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## RECENT CASES

### NOTES

#### TUPE and Mothballs

#### *Crystal Palace FC Limited and Another v Kavanagh and Others* [2014] IRLR 139, CA

*Crystal Palace FC Limited and Another v Kavanagh and Others*<sup>1</sup> addresses, in the context of transactions out of administration, the issue of the responsibility, as between transferor and transferee, for liabilities arising from dismissals of employees effected prior to a 'relevant transfer' for the purposes of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ('TUPE'). In the course of considering the decision of the EAT<sup>2</sup> upholding an appeal against the judgment of the employment tribunal, the Court of Appeal considered the proper approach to the application of TUPE in this context and raises some wider issues of principle concerning its interpretation.

Where the transferor is insolvent, the treatment of liability for dismissals effected prior to a relevant transfer is of considerable importance to the various relevant parties. As permitted by Directive 2001/23/EC ('ARD'), regulation 8(7) of TUPE disapplies from 'terminal insolvencies' (ie those insolvency procedures commenced with a view to liquidation) the protections which otherwise apply in respect of automatically unfair dismissal, liability being borne by the transferee and the like. In other 'non-terminal' insolvency situations, save to the limited extent provided by its regulation 8(2)–(6) in relation to the transferor's debts and the 'permitted variations' validated by its regulation 9, TUPE applies to transactions otherwise falling within its scope. The potential application of TUPE to acquisitions out of administration was confirmed by *Key2Law (Surrey) LLP v D'Antiquis*.<sup>3,4</sup>

<sup>1</sup>[2014] IRLR 139, CA.

<sup>2</sup>[2013] IRLR 291, EAT.

<sup>3</sup>[2011] IRLR 272, CA.

<sup>4</sup>See C. A. Wynn-Evans, 'In Defence of Service Provision Changes?' (2011) 40 ILJ 451, and K. Creighton-Selvay, 'Pre-Packaged Administrations: An Empirical Social Rights Analysis' (2013) 42 ILJ 85.

Under regulation 7(1) of TUPE, liability for a dismissal prior to transfer which is automatically unfair by virtue of its relationship with the transfer is inherited by the transferee. Classically, this protection applies to the pre-transfer dismissals of staff who would otherwise transfer to the transferee in order to make the business more saleable. However, if there is an economic, technical or organisational (ETO) reason entailing changes in the workforce for a pre-transfer dismissal, then liability for that pre-transfer dismissal remains with the transferor pursuant to regulation 7(2) of TUPE. At the time of the dismissals considered in *Crystal Palace*, the requisite relationship with the transfer was that the sole or principal reason for the dismissal be '(a) the transfer itself; or (b) a reason connected with the transfer which is not an economic, technical or organisational reason entailing changes in the workforce' ('an ETO reason'). It should, however, be noted that, since *Crystal Palace*, the Collective Redundancies and Transfer of Undertakings (Amendment) Regulations 2014 have amended the application of TUPE to transfer-related dismissals. The automatic unfair dismissal provisions of regulation 7(1) of TUPE no longer engage in relation to dismissals for which the sole or principal reason is 'the transfer itself' or a reason 'connected with' the transfer (in either case which is not an ETO reason); they now engage only where the sole or principal reason for the dismissal is 'the transfer'. The practical impact of this apparent narrowing of the scope of TUPE's application—which is intended to align TUPE more closely with the ARD by mirroring its language more precisely—remains to be seen but does not undermine the importance of the issues addressed in *Crystal Palace*.

In relation to a transaction out of administration to which TUPE applies, an employee who is dismissed prior to the transfer in question will not only potentially seek to establish that his or her dismissal is unfair. A key issue for such a dismissed employee will also be whether the individual can enforce any resulting claims against the (presumably) solvent transferee—on the basis that it inherits liability for an automatically unfair dismissal—or whether the individual can only enforce any dismissal-related claims against the insolvent transferor with obvious consequences for the feasibility of any actual financial recovery. An acquirer of a business out of administration by way of a transaction falling within the scope of TUPE will need to be able to assess the extent to which it will inherit liabilities for pre-transfer dismissals in relation to the price it offers for the business and its plans post-transfer. The liabilities which a potential purchaser might inherit can materially affect the price it is prepared to pay for the business and therefore distributions to creditors—as well as a purchaser's willingness to enter into a transaction out of administration at all.

