LEWIS SILKIN

Ius Laboris UK Global HR Lawyers
LEWIS SILKIN

Insolvency and TUPE



Inside

Buying a business – does TUPE apply?

Implications of TUPE

How TUPE works – liquidation and administration

Information and consultation

Ask before you buy!



Buying from an administrator can be a golden opportunity to pick up a business at a substantial discount to market value. It is a chance for a fresh start, without the debt and creditor demands experienced by the insolvent owner. But no business can run without people – and employment law tends to protect employees.

This Inbrief covers the law on transfers of undertakings (TUPE) in the context of an insolvency, summarising the main employment considerations. TUPE's general thrust is to switch employees, their contracts and any claims from the seller to the buyer. This guide explains how this works and how legal risks can be mitigated.

Buying a business – does TUPE apply?

Buying a business can trigger employment protection and other obligations under TUPE, which applies where there is a transfer from one employer to another of an "economic entity". This is an organised grouping of resources which has the objective of pursuing an economic activity.

The sale of a business, which typically comprises assets such as premises, equipment, customers, staff and goodwill, involves the transfer of an economic entity. If there is an element of continuity in what the business does once the buyer owns it, TUPE is likely to apply. For more information, see our Inbrief on TUPE.

Implications of TUPE

If TUPE applies, the normal rules (outside an insolvency context) are that:

- Employees transfer to the buyer
- Employment contracts transfer to the buyer
- Claims and liabilities transfer to the buyer
- There is a duty on the seller and possibly the buyer to give employee representatives information about the transfer and to consult
- Employees dismissed by the seller may have claims against the buyer, even though it has never met them
- Changing terms is difficult unless there is a good business reason for doing so

How does TUPE work in an insolvency context?

Buying a business from an insolvent company is either a different story or a very different story, depending on the type of insolvency process that has been put in place. If TUPE applies (and it won't always, you still need to apply the test above), the way in which it normally works is modified and limits what the buyer takes over. This is intended to encourage the survival of businesses.

But don't get caught out. The changes to how TUPE operates only apply where insolvency proceedings have been commenced and an insolvency practitioner has been formally appointed. They will not apply where, for example, an insolvent company sells its business before the appointment of an administrator – even if the administrator has been acting in a business advisory capacity in the background, as typically happens in a "pre-pack" administration. The ordinary TUPE provisions would apply, with the buyer facing transfer of employees and the full range of liabilities in the normal way.

Liquidation

Where a liquidator has been appointed, the aim will be to wind up the insolvent company. If the liquidator finds a buyer for the business, it will take on very little under TUPE - there is no transfer of employees, employment contracts, liabilities or claims. If the seller dismisses employees, the buyer won't take on any responsibility.

This means a liquidation scenario gives a buyer much more freedom. The buyer can choose whether to hire the seller's employees directly or not at



all. If it does hire them, it will not be bound by existing employment contracts and it can offer different terms from those applying before the transfer. This is good news for a buyer who wants to achieve harmonisation with the contracts of its existing employees, or where other changes would improve the viability of the business, such as reducing pay or holiday entitlement.

Importantly, however, employees recruited from the insolvent seller will have continuity of employment where there is a transfer of an undertaking. Employees need two years' service to claim unfair dismissal or to receive statutory redundancy pay. The clock is not reset to zero after the transfer - employment with the seller will still be counted.

When buying from a liquidator, the main risk for a buyer arises from the duty to inform and consult (see below).

Administration

Where an administrator has been appointed over the insolvent company, the primary purpose will be to rescue the company as a going concern and - if that is not practicable - to maximise the return for all creditors. Typically, this will involve trying to find a buyer for the business.

Unlike in a liquidation, a buyer faces exposure under TUPE in this scenario. Employees transfer and most liabilities transfer, including liability for automatically unfair dismissal by the seller. However, certain liabilities are carved out in order to make purchase of the business from the insolvent seller more appealing and to encourage rescue.

Carve-out of liabilities

Although employment liabilities transfer, liabilities relating to employment prior to the transfer which the employee can claim from the Insolvency Service are carved out. The employee would need to seek these payments directly from the Insolvency Service rather than the buyer.

These sums typically include up to eight weeks' arrears of pay, holiday pay and unpaid pension contributions. An employee's pay is, however, capped for these purposes (currently at £571 per week). So, the buyer may still take on considerable liabilities for any payments in excess of the statutory cap, and for any other contractual payments or liabilities not covered under the relevant statutory schemes.

