TUPE, ADMINISTRATION AND MINIMISING EMPLOYEE LIABILITIES FOR TRANSFEREES

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Introduction

1. As a general rule, in practice it is fairly unlikely that an administrator will be directly interested in what happens to the purchaser of a business after the event, as long as the administrator's job is done and fees/expenses are paid. It is equally unlikely that the administrator will offer the purchaser any indemnities against potential employee liabilities that might arise out of the transaction, which may not come to light until several months later, when employment tribunal claims start rolling in.

2. However, the administrator *will* generally be interested in the price that the purchaser pays. Indeed, the administrator is under a professional duty to try to achieve the best price possible. For that reason, some recent legal developments in the employment law sphere ought to be of interest. Their effect on the price a purchaser will be willing to pay, if sufficiently well advised, could be significant. Moreover, there are practical steps that can be taken by administrators which would reduce potential liabilities for purchasers (thereby increasing the value of the business being sold), and which purchasers can look for in order to inform themselves properly as to what they are buying. It is not proposed however to deal with the limited means by which liabilities for a failure to consult may be contained, since that would constitute a substantial lecture in itself.

Pressure Coolers and the importance of timing

3. Under ss.182-186 of the Employment Rights Act 1996, where an employer becomes insolvent, the Secretary of State takes on responsibility to make various payments to the employee upon the termination of his or her employment, out of the National Insurance Fund.

4. As a general rule, the Secretary of State will make payment in respect of awards for quantifiable debts (within certain limits), which have accrued. Further, a termination of employment is required for the State guarantee to be triggered. Regulation 8(3) of the TUPE Regulations 2006 deems there to have been a termination by the transferor at the date of the transfer in respect of such liabilities already accrued by the transferor.

5. In a recent judgment, the EAT had to consider whether or not Reg.8(3) rendered the Secretary of State liable to pay an unfair dismissal basic award and notice pay in respect of that deemed termination, in circumstances where the employee in question had transferred under TUPE from his insolvent employer to a new company, and was in fact dismissed by the solvent transferee after the transfer.

Pressure Coolers Ltd v Molloy and ors [2012] IRLR 630 (EAT)

6. Mr Molloy had been employed by Maestro International Plc ("Maestro"), since January 1989. He worked mainly on the manufacture of safety equipment, but sometimes worked on other parts of the business including the manufacture of water coolers and drinking fountains.

7. By 2008, the company was in financial trouble. It entered into a creditors' voluntary arrangement, which was overseen by a Mr Lord (an Insolvency Practitioner). The CVA did not solve Maestro's problems, and negotiations ensued between Mr Lord (along with Maestro's directors) and the Managing Director of Pressure Coolers Ltd ("PCL"). Agreement was reached in principle for PCL to buy Maestro's assets following a "pre-pack" administration.

8. Before any agreement was concluded, the PCL MD intimated that he wished to make redundancies. Mr Molloy was selected, along with six others. The MD of PCL sent Mr Lord an

email on 12 January 2009, containing a list of intended redundancies and asking for letters to be sent out to them.

9. On 13 January, PCL and Maestro entered into a formal agreement for PCL to buy Maestro's assets, and Mr Lord was formally appointed administrator of Maestro simultaneously. At 11am, Mr Lord telephoned the MD of PCL to inform him that the deal had been completed. As part of the deal, some fifty Maestro employees transferred to PCL, and PCL continued to trade using all of the former Maestro assets. Mr Lord had not made the chosen employees redundant as requested however.

10. Later on that afternoon, at about 3pm, the PCL MD held a meeting with the seven selected employees, including Mr Molloy, and informed them that they were redundant. Letters to that effect followed, having been typed at some point on 13 January after completion of the sale agreement.

11. At the point of dismissal, Mr Molloy was owed wages and sums for accrued but untaken holiday. He received no notice of dismissal and no pay in lieu of notice. He brought claims of age discrimination, unfair and wrongful dismissal, unlawful deductions, and a failure to consult in respect of TUPE, in an employment tribunal.

