

The TUPE
exception in
transfers from
insolvent
companies –
what is your
responsibility to
employees?

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TUPE UPDATE FOR HR MANAGERS

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1. Background and introduction

The exception to the rule that employees automatically transfer under TUPE is a very useful tool for Human Resources professionals advising on a transfer involving an insolvent company. However, careful analysis of the situation is required, and the law is far from certain on this point, especially where the insolvent company is subject to Administration.

There can be many benefits in purchasing the healthy parts of an otherwise insolvent business, not least because such purchases often bring goodwill or client contracts/connections and can often be acquired at undervalue. However in such circumstances, the sales, often through an Administrator, must be conducted within a very short time period and consequently without the prospective purchaser having the opportunity to carry out a full due diligence exercise to find out the true value of any contracts or assets being purchased. Also, more importantly for our purposes, whether there are employees who would be assigned to the purchaser under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”).

The purpose of this report is to examine the benefits of such acquisitions to a purchaser, alongside the undeniable difficulties which must be considered by Human Resources professionals and lawyers when advising the company making that acquisition.

2. What are 'pre-packs' and why are they controversial?

This issue has become controversial of late and has generated a number of high profile employment cases. One of the issues in dispute is the applicability of the employment rights afforded by TUPE in such situations. Regulation 8(7) is effectively an exception to the rule that a transferee acquiring an undertaking or part of an undertaking must also accept responsibility for employing those assigned to that undertaking, and protecting their on going employment rights, including maintaining their previous terms and conditions. The question is whether employees are given the full protection of TUPE when they transfer from an insolvent business which is in Administration, or not. Additionally, sales of assets from insolvent companies are conducted some times at lightening speed and therefore this has led to questions as to whether the rights of unsecured creditors are properly protected. In particular, the use of a "pre-pack" strategy by the Administrators has become controversial. A pre-pack occurs when a company is placed into Administration and then its business or assets are sold immediately to a purchaser waiting in the wings, by means of a pre-arranged sale. Such sales occur within a matter of days of the Administration and the concern is that these do not maximise the returns for unsecured creditors. However, there are advantages to such a strategy in that it can avoid an erosion of the business because it allows for continuity with clients and customers, and may theoretically save more jobs if this allows parts of the business to continue to function. The Courts have recognised that a pre-pack strategy is a legitimate tool for Administrators to use.

Usually, when a business or part of a business (an undertaking) transfers ownership, the parties are bound by TUPE, and the Regulations protect the interests of the employees assigned to that part of the business. The main provisions are contained in Regulation 4 of TUPE, which transfers the contract of employment, as formed between the insolvent company and the employee, to the purchaser, which then steps into the shoes of the previous employer, and is bound by all of the

terms and conditions contained in the contract of employment, subject to some minor exceptions regarding such things as pensions. The other main protection is contained in Regulation 7 and effectively prohibits the dismissal of an employee where the reason for that dismissal is the transfer itself or a reason connected with the transfer that it is not an economic, technical or organisational reason entailing changes in the workforce. This is often referred to as an ETO reason. ETO reasons often present themselves as redundancy situations, where, as a result of the transfer, the needs of the business change so there is a diminished requirement for employees to perform particular tasks, and they become potentially redundant. TUPE therefore places far greater restrictions on the dismissal of employees than would apply in other circumstances.

3. The exception contained within TUPE and the 'fact based' approach

Regulation 8(7) reads as follows:

“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 the liquidation of the assets of the transferor and are under the supervision of an insolvency practitioner”.

This exception does not mean there is no TUPE transfer, just that the employee cannot claim that his employment transfers automatically under Regulation 4, or automatic unfair dismissal under Regulation 7 if his employment is not continued. There are a number of ways in which an insolvent company can be dealt with by insolvency practitioners, including Liquidation, Administration, Creditors' Voluntary Arrangement and Dissolution.

The 2008 Employment Appeal Tribunal case of *R Oakland v Wellwood (Yorkshire) Limited* highlighted the importance of Regulation 8(7) and the exception to the applicability of TUPE where the company is subject to Administration. Although the employee had continued to work in the business after the acquisition, it was argued that because of the 8(7) exception, his continuity of employment had been broken, because his contract of employment had not transferred to the acquiring company under TUPE. He therefore did not have the required period of service in order to claim unfair dismissal. The facts as found by the Employment Tribunal were that soon after the appointment of the Administrators they had realised that it was not possible for the business to be rescued as a going concern and that any further period to allow the business and assets to be marketed for sale would have reduced the funds available for distribution to its creditors. The Administrators anticipated that the company would later move into a creditors' voluntary liquidation. Before the EAT the employee argued that Regulation 8(7) did not apply because the business had continued to trade following the appointment of Administrators and it was not therefore an immediate liquidation.

The EAT decided that the Courts and Employment Tribunals should decide on the applicability of the 8(7) exception on a case by case basis, by referring to the facts of each case. Parliament had not decided which of the various insolvency proceedings options were characterised as having been instituted with a view of the liquidation of the assets and have therefore not given guidance as to which should fall within the exception to TUPE. The EAT said that on the facts, where a business continued to trade after the administration with a view to being sold as a going concern then any subsequent sale would attract the protection of TUPE for the employees assigned to that part of the business. However, referring to the facts as decided by the Employment Tribunal they said that in this case, the Administrators had decided that owing to the weak financial position of the company, it was not possible for the Administrators to continue trading the business and therefore the purpose of the administration was to realise the optimum return for creditors in the

final liquidation of the company where its assets were sold. As the appointment of the Administrators was with a view to the eventual liquidation of the assets, Regulation 8(7) applied, and the employees did not get the protection they would otherwise have enjoyed under TUPE.

4. Section 218 and continuity of employment

The Oakland case was essentially one of continuity of service and deciding whether the claimant had sufficient service to make a claim of unfair dismissal. As it was found that he was not protected by TUPE during the transfer, his continuity was not protected by TUPE. However, there are a number of ways in which continuity of employment may be preserved where there is a change of employer. Section 218 of the Employment Rights Act 1996 preserves continuity of employment where a business or undertaking has transferred. There is very little case law interpreting this section but it would seem, from the decision of the Court of Appeal, that it is not reliant on their being a legal 'transfer' under TUPE. It may effectively soften the blow for employees who are not given the full protection of TUPE, for whatever reason (including insolvency of their former employer) so that at least their continuity of employment is preserved. Where their employment is continued with the new employer s. 218 will give them continuity of service and (if they have sufficient service) the right to claim unfair dismissal and possibly a redundancy payment if they are dismissed by the new employer. The caveat for those advising the purchaser is that this section should be taken into consideration when offering employment to those previously engaged in the business, even if the opinion is that TUPE does not automatically transfer the employment of those individuals. It may allow such employees a 'back door' through which to claim unfair dismissal and other service related rights.

5. The 'absolute' approach

Lawyers were aware for many months that other similar cases were progressing through to the Appeal Tribunal and therefore the state of the law was uncertain. In February 2011 the Employment Appeal Tribunal heard together five cases on which the main point was the applicability of the 8(7) exception contained within TUPE. The main case was OTG Ltd v Barke & Others. The much awaited decision disagreed with the EAT in *Oakland* and decided that an Administration can never fall within the exception to TUPE. They rejected a fact based approach for an absolute approach. The decision was based on an assumption that once Administrators were appointed they would need to take some time to consider the question as to whether the appropriate action was to liquidate the assets or to continue to trade with a view to selling the business as a going concern. In such circumstances, they decided that it could not be said that any Administration was embarked upon with the object of liquidating the assets and that, therefore, Administrations did not fall within the exception to TUPE. Where there was an Administration and a purchase of assets or part of a business as a result of that administration, the employees would always be protected by the rights afforded to them under TUPE. This was a complete reversal of the *Oakland* decision. But the chapter is far from over and the law is still emerging on this point.

6. A glimpse at the future

One of the five cases brought before the EAT with OTG Ltd was the case of Key2Law (Surrey) LLP v D'Antiquis & Others. This case progressed to the Court of Appeal and was heard on 17th October 2011. The full written decision is still awaited, however the questions asked at the Court of Appeal hearing indicate that the Court may be minded to favour a fact based approach, as in *Oakland*. Although Parliament has recognised the need to ensure that employees are protected where a business changes hands, and that this protection has been embodied both in UK and European Law, one opposing objective is to encourage a rescue culture for failing businesses, in

order to save jobs and protect the interests of larger groups of employees. This conflicts with the ability to protect the rights of particular individuals as it requires a relaxation of the TUPE Regulations in order to encourage a purchaser to come forward and rescue a failing business and therefore save jobs where possible. The fact based approach and a more flexible approach to applying the exceptions to TUPE encourages a rescue culture.

At present there are a number of dilemmas for those advising purchasers of assets from companies in Administration. By accepting employees and continuing their employment on the same terms and conditions the purchaser avoids the liability of potential unfair dismissal claims. However, this may be commercially unacceptable, given the failing nature of the business. Employing on a 'wait and see' basis is also undesirable, as s. 218 can give employees continuity of service and future rights to claim unfair dismissal. It is a thorny issue and one which should be resolved soon.

We will update you further as soon as the Court of Appeal hands down its judgement.

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