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Slimming Down Businesses: When Are Dismissals Unfair or Not?

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If the sale of a business occurs in an insolvency there are special provisions which affect employees arising under the Transfer of Undertakings (Protection of Employment) Regulations 2006 SI 2006/246 commonly called TUPE.

All insolvency practitioners must address the need to transfer the business over which they are appointed and this can take the form of two principal techniques. The first is by disposal of the business to an unconnected third party. The second is by virtue of the hive down procedure although the latter is perhaps less common nowadays in the light of a dwindling justification to pursue tax losses. In either case there may be a need for swingeing dismissals.

If TUPE apply, the general rule applicable to the relevant transfer is that all liabilities owed by the insolvent company to or in respect of the employees employed in the relevant business will automatically transfer to the purchaser. Again as a general rule the liabilities which pass to the purchaser/transferee will include liabilities incurred both prior to and following the transfer. This involves a form of statutory novation but under the predecessor regime to the present TUPE, ie TUPE 1981, this novation was limited under that regime to employees employed in the business by the transferor 'immediately before the transfer': see Regulation 5(3) TUPE 1981. In *Litster v Forth Dry Dock* [1990] 1 AC 546 the House of Lords interpreted the phrase 'immediately before the transfer' to mean 'or would have been so employed if he [the employee] had not been unfairly dismissed in the circumstances' as prescribed by the previous TUPE Regulation 8(1), a Regulation that will be dealt with in further detail below.

TUPE 2006 followed and applied the effect of the *Litster* decision. In the wake of *Litster* there has been much debate, not least in the cases, as to when dismissals by an insolvent company are to be regarded as being by reason of a subsequent transfer. If a proposed purchaser asks for the dismissals then the dismissals would clearly be regarded as having arisen by reason of a subsequent transfer.

The real debate has been about those cases in which the dismissals by the insolvency practitioner can be said to have been for operational reasons. In other words, what is the approach to take when the insolvency practitioner takes the view that the company simply cannot afford to transfer the workforce on and what about the position when such a view is taken prior to any contact with let alone transfer to the proposed purchaser?

The relevant Regulations are Regulation 7 and 8 of TUPE 2006. They were formerly in Regulations 7 and 8 of TUPE 1981. Regulation 7 of TUPE 2006 provides that:

> '(1) Where either before or after a relevant transfer, any employee of the transferor or transferee is dismissed, that employee should be treated for the purposes of Part X of the 1996 Act (unfair dismissal) as unfairly dismissed if a the sole or principal reasons for his dismissal is –
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> (a) the transfer itself; or
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> (b) a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce.'

Regulation 7(2) provides as follows, namely:

> '(2) This paragraph applies where the sole or principal reason for the dismissal is a reason connected with the transfer that is an economic, technical or organisational reason entailing changes in the workforce of either the transferor or the transferee before or after a relevant transfer.'

The phrase 'economic, technical or organisational' is called an ETO reason.

Regulation 8(1) of TUPE 1981 provided that:

> '(1) Where either before or after a relevant transfer, any employee of the transferor or transferee is dismissed, that employee shall be treated ... as unfairly dismissed if the transfer or a reason connected with the transfer is the reason or principal reason for his dismissal.'

Regulation 8(2) provided that Regulation 8(1) shall not apply to a dismissal where:

> '... an economic, technical or organisational reason ("ETO reason") entailing changes in the workforce or either the transferor or transferee before or after the relevant transfer is the reason or principal reason for dismissing an employee.'

It can be seen that the new Regulations are substantially the same as under TUPE 1981 although Regulation 7(3) now makes it clear in the legislation that where the dismissal is for an ETO reason this will be regarded as a redundancy dismissal.

If Regulation 8(2) of TUPE 1981 (now Regulation 7(2) and (3) of TUPE 2006) applies, the dismissal is not automatically unfair. However, it could still constitute an unfair dismissal under general employment law principles.

To summarise matters so far, if an insolvency practitioner upon his appointment or shortly thereafter arranges for the company to dismiss some or all of the employees and only subsequently decides to sell the business there will be no transfer of the relevant liability to the transferee/purchaser unless the employee can demonstrate that he or she was dismissed by reason of the transfer.

