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RECENT CASES

NOTE

TUPE, Administration and the Rescue Culture: *OTG Limited v Barke & Others* and Consolidated Appeals

In its recent decision in *OTG* ([2011] IRLR 272), EAT the Employment Appeal Tribunal (EAT) addressed the application of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE 2006) to transactions entered into in relation to the business of a company which is in administration pursuant to Schedule B1 of the Insolvency Act 1986 (Schedule B1). In doing so, the EAT revisited the proper interpretation of regulation 8(7) of TUPE 2006 previously considered in *Oakland v Wellswood (Yorkshire) Limited* by both the EAT ([2009] IRLR 250, EAT) and (albeit only in passing) the Court of Appeal ([2010] IRLR 82, CA).

Whether the transfer of undertakings legislation applies in its full rigour to transactions out of administration is of considerable importance not only to the employees affected but also to those devising, structuring and negotiating such transactions. The increased use of pre-pack administration in recent times has brought this issue into particular focus. As the EAT noted in *OTG*, referring to *Annotated Guide to the Insolvency Legislation* by L.S. Sealy and D. Milman, in a pre-pack administration, the intended administrator is involved prior to appointment in 'planning in advance an arrangement under which the business of the company is to be sold immediately after his appointment, bypassing the statutory procedure of the creditors meeting, and without any direction from the court'. Pre-pack administrations have attracted controversy in some quarters, especially given the number of high-profile transactions in recent times where the acquirer has been associated with the previous ownership of the insolvent business. Perceived advantages of pre-packs for those wishing to restructure insolvent businesses include not only the avoidance of debts and contracts but also the potential for acquisition post insolvency of only part of the relevant business. The speed of the pre-pack process also reduces disruption to the ongoing business as well as the cost of the administration itself (since the immediacy of sale avoids the need to fund the trade of the business through the period of the administration). The utility and attractiveness of the pre-packs to those seeking to reposition and restructure an insolvent business would be further

enhanced if related transactions were to evade the protections for employees otherwise established by the transfer legislation. That said, it is important to note that, while in *OTG* the conjoined appeals involved a variety of transactions out of administration, no distinction was drawn by the EAT between pre-packs and other transactions out of administration for the purposes of considering the proper application of TUPE 2006.

TUPE 2006, in replacing the 1981 incarnation of the UK's domestic transfer of understandings legislation, incorporated certain specific provisions addressing its application to insolvency situations as permitted by the Acquired Rights Directive (ARD) (Directive 2001/23 2001 OJ L82/16). Regulation 9 enables, in insolvency situations, the variation (through agreement with 'appropriate representatives' of the relevant employees) of the employment contracts of the transferring employees (so-called 'permitted variations'). Regulation 8(6) and related provisions provide that certain of the debts owed by the transferor to the transferring employees do not transfer to the transferee as would otherwise be the case but are borne by the Secretary of State (for more detail on these provisions and TUPE 2006 more generally, see J. McMullen, 'An Analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' (2006) 35 ILJ 2; C. A. Wynn-Evans, *Blackstone's Guide to the New Transfer of Undertakings Regulations* (Oxford: OUP, 2006)). These provisions, as the EAT noted in *OTG* (at paragraph 10), apply to insolvency proceedings generally rather than the narrower category of what can in shorthand terms be described as 'terminal insolvencies' in relation to which regulation 8(7) disapplies two specific protective aspects of TUPE in relation to the individual position of employees—namely, the automatic transfer of the contracts of employment and associated liabilities of the employees who are 'in scope' for the purposes of the legislation (regulation 4) and the rendering automatically unfair of dismissals not capable of justification by virtue of an 'economic, technical or organisational reason entailing changes in the workforce' (regulation 7).

Regulation 8(7) provides that the protections of regulations 4 and 7 do not apply to transactions relating to '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'. The inapplicability of ARD—or, to be more precise, the option for member states to disapply their domestic legislation—in cases of terminal insolvency was originally confirmed by *Abels* [1987] CMLR 406, ECJ. The distinction was drawn by the ECJ between terminal insolvencies (ie liquidation proceedings where the individual protections of ARD would not apply) and other forms of insolvency procedure to which ARD would apply—in that case the Danish SvB procedure over which there was lesser judicial supervision than the applicable liquidation proceedings and where the objective was primarily to safeguard the relevant assets and, where practicable, to continue the business.