Tribunal finds Secretary of State not liable

12. The employment tribunal had little difficulty in upholding the claim that there had been a complete failure to consult in respect of TUPE, since the evidence was that there had been no consultation at all. It further found that the dismissal effected by PCL was on grounds of Mr Molloy's age, and that his dismissal had been unfair. Mr Molloy was owed his notice pay and a sum in respect of accrued but untaken holiday pay.

13. PCL tried to argue that it was not liable in respect of any of these matters, by relying on reg.8(7) of the TUPE Regulations 2006. Reg.8(7) says that where bankruptcy or other analogous proceedings are on foot at the time of the transfer, Regulations 4 and 7 (dealing with the effect of the transfer on employment contracts an unfair dismissal) will not apply. If Reg.8(7) applied, Mr Molloy would have been deemed not to have transferred to PCL at all. Maestro would have remained liable, but because Maestro was insolvent, the statutory guarantee under s.184 of the Employment Rights Act 1996 would have rendered the Secretary of State liable to make payment for some (but not all) of the awards.

14. The tribunal rejected that contention, for the simple reason that on the evidence the order of events was clear: there had been a TUPE transfer, and PCL (which was solvent) had subsequently effected the dismissal. Ultimately PCL was found liable for everything. PCL appealed to the Employment Appeal Tribunal.

EAT upholds full PCL liabilities

15. Before the EAT, PCL did not resurrect the argument based on Reg.8(7) that it had deployed before the tribunal. It was accepted that Reg.8(6) applied instead, given that the insolvency procedure that Maestro had entered into could not be said to have been with a view to the liquidation of the assets of the transferor.

16. Under Reg.8(6), the transferee nevertheless does not pick up all of the liabilities that pass from the insolvent transferee.

17. Regulation 8(3) deals with the extent of the liabilities that do pass under Reg.8(6). It renders the Secretary of State liable for obligations that are outstanding at the date of the transfer, that fall within the list at s.184 ERA 1996. There is a deemed dismissal on the date of the transfer only for the purpose of fixing those liabilities, and any liability in excess of the statutory limits to the State guarantee will pass to the transferee.

18. PCL argued that that was the situation in the present case: because Maestro was in a Reg.8(6) insolvency process, there was a deemed dismissal of Mr Molloy by Maestro on the

date of the transfer, and the Secretary of State therefore became liable to pay Mr Molloy's basic award for unfair dismissal, notice pay, and any other payments listed under Part XII ERA 1996 at s.184 (including outstanding holiday pay and arrears of pay). It was contended that all of these "debts" crystallised as at the date of the *deemed* dismissal: on a proper application of Reg.8(3), the debts do not need to have actually arisen prior to the transfer date.

19. The Secretary of State argued on the other hand, that the tribunal had been entirely correct in its analysis of Reg.8(3). The debts of the transferor which come within the scope of the State guarantee (ie s.184 ERA) are frozen at the point of the transfer and paid by the State, but only if those debts have arisen prior to the transfer date. The deemed termination inserted by Reg.8(3) exists to enable employees to recover sums under the guarantee, that they would not otherwise be able to obtain because Reg.8(6) prevents those liabilities from passing to the new employer and there would have been no technical "termination" by the transferor as required by s.182 ERA 1996. Reg.8(3) corrects that problem by simply deeming there to have been a dismissal for that specific purpose.

20. The EAT agreed with the Secretary of State. It was important to consider that Regs.8(2)-(6) were intended to implement in domestic law, Art.5(2)(a) of the Business Transfers Directive 2001/23/EC. That article provides that:

"*the transferor's debts arising from any contracts of employment or employment relationships and payable before the transfer … shall not be transferred to the transferee…*"

21. Against that background, Parliament could not have intended Reg.8(3) to mean that debts arising *after* the transfer would also reside with a transferor who had not caused the debts to be incurred.

