

Revision of the Transfer of Undertakings (Protection of Employment) Regulations 1981

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<http://www.dti.gov.uk/er>

1. The Transfer of Undertakings (Protection of Employment) Regulations 1981, commonly known as the TUPE Regulations, implement the EU Acquired Rights Directive and safeguard employees' rights when the business in which they work changes hands between employers.

Purpose and intended effect

Objective

2. The aims of the legislation are to:
 - assist the smooth management of necessary business restructuring and public sector modernisation by securing the interests and commitment of the employees affected;
 - promote a co-operative, partnership approach toward change; and
 - help create a level playing field, and reduce transaction risks and costs, in business acquisitions and in contracting operations in the business services sector.
3. There are at present, however, a number of problems with the way the Regulations operate, and transfers can be the subject of confusion and dispute. The Government has therefore decided to amend the Regulations with the objective: a) to improve and simplify their operation, remedying some widely recognised shortcomings and reducing the potential for disputes and litigation; and b) to take advantage of some additional flexibilities afforded by a number of new Member State options introduced in a revised version of the Directive adopted in June 1998, following successful negotiations under the UK Presidency.

Background

4. The 1981 TUPE Regulations provide that when an undertaking or business, or part of one, is transferred from one employer to another:

- The employment contracts of the employees, along with all the rights, powers, duties and liabilities of the old employer (transferor) pass automatically to the transferee
 - Employees of the transferor or of the new employers (transferee) may not be lawfully dismissed by reason of, or for a reason connected with the transfer. However, the Regulations provide that that prohibition shall not prevent lawful dismissals for an economic, technical or organisational reason entailing a change in the workforce; the employer will remain under a duty to act reasonably in the circumstances.
 - Both the old and the new employer must inform employee representatives and consult them about the legal, economic and social implications of the transfer and any measures envisaged in relation to any of the employees affected by the transfer.
5. At the end of 2001, the Government carried out formal public consultation on a package of proposals for reform of the Regulations. This was both preceded by and followed by extensive informal consultation with key stakeholders and TUPE specialists. In February 2003, the Secretary of State for Trade and Industry announced the Government's decisions as to how the reform would be taken forward.
 6. In March 2005, the DTI issued another consultation document containing new draft TUPE Regulations¹, seeking views as to whether or not the draft Regulations correctly and effectively implement the policy decisions taken in February 2003.
 7. The 2005 public consultation document included a Partial RIA. The present RIA has been developed from that, in the light of comments received on the proposed measures.

Rationale for government intervention

8. The Regulations are widely regarded, by all groups whose interests are affected by them, as less than satisfactory in their present state. For instance:
 - The scope of the legislation is the most extensively debated and litigated aspect of the current Regulations. Ideally, everyone should know where they stand, so that employers can plan effectively in a climate of fair competition and affected employees are protected as a matter of course. In the past, however, this has not always been the case. There are two particular areas which have been a frequent source of dispute – avoidance devices and service provision changes.
 - It is often difficult for the transferee to understand the rights and obligations of employees conferred by the transferor. This

¹ TUPE Draft Revised Regulations: Public Consultation Document, Employment Relations Directorate, DTI, March 2005, URN 05/926

increases the degree of uncertainty of the transfer market, thus leading to unnecessary barriers.

- There are a number of disputes that arise because of a lack of clarity of whether dismissal by reason of a transfer of an undertaking is always unlawful.
 - It is unclear in which circumstances the regulations allow transfer related changes to terms and conditions that arise for an economic, technical or organisational reason entailing changes in the workforce. This results in uncertainty and unnecessary disputes.
 - Around 69 per cent of insolvencies result in the break-up of the assets of the company, thus resulting in job losses and a loss of productive potential.² There are a number of barriers that could potentially prevent a rescue of an insolvent business that could be reduced by changes to the TUPE regulations.
9. Failure to introduce the revised Regulations would mean that their shortcomings remained unaddressed, contrary to the Government's commitment to review and where necessary reform outdated and deficient regulation that imposes undue burdens on business. It would also mean that the valuable new flexibilities in the revised Directive, successfully negotiated by the UK in 1998, were not taken advantage of. It would impact negatively on policy priorities not only of the Department of Trade and Industry (DTI) but also of a number of other government departments.