Two contrasting decisions prior to *Crystal Palace* illustrate the application of TUPE to pre-transfer dismissals and the task which falls to the employment tribunal to determine the sole or principal reason for dismissal when a variety of competing influences may be argued to have prompted dismissal—the business having insufficient money to pay staff, a genuine rationalisation, dismissals to make a sale more attractive or a combination of those factors. *Spaceright Europe Ltd v Baillavoine*

[2012] IRLR 111, CA, which was referred to in *Crystal Palace*, is an example of a pre-transfer dismissal being automatically unfair, liability for which was therefore borne by the transferee. The Court of Appeal was satisfied that the real motivation for the dismissal of the chief executive of the business in question was not the ongoing conduct of the business but the prospective sale of the business and that, since the role of chief executive continued to exist post-transfer (and to which the transferee would make its own appointment), the dismissal was not for an ETO reason.

In *Thompson v SCS Consulting Limited*,<sup>5</sup> which was not referred to in *Crystal Palace*, Mr Thompson was dismissed some 11 hours before a transfer agreed by receivers. His dismissal, at the behest of the transferee, was held to be for an ETO reason on the basis that the dismissal was decided upon as part of a reduction to the size of the workforce of an overstaffed, inefficient and insolvent business. This was held not to be a case of collusion between transferor and transferee to effect dismissal in order to secure a sale or enhance the sale price. Accordingly, even though it was transfer related, and extremely close to the time of the transfer, the dismissal was not automatically unfair because it was for an ETO reason. Consequently, liability for the dismissal, even if unfair on normal principles, remained with the transferor.

In *Crystal Palace*, after the employer football club had become insolvent, the claimant employees were dismissed by the employer's administrator. At the time of dismissal, there was a serious prospect of liquidation and the possibility of a successful sale of the club effectively as a going concern was complicated, delayed and made less certain because of the separate ownership of the club's stadium. The employment tribunal had to adjudicate between two competing propositions as to the reason for the administrator's decision to dismiss the claimant employees. As the EAT summarised the position,<sup>6</sup> the employees argued that the true reason for their dismissals was 'to make the purchase of the Club more attractive'. The respondents, seeking to avoid liability post-transfer for those dismissals made before transfer, argued that those dismissals were effected because the administrator could 'no longer afford to pay all the Club's employees and he had to reduce the workforce and wage bill in order to mothball the Club in the hope that a purchaser would be found'.

The employment tribunal found that the employees' dismissals were connected with a subsequent sale of the employer's business (and which constituted a 'relevant transfer' for the purposes of TUPE) but that there was an ETO reason for those dismissals. Consequently, the dismissals were not automatically unfair and the transferee was not liable for any associated unfair dismissal liabilities. As noted by the Court of Appeal<sup>7</sup> the employment tribunal found that the administrator dismissed the employees 'in order to keep the Club alive as a going concern, in the hope that there would be a sale in the future'. Moreover, the employment tribunal

<sup>5</sup>[2001] IRLR 801, EAT.

<sup>6</sup>At [22] and [23].

<sup>7</sup>At [8].

drew a distinction between the administrator's reason for the dismissals—'reducing the wage bill in order to continue the business—and his ultimate objective—being able to sell the business.'<sup>8</sup> Importantly, the employment tribunal expressly found that administrator did not take the step of making the dismissals in question specifically contemplating that this would facilitate the sale of the employer's business—at that point the sale of the Club faced considerable commercial and practical obstacles. The employment tribunal accepted that the employer had run out of money and the intention was to run the Club with a skeleton staff in the hope that it might be sold in the future.<sup>9</sup>

The EAT held that the employment tribunal's conclusions were untenable by reference to its own factual findings. It found<sup>10</sup> that the employment tribunal's 'findings of fact pointed unambiguously to the fact that there was no intention on the part of [the administrator] to continue to conduct the business. On the contrary, his decision was to put the club in mothballs (that is to say, not to conduct any business but to preserve it so that it could, in new hands, if that came about, resume the conduct of business).'<sup>11</sup> In the EAT's opinion, the only possible conclusion that the employment tribunal could properly draw from its findings of fact was 'that the dismissal of the Claimants was for the purpose of selling the business, albeit it was not at that stage certain that there would be a sale, nor necessarily to whom the sale would be.'<sup>12</sup> Although the EAT did not put it quite this way, the argument against the decision of the employment tribunal—and indeed that of the Court of Appeal—is that 'mothballing' the business and dismissing a considerable proportion of its workforce 'in the hope of' a sale which took place one week later should not have been viewed either as a step taken to continue the conduct of the business or as distinct from the intended sale in the hope of which the dismissals were made.