22. The purpose of the law operating in this way is so that the State effectively subsidises a rescue culture, whereby businesses are free to purchase the assets of companies in non-liquidation insolvency processes, without inheriting all of the insolvent company's liabilities. It is not intended that the State should foot the bill for liabilities incurred by the solvent transferee of its own volition after the transfer has already happened. Accordingly, PCL's appeals were dismissed, and PCL remained liable to pay Mr Molloy's basic award and notice pay.

Practical steps: dismissal before transfer

23. Plainly, if there are going to be any dismissals, it makes sense from the transferee-purchaser's point of view, for those dismissals to take place before the transfer happens. That way, a good portion of the liabilities arising out of those dismissals will be covered by the Secretary of State.

24. If the PCL MD had thought of it, he might have made carrying out the desired dismissals in advance of the transfer, a condition of purchase. The subsequent discovery that the dismissals had not been carried out, in breach of contract, would probably create a liability arising out of a contract entered into by the administrator (i.e. the contract for the sale of the business/assets), which would then have "super-priority" over the administrator's remuneration and expenses under para.99 of Schedule B1 to the Insolvency Act 1986.

25. At the very least, this state of affairs might well make litigation by the purchaser/transferee against the transferor a realistic and worthwhile possibility, in respect of the value of the money the Secretary of State would have paid if the employees had been dismissed before the transfer. Hence, purchasers may well start looking to impose such a condition in appropriate cases.

26. The potential downside for the purchaser is that such an agreement, if implemented, will make the dismissals automatically unfair (see "*Spaceright* and preventing the transfer of liabilities" below), which may increase liabilities elsewhere. Equally, the response by administrators might be to say that no such condition of sale would be agreed to. But then,

any sale would be less likely - or would only be possible at a lower price - thereby increasing the likelihood of liquidation becoming necessary. The size of the problem clearly increases with the number of employees involved.

27. The straightforward answer therefore would be to agree to any such condition that is proposed by a purchaser, and then simply to ensure that the condition is fulfilled. Making sure that happens, will plainly require a clear understanding as to the date when the transfer will be said in law to have occurred.

Identifying the date of the transfer

28. Reg.3(6) of the 2006 TUPE Regulations provides that a relevant transfer may be effected over "a series of transactions".

29. However, the House of Lords (following a reference to the then European Court of Justice) had already made clear in *Astley v Celtec Ltd* [2006] IRLR 635, that irrespective of whether or not there has been a series of transactions, there will always have to be a single identifiable date on which the transfer is said finally to have occurred.

30. This begs the question as to how to identify that precise date, and which transaction in a series will be said to constitute the critical transaction. Indeed, in an administration context, it may be that the purchaser purchases the business or assets via a number of different transactions. It may also be that the consideration paid in respect of those assets is paid by way of a series of staged payments. Further, there might be a delay before any employees of the transferor that the transferee wants to take on, actually start work.

31. The House of Lords' view in *Celtec,* was that the appropriate date was "*the date on which the responsibility as employer for carrying on the business of the unit transferred*". That was in the context of a case where an NHS employer had sent a number of employees out on "secondment" in 1990, and where the relevant employees resigned from their NHS employment some three years later, at which point they explicitly became employees of the new organisation. The House of Lords found that the date of the transfer had been the date of the original secondments in 1990 however, and it was on that date that legally they had ceased to be NHS employees.

32. Where the transfer is effected by a contractual agreement (as would normally be the case in an administration context), the answer ought to be more straightforward. Until recently, the date of the transfer could be said to be the date of completion of the contractual agreement (as opposed to *exchange*), following *Wheeler v Patel* [1987] ICR 631 (EAT).

33. However, serious doubt has been cast on *Wheeler v Patel* as a general proposition by the EAT more recently, in *Commercial Motors (Wales) Ltd v Howley* 24.02.12, UKEAT/0491/11/ZT.

Date on which responsibility as employer for carrying on the business transferred

34. The EAT decided in *Howley,* that the proposition in *Wheeler* was essentially confined to its own facts. *Wheeler* involved a particular set of circumstances, where the new owners did not take over or run the business prior to completion. The date of completion was the important date in that case, because that was the date on which the transferee purchaser took over responsibility as employer for carrying on the business.