The justification for excluding terminal insolvencies from the full application of the transfer legislation was described by the EAT in *OTG* (at paragraph 11) reflecting the distinction drawn in *Abels* and ARD between terminal and other insolvencies. A liquidation has the objective of the disposal of the relevant assets. The collective interests of the employees are seen as best served in such circumstances by disapplying the protection of the transfer legislation on the basis that the obligation to take on the entire workforce on the same terms might operate as a disincentive to potential purchasers of the business as a going concern. On this analysis, the risk of the dismissal of some employees and the diminution of terms for others who are retained is preferable to the relevant staff all losing their jobs.

There had been some doubt as to whether *Abels* did actually operate to disapply the 1981 legislation from terminal insolvencies (see D. Pollard, 'Insolvent Companies and TUPE' (1996) 25 ILJ 191). There no specific mention of insolvency in the 1981 regulations which could be taken as indicating that the transfer legislation was intended to extend to insolvency situations. Moreover, subsequent to *Abels*, amendments were made to the 1981 regulations in 1993 which could 'by implication, be taken to have confirmed the statutory authority of all TUPE' (D. Pollard, 'Insolvent Companies and TUPE' (1996) 25 ILJ 191) on the basis that the option by then presented in *Abels* to disapply the transfer legislation in cases of terminal insolvency was not taken up. Nonetheless, the possibility that *Abels* did not apply to the domestic transfer legislation was scotched by the EAT decision in *Perth & Kinross Council v Donaldson and others* [2004] IRLR 121, EAT and the introduction in 2006 of regulation 8(7).

Regulation 8(7), it should be noted, was not mandatory under ARD. As Collins had noted in relation to a previous incarnation of the legislation, ARD 'deliberately left to member states the allocation of liability in the event of insolvencies followed by sales of the assets of businesses in liquidation' (H.G. Collins, 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144). Article 5.1 of ARD provides for the terminal insolvency exception save where national law provides otherwise. TUPE 2006 could thus have been applied in full to terminal insolvencies. However, regulation 8(7) was adopted as being 'in line with the "rescue culture" that the Government aims to promote' (paragraph 87, *Transfer of Undertakings (Protection of Employment) Regulations 1981, Government Proposals for Reform, Detailed Background Paper*, DTI, September 2001, URN 01/1158). The rescue culture has the objective of facilitating business survival in insolvency situations with consequent potential preservation of employment to a greater or lesser extent. As Davies described it, reference to the rescue culture is 'to a shift in emphasis on the part of insolvency practitioners, appointed to take over the management of ailing companies, away from the sale of the company's assets on a break up basis and towards continuing to trade with a view to disposing of the business, or at least parts of it, as a going concern' (P.L. Davies, 'Employee Claims in Insolvency: Corporate Rescues and Preferential Claims' (1994) 23 ILJ 141).

Consistent with *Abels* and other subsequent case law, the introduction of regulation 8(7) in TUPE 2006 was not intended to change the legal position but rather to make explicit what was viewed as previously implicit (paragraph 65, TUPE, Draft Revised Regulations, Public Consultation Document, DTI, March 2005, URN 05/92). In introducing explicitly into the domestic legislation an exclusion for transactions out of terminal insolvency, regulation 8(7) adopted directly the (generic) wording of the exemption permitted by Article 5.1 (and which itself reflected the analysis of the ECJ in *Abels*). This 'copying out' approach was justified on various grounds: it ensured a simpler provision that might otherwise be the case (by avoiding the need to list the various different insolvency procedures in England and Wales, Scotland and Northern Ireland), 'future proofed' the provision against subsequent changes in insolvency procedures and ensured that TUPE 2006 went no further than was permitted by ARD in derogating from the normal protection of the transfer of undertakings legislation (see paragraphs 58 and 64 of the 2005 consultation document). While at the time of the introduction of TUPE 2006, it was acknowledged that there was uncertainty as to whether the terminal insolvency exclusion applied in relation to creditors' voluntary winding up (see paragraph 64, footnote 8, of the 2005 consultation document), administration is the category of insolvency procedure over which litigation has ensued.