The EAT and the Court of Appeal both considered the force of the observations of Mummery LJ in *Spaceright*<sup>13</sup> where he indicated that '[f]or 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'. The EAT<sup>14</sup> did not consider that this statement could be interpreted as holding that an administrator could never dismiss staff pre-transfer for an ETO reason. Rather, it drew the distinction between a dismissal by reason of a decision to change the workforce and carry on the business—in relation to which an ETO

<sup>8</sup>Ibid.

<sup>9</sup>Ibid.

<sup>10</sup>At [30].

<sup>11</sup>Ibid.

<sup>12</sup>At [31].

<sup>13</sup>Above, at [47].

<sup>14</sup>At [26].

reason could be made out—and dismissal as ‘part and parcel of a process, with the purpose of selling the business’—where an ETO reason could not be established.

The Court of Appeal took the view that Mummery LJ’s comments were made in the fact-specific context of *Spaceright* and did not invalidate the employment tribunal’s decision in *Crystal Palace*—which the Court of Appeal unanimously held it was entitled to reach. In so doing, the Court of Appeal noted the difference between *Spaceright*—where the chief executive was not dismissed because the money had run out but to make the business more attractive to the purchaser which would wish to appoint its own chief executive—and *Crystal Palace*—where the dismissals did not make the business more attractive to a purchaser and in effect cash constraints required dismissals to avoid liquidation. Noting<sup>15</sup> that the employment tribunal’s decision in *Crystal Palace* was ‘fact-sensitive’ as it was in *Spaceright*, Maurice Kay LJ concluded that in this case the dismissals ‘unquestionably entailed changes in the workforce’. Consequently, the employment tribunal was entitled to hold as it did that there was an ETO reason for the dismissals. Whilst the number of non-playing staff was reduced to enable the Club to carry on, the players and sufficient non-playing staff were retained to maintain the operation and avoid liquidation. In Maurice Kay LJ’s opinion, the EAT had, in overruling the employment tribunal’s decision, relied too heavily on the concept of ‘mothballing’ of the Club as indicating that the employees’ dismissals were with a view to sale.

In reaching the decision that it did, the Court of Appeal could have confined itself to a review of the fact-sensitive conclusion of the employment tribunal and whether that was sustainable. As Briggs LJ put it,<sup>16</sup> TUPE ‘unambiguously requires a subjective fact-intensive analysis of the ‘sole or principal reason’ for the relevant dismissal, so that the Employment Tribunal needs to be astute to detect cases where office holders of insolvent companies have attempted to dress up a dismissal as being for an ETO reason, where in truth it has not been’. The *Crystal Palace* decision is of value as it in essence holds as legitimate the nuanced distinction adopted by the employment tribunal which acknowledges that sale will often be the ultimate objective of an administrator but that the effective cause of or reason for actual dismissal may be the reduction of the workforce in the meantime to keep the business going. Perhaps therefore the principal benefit of the *Crystal Palace* decision in terms of clarifying the legal position, at least from the perspective of administrators and transferees, is its confirmation of legitimacy of this distinction. This may ease concerns over whether in appropriate circumstances an administrator can, whilst still pursuing sale options, make genuine economic dismissals which avoid automatically unfair dismissal for which liability is inherited by the eventual purchaser. The distinction adopted by the employment tribunal between the reason for dismissal and the ultimate objective of the administrator is of course consistent

<sup>15</sup>At [14].

<sup>16</sup>At [26].

with the structure of regulation 7(1) which is based on the 'sole or principal reason' for dismissal—a potentially crucial point when dismissal may be decided upon by reference to a variety of facts and matters.

However, an intriguing and potentially concerning aspect of the Court of Appeal decision in *Crystal Palace* is its reliance on the wider policy and legal framework in upholding the distinction adopted by the employment tribunal between the administrator's reason for specific dismissals and his ultimate objective. To the extent that this wider context appears to have influenced the Court of Appeal's decision it is potentially open to criticism.