Consultation

(i) Within government

10. These proposals have been developed in consultation with interested government departments including HM Treasury, The Department for Work and Pensions and Cabinet Office.

(ii) Public consultation

11. In 1997, the Government made it a social affairs priority for the then forthcoming UK Presidency of the EU to secure a revision of the Acquired Rights Directive, so as to: a) clarify the meaning of certain provisions by incorporating elements of the jurisprudence of the European Court of Justice (ECJ); and b) give the UK – and other Member States – increased flexibility in tailoring national implementing legislation to domestic circumstances. The DTI carried out a formal public consultation exercise to canvass views on the UK's stance in the negotiations leading up to the revision.

² Source: R3 (2004) *12th Corporate Insolvency Survey*. Available at www.r3.org.uk/publications

12. In September 2001, the DTI published another formal public consultation document, accompanied by a detailed background paper, setting out specific policy proposals for the reform of the Regulations.
13. In the light of those consultations, the Government announced in February 2003 that it would proceed with its policy proposals. Since that date, the Government has been working on a new set of TUPE Regulations to replace the existing ones, and, as part of that exercise, it has undertaken extensive prior consultations with interested parties.
14. On 15 March 2005, the DTI issued another consultation document containing new draft TUPE Regulations. It sought views as to whether or not the draft Regulations correctly and effectively implement the policy decisions taken in February 2003. The consultation document made it clear that the Government was not seeking views on the policy proposals, except in relation to a few outstanding issues such as the exemption of "professional services" from the scope of the Regulations. The document was therefore aimed principally at TUPE specialist groups such as legal advisers, trade unions, employer's organisations and experts with knowledge of the operation of the Regulations.
15. The consultation closed on 7 June 2005. There were 72 responses to the consultation overall. However no concerns were raised with respect to the estimated costs and benefits presented in the Partial Regulatory Impact Assessment.

Options

16. A range of options was considered in the 2001 consultation. These were mainly concerned with the provision of pensions (which have been addressed in the Pensions Act 2004) but also included the costing of policy recommendations to deal with the problems described above. The results of the formal and informal consultation, have enabled the drafting of legislation on the following measures to, briefly:
 - give more comprehensive coverage to service contracting operations, with the aim of improving the operation of the market, promoting business flexibility and reducing insecurity for employees affected by such operations;
 - introduce a requirement on the transferor to notify the transferee of the employees and associated employment liabilities that it will be transferring, thus increasing the transparency of the transfer process and combating 'sharp practice';
 - clarify the circumstances in which employers can lawfully make transfer-related dismissals and negotiate transfer-related changes to terms and conditions of employment for 'economic, technical or organisational' (ETO) reasons; and

- introduce new flexibility into the Regulations' application in relation to the transfer of insolvent businesses, giving a worthwhile boost to the promotion of the 'rescue culture'.

Costs and benefits

Assumptions

17. The RIA considers the different aspects of the revision of the Regulations individually. Some of the assumptions are common. We use evidence from the Workplace Employee Relations survey 1998 (WERS 98) and from the Small Business Survey business database to establish the proportion and numbers of employees and undertakings likely to be affected.
18. WERS 98 questioned managers of workplaces with over 25 employees about whether or not there had been a change of ownership in their workplace over the past 5 years. 312 responded 'yes', and of those, 94 implied that a private sector to private sector TUPE transfer was involved.³ The latter equates to 4.3 per cent of those surveyed, or about 1 per cent per annum. Anecdotal evidence shows – as would be expected – that small firms are less likely to be involved in transfers. We assume therefore that those affected comprise: between 0.1 per cent and 0.5 per cent of businesses with 1-9 employees; between 0.5 per cent and 0.9 per cent of businesses with 10-19 employees; and 1 per cent of businesses with 20 or more employees.
19. This indicates that between at least **2,500 and 7,100** businesses with between about **200,000 and 220,000** employees will benefit each year from the changes to the legislation. The true figure will be somewhat higher, however, as while the WERS data gives a good indication of the incidence of businesses changing hands through ordinary sales and buy-outs, it probably does not capture transfers occurring through contracting-out and analogous operations. The proportion of such operations to which the Regulations will apply in future will be increased by the changes. The numbers likely to be affected in these cases are considered further below.
20. We assume that there would be no additional implementation costs to companies. Companies who are involved in a TUPE transfer, would in any case be referring to lawyers on what they can and cannot do, so would incur the costs with or without the changes in the Regulations.