As the Editors of Harvey on Industrial Relations and Employment Law put it (Division F H[167.06]), the EAT in *Oakland* defied the assumption—based on the view that 'the purpose of administration generally is not to put the company into liquidation but to rescue its business'—that regulations 4 and 7 apply to administration and are not disapplied by regulation 8(7). As a rescue rather than a liquidation strategy, administration had been assumed not to constitute an insolvency procedure instituted with a view to the liquidation of the assets of the transferor. Consistent with that assumption, the Insolvency Service indicated in its 2009 guidance its view that 'TUPE does apply to insolvencies where the intention is to rescue the business. If your employer is in administration . . . you will be protected by TUPE' (paragraph 39, 'Insolvency and Redundancy—A Guide for Employees', URN 09/1558). In *Oakland*, the EAT considered that whether regulation 8(7) operated to exclude the application of regulations 4 and 7 was a question of fact for the employment tribunal to determine on the particular facts of the specific insolvency procedure in question. On the facts, the employment tribunal found that the administrators had considered that, of the three statutory objectives of administration set out in Schedule B1, the first (rescuing the company as a going concern) was not achievable, the second (achieving a better result for creditors as a whole than would be likely on a winding up) would be prejudiced by the losses consequent upon further trading and therefore they should pursue the third objective of an administration (to realise property to make a distribution to creditors). The administrators had anticipated a move in due course from administration to creditors' voluntary liquidation.

The EAT upheld the employment tribunal's finding that the appointment of the joint administrators was, as a matter of fact, made with a view to the eventual

liquidation of the assets of the transferor and that therefore regulation 8(7) was engaged. Peter Clark J considered this result to accord with the policy behind Article 5.1 of ARD and of regulation 8(7), 'namely the "rescue culture" whereby a purchaser . . . is not put off by the effects of TUPE protection. The outcome, as demonstrated by the case, was that some jobs were preserved and the creditors benefited from the best available option'. The EAT accepted that, where the joint administrators continued to trade with a view to a sale as a going concern, a relevant transfer for the purposes of TUPE 2006 would attract the protection of its regulation 4. However, where, as in this case, the administrators took immediate steps to dispose of the assets of the business, the EAT held that the employment tribunal was entitled to hold that the appointment of the administrators was with a view to the eventual liquidation of the assets of the relevant business.

When *Oakland* reached the Court of Appeal, the primary issue for consideration was whether those employees who were in the event engaged by the relevant purchaser retained continuity of employment for statutory purposes pursuant to section 218(2) Employment Rights Act 1996. The Court of Appeal declined to determine the proper interpretation of regulation 8(7) of TUPE 2006 as it considered it unnecessary to do so for two reasons—first, the continuity of employment issue was resolved on the basis of the Employment Rights Act 1996 rather than TUPE 2006; second, it had not heard full argument on the proper interpretation of regulation 8(7). Nonetheless, Moses LJ (at paragraph 10) expressed the (clearly obiter) view that there were 'strong grounds for thinking that both the employment tribunal and the employment appeal tribunal took the wrong approach to their construction of both Article 5 of the Directive and to regulation 8'.

When the regulation 8(7) issue came before the EAT again in *OTG*, the EAT appreciated the commercial context of this litigation, noting that transferees seeking to avoid employment liabilities would favour the fact based approach whilst employees would favour the absolute approach (as it would ensure their protection by TUPE 2006). For TUPE 2006 to apply in full to administrations would also reduce the liabilities faced by the Secretary of State pursuant to the guarantees established by Chapter VI of Part XI Employment Rights Act 1996 (in respect of redundancy payments) and Chapter XII of the same legislation (in respect of various other prescribed payments).