Prior to the recent Employment Appeal Tribunal decision of *CAB Automotive Ltd v Blake and others* (UK EAT/0298/07/CEA: 12 February 2008) there had been some confusion about these issues. In *Ibex Trading v Walton* [1994] IRLR 564, another decision of the Employment Appeal Tribunal (and somewhat unusually it might be thought) the transferee/purchaser went into liquidation during the original tribunal hearing. It was reasonably clear that the transferor company remained a more lucrative target than the transferee from the point of view of certain dismissed employees. The EAT upheld their claim that the relevant liabilities should not be treated as having been transferred. It stated at page 567:

> '(1) ... we attach significance to the definite article in Regulation 8(1) 'that an employee shall be treated ... as unfairly dismissed if the transfer or a reason connected with it is the reason or the principal reason for dismissal'. The link, in terms of time, between the dismissals and transfers will vary considerably. In *Litster* the time difference was 1 hour; often it will be more. The transfer is not just a single event: it extends over a period of time, culminating in a completion. However, here, the employees were dismissed before any offer had been made for the business. Whilst it could properly be said that they were dismissed for a reason connected with the possible transfer of the business, on the facts here, we are not satisfied that they were dismissed by reason of the transfer or for a reason connected with the transfer. A transfer was, at the stage of the dismissal, a mere twinkle in the eye and might well never have occurred. We do not say that in every case it is necessary for the prospective transferee to be identified; because sometimes one purchaser drops out at the last minute and another purchaser replaces him.
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> (2) In any event, it seems to us, on the facts, to be difficult to say, by reason of the timing of the dismissal and the sale of the business, that the employees would have been employed at the date of the completion but for their dismissal.'

In *Morris v John Grose Group Limited* [1998] ICR 655, another EAT decision, the employee was employed by the transferor until he was dismissed by reason of redundancy on 30 September 1996. It was decided to make him redundant three days before the date on which receivers were appointed. He and other employees were made redundant in order to cut down the workforce and make the company more saleable. Two months later the company was transferred and the employee made a claim against the transferee for unfair dismissal. The Tribunal found the defendant liable. Effectively it confirmed that since the receivers had not definitely decided to transfer the business to the transferee (although it was found that they clearly had that possibility in mind) the employee could not be regarded as having been dismissed by reason of 'the' transferee. The most that could be said was that the receivers had only 'a' transfer in mind.

The EAT disagreed with that analysis. It said the tribunal had made an error in law in attaching significance to the work 'the'. The true question was whether a transfer to any transferee who might appear or a reason connected with such a transfer constituted the reason or principal reason for the dismissal. The EAT allowed the employee's appeal and remitted the matter to a new tribunal.

In the CAB decision the evidence was that the day after the administrators' appointment one of the administrators informed a consultant responsible for the day to day management in the transfer or company that the latter's role 'was to tidy up the business to sell to somebody else'. One of the objectives of the administration was, as is commonly the case, to achieve a better realisation for the creditors as a whole than would be effected in a winding up. The employees claimed before the tribunal that they had been dismissed by reason of the transfer which occurred later, albeit a short time later. In particular the tribunal determined first that the evidence established that the administrators' motivation was not simply to reduce overheads but was part of a overall plan to reduce size with a view to sale. Secondly, on those grounds it found, therefore, that the dismissal was connected with the subsequent transfer even though the actual identity of the transferee was not then known.

The EAT disagreed. Regulation 8(1) means that it has to be decided whether the transfer of the slimmed down undertaking was the 'reason or principal reason' for the dismissal. The EAT held that the tribunal had mistakenly taken the view that the transfer or reason connected with it needed only to be one of the reasons for the dismissal. In addition Regulation 8(1) and Regulation 8(2) were not alternative. The latter came into play only if Regulation 8(1) had been specifically addressed and answered in the affirmative. Again the

tribunal had failed to do this. The case was remitted to a fresh tribunal.

The EAT expressed its preference for the decision in the *Morris* case over the early decision in *Ibex Trading*. The EAT observed the Regulation 8(1) could apply for example where there were a number of potential transferees expressing an interest but at the time of the dismissal matters remained at a very early stage.

The immediate upshot in practical terms of the CAB decision is that in most cases where workforces are 'trimmed' there is very likely to exist a potential for dismissal. There will have to be clear evidence indicating a desire to create general redundancies and not to trim the workforce with a view to subsequent onward sale. If there is any suggestion whatsoever that dismissal is likely to make a sale easier or more advantageous to the insolvency process then the case is unlikely to get through what could be called the ETO gateway. Whether this tightening up of the law and practice in this area is a good thing remains to be seen.

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