Maurice Kay LJ<sup>17</sup> identifies the dismissal-related provisions of regulation 7 of TUPE as the 'legal fulcrum' for resolving the tension between, on the one hand, the employment protection policy of TUPE and, on the other hand, the policy of administration potentially achieving a better result for creditors than would be achieved on liquidation. His focus nonetheless appears primarily to be on the intensely fact-sensitive nature of the issues and the need to avoid illegitimate avoidance or manipulation of the TUPE regime. However, Briggs LJ went further, considering that *Crystal Palace* raised some 'fundamental issues about the interaction between two statutory regimes, namely that which protects employment on the transfer of an undertaking (TUPE) and that which seeks to preserve jobs from the consequences of corporate insolvency (administration)'.<sup>18</sup>

Briggs LJ analysed the commercial context as follows. In the context of insolvency, dismissal of employees is a principal method by which administrators can achieve the economies necessary to 'maximise the period before a lack of resources compels closure' and to make the business more attractive to purchasers.<sup>19</sup> If liability for pre-transfer dismissals will be inherited by the purchaser as a consequence of TUPE, this will lead to reductions to the proceeds of sales out of insolvency and therefore to distributions to creditors. On this analysis, where TUPE operates to transfer to the transferee liability for pre-transfer dismissals, the dismissed employees' claims 'will achieve a priority in the insolvent distribution not contemplated by the insolvency code'.<sup>20</sup> It was the 'propensity' of TUPE to produce what he perceived to be a 'favourable result'—of recovery against transferees by those dismissed pre-transfer by administrators—which in his judgment called for 'an anxious consideration of the relationship between the two regimes' of TUPE and insolvency.<sup>21</sup> In his view this reinforced the correctness of the distinction adopted by the employment tribunal in *Crystal Palace* between the reason for the specific dismissals in question—aimed at keeping the business going—and the ultimate objective of a sale.

<sup>17</sup>At [11].

<sup>18</sup>At [18].

<sup>19</sup>At [22].

<sup>20</sup>At [23].

<sup>21</sup>Ibid.

It is strongly arguable that the interaction of TUPE with the domestic insolvency regime—and any ‘propensity’ of TUPE to deliver a certain kind of result with particular consequences for an insolvency—should be irrelevant to the determination of the proper application of TUPE, derived as it is from the ARD. On this analysis, the domestic insolvency regime does not and cannot dilute the safeguards provided for employees pursuant to the ARD, the full effectiveness of which the national court is required to ensure when determining a dispute before it concerning TUPE. As it was put by the Court of Justice of the European Union (‘CJEU’) in *Küçükdeveci v Swedex GmbH and Co KG*,<sup>22</sup> as a recent restatement of a longstanding principle, ‘... in applying national law, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the Directive in question, in order to achieve the result pursued by the Directive’ and ‘the requirement for national law to be interpreted in conformity with European Union law is inherent in the system of the Treaty, since it permits the national court, within the limits of its jurisdiction, to ensure the full effectiveness of European Union law when it determines the dispute before it.’<sup>23</sup> Given the primacy of EU law and therefore the employment protections, one would have thought that there was no place for the consequences of TUPE in relation to insolvency situations to be taken into account in determining its application.

The Court of Appeal also made reference to certain dicta of Jonathan Parker J (sitting as an additional judge of the Court of Appeal) in *Whitehouse v C. A. Blatchford Ltd*,<sup>24</sup> a case which did not concern an insolvent transferor. In that case Jonathan Parker J noted that ‘[t]he purpose of the [Acquired Rights] Directive is to safeguard the rights of employees, vis-à-vis their employers, where an undertaking or business is transferred, but not to place employees in any better position vis-à-vis their employers by virtue of such a transfer.’<sup>25</sup> In the context of *Crystal Palace*, this principle was seen by the Court of Appeal<sup>26</sup> as serving as ‘a reality check, in cases where the resolution of the reg. 7 issue appears to produce a result apparently in conflict with the underlying purpose’ ie where employees dismissed pre-transfer would have rights on dismissal as against the transferee more favourable than those otherwise applying under the insolvency code. The appropriateness of this sort of consideration is also open to challenge. It is fair to say that TUPE does not improve the transferring employees’ entitlements by creating new rights<sup>27</sup> or, for example, by extending to them automatically the transferee’s existing employee benefits.<sup>28</sup> However, the operation of TUPE in relation to pre-transfer dismissals in

<sup>22</sup>[2010] IRLR 346.