In *OTG*, the EAT concluded that as a matter of principle, administration can never fall within the scope of regulation 8(7) and therefore always falls within the protective scope of regulations 4 and 7 of TUPE 2006. This analysis was described as the 'absolute approach' in contrast to the 'fact-based approach' adopted by the EAT in *Oakland*. This debate as to whether and how administration should or should not be categorised as a terminal insolvency procedure to which the individual protections of TUPE 2006 would not apply had been anticipated by Pollard. He noted that it was unclear from the drafting of regulation 8(7) whose view as to the purpose of an administration would determine whether regulation 8(7) would apply and when that

view would be assessed (paragraphs 13.67–13.69, D. Pollard, *Corporate Insolvency: Employment and Pension Rights* (Haywards Heath: Tottel, 2007)). Neither the Notice of Appointment statutory declaration (which only confirms that appointment is in accordance with Schedule B1) nor the Statement of Proposed Administration states the purpose of the particular administration. That said, Pollard's view was that the use of the concept of proceedings being instituted with a view to the liquidation of assets implies 'looking at what happened when the process started' (D. Pollard, *Corporate Insolvency: Employment and Pension Rights* (Tottel, 2007), paragraph 13.69). In *OTG*, it became apparent that the crux of the matter was whether the test is, on the one hand, of the legal nature of the process in principle when it starts or, on the other hand, of the factual nature of the process when it is implemented.

The argument in support of the fact-based approach centred upon the contention that rescuing the company as a going concern is not always the purpose of every administration, as a matter either of practical reality—as survival as a going concern is not a realistic prospect in a substantial number of administrations – or of the legal responsibility of the administrator—who is not required by Schedule B1 to pursue the objective of rescuing the company as a going concern if either this is not reasonably practicable or winding up achieves a better result for creditors. Transactions out of administration should not therefore automatically be treated as falling outside the regulation 8(7) exception. To ascertain whether the regulation 8(7) exception applies therefore entails an assessment of the actual objective of the administration in question to see if it was instituted with a view to liquidation of the relevant assets.

The fact-based approach was rejected in *OTG* in favour of the absolute approach on a number of grounds. Analysis based on the general objective of the relevant type of insolvency procedure, rather than the intention of the administrator in the particular factual matrix, produced legal certainty and avoided the risk of difficult and unpredictable disputes about the administrator's intentions upon which it would be undesirable for employment protection rights to depend. As the EAT put it at paragraph 22, 'a bright-line rule has clear advantages'. More particularly, Article 5.1 of ARD was interpreted as expressly identifying terminal insolvencies by reference to the object of the procedure when instituted. At the outset of an administration, the primary objective is to rescue the company as a going concern, rather than a liquidation of assets, and the administrator is not required to identify by that stage which of the objectives set out in paragraph 3 of Schedule B1 he is intending to pursue. Consequently, administration (properly assessed at the point of its being instituted rather than by reference to how it might subsequently develop) was viewed by the EAT in *OTG* as having the objective of rescue of the company as a going concern, not liquidation of its assets, and therefore as falling outside the scope of the regulation 8(7) exemption. The legislator was seen as drawing a distinction between liquidation and other proceedings based on their legal character rather than the intentions of the relevant insolvency practitioner.

That said, certainty was not the only basis for this decision. The EAT viewed the insolvency provisions of ARD and TUPE 2006 as derogations from the overall employee protection objective of the transfer legislation. Consequently, any uncertainty as to the application of regulation 8(7) should be resolved against the background of that objective. The EAT therefore took the view that the primary purpose of the transfer legislation of employment protection 'in any doubtful case must prevail' (paragraph 21). This analysis supported the adoption of the absolute approach over the fact-based approach.

By way of commentary, it can be argued that it would be unfair entirely to allocate responsibility for the need to adjudicate between the absolute and fact based approaches—and the fact that different divisions of the EAT have reached opposing conclusions—to the decision to 'copy out' into regulation 8(7) the generic description of terminal insolvency contained in Article 5.1 of ARD, rather than to specify which particular insolvency procedures fall within the scope of the exception established by that provision. Even if administration had been specified as falling within the scope of regulation 8(7), there would still (as *Oakland* and *OTG* demonstrate) have been scope for dispute as to whether administration truly constitutes a terminal insolvency capable under European Union (EU) law of being excluded from the scope of the transfer legislation pursuant to Article 5.1. The reverse argument would of course not be available as member states are entitled specifically to apply their transfer of undertakings regime to insolvencies.