Extension of scope

21. The aim of this aspect of the revision of the Regulations is to reduce the high degree of uncertainty felt by the parties involved in service

³ The takeovers included in the analysis include 'sold by parent organisation' and 'management buyout'. See Annex A for details. It should be pointed out that WERS 98 was not a survey conducted to answer TUPE questions

provision changes, as to whether or not the Regulations apply in relation to their particular case.⁴ The measure will involve the scope of the Regulations being extended to give more comprehensive coverage to service provision changes.

22. The practical impact of this change will be essentially confined to purely private sector transfers, i.e. transfers not involving a public sector or former public sector service. This is because TUPE-type requirements are already applied comprehensively when public sector service contracts change hands between private sector contractors, by virtue of the public policy set out in the Cabinet Office Statement of Practice "Staff Transfers in the Public Sector". The Government remains committed to this policy. The Local Government Act 2003 confers powers on the Secretary of State, the National Assembly of Wales and Scottish Ministers to require best value authorities in England, Wales and Scotland to deal with staff matters in accordance with Directions. The purpose of these powers was to enable the provisions of the Statement of Practice to be made a statutory requirement for those authorities. No Directions have yet been issued under these powers.

23. The change will entail new provisions being made to the effect that if:

- a service provision change is to take place; and
- prior to the change, there are employees assigned to an organized grouping the principal purpose of which is to perform the service activities in question specifically on behalf of the client concerned;

then, subject to certain specified exceptions:

- the employees assigned to the organized grouping shall be treated in the same way as in cases where the TUPE Regulations normally apply; and
- the party with responsibility for the carrying out of the service activities before the change shall be treated as the transferor, and the party with responsibility for this after the change shall be treated as the transferee.

24. The measure is expected to impact principally on private sector clients for, and contractors providing, 'blue collar' services such as office cleaning, workplace catering, security guarding, maintenance, and some computer services; and on the employees of such clients and contractors.

25. To estimate the numbers of businesses and employees involved in this type of service provision we use statistics from a selection of industry sectors.⁵ We then make assumptions about the number of

⁴ 'Service provision changes' is a term coined to describe a) contracting-out ("outsourcing"); b) reassignment of a contract ("re-tendering") and c) contracting-in ("insourcing") of labour-intensive services

⁵ See Annex B

times that service providers are changed, including being contracted-in. Annex B provides details.