35. In *Howley* however, the facts were rather different. Mr Howley worked for Commercial Motors (Newport) Ltd ("Newport"). In 2008, a Mr Sheddick and a Mr Manchip commenced negotiations to buy Newport and Commercial Motors South West Ltd ("South West"). Those negotiations were protracted. A new company, Commercial Motors (Wales) Ltd ("Wales") was incorporated on 3 December 2008 to buy the businesses, and a number of draft sale agreements were produced during December 2008.

36. Eventually on 24 December, the “Christmas Eve Agreement” was entered into. That was a conditional sale agreement relating to the businesses operating at the Newport site. It stipulated a completion date, which was conditional on the lease for the property being finalised, and on the necessary finance being in place for the purchaser.

37. A subsequent agreement replaced the Christmas Eve agreement changing the completion date, and completion eventually occurred on 6 March 2009. In the interim, possession was taken on 2 February, and Wales began to run the Newport business in its own right from that date. As at 2 February 2009, a conditional sale agreement was in place, and the condition in respect of finance was satisfied. Only the property arrangements remained. Mr Howley was dismissed on 10 February 2009. Newport went into liquidation on 21 July 2009.

38. The employment tribunal found that the transfer occurred on 2 February, despite completion not occurring until 6 March 2009, and the EAT agreed. The true test, is the test applied by the ECJ (now CJEU) and House of Lords in *Celtec*, namely the date on which responsibility as employer for carrying on the business of the unit transferred, which was 2 February.

Practical issues

39. Clearly if there is to be any condition of sale to the effect that any desired dismissals will be effected by the administrator prior to the transfer, the parties will need to be clear about when the purchaser will assume responsibility for running the business in practical terms: the administrator will of course need time to effect the dismissals before that occurs. Perhaps the simplest way to achieve certainty in this regard, is to adopt the *Wheeler v Patel* approach as the purchaser, and not take any steps towards actually running the business until after the agreed completion date has passed.

40. As an aside, the dismissals effected by the administrator in this way, are likely to have to be explicitly without notice and in breach of contract (depending on the timescales in any given case), otherwise there is a risk of the employees’ notice periods straddling the transfer, leaving the transferee liable for the dismissals after all, which would defeat the purpose of the exercise.

***Spaceright* and preventing the transfer of liabilities**

41. Thus far, we have dealt with the issue of attempting to reduce liabilities to transferees by ensuring that as large a portion of the total employee liability is left with the Secretary of State as possible. But as will have been seen, the residual liability (for example, for ongoing loss of earnings in respect of an unfair dismissal claim) will nevertheless pass to the transferee purchaser.

42. That will be the case wherever the dismissal by the administrator is because of the transfer itself, and therefore automatically unfair (under reg.7(1)). The Regulations provide that in those circumstances, the employees dismissed shortly before the transfer, will be deemed to have been employed “immediately before the transfer”, so that liability for the unfair dismissal will then pass to the transferee under reg.4(3).

43. If it can be shown however, that the dismissal was not by reason of the transfer itself, but instead for a reason “connected with” the transfer that is an “economic, technical or organisational reason entailing changes in the workforce” (an “ETO” reason: reg.7(1)(b)), then although the dismissal may still turn out to be unfair procedurally, the important point is that it will not be *automatically* unfair by reason of the transfer itself, and liability for that unfair dismissal will not therefore pass under reg.4(3) to the transferee purchaser to any extent.

44. Achieving this result will be fairly important, because compensation for loss of earnings will then usually be limited to the period of time over which proper consultation would have lasted, which will be minimal, and not likely to be received from the insolvent transferor in any event. Whereas, with an automatically unfair dismissal, there is a greater likelihood of a compensatory award to reflect what would have happened if there had been no dismissal at all: the employee would have transferred and continued to be employed, subject to evidence

as to the need for any redundancies in the transferee's business shortly after the transfer. In this way, although the basic award would be met by the Secretary of State in the event of an automatically unfair dismissal prior to the transfer, some residual liability in respect of some loss of earnings would transfer. This will often be cheaper for the purchaser than taking on the liabilities otherwise picked up by the State however, which is what would occur in the event of dismissing after the transfer.

45. Often in an administration context, there will be an "ETO" reason for dismissal: the company not having enough money to pay the staff. It may even be the case that the pressing need to dispense with the more usual consultation of the employees being made redundant, results in a finding that the dismissal is *fair* : *Warner v Adnet Ltd* [1998] ICR 1056 (CA), although this will be an exceptional case.

46. The problem comes if there is no ETO reason for the transferor. The transferor cannot rely on the transferee's ETO reason, so that the dismissals will be automatically unfair if the administrator dismisses the staff in anticipation of the transferee's staffing requirements: *Hynd v Armstrong* [2007] IRLR 338 (Ct Sess).

47. Importantly, a recent Court of Appeal judgment has clarified that that principle will hold true, even if the administrator dismisses the employees in order to make the business a more attractive sale proposition without having any particular purchasing party in mind.

***Spaceright Europe Ltd v Baillavoine and anor* [2012] IRLR 111**

48. Mr Baillavoine was employed as managing director of Ultralon which (along with its subsidiary) went into administration. The administrators decided that the best way of achieving the objective of the administration was to try to sell the business as a going concern. It was necessary to continue trading while seeking possible purchasers. They dismissed a number of employees, including Mr Baillavoine. The view was that any company purchasing the business would have its own chief executive or an individual to fulfil that role, so that Mr Baillavoine was redundant at the point when the administrators were appointed. His salary was high and his dismissal resulted in substantial cost savings. The administrators later sold the business and assets of the Ultralon companies to Spaceright Europe Ltd.

49. The employment tribunal upheld a claim by Mr Baillavoine for automatic unfair dismissal under reg. 7(1) of the 2006 TUPE Regulations. The reason for the dismissal was connected with the relevant transfer to Spaceright and was not an ETO reason: Mr Baillavoine had been dismissed to make the business more attractive to potential purchasers, rather than for a financial reason unconnected with any transfer.

50. Spaceright failed in an appeal to the EAT. It did not accept a submission by Spaceright that the tribunal was obliged to find that the administrator dismissed Mr Baillavoine because the business could not afford his salary. The bank had funded the business while a purchaser was being sought and it was not the case that the administrator had no choice. The EAT found that there was no doubt that the administrator was contemplating a transfer at the time of the dismissal.

51. The Court of Appeal then had to decide the same issue. It reached the same conclusion, in the process resolving conflicting lines of authority at EAT level.

52. In *Ibex Trading Ltd v Walton* [1994] IRLR 564 the EAT held that, where administrators had dismissed employees with the aim of making an insolvent business more attractive, the reason for the dismissal was not connected with the transfer that occurred later, because, at the time of the dismissal, there had been only the possibility of a transfer.

53. In *Harrison Bowden Ltd v Bowden* [1994] ICR 186 however, the EAT held that a dismissal could be for a reason connected with transfer that is not an ETO reason, even though no actual prospective transferee had been identified at the time of the dismissal. *Morris v John Grose Group Ltd* [1998] IRLR 499 was to like effect.

54. Spaceright contended that the Court ought to follow the reasoning in *Ibex Trading*, but the Court disagreed. In its view, the natural and ordinary meaning of the language of reg. 7(1) does not require a particular transfer or transferee to be in existence or in contemplation at the time of the dismissal. As a matter of ordinary English and of plain common sense, a dismissal prior to a transfer could be for a reason "connected with the transfer", even though that particular transfer or transferee is not known, identified or contemplated at the date of dismissal.

55. Further, the transfer-connected reason was not an ETO reason. For an ETO reason to be available there must be an intention to change the workforce and to continue to conduct the business, as distinct from the purpose of selling it. It is not available in the case of dismissing an employee to enable the administrators to make the business of the company a more attractive proposition to prospective transferees of a going concern.

56. The approach of the EAT in *Harrison Bowden* and *Morris* was to be preferred to that in *Ibex*, being more consistent with the broad purpose of the Directive and TUPE to protect employment in the event of the transfer of an undertaking and the natural and ordinary meaning and effect of the language of reg. 7(1). In the present case, the tribunal had made no error of law in reaching its conclusion.

57. Essentially, it is now clear that for dismissals by the administrator to be potentially fair (ie for an ETO reason) it will have to be clear on the evidence that improving the prospects of a potential sale was not a factor at the time of dismissal. Certainly in a "pre-pack" situation, that will be impossible.

58. As a subsequent first instance tribunal decision indicates (*Kavanagh and ors v Crystal Palace FC (2000) Ltd and ors*) it will still be possible to separate out the motivation at the time of a dismissal from the fact of a contemplated sale, but the ability to do so will depend on the evidence being clear that at the time of dismissal that sale was not the reason for the dismissal. In *Kavanagh* the reason was found to be instead a pressing need to reduce costs in order to continue trading in circumstances where a proposed and contemplated sale was stalling. There was evidence that the proposed purchaser did not want staff to be made redundant. Generally however, having the purpose of sale in mind at the point of dismissal will make matters difficult.

Practical issues

59. The best scenario all round for achieving the highest price for the business, is where any employees that are going to be dismissed, are dismissed by the administrator genuinely because of financial reasons not related to any prospective sale: a simple lack of funds being the driver. The greater the distance in time between those dismissals and the eventual transfer, the better.

60. If there is any evidence that the attractiveness of the business for a future sale was in the administrator's mind when dismissing, rather than him genuinely trying to reduce costs in the immediate term, then there is a very substantial risk of a finding of automatic unfair dismissal, meaning that more substantial unfair dismissal liabilities will transfer (subject to the Secretary of State meeting a portion of them).

61. If a potential purchaser comes along to find that dismissals have been effected already, he may wish to see evidence in relation to the conduct of those dismissals before buying. Letters of dismissal for example, may have made the mistake of referring to the need to make the business more attractive for sale, which would then give rise to greater liabilities for the purchaser to inherit, thereby reducing the purchase price.

62. Certainly as referred to at para.26 above, if any condition of purchase to the effect that certain employees must be dismissed before the transfer is stipulated, that will be strong *prima facie* evidence rendering those dismissals automatically unfair, since necessarily the dismissals will be at the behest of the transferee and because of the transfer. But if the transferee purchaser would have to carry out the dismissals shortly after the transfer itself anyway, it may be

sensible for the purchaser to impose such a condition so as to ensure at least that the Statutory Guarantee elements of any liabilities are left behind. The alternative would be to carry on employing the relevant employees for a substantial period of time and then to conduct a fair redundancy exercise, which will often not be cost effective because of having to pay the sums that the State would otherwise have paid.

Conclusion

63. A prospective purchaser would be wise to:

(i) Say nothing and investigate what dismissals have been effected by the administrator, when, and investigate whether there was any evidence of any desire to improve the attractiveness of the business at the time rather than a simple desire to control costs. He can then negotiate the price according to what he finds.

(ii) If upon undertaking that exercise the prospective purchaser determines that there are employees that would need to be dismissed who have not been, there will be no option but to accept the fact that liabilities are going to be incurred in respect of the dismissal of such employees. However, those liabilities could then be reduced by requiring the administrator to carry them out in advance of the transfer, leaving the Statutory Guarantee elements to the Secretary of State.

(iii) In a “pre-pack” situation, the latter is likely to be the best that can be achieved, since the pre-ordained nature of the arrangements makes it inevitable that dismissals by the administrator shortly before the transfer will be automatically unfair.

64. The administrator should:

(i) Take its own view as to whether dismissals are needed, and do so with as little delay as possible;

(ii) Take care to ensure that the reason for any such dismissal is purely and simply the inability to pay the wage bill: reference to making the business more saleable should be avoided at all costs.

(iii) Where it is agreed that certain dismissals need to be made before the transfer as a condition of sale (whether as part of a “pre-pack” or not), that agreement should be lived up to, on pain of possible litigation by the purchaser.

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