Theoretical perspectives on insolvency law (see S.E. Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory' (2011) 32 *Company Lawyer* 99) are arguably of little assistance in assessing the correctness of the EAT decisions in *Oakland* and *OTG*. These decisions debate the implementation of the broad choice already made in the legislation about the scope of the exception to the normal effect of the transfer legislation in the context of insolvencies. The adoption by ARD of the distinction between terminal and other insolvencies reflects the balance struck by the legislator at EU level between employee protection and the facilitation of business rescue and the degree of compromise which was considered appropriate between employee rights and the interests of creditors. To the extent that employee rights are protected as a consequence of the adoption of the distinction between terminal and other insolvencies, this is consistent with the 'traditionalist' concept of insolvency which argues for a more stakeholder-based view than the 'proceduralist' approach which is creditor-biased. However, in domestic terms, once the policy decisions had been taken to take up the terminal insolvency derogation permitted by Article 5.1 in regulation 8(7) and the drafting decision was taken to follow the 'copying out' approach, the question became not one of policy but rather the technical analysis of the nature of administration and whether it fell into the category of terminal insolvency—to adopt the parlance of the EAT in *OTG*, where the line between terminal and other insolvencies is to be drawn and how bright it should be.

The EAT in *OTG* acknowledged that the distinction between liquidation and other insolvency proceedings is 'debatable' (paragraph 12). It can be argued that in practice administrations, and particularly pre-packs, may involve asset disposals whilst liquidation may entail trading for a period—a sale of part of the business and disposal of the remaining assets can be the preferable solution in relation to a liquidation as much as an administration. To a degree, the EAT in *Oakland* endorsed that view by focusing on the actual objective of the particular administration such that regulation 8(7) would apply where the aim of the administration was the liquidation of the company's assets. Nonetheless, whilst in *OTG* the EAT acknowledged that the distinction between terminal and other insolvencies is 'somewhat blunt' (paragraph 24), it preferred the restrictive interpretation of the absolute approach, which produces certainty and favours employee protection, over the less predictable fact-based approach. The EAT preferred to resolve the question of the proper application of regulation 8(7) as one of principle based on a precise reading of ARD rather than by reference to potentially unpredictable transaction-specific practice. A further argument in favour of the absolute approach is that the situation of a business (in terms of its viability and sale prospects) where administration is the chosen insolvency procedure is as a general rule arguably likely to be not so serious as to warrant the disapplication of the protections of TUPE 2006 in contrast to a liquidation where this is permissible to facilitate the salvage of the business or part of it.

Critics of the absolute approach will argue that the purpose of an insolvency procedure is inevitably fact specific and will vary between different insolvency situations. On this basis, to adopt a blanket rule that administration falls outside the scope of regulation 8(7) risks an avoidable fetter on the rescue culture, with consequent (as the EAT put it at paragraph 23) 'disincentives to rescue', by applying too rigid a test to the application of regulation 8(7). In light of the fact that there are various objectives which can legitimately be pursued in accordance with Schedule B1, the actual objective of a particular administration should determine its effect and this is a legitimate factual task for the employment tribunal to undertake. This analysis would contend that, once the objective of the procedure is the focus, concerns about uncertainty as to the generic legal character of administration and employee protection are no longer relevant or problematic because the factual task of the tribunal is to assess whether the particular administration has the objective of liquidation, which would then legitimately take it outside the scope of regulations 4 and 7.

The very least that can be said about the *OTG* decision is that, in determining that a restrictive interpretation of regulation 8(7) based on the legal character of administration should resolve the uncertainty produced by the 'copying out' approach in favour of the underlying legislative objective of employee protection, the EAT has sought to achieve certainty for those affected by administration. The adoption of the absolute approach potentially increases the employment costs

involved for those seeking to acquire businesses or parts thereof out of administration, when compared to the fact-based approach, by making invariable the application of the protections of TUPE 2006. Only time will tell if the view of the Editor of the *Industrial Relations Law Reports* ([2011] IRLR 271) is correct that *OTG* 'which was decided after extensive argument and which accords with Government guidance on TUPE, is likely to be the case that is followed'.

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