26. We estimate that between about **2,500 and 4,500** businesses employing between about **60,000 and 100,000** employees are involved each year in a service provision change not involving a public sector service.
27. We further assume that 65 per cent of these service provision changes are, at the point when they actually take place, clearly TUPE transfers under the current Regulations, and are generally recognized and treated as such by all parties concerned. We also assume that 10 per cent of cases are clearly not TUPE transfers under the current legislation. This implies that in 25 per cent of cases it is, at present, legally uncertain and unclear to the parties involved whether or not the change involves a TUPE transfer. Some of the cases in this category will in fact involve TUPE transfers (and may eventually be established to do so by way of legal action); others not. It is impossible to say exactly where the dividing line currently falls, owing to the legal uncertainty. 25 per cent is, in effect, the margin of uncertainty.
28. It should be noted that this considerably understates the true degree of uncertainty surrounding service provision changes as, although the majority – as indicated in the preceding paragraph, we assume 65 per cent – are clearly TUPE transfers at the point when they actually take place, they may well have been subject to uncertainty at an earlier stage. This is because the uncertainty arises mainly where the new service provider declines, or seeks to decline, to take over a major part (in terms of numbers or skills) of the old service provider's workforce, and it may not be known at the outset – for instance, at the stage when a client invites contractors to bid for a contract – whether or not any given case will ultimately fall into this category. The parties themselves can however take steps to reduce the chances of their case ultimately falling into the 25 per cent margin of uncertainty. The client, for instance, can make clear in initiating a tendering exercise that it will exclude bids that contemplate the existing workforce not being taken over; and, even where the client makes no such stipulation, the contractor can choose to bid on a basis that will almost certainly involve a TUPE transfer (provided of course that the bid is successful, and that the contractor is not undercut by a competitor bidding on a purported 'non TUPE' basis).
29. The extension of scope is expected to bring clearly within the coverage of the Regulations the majority of cases that are currently within the assumed 25 per cent margin of uncertainty. It will also bring within the coverage of the Regulations a proportion of the assumed 10 per cent of cases that are, at the moment, clearly not TUPE cases. We assume that, under the new Regulations, 85 per cent to 90 per cent of cases will be clearly TUPE cases, and 5 per cent clearly not TUPE cases. This will leave 5 per cent to 10 per cent of

cases in which there will still be uncertainty over whether or not the Regulations apply. The change will thus bring certainty to an additional 15 per cent to 20 per cent of cases, involving the transfer of 390 to 880 businesses with between 9,000 to 21,000 employees per annum⁶ – a considerable reduction in the margin of uncertainty.

30. We assume that, of this subset of cases, 10 per cent will already apply the full TUPE Regulations even if they do not have to. This may, on first consideration, seem a low percentage. However, as explained above, where the new service provider in a service provision change does in fact take over a major part (in terms of numbers and skills) of the old service provider's existing workforce, this generally, in practice, has the effect of causing the Regulations clearly to apply – i.e. of avoiding those cases falling within the margin of uncertainty in the first place. There are, where a labour-intensive service is concerned, only a relatively narrow range of circumstances in which the new service provider might take over a major part of the existing workforce and treat them as if TUPE applies, when in fact TUPE does not apply. An example might be a case where the business is completely reorganized following the change, so that the undertaking does not 'retain its identity' in the hands of the new service provider – part of the test for the transfer of an undertaking under the Directive and the existing Regulations.
31. This leaves the net numbers likely to be affected at between 350 and 790 businesses with (prior to the service provision changes) between 8,000 and 19,000 employees in total. Again, however, these estimates understate the benefits of the change in terms of avoiding disputes, because: a) disputes would at present arise in a proportion of the 10 per cent of cases where, notwithstanding the uncertainty, TUPE was ultimately applied; and b) because – for reasons explained in the following paragraph – the 5 per cent to 10 per cent of cases in which legal uncertainty will remain following the change will be the types of cases in which disputes are, in practice, relatively unlikely to arise.
32. It is unavoidable that some uncertainty will remain following the extension of scope, because the precise facts will be different in every case and it is impossible to draft provisions that draw an absolutely clear line between those that fall within the Regulations' coverage and those that do not. There could potentially be uncertainty about such matters as whether or not there was, prior to the change, an organised grouping of employees dedicated to meeting the needs of one particular client.
33. The main benefits of making this change are that it will:
- help to ensure that all parties involved in service provision changes know where they stand from the outset, and thereby:

⁶ These results are obtained by applying the percentages to the numbers of service provision changes that we estimate will be affected each year, as set out – after rounding - in paragraph 19.

- reduce transaction risks and costs for clients and contractors, and allow for services to be provided more cheaply, in part because of a reduction in the cost of commercial indemnity insurance;
 - help 'take the fear out of transfer' and reduce insecurity for affected employees;
 - reduce the number of TUPE-related employment tribunal and court cases;
- help to create a 'level playing field' for contract bids and promote fair competition, encouraging *bona fide* potential bidders (including small firms) to become involved in service contracting while deterring 'cowboys' who would seek to compete by cutting employees' terms and conditions;
 - minimise the risk to employees of facing redundancy, and to contractors of facing large associated redundancy payment liabilities, when contracts reach the end of their term;
 - help to insulate contractors, clients and employees from possible future upheavals in the case law on this aspect of the scope of the Directive, such as occurred when the European Court of Justice gave its unexpected judgment in the *Suzen* case in 1997;
34. Set against this, there will be some marginal costs arising from the additional protections that employees will gain in the 350 to 790 cases per annum in which the change will have a direct impact (i.e. in which the legal position will change, leaving aside the indirect impact of providing greater certainty and helping to avoid disputes in cases where the legal position will remain the same). Even leaving aside the – unquantifiable – benefits described in the preceding paragraph, these will be largely offset by savings. A more detailed analysis of quantifiable costs and savings follows.
35. Redundancy payments: In cases where the change results in TUPE being applied, and where otherwise it would not have been, there is likely to be a significant reduction in the number of redundancies made. This is because:
- a. the workforce will pass from the old service provider to the new along with the contract whereas, but for the application of the Regulations, all those who could not be redeployed by the old service provider on other work would have had to be made redundant by the old service provider; and
 - b. this is likely to result in more employment stability in these sectors as new contractors will have less freedom, and less incentive, to undercut using cheaper labour on worse terms and conditions.
36. We assume below that, if TUPE did not apply, only 5 per cent of the workforce on average would be able to be redeployed by the old

service provider. (Some of the others might subsequently be taken on, on new contracts, by the new service provider; but this would not avoid the necessity for the old service provider to make them redundant and pay them – subject to the normal qualifying conditions – a statutory, or possibly an enhanced contractual, redundancy payment.)

37. The new service provider might still wish to make some redundancies following the transfer, however, if this is warranted by increased efficiency, meaning that fewer employees are required. We assume that, on average, there would be a reduction of 25 per cent in the number of employees engaged in carrying out the service activities, and that these employees would all be shed through redundancy (although it would be wrong to suppose that they would necessarily all be employees who had transferred from the old service provider, as there would need to be a fair redundancy selection exercise). This compares with 95 per cent of employees being made redundant by the old service provider if TUPE did not apply - i.e. a 70 per cent reduction in the total number of redundancies. **This will result in a saving to business of £6.5million to £14.5 million each year in redundancy payments.**⁷ The cost of redundancy payments for the 25 per cent of employees who were made redundant would shift from the old service provider to the new. This would be a shift of £2 million to £5 million each year.

38. Number of tribunal applications: Currently there are 1,428 applications each year to the Employment Tribunals Service that include a claim of unfair dismissal under TUPE and 1,321 that include a claim regarding failure to inform and consult under TUPE.⁸ A certain proportion of breach of employment contract claims (which are generally heard in the civil courts rather than the Employment Tribunals), claims for unauthorized deductions from wages and redundancy payment claims will also be claims arising from a dispute over the application of the TUPE Regulations, but these are not separately identified in the statistics that are collected and cannot be quantified – hence the analysis below understates the benefits of the change in terms of reducing costs associated with legal proceedings. We assume therefore that the number of cases that include either types of claim to be between 1,400 and 2,700 each year.

39. A certain proportion of these TUPE-related claims arise from the current uncertainty over the Regulations' scope in relation to service provision changes. As discussed above, extending the scope of the Regulations is expected to reduce significantly the proportion of cases in which disputes, and consequent legal proceedings, arise.

⁷ We assume an average duration of employment of 4 years. The calculation is therefore: $8,000 \times £280 \times 4 \times 0.70 = £6.546$ million, $19,000 \times £280 \times 4 \times 0.70 = £14.546$ million. This is based on the assumption that employers only pay the statutory minimum of £280 per year of service. They may choose to pay more.

⁸ Source: Employment Tribunal Service Annual Report 2003/04.

This will mean savings to employers and the Exchequer. On average, a tribunal application costs the employer involved £3,000⁹ and the Exchequer £990.

40. On the other hand, broadening the scope of the legislation will mean more cases in which there is potential to make a claim; particularly a claim regarding an alleged transfer-related change to terms and conditions. We assume however, that this effect will be overