incentive to assume responsibility for pre-transfer staff. This, in effect, relegates the rights of the unskilled workforce and creates a multi-tiered system.

The paradoxical approach purported by *Suzen* has been partially corrected by UK case law. Where *Suzen* determines the rights of an employees to transfer on whether other staff transferred, *ECM (Vehicle Delivery Services) Ltd v Cox*, looks at the motivation behind non-transfer of staff and suggests that if the that motivation to avoid transfer of undertakings then such an undertaking will still exist.

Employee Liability Information

The ARD states that “*Member States may adopt appropriate measures to ensure that the transferor notifies the transferee of all the rights and obligations which will be transferred to the transferee under Article 3.2, so far as those rights and obligations are or ought to have been known to the transferor at the time of the transfer*”.

With this amendment the ARD outlays the basis premise of Employee Liability Information on which TUPE 2006 is based. We shall discuss the UK domestic interpretation of this Article later.

Pensions

Article 4a. of the ARD states “*unless Member States provide otherwise, paragraphs 1 and 3 shall not apply in relation to employees' rights to old-age, invalidity or survivors' benefits under supplementary company or intercompany pension schemes outside the statutory social security schemes in Member States*”.

The Article provides that the rights of employees to transfer their rights and obligations and for the transferor to notify the transferee of such rights does not apply to occupational pension schemes save from benefits links to old age, invalidity or survivors. This text was directly transposed in to the TUPE Regulation 10(2) and will be discussed in further detail in the context of the domestic legislation.

Formation of TUPE (2006)

The reformation of the TUPE (1981) Regulations took sometime. This was, firstly, due to the Directive undergoing amendments and then, secondly, by a complex domestic consultation process. The latter was really due to the UK Government’s original intention of placing provision for occupational pensions within the TUPE Regulations. The delay meant the new Regulations came into effect on 6 April 2006, and, perversely, did not contain any provision for occupational pensions.

Although TUPE 2006 does make some substantial advances in the areas of insolvency scenarios, employee liability information, and contracting out services, the UK Government was not able to incorporate all the changes it sought because these were integrated in to the ARD. In fact, outside of the areas mentioned above, the vast majority of the changes to the ARD from the 1977 version are word alterations to align European and Member State legislations with current case law findings.

We shall now discuss some of the changes of TUPE 2006 before moving on to an in-depth analysis of two major areas of this script: TUPE 2006 in insolvency scenarios, and the ability of TUPE 2006 to facilitate changes to employees Terms and Conditions.

Service Provision Changes

As previously discussed, one of the main features of TUPE (2006) is the addition of a provision from contracting out of services. This definition of a relevant transfer was not transposed from the ARD but an innovation of the domestic legislation. In the Regulations, this is referred to as “service provision changes” (SPC). This legislation is an extension and clarification of precedent case law based on TUPE 1981, some of which has been previously discussed (notably the *Suzen, Spijkers, Schmidt and ECM* cases).

The SPC mirrors the legislation for the undertaking of a business (reg. 3(1a) apart from the substantial omission of the need for the relevant transfer to retain its identity post-transfer. This was put in place by the UK Government to stop the practice of “innovative bidding”.

We have previously discussed the nature of identity retention and outlined some key cases that demonstrate the court’s parameters. The parameters of identity retention are sensitive and, as we have discussed, changing more than one aspect of a business has proven to alter the businesses identity in the eyes of the court. This sensitivity was exploited by creative lawyers by tendering for a contract and including scope for carrying out the service in different manner, thereby not retaining the business identity and transferring undertakings. This process was coined “innovative bidding”.

Let us now look at the 2005 Government consultation paper’s reasoning behind differentiating between an SPC and business transfer:

If the incoming contractor intends to carry out the service activities in a novel manner – for instance, using a computerised process in place of a previous manual one – it is likely that some of the employees who have been performing the activities for the old contractor (or, in the case of an initial contracting-out, the client) will lack the necessary skills and will have to be made redundant. There are, however, clear advantages in providing for the organised grouping of employees to transfer to the new contractor before any redundancies are made, even in cases where there would not be a transfer under draft Regulation 3(1)(a) in any event. If the employees remained with the old contractor, the likelihood is that they would all have to be made redundant (as, on losing the contract, the old contractor would probably have no work at all for them to do). Some, however, may be able to retain their jobs with the new contractor, if they happen to have the skills necessary to adapt to the new working methods, or can be easily retrained, or can be reallocated to other parts of the new contractor’s business¹³.

This is in-line with the employment protection aim of the Regulations, and would also be likely to assist the new contractor in reducing recruitment and training costs. Additionally, and importantly, treating all contractors – including those making “innovative bids” – on an equal footing will contribute toward the key policy objective of creating a “level playing field” in tendering exercises, and increased certainty and confidence for all concerned.

¹³TUPE, Draft Revised Regulations, Public Consultation Document, Employment Relations Directorate Department of Trade and Industry, March 2005

The removal of the need to show retention of identity for SPC has certainly diminished the practice of innovative bidding and as such has shown the move by the UK Government to introduce a separate Regulation for SPC and differentiate from a business undertaking to be successful, for which it should be commended.

However, this type of strategy – whereby the transferee setups the transfer, *pre-transfer*, has shifted to pre-pack insolvency proceedings. It could be argued that the latter is more the extreme version of this type of tactic. Certainly, the fact that the business has to be insolvent means that the range of companies where this strategy can be applied is narrower than of innovative bidding, however the rewards are far greater. So, although innovative bidding may have disappeared, it could be said that it has morphed into pre-pack administration.

Employee Liability Information

Draft Regulations 11 and 12 are designed to implement the Government’s decision to take advantage of the Member State option in Article 3.2 of the Directive. This is an option to introduce provisions requiring the transferor to notify the transferee of all the rights and obligations in relation to employees that will be transferred – so far as those rights and obligations are or ought to be known to the transferor at the time of the transfer.

The Regulations state the following information should be provided¹²:

- identity of employees who will transfer;
- the age of those employees;
- information contained in the ‘statement of particulars’ of those employees;
- information relating to any collective agreements which apply to the employees;
- instances of disciplinary action within the preceding two years taken by the transferor in respect of those employees in circumstances where the statutory resolution procedures apply¹³ or from 6 April 2009 of the ACAS Code of Practice on disciplinary and grievance procedures;
- instances of any grievances raised by those employees within the preceding two years in circumstances where the statutory dispute resolution procedures apply or from 6 April 2009 the ACAS Code of Practice on disciplinary and grievance procedures;
- instances of any legal actions taken by those employees against the transferor in the previous two years and instances of potential legal actions which may be brought by those employees where the transferor has reasonable grounds to believe such action might occur.

¹² BIS, Employment Rights on the Transfer of an Undertaking, 2009

¹³ These circumstances are set out in the Employment Rights Act 2002 (Dispute Resolution) Regulations 2004.

Draft Regulation 12 sets out the remedy that is to be available to a transferee in a case where the transferor breaches the requirements of draft Regulation 11. The claim must be made within three months of the date of transfer and the compensation will be no less than £500 per employee. This is a severe penalty, designed to ensure that TUPE 2006 Regulations do not falter on business lack of motivation to provide accurate information – for without this, the whole transaction could fall apart.

The legislation benefited not only to the employees who transfer but also to the transferees themselves.

The legislation has improved transparency in the transfer process and to prevent instances of sharp practice – such as where, shortly before a transfer is completed, the transferor changes the terms and conditions and/or the composition of the workforce assigned to the undertaking in question, to the disadvantage of the transferee.

In addition, it has promoted competitiveness by removing a significant disincentive to some businesses – particularly those, such as small firms, that may have insufficient bargaining power to negotiate equivalent contractual safeguards – becoming involved in transfers in the first place.

However, the Regulations require in the transferor to pass over the employee information at least two weeks before the transfer. This can pose a problem; in a large transfer scenario, there will be huge amount of data to analyse in only two weeks. The transferee may have to trawl through thousands of employee files and assess how the impact of any outstanding high profile issues, say for example an ongoing tribunal case.

Moreover, the *Terms and Conditions* of the employees' contract may not be divulged until two weeks prior to transfer, and this may throw up some serious issues with integrating the staff. In reality, where the transfer is a merger or acquisition the employees' information - especially the Terms and Conditions - would be handed much sooner than two weeks before the transfer. The transferee would insist on viewing the Terms and Conditions and any other information that it considered important when the finance was being negotiated.

However, where the transferee is being handed over from one contractor to another, and hence there is no relationship between transferor and transferee, the employee is likely to be handed over just two weeks before the transfer because the transferor can be agitated due to losing the contract. This is probably the main problem with the Employee Liability Information Regulations and the problem is exacerbated by the indemnities.

In a transfer of undertakings the transferor and transferee will indemnify against the information being inaccurate and costing one of the parties' money in tribunal claims. However, if there is no business link between transferor and transferee then taking out this insurance is not normally viable.

The timeline of two weeks is not defined in the ARD but rather legislation put in place by the UK Government. In the opinion of the writer, this timeline is too constrictive. A smaller company will probably have fewer records to sort through,

however it will also have limited resources, and a larger company could potentially have thousands of records to analyse. What is the benefit of such a tight time constraint? Possibly, the shorter the period the transferee has the T&Cs, the less likely amendments are to be effected. However, as will be discussed later, the ability to vary T&Cs during a transfer of undertakings is limited and as such the process may have benefited from a longer period between exchange of employee information and the transfer date.

Pensions

As discussed, the introduction of the TUPE 2006 Regulations was delayed due to complexities of including a provision for the transfer of occupational pensions. However, due to these complexities, no such provision was included in the Regulations, nor the ARD.

The Regulations state that no occupational pension should be transferred (Regulation 10(1a) as defined by The Pension Schemes Act s1 (1993). This has the effect of not totally embargoing all rights related to pensions. For example, there are many pensions schemes that only just fall short of the definition of an occupational pension – such as where an employer pays a regular sum into the employers personal pension plan. This type of pension would transfer.

In addition, Regulation 10 (2) states that:

“any provisions of an occupational pension scheme which do not relate to benefits of old age, invalidity or survivors shall not be treated as part of the scheme”.

As such, these benefits are not part of the occupational scheme and therefore will be transferred. These benefits could include private medical insurance, life insurance, and long-term disability benefit. Note that ‘old age’ benefits are triggered by retirement.

The principle problem that both the European Commission and UK government encountered when trying to implement the transfer of occupational pension in via the ARD and TUPE, respectively, was the fundamental problem of the transferees’ financial capacity. Essentially, if the transferee cannot afford to carry the occupational pensions provided to the transferors’ employees then the merger/acquisition will fail, compromising the Directive and Regulations. Hence, the legislation provided is really the maximum facilitation of pension transfer, with state pensions and some benefits being more transferable than full occupational pensions.

The Pensions Act was introduced in 2004 and set a minimum standard of occupational pension entitlement to be afforded to all transferred employees who had such an entitlement prior to the transfer; and as discussed, the Government continued to follow the more generous policy set out in *A Fair Deal for Staff Pensions* for the public sector. The introduction of this legislation two years prior to the new TUPE Regulations meant that the similar TUPE Regulations were low impact.

Variation of Terms and Conditions and TUPE

The business world can be fast paced and this sometimes requires changes in the workforce and the Terms and Conditions (T&Cs) of its contracts. Varying T&Cs can be tricky at the best of times however in a TUPE scenario it can be very difficult. The TUPE (1981) Regulations did not provide any legislation for contract variation. As such, the revamped 2006 Regulations offered a great opportunity to provide the business world with a tool to implement T&Cs. However, the Government decided not to use this opportunity, instead leaving precedent case law to guide the business and legal community. In this chapter we will map out the legal landscape and the options that are available to vary T&Cs.

Restrictions of Contract Variation

The ARD is designed to protect the employees' original rights and, more specifically, the T&Cs of employment by ensuring s/he will enjoy the terms post-transfer. A landmark case in contract variation is *Foreningen AF Arbejdsledere I Danmark v Daddy's Dance Hall*¹⁴.

The case went to the ECJ and concerned the transfer of the lease on some restaurants and bars from Irma Catering to Daddy's Dance Hall. The ECJ found that the ARD covered the transfer. An employee, Tellerup, had previously worked for Irma and was then taken on by Daddy's Dance Hall. The T&Cs of the new contract, taken as a whole showed no detriment when compared to the old Terms. However, when the individual terms of the contract were compared, some were advantageous, some disadvantageous. The advantageous terms were enforceable, and the disadvantageous were not, hence the employee came out with a far superior contract. However, the ECJ ruling was clear – employees were not able to agree changes to their contract that were caused by the transfer.

The TUPE (2006) Regulations set out that change to an employee's T&Cs cannot be made where the sole or principal reason is:

- the transfer itself;
- a reason connected to the transfer which is not an economical, technical, or organisational reason entailing changes in the workforce.

Note that 'changes in the workforce' refers to change in the numbers of staff. We shall now discuss each of the above bullet points.

¹⁴*Foreningen AF Arbejdsledere I Danmark v Daddy's Dance Hall* (1988) IRLR 315

Changes due to the transfer itself

Since the *Daddy's Dance Hall* case, several other cases have posed the question of whether the inability of an employee to agree to detrimental contractual changes only applies where the transfer is the sole reason for the change, or does it extend to when the change is *connected* to the transfer?

The case of *Ralton v Havering College of Further and Higher Education*¹⁵ clarified the situation. In the instant case, three college lecturers employed were on terms called the 'silver book' – a collective agreement between local authorities and the Unions. Two were on fixed term contracts and when these expired they were offered employment on the college's terms, not those of the silver book. The third worker was on an ongoing contract but accepted a promotion on the college's terms. All three claimed they should have been employed on the silver book terms. The EAT indicated that the transfer had to be the *sole reason* for the change. There are two main aspects to the EAT decision; the *terms of the transfer* under the Directive, and whether the change was *connected to the transfer* and therefore invalid.

The Terms of the Transfer

In the *Ralton* case, the EAT held that the employees transfer on their existing terms. If they had remained in the employment of the local authority they would have probably maintained the silver book terms and conditions, although not legally bound to do so. The EAT stated that all three lecturers should receive the silver book terms post-transfer. However, the college was free to offer new T&Cs on promotion or renewal of fixed term contract.

Changes connected to the transfer

In the instant case, the EAT found that additional factors had influenced the colleges decision to not provide the silver book T&Cs. The demand for courses, the promotion and the renewal of fixed term contracts were all factors and hence the change was valid.

TUPE Regulation 4(4) states that:

“any purported variation of the contract shall be void if the sole of principal reason for the variation is ...”

So, as in the *Ralton* case, additional factors will permit the variation to the contract. This creates an opportunity to circumvent the TUPE Regulations by ensuring that other factors exist. If no other factors can be shown then there is a second opportunity to validate the change to T&Cs by providing an ETO defence.

¹⁵*Ralton v Havering College of Further and Higher Education* (2001) IRLR 743 EAT

The case of *Martin and ors v South Bank*¹⁶ seeks to clarify whether variations made to T&Cs where the reason for the change is connected to the transfer are void and then subsequently remedied in the manner of *Daddy's Dance Hall*.

The claimants worked at Redwood College of Health Studies as nursing lecturers. Their employment was governed by the General and Nurses and Midwives Whitley Council (GWC) and they were members of the pension scheme. The scheme provided enhanced retirement pension compensation in the event of redundancy; in the interests of the efficiency of the service; or an organisational change. Redwood College then became part of South Bank University (SBU). SBU then informed the claimants that they would be able to remain in the NHS pension scheme. Three options were offered to the claimants:

1. leave the NHS pension scheme and start a new arrangement;
2. transfer from the NHS pension scheme to a SBU scheme;
3. leave the NHS pension scheme alone and not take out a new pension scheme.

The claimants did not accept the Terms and Conditions of the SBU contract. They joined the Teacher's Superannuation Scheme and applied for the NHS pension to be transferred. Martin was not able to do this because she was over 60 at the time of the transfer of undertaking. Because of changes made by the government, SBU contacted all academic staff aged over 50 and advised them that they may not be able to take early retirement after 31 March 1997. Martin chose to take early retirement before this date. Martin then complained that she should have received a more favourable retirement package under the T&Cs of GWC.

The case concluded with a multifaceted analysis. However, the judgement we are interested in is:

"SBU wished to bring the terms upon which it offered early retirement to the transferred employees into line with those offered to its other employees. In such circumstances, an alteration of the employment relationship had to be regarded as connected to the transfer, and any consent given by transferred employees to the alteration was invalid in principle".

So, alterations to employees' T&Cs that are *either* the 'reason or principal reason for the change' or 'a reason connected to the transfer' will invalidate the variation and the transferee will be deemed responsible for making amends.

So, how can we validate changes to T&Cs that are related to the transfer? Firstly, it should be noted that the strength of the connection between the transfer and the change to T&Cs will not weaken over time¹⁷. We shall now look at some strategies to vary T&Cs in connection to a relevant transfer.

¹⁶Martin and Ors v South Bank (2003) E.C.R. I-12859

¹⁷Taylor v Connex South Eastern (2001) Emp L.R 72

Harmonisation strategies

The central motivation behind aligning new employees that have arrived to the business via TUPE with existing employees is create a workforce that is aligned. Inconsistencies in T&Cs can spread industrial relations unrest. It may be that the advantageous T&Cs are not visible to other members of staff. However, it may be that not only are the T&Cs highly visible but also highly disruptive. For example, a merger of two high street retailers where the shops are re-branded as one and the two sets of staff are contracted to different working hours. This would be very disruptive to the working environment of the shop; with employees working unaligned shift patterns. So what strategies can be used to harmonise the potentially multi-tiered workforce?

Natural Re-alignment

The obvious solution to harmonise contracts is by natural re-alignment, whereby as employees leave the company, new employees are brought in on T&Cs favoured by the business. However, this has two main problems. Firstly, the process can take a very long time and is passive – in the sense that the business does not have a firm control over progress. Secondly, as the process takes a long time, the requirements of the business may change, and hence the T&Cs of the workforce will need to adapt. So, in effect the business is chasing a moving target.

ETO Defence – Dismissal and Re-engagement

The use of the ETO defence is based on the case of *Wilson v St.Helens Borough Council Meade and Baxendale v British Fuels Ltd*¹⁸. In the instant case, Lancashire County Council held the contract to manage a care home owned by a Trust. The Council could no longer afford to run the home and the contract was offered to St.Helens, whom accepted the offer on the condition that it did not become an additional financial burden. Such a financial burden would be negated by reducing staff numbers and negotiating payments. There were 162 employees working at the home, all of which were made redundant. A total of 72 workers transferred to St.Helens, some which carried out different duties and had different remunerations; some staff were placed at an advantage some at a disadvantage.

¹⁸*Wilson v St.Helens Borough Council and Meade and Baxendale v British Fuels Ltd* (1997) IRLR 505 CA; (1998) IRLR 706 HL.

The House of Lords made the following decisions in relation to the dismissal and re-engagement.

- Dismissals connected to the transfer are automatically unfair unless there is an ETO reason under Regulation 8(2);
- The dismissal are not void but are effective, the employment does not transfer to the new employer;
- However, unless an ETO defence is substantiated, employment liabilities will transfer to the new employer;
- As the old contract has ended, the dismissed employee can be re-engaged on a new contract with the new employer. Although the employee can still seek compensation, re-engagement of previous T&Cs, or re-instatement.

The strategy to dismiss employees pre-transfer and then new employer re-engage on new T&Cs appears to be legally sound. Although, there is the risk that the employees take action against the transferee for unfair dismissal. The process is extreme and poses the problem that if more than 20 employees are being dismissed then collective redundancy consultations have to be held.

Let us take a closer look at the process that would have to be followed to carry out the variation of T&Cs by dismissal and re-engagement using an ETO defence.

- the employer must have a valid ETO defence;
- the employer should draft the proposed T&Cs (in-line with transferee's current T&Cs);
- if more than 20 employees are to be dismissed then collective redundancy consultations should be followed;
- the draft proposal should be able to be amended during the consultation process;
- during consultation the employee or Union representatives may Agree to the new T&Cs and this should be the aim;
- individual employees must be consulted;
- notice can then be served to the employees;
- these employees can then be re-engaged by the transferee.

A Choice of New Terms

Another strategy used by transferees in an attempt to harmonise the transferred employees with the older workforce is to present the new employees with new T&C's that are *overall* more favourable than those contained in their previous contract. This will seem attractive to the employee. In practice, this can be effective because if the employee favours the T&Cs s/he is, hopefully, unlikely to seek legal recourse.

However, legally it is fraught with problems. As discussed, the *Daddy's Dance Hall* case set a precedence to allow the employee to go through each of the T&Cs and 'cherry pick' the best from both the contracts – which clearly is not an attractive outcome for the employee.

Pre-transfer Changes

Is it possible for the *transferor* to vary the staff's T&Cs who will transfer? The case *Mairs (HM Inspector of Taxes) v Haughly*¹⁹ sheds some light on this strategy. The instant case concerned the privatisation of Harland and Wolff. The employees would transfer to Harland and Wolff 1989 Ltd on new T&Cs. The main change was that after a two year period they employees would forego their contractual enhanced redundancy entitlement. In return they received 30% of the redundancy payment they would receive at the time in addition to £100 per year of service. The case was related to the tax payable on the sum payable. The employees won the case: there was no tax payable because the redundancy payment would have been exempt. However, the case does highlight the possibility for pre-transfer contract variations without the requirement for dismissal and re-engagement. In this case the employees signed a statement accepting the new T&Cs, which were activated upon transfer. The strategy requires additional review by the Tribunal system. However, it may be that in this scenario the employees were concerned with receiving a tax-free payment and not concerned with restoration of pre-transfer rights.

¹⁹*Mairs (HM Inspector of Taxes) v Haughly* (1993) IRLR 551 HL

Was the Government's Approach to Contract Variation Correct?

The advent of the TUPE (2006) Regulations provided an opportunity for The UK Government to gift the business and legal community legislation to vary T&Cs on the transfer of an undertaking. However, this opportunity was not taken. Instead, it has been left to precedent case law to map out the options available for employers. Has this strategy been successful? Was it to correct strategy to take?

Let's take it back to the ARD's purpose regarding variation to T&Cs in a TUPE scenario; to ensure the employees enjoy the same T&Cs post-transfer as they did pre-transfer. The *Daddy's Dance Hall* case is perfect to illustrate how this ethos has been carried out. In the event of T&Cs being varied, detrimental variation will be come void and the employee can enjoy cherry picking from both the contracts. Effectively, the employee contracts are preserved and there lies potential to for a punitive remedy towards to transferee by improving the employee's contract.

Moreover, case law has demonstrated that this protection exists whether the alteration to the T&Cs is the '*reason or principal reason*' or '*a reason connected to the transfer*'.

The only proven strategy is to use the ETO defence to dismiss and to re-engage. This is an extreme strategy and contains risk of claims for unfair dismissal, compensation, and re-instatement of previous T&Cs. This is an intriguing legal landscape because what it effectively means that employers have to be in a very tight spot to take on the risk of reprisal, and also, have good communication between transferor and transferee - hence this would not be viable in service provision between two contractors. In addition, this confrontational strategy can easily damage industrial relations. Thus, it is really only a viable option for very specific situations.

Over recent years there has been discussion by the Labour Government permitting contract variation under TUPE via an ETO *without dismissal*. This would reduce the risk taken compared with dismissal and re-engagement. At the time of writing the Coalition Government's views on this action are unknown. However, the Government, notably Cameron, has voiced concerns with the business world becoming over run with too much employment law legislation, as would be expected from a Conservative voice with strong links to big business. This would infer that the TUPE Regulations may be relaxed to spur on mergers and acquisitions by permitting contract variation with an ETO without the need for dismissal. This would certainly be significant step to take and add a very interesting angle to the TUPE Regulations. But is such action limited by European Law?

The ARD does not provide any specific legislation on the Member States providing legal machinery to facilitate amendments to T&Cs. We have seen from case law how an ETO defence can be used when coupled with dismissals and this action is unsupported by the ARD. Could the boundary be pushed farther to accommodate an ETO defence without dismissals? This would be have be tested the ECJ.

Moreover, should the UK Government have proceeded to provide legislation to facilitate T&Cs variation via an ETO defence *without* dismissal upon the construction of the TUPE (2006) Regulations? The ARD does not provide any legislation for T&C variation via an ETO defence *with* dismissals. As such, this part of the TUPE Regulations was a departure from the ARD and could have been shown to be contradicting the Directive. However, given that this Regulation 7(2) was transposed from the 1981 Regulations, why not facilitate mergers and acquisitions in 2006 rather than wait until a later date?

Whilst putting place legislation to vary T&Cs via ETO without dismissal would be benefit employers and stimulate mergers and acquisitions, it would of course, remove protection afforded to the employees. It is this balance that both the ARD and TUPE Regulations attempt to find. It should always be remembered that the ARDs purpose is to permit employees to enjoy the same T&Cs pos- transfer and they did pre-transfer. It is possibly for this reason the UK Government has not put such legislation in place and has remained true to the ARD.

Insolvency and TUPE

Background

The 1977 ARD did not provide any legislation on the transfer of undertakings in an insolvency setting as such the TUPE 1981 Regulations were also weak in this area. The TUPE 1981 Regulations *did* state that any dismissal made in connection with the transfer, or had the dismissal as its primary reason, was automatically unfair unless it was for economical, technical or organisation (ETO) reason. This meant that the transferee took on the staffs' employment contracts and these could not be altered after the sale of the business. This acted as a major disincentive to prospective buyers of the insolvent company because the ability to impact and manipulate the staff setup.

The landmark case with the ECJ with regards to the ARD and insolvency situations is *Abels v Administrative Board of the Bedrijfsvereniging voor Metaalindustrie ende Electotechnische Industrie*²⁰. In the instant case, the ECJ first set out its now well versed opinion:

“It cannot be concluded that Directive no.77/187 imposes on the Member States the obligation to extend the rules laid down therein to transfers of undertakings, businesses or parts of businesses taking place in the context of insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of the competent judicial authority”

This opinion is echoed throughout the TUPE Regulations in insolvency situations, as we shall now discuss.

²⁰*Abels v Administrative Board of the Bedrijfsvereniging voor Metaalindustrie ende Electotechnische Industrie* [1985] ECR 469 ECJ

ETO in Insolvency Situations

The TUPE Regulations have always lacked clarity with regards to economic, technical and organisation reasons – within or outside an insolvency situation. Instead, the Government has opted for case law to set a precedent. As such, we shall now discuss some of the landmark cases that have defined these three categories defence for changed Terms and Conditions with an insolvency situation. Later, we will discuss how these transcend into the TUPE 2006 Regulations.

The courts have always viewed the ETO defence as that of one that related to a business' conduct. A prime example of this is the case of *Wheeler v Patel*²¹, where the EAT stated that trying to achieve an improved value on the business is not an 'economic reason' because it is not related to conduct. This requirement for the ETO to be related to conduct under the TUPE (1981) Regulations²² was further clarified in the case of *Thompson v SCS Consulting Ltd*²³. In the instant case, when deciding whether a dismissal is validated by an ETO reason, the EAT stated an employment tribunal;

“must consider whether the reason was connected with the future conduct of the business as a going concern”.

Moreover, the EAT also stated that a tribunal can and should take into account whether there has been any collusion between the transferor and transferee in relations to the dismissal.

The timing of the dismissals has also shown to be factor in their connection to an ETO reason – the longer the period from the transfer the less likely it is for a connection to be made.

In *Ibex Trading Co Ltd v Walton*²⁴, employees were dismissed on 16 October 1991, with effect from 4 November 1991. An offer for the business was made on 11 November 1991 and this led to the sale of the company on 13 February 1992. The EAT held that the dismissal was not connected to the transfer on the basis that that at the time of dismissal not only had the transferee not been identified, but the prospective of finding a purchaser was only a concept.

An intriguing juxtaposed case to that of *Ibex* is *Harrison Bowden Ltd v Bowden*²⁵. An employee had worked for the company for two and a half years when the administrators placed an advertisement for the sale of the business. The next day most of the staff was made redundant. The EAT held that although there was no identifiable transferee the reason was connected to the transfer under Regulation 8(1).

²¹ *Wheeler v Patel* [1987] IRLR 221 EAT

²² Regulation 8(2) TUPE Regulations (1981)

²³ *Thompson v SCS Consulting Ltd* [2001] EAT 34/00

²⁴ *Ibex Trading Co Ltd v Walton* [1994] IRLR 564 EAT

²⁵ *Harrison Bowden Ltd v Bowden* [1994] ICR 186 EAT

However, later case law has show the *Ibex* ruling to fall out of favour with the courts as stated in *Morris v John Grose Group Ltd*²⁶.

In the later ruling of *Michael Peters v Farnfield*²⁷, the EAT took a wider view on the connection between dismissal and transfer. Although, in the instant case the EAT found there was connection between dismissal and transfer, it also stated that dismissal were connected to the eventual sale of the business as they are deemed necessary to facilitate the purchase.

The ETO exceptions discussed above are in relation to TUPE (1981), however the legislation was transposed into TUPE (2006) Regulation 4(5) and as such the above cases provides the reader with some clarification of ETOs.

Insolvency and the TUPE 2006 Regulations

The insolvency provisions in TUPE (2006) are contained in Regulation 8 and 9. Regulation 8 excludes certain insolvency proceedings from the application of provisions on transfer related liabilities and unfair dismissal and dictates where the liability for the pre-existing debt to employees lies. Regulation 9 lays out the permitted variations to employees' contracts Terms and Conditions in relation to transfers of insolvent businesses.

As previously discussed the *Abels* case provides the basis for Article 5.2 of the ARD that unless Member State provide otherwise:

“It cannot be concluded that Directive no.77/187 imposes on the Member States the obligation to extend the rules laid down therein to transfers of undertakings, businesses or parts of businesses taking place in the context of insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of the competent judicial authority”

Under the Insolvency Act 1986, the principal administrator on the debtor's assets should be professionally qualified. As such, there are procedures available under the Insolvency Act 1986 that will be excluded from the ARD under Article 5.1- these will be those that have liquidation of assets as their purpose, and, therefore, no expectation of business continuity. Types of insolvency proceedings that fall into this scenario will be;

- Compulsory wind-ups
- Bankruptcy
- Creditors voluntary wind-ups (in some instances)
- Administration with a view to liquidation

Definitions of the above scenarios can be found in the Appendix 1, as stated a BERR publication²⁸.

²⁶ *Morris v John Grose Group Ltd* [1998] EAT 773/97

²⁷ *Michael Peters v Farnfield (in administrative receivership)* [1995] IRLR 190 EAT

²⁸ REDUNDANCY AND INSOLVENCY PAYMENTS - www.berr.gov.uk/files/file30031.pdf

Article 5.1 is reflected in Regulation 8(7) of the TUPE (2006) Regulations, which states;

“Regulations 4 and 7 do not apply to any relevant transfer where the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to liquidation of the assets of the transferor and are under the supervision of an insolvency practitioner”.

Where the relevant sections of Regulation 4 to insolvency refer to:

- restrictions on employment contract termination/variatioins;
- restrictions on transferors rights, duties, powers and liabilities in relation to employment contracts will be passed to the transferee.

Also, the relevant sections of Regulation 7 to insolvency refer to:

- any dismissal related to, or a reason connected to, the transfer that is not for an ETO reason will be treated as an unfair dismissal as per Part X of Employment Rights Act (1996);
- where dismissal is deemed to be by reason by an ETO, this must be shown under Sections 98(1)(2c)(4) and 135 of The ERA (1996) to by means of redundancy.

The overall effect of Regulation 4 is that in an insolvency situation no liability at all passes over to the transferee and provisions relating to automatic unfair dismissal do not apply.

Article 5.2 of the Directive gives Member States two options in cases where its requirements are applied in relation to “insolvency proceedings ... under the supervision of a competent public authority (which may be an insolvency practitioner determined by national law)”.

The two new options are to provide that:

- in cases giving rise to protection for employees at least equivalent to that provided for in situations covered by the EC Insolvency Payments Directive (80/987/EEC), the transferor’s pre-existing debts toward the employees do not pass to the transferee; and/or
- employers and employee representatives may, exceptionally, agree changes to terms and conditions of employment by reason of the transfer itself, provided that this is in accordance with national law and practice and with a view to ensuring the survival of the business and thereby preserving jobs.

The underlying aim of these options is to allow Member States to promote the sale of insolvent businesses as going concerns. The Government has decided to take advantage of both options, as proposed in the September 2001 public consultation document. This is in accordance with its policy to promote the “rescue culture”.

The net effect of draft Regulations 8 is to ensure that, where the transferor is in one of the types of insolvency proceedings described in Article 5.2, all ‘relevant employees’²⁹ – those who transferred to the transferee and those who were unfairly dismissed by the transferor by reason of the transfer itself or a non-ETO reason connected with the transfer – are entitled to receive payments from the Secretary of State in respect of relevant debts incurred by the transferor. This is just as if they had been dismissed by the transferor in circumstances where the dismissal would have been potentially fair – i.e. fair subject to the usual test of reasonableness in the unfair dismissal legislation. In cases where the relevant employee has transferred – i.e. where the relevant employee falls within draft Regulation 8(2)(a) – the date of transfer is treated as the date of dismissal for the purposes of calculating insolvency payments in respect of which the “appropriate date” (see section 185 of the ERA 1996) is the date of dismissal, as stated in Regulation 8(3).

The Redundancy Payments Office handles claims related to wages, or pay in lieu of notice, accrued holidays, the basic award of compensation for unfair dismissal and unpaid pension contributions. The liability for any other debts owed by the insolvent transferor to relevant employees will still pass to the transferee in the relevant transfer, as they would do under the existing Regulations. Note that the maximum Redundancy payment made by an insolvent company is £800 per employee³⁰, which may represent a substantial reduction in total redundancy payouts.

The UK Government discounted the alternative of providing for all debts to remain with the transferor, on the grounds that any debts that were not payable under the insolvency payments provisions would fall for consideration, along with debts owed to other creditors, in the insolvency proceedings, and it is considered that this would provide insufficient protection for the relevant employees.

Regulation 8(6) defines relevant insolvency proceedings as meaning insolvency proceedings which have been opened in relation to the transferor employer but not with a view to liquidate the assets of the transferor and which are under the supervision of the insolvency practitioner.

A recent EAT decision in the case of *Secretary of State v Slater*³¹ held that Regulation 8(6) applied where an insolvent business was being liquidated. However, the business had to be insolvency proceedings when transferred and also subject to the supervision of an insolvency practitioner. In the instant case, the business was not under the supervision of an insolvency practitioner and as such the liability of debts did not lie with the Secretary of State.

²⁹ ‘Relevant employee’ is defined as being an employee of the transferor whose employment contract passes from the transferor to the transferee by virtue of the operation of the TUPE Regulations 2006 in relation to the relevant transfer, or whose employment contract is terminated prior to the relevant transfer in the circumstances described in Regulation 7(1).

³⁰ www.niassembly.gov.uk/researchandlibrary/2010/2210.pdf

³¹ *Secretary of State v Slater* [2008] ICR 54

Pre-pack insolvency

As previously discussed, the emphasis on the intent for a business when insolvent is pivotal when determined whether the TUPE Regulations apply. This ‘intent’ has been taken one stage further with the advent of ‘pre-pack’ administration – where the company is put into administration and then sold under an arrangement *before* the administrator is appointed. The intent at the point of transfer is to liquidate the company and so standard TUPE Regulations are not triggered.

This scenario was highlighted the business community by the *Oakland v Wellswood (Yorkshire) Ltd*³² case. Mr Oakland was a general manager at Wellswood Ltd (referred to as ‘OldCo’) between 2003 and 2006. As a result of financial difficulties, OldCo appointed administrators on 6 December 2006. Prior to going into administration, OldCo discussed the financial problems with a customer called Gilbert Thompson Leeds Ltd (GTL), the result of which led GLT to setup a new company (NewCo) to wholly own OldCo as a subsidiary. NewCo was used a vehicle to purchase OldCo’s assets, including the industrial units and all the equipment required to wholesale fruit and vegetables. Five out of the seven employees (including Mr Oakland) of OldCo became employees of NewCo. After NewCo had been trading for just under one year, Mr Oakland was dismissed with no notice. Mr Oakland brought proceedings for unfair dismissal on the grounds of continuity of service from OldCo that provided him with over one year service and associated rights.

The EAT scrutinised the application of Regulation 8(7). Notably, Judge Peter Clark highlights that the “issue arises in this case because Parliament has declined to specify which particular insolvency proceedings are to be characterized as having been instituted with a view to the liquidation of the transferor company's assets. Nor do I derive any assistance from the BERR Guidance to the 2006 TUPE Regulations”. The UK Government has missed an opportunity to clearly state which insolvency scenarios will trigger Regulation 8(7); an opportunity provided to all Member States in ARD 5(2). Hence, clarification was left to case law.