Flexibility over changes to employment terms

The second change to TUPE in an administration enables the seller, insolvency practitioner or buyer to agree "permitted variations" to employees' contracts of employment, despite the reason for this being the transfer itself. The variation must aim to safeguard employment by ensuring survival of the business. This could, for instance, include a pay cut or reduction of contractual holiday entitlement.

The buyer does not need the agreement of each individual employee, but rather must agree the variation with "appropriate representatives". If the employer recognises a trade union, they must be union representatives. If the employer does not recognise a union, they may be elected representatives or a standing body of representatives with the appropriate mandate. Where there are no union representatives, the employer must give a copy of the proposed terms and conditions to all employees who are impacted, along with any guidance that would reasonably be needed to understand it. Each representative must then sign the terms and conditions.

There is no guarantee that representatives will agree. If there is time, it may therefore be safer for a buyer to get the seller or insolvency practitioner to agree the changes before buying the business, so that it knows exactly the terms on which employees will transfer. It might also reduce the price if representatives do not agree.

Information and consultation

Whether an insolvent company faces rescue or wind-up, the normal rules on information and consultation under TUPE apply.

The seller will have an obligation to provide employee representatives with prescribed information on matters such as the transfer, its implications for affected employees and any proposed measures. It must then consult on any measures proposed in connection with the transfer.

The buyer must provide information to the seller about any measures it is proposing to take after the transfer.

Where a seller or buyer fails to comply with the rules on information and consultation, an Employment Tribunal can order a penalty of up to 13 weeks' pay per affected employee. Claims can be brought against just one party or both for failure to inform and consult. The buyer is jointly liable to pay any penalty incurred, whichever party was at fault. Assuming the seller is insolvent and has no assets to meet the liability, the employees will most likely look to the buyer.

Mitigating the risks

A buyer will therefore want to ensure that the seller has carried out its legal obligations as fully as possible, within the often-hurried context of a sale in an insolvency setting.

If there are "special circumstances" which mean that it is not reasonably practicable to comply with the information and consultation rules in full, and an employer can show it did all that was reasonably practicable, this may provide a defence to claims. The provision is construed narrowly but, if the seller takes some genuine steps to discharge its information and consultation obligations, that is likely to be better than bypassing them entirely and may reduce any award.

A buyer could also negotiate a reduction in the price paid to take account of the risk of claims. It might also consider keeping certain employees on, on the basis that they are less likely to rock the boat by claiming against their new employer.

Ask before you buy!

Even where a business is purchased from an insolvent company, a buyer can face significant liabilities under TUPE. For this reason, it is essential that a buyer finds out as much as it can:

- What sort of insolvency procedure? Is it an administration or Company Voluntary Arrangement (CVA), or a liquidation?
- Has the procedure started formally? If so, when and who is appointed as the insolvency practitioner?
- In case of a liquidation - has the seller complied with its obligations to inform and consult employee representatives? The buyer faces liability for any failure by the seller.
- In case of an administration/CVA:
  - *Does TUPE apply?* Consider the usual tests. Will an "economic entity" transfer? If a buyer is just purchasing assets, this will not trigger TUPE - there needs to be more that makes it a business purchase. What does the business do now and how is that work carried out by employees? TUPE will only apply if there will be continuity when the buyer takes over.
  - *Which employees are working in the business and will transfer under TUPE?* The buyer may want to retain certain key workers and should check that they are deemed to be in scope to transfer.
  - *What terms and conditions are those employees working on?* There may be potential for making changes (discussed above).
  - *Have there been any dismissals prior to appointing an insolvency practitioner?* If so, who carried them out – the seller or the practitioner – and what was the reason? The buyer will be liable for any dismissals by reason of the transfer. But if the seller has a good business reason for dismissing – described by TUPE as an "economic, technical or organisational" reason - that liability will not transfer. The buyer will not be liable for dismissals unconnected to the transfer. Administrators are highly unlikely to give any warranties regarding the reason for dismissal, but the buyer should speak to the administrator and seek a written confirmation.
  - *Has the seller complied with its obligations to inform and consult employee representatives?* The buyer faces liability for any failure by the seller.

For more information on this subject please contact:



Lee Nair
Partner

+44 (0)20 7074 8275
lee.nair@lewissilkin.com

This publication provides general guidance only: expert advice should be sought in relation to particular circumstances. Please let us know by email (info@lewissilkin.com) if you would prefer not to receive this type of information or wish to alter the contact details we hold for you.

© January 2023 Lewis Silkin LLP