<sup>23</sup>At [48].

<sup>24</sup>[2000] ICR 542, CA.

<sup>25</sup>At 555.

<sup>26</sup>At [25].

<sup>27</sup>Per L. J. Buxton in *Whitehouse* at [41].

<sup>28</sup>See *Jackson v Computershare Investor Services plc* [2008] IRLR 70, CA.

any situation, whether or not concerning insolvency, has nothing to do with creating new rights but rather with ensuring that the appropriate commercial party is liable for liabilities arising from pre-transfer dismissals—the transferor if the dismissals relate to the conduct of the business as an ETO reason and the transferee if the dismissals are effected to facilitate the transfer.

That said, the Court of Appeal does not suggest that the domestic insolvency code can override TUPE. As Briggs LJ put it, '[p]lainly, the tie-breaker which must be applied to resolve the potential conflict between the insolvency code and the TUPE regime for the protection of employees is, in the UK at least, reg. 7 of the 2006 Regulations. It was designed to implement in the UK the spirit and intendment of Art. 4.1 of the Directive....'<sup>29</sup> However, it is potentially significant that it was apparently considered appropriate for the application of TUPE potentially to be checked or balanced against its possible consequences on an insolvency process and for there to be, as Briggs LJ put it, '[t]he need to keep the operation of reg. 7 within the bounds contemplated by the Directive.'<sup>30</sup> Divining the sole or principal reason for a pre-transfer dismissal can be far from straightforward, as *Crystal Palace* demonstrates, when the administrator has various necessarily intertwined motivations for his actions. The focus of the employment tribunal in disputes such as this should, it is submitted, not be on the any perceived conflict between TUPE and the domestic insolvency code, or on keeping TUPE within whatever might be seen as its proper bounds, but on the reason for dismissal—which is, as Cairns LJ famously described it in *Abernethy v Mott Hay & Anderson*,<sup>31</sup> 'a set of facts known to the employer, or it may be a set of beliefs held by him which cause him to dismiss the employee'.

*Crystal Palace* is not the only recent decision in which the primacy of the protection of the rights of employees has been called into question in relation to the proper operation of European and domestic transfer of undertakings legislation. The CJEU decision in *Alemo-Herron*<sup>32</sup> provides for the ARD and its implementing domestic legislation to be interpreted by reference to wider principles than solely employment protection.<sup>33</sup> The approval by the CJEU of the 'static', as opposed to the 'dynamic', approach to the assessment of the effect after a transfer of pre-transfer collective bargaining arrangements to which the transferee is not a party after the transfer explicitly relied on the freedom to conduct a business under Article 16 of the EU Charter of Fundamental Rights. It also introduced the idea that the ARD not only seeks to

<sup>29</sup> At [24].

<sup>30</sup> At [27].

<sup>31</sup> [1974] IRLR 213, CA.

<sup>32</sup> [2013] ICR 1116.

<sup>33</sup> See J. Prassl, 'Freedom of Contract as a General Principle of EU Law? Transfers of Undertakings and the Protection of Employer Rights in EU Labour Law: Case C-426/11 *Alemo-Herron and Others v Parkwood Leisure Ltd*' (2013) 42 ILJ 434, and C. A. Wynn-Evans, 'Transfers of Undertakings—Principle and Pragmatism in the CJEU' (2014) 130 LQR 202.



safeguard the interests of employees in the event of a transfer but also seeks to ensure a fair balance between the interests of employees and the transferee.

These case law developments, together with the various amendments made to TUPE by the 2014 amending regulations, appear to reflect continuing concern as to whether the levels of employee protection established by the ARD remain appropriate and that, to adopt Anne Davies' analysis, the ARD's 'simple focus on worker protection from the 1970s does not fit easily with the current focus of EU labour law on flexicurity'.<sup>34</sup> Whether cases such as *Crystal Palace* and *Alemo-Herron* do represent a significant shift in the direction of travel for the ARD and TUPE, taking greater account of employers' interests and/or the 'rescue culture' which the domestic insolvency legislation seeks to promote, remains to be seen.

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<sup>34</sup> *EU Labour Law* (Cheltenham: Elgar, 2012) at p 231.