The instant case distinguished between two types of administration, ongoing concern and that of liquidating assets and distinguished the latter scenario as that which triggered Regulation 8(7). This decision, coupled with that of *Slater*, provides that the ‘pre-pack’ insolvent sale of a company can exist in the following conditions:

- at the point of transfer an insolvency practitioner must be appointed;
- the administrative procedures must be bankruptcy, a compulsory wind-up, administration with a view to liquidation, or a creditors voluntary windup;
- the pre-pack sale has been constructed with a view to liquidate;
- the insolvency practitioner must view the best course of action to be liquidation;

³²*Oakland v Wellswood (Yorkshire) Ltd* [2009] EWCA Civ 1094

The *Oakland* case and the advent of the insolvency pre-pack has undoubtedly provided businesses with another angle to rescue organisations in trouble. The case law has clarified that TUPE insolvency Regulations can be applied to organisations in administration if they are facing liquidation. However, the presale of the company and subsequent stripping down of the company post-insolvency announcement permits the company to carry on trading. Whilst this has been a valuable tool in the engineering of phoenix deals, it has also provided much scope for a struggling business to pitch to new business partners and venture capitalists.

Permitted Variations of Terms and Conditions

Regulation 9(1) provides for the alteration of terms and conditions on employee's contract in the event of insolvency. The exact wording is as follows:

“If at the time of a relevant transfer the transferor is subject to relevant insolvency proceedings these Regulations shall not prevent the transferor or transferee (or an insolvency practitioner) and appropriate representatives of assigned employees agreeing to permitted variations”.

The Regulation is quite succinct in patently grasping hold of the ‘rescue culture’ ethos of the ARD. Indeed, Regulation 9(2) is transposed from Article 5(2b). As has been discussed previously in this document, outside of an insolvency situation, ETO reasons need to be cited to justify changes to employees’ terms and conditions. However, the ETO defence is not required in an insolvency scenario provided that certain conditions are met. The safeguards provided in Regulation 9 are as follows:

- the changes should be agreed by either the transferor or the transferee and the employee (or employee representatives) of the opposing side;
- the variations to the contract must be to “safeguard employment opportunities by ensuring the survival of the undertaking or business part of the undertaking or business”.

The definition of “ensuring the survival of an undertaking” is one of contention and has never been defined by precedent law. Presumably, it encompasses variations that the transferee is prepared to accept and proceed with a rescue plan.

The definition of “appropriate representative” is stated in Regulation 9(2). Essentially, a Trade Union Representative can be used or Employee Representatives that have either been appointed or elected. If elected the election procedure is as stated in Regulation 14 (not including 14(d)).

The legislation has been designed to provide employees with the confidence and freedom to negotiate with potential buyers. However, the Regulations do still contain some constraints that may impinge on the practicality of negotiating variations to terms and conditions.

The central constraint is that of time. Insolvency scenarios often require fast negotiations. This is particularly true of businesses in the public eye who may wish to complete the deal before it is highlighted in the media. The TUPE Regulations have a

requirement for consultation of representatives, the additional consultation requirement laid out in Regulation 9 for contract variation add another layer of procedures in an already tight timeline. This is particularly evident in a non-union scenario where employee representative elections may have to be held.

Has a 'Rescue Culture' been created?

The outlook for a financially struggling business is considerable and certainly subscribes to the ARD's proposed 'rescue culture', providing additional funding can be sourced. However, the domestic integration of the ARD has certainly been controversial with high profile companies such as Whittards of Chelsea and the restaurants of Anthony Worrall Thompson going through high profile pre-pack administration sales. Has the TUPE Regulations created a 'rescue culture'; is this at the expense of protecting employees?

Scope of legislation

As discussed, the insolvency procedures apply to a range of the more severe insolvency scenarios, and do not apply, for example, to voluntary arrangements or members' voluntary liquidation. The UK Government has set the threshold at which point the rescue options become available as low as possible in order to reduce engineered insolvency transfer proceedings. However, this has still left open a narrow avenue for 'phoenix deals'; whereby senior management place the company into insolvency - and activate Regulation 8(7) - which then places the business in a position to gain external financial support and strip down the organisation.

Stripping down the business

The purpose of ARD 5.2 and Regulation 8 and 9 of the domestic Regulation are to create a rescue culture. This has shown to be a doubled edged sword, because whilst the Regulations have been abused, they have also undoubtedly aided the continuation of many organisations.

The ability to make employees redundant with a maximum payout from the business of £800/employee, and vary remaining employees' contracts provides huge scope to ensure the continuation of the business. Moreover, the Regulation also limits the scope of the variation of the contract by placing very tight deadlines. The variations have to be consulted upon via a Trade Union Representative or elected employee representative and this is time consuming and hence places time constraints on trashing out variations on employment contracts. It could be argued that this will reduce the likelihood of major detriment to employees' Terms and Conditions.

Are employees afforded enough protection?

Whilst employees may suffer material detriment via variations to their contracts and others may be made redundant, the core of the staff will remain; which of course would not be the case if the business was liquidated. The biggest losers in a insolvency transfer are the creditors and potentially employees and ex-employees with occupational pension plans. Which, conversely, are often the main financial targets of the transferee.

Are the employees of the transferor protected enough in a TUPE insolvency situation? Whilst their T&Cs of their contracts may be substantially altered and redundancy via an ETO dismissal are relatively easy, this is balanced out by transferor looking more attractive to potential investors and hence the employees have a greater chance of maintaining employment. In addition, the Government ensured that debts to employees do not remain with the transferor, which increases the probability of remuneration.

The problem may occur, however, where the protection afforded to the employees is reliant on the free market investing in the transferor, and this protection is not directly by way of legislation: rather the legislation opens the door for protection via a possible rescue. This is a huge deviation from the protection afforded to employees in a non-insolvency TUPE situation, where alteration of T&Cs and dismissals have a far higher barrier.

Government crackdown

The new Coalition Government has vowed to crack down on the exploitation of so-called "pre-pack" administrations by closing loopholes used by owners of insolvent businesses. The pressure has come from media stories citing some directors taking advantage by selling the business to themselves at a reduced price to free themselves of debts, leaving creditors – usually local businesses – at a financial deficit.

The amended Directive provides a clause for Member States to take action against “engineered” insolvency proceedings. The ARD allows Member states to “take action measures with a view to preventing misuse of insolvency proceedings in such a way as to deprive employees of the rights provided for in this Directive”.

A government body, the Insolvency Service, introduced new reporting guidelines last year for administrators to make pre-pack deals more transparent, particularly when they involved a management buyout of part of the business. This would give creditors more information about whether a fair price was achieved in any transaction, and would allow them to make a legal challenge if they believed their claims were being ignored. But the Insolvency Service claims that a third of the new "SIP 16" reports administrators are required to draw up are incomplete or missing entirely. It wants to make completion of the report compulsory and to appoint an official receiver to provide independent scrutiny of directors’ and administrators’ actions.

The new rules, backed by the government, would try to prevent conflicts of interests by making it impossible for a person advising on a pre-pack to be the administrator. Creditors would also have to sanction pre-pack deals involving connected parties such

as company directors. But the insolvency profession trade body, R3, has blamed the Insolvency Service for not providing clear guidelines on how to complete the SIP 16 forms and said the changes could drive up costs.

Overall, the insolvency proceedings Regulations in TUPE have stimulated a rescue culture of struggling businesses. However, like any system it is open to abuse and the Regulations need to be refined. The ARD provided Member States with the capacity to make amendments and with media coverage of the systems abuse, notably phoenix deals, pressure will mount on the new coalition Government to make such changes.

Conclusion

Throughout this text we have discussed several intriguing aspects of the TUPE Regulations; how it has evolved to close down loopholes and struggled to maintain the balance of employee protection – as proposed by the ARD – and stimulating the business environment to facilitate mergers and acquisitions.

One of the more radical approaches of TUPE 2006 was the formation of legislation that specifically dealt with the transfer of a service. Such provision was not included in the ARD and as such this was an innovative approach for the UK Government. The legislation provided a simple solution to a problem that seemed intrinsic to TUPE: that of altering a company's identity. Whilst this remains a problem for business transfers, where a couple of factors can be changed post-transfer to show a lack of identity retention, the service provision removed the need to show identity retention. This successfully closed a loophole being exploited to facilitate innovative bidding.

The introduction of Employee Liability Information was undoubtedly a major step forwards to increasing transparency to transfer of undertakings. However, the two week time period imposed to exchange the information seems to be very tight. Larger transfers could have thousands of records to sift through, whilst smaller transfer may see smaller organisations involved with tight resources. It may be that this short timeline reduces the ability for transferees to vary T&Cs, so may actually protect employees, although at present this is not quantified.

TUPE 2006 will always be blighted by the lack of any provision to transfer occupational pensions. The UK Government spent a lot of energy trying to facilitate this, however, as in the ARD, the fundamental problem lay in the transferee requiring the financial capacity to take on the pension schemes. Moreover, with the pension crisis tumescing over the last decade, they are often a major target of the transferee to negate. Hence, facilitating their transfer would disincentivise potential investors.

Probably the biggest missed opportunity of TUPE 2006, was not providing an enhanced legal framework for altering T&Cs. This could have been achieved by permitting an ETO defence without the requirement for associated dismissals. However, this would have been a departure from the ARD and would have reduced the protection of employees, in the writer's opinion, by too much. The Labour Government was indicating allowing variation via ETO without dismissal, however at the time of writing the Coalition's views are unknown. However, the Government, notably Cameron, has voiced concerns with business becoming drowned in employment law legislation, so one could speculate it's on its agenda.

The Government has pushed manoeuvrability for employers towards businesses which are insolvent. In this area of the mergers and acquisitions market, the balance of power moves dramatically towards the employers, who can vary T&Cs and dismiss without an ETO defence as long as the action is "*ensuring the survival of an undertaking*". Whilst employee rights have been stripped down here, this actually makes the insolvent company more attractive to potential investors and hence may maintain employment. It is this "*rescue culture*" that the ARD was attempting to promote and that has been highlighted in the media by high profile cases

The advent of the insolvency ‘pre-pack’ has provided business with another angle to rescue organisations in trouble. The *Oakland* case clarified the mechanics of the TUPE Regulations for businesses that are insolvent and facing liquidation. Whilst this has caused controversy amongst the public, it does effectively facilitate the purchase of the company and allow it keep on trading.

Perhaps more infuriating to the public is the rise of the ‘phoenix deal’; whereby senior management places a business insolvent and activates Regulation 8(7). This allows the organisation to gain external funding and strip down the business by reducing debt, pensions, amending employments contracts and dismissing employees. The new Coalition Government has vowed to crackdown on pre-pack and phoenix deals by closing loopholes. Whilst this may be a political crowd pleaser and a possible step forwards, it is the complexity of the TUPE Regulations that often causes problems because history informs us that as one loophole is closed another opens.

Appendix

Definitions of Insolvency Scenarios

Bankruptcy

Where a trustee in bankruptcy sells a business that was run by the bankrupt there is no question of the employees' contracts of employment passing to the purchaser. In such a case there will be a redundancy of the employees and redundancy and insolvency payments owed to employees will be payable by the Secretary of State in accordance with the provisions of Parts XI and XII of the Employment Rights Act 1996. The reason for this is that regulation 8(7) provides that neither regulation 4 nor regulation 7 is to apply to bankruptcy proceedings.

Compulsory liquidation

Where a company is wound up by an order of the court on grounds that it is unable to pay its debts, regulations 4 and 7 of the 2006 TUPE Regulations do not apply as such proceedings are liquidation proceedings under the supervision of an insolvency practitioner that are analogous to bankruptcy proceedings. The position under case law was that on the making of a winding-up order this operates to terminate the contracts of employment of any employees as at the date of the making of the order. Employees will be entitled to insolvency and redundancy payments out of the National Insurance Fund in accordance with the provisions of the Employment Rights Act 1996.

Creditors' voluntary liquidation

Where a liquidator sells a business run by a company that is in creditors' voluntary liquidation regulation 4 and regulation 7 will not apply. These provisions are disapplied by regulation 8(7) by virtue of the fact that creditors' voluntary liquidations are liquidation proceedings under the supervision of an insolvency practitioner that are analogous to bankruptcy proceedings.

Accordingly a transfer of a business by the liquidator in a creditors' voluntary liquidation would cause the dismissal of those employees who immediately prior to the transfer were employed by the company unless prior to the transfer there is an agreement between the parties (including the employees) that the transferee is to be substituted as their employer. In the absence of any agreement substituting the transferee as their employer, employees whose contracts of employment with the transferee are terminated will be entitled to be paid redundancy payments and arrears of wages etc. from the National Insurance Fund in accordance with the provisions of the 1996 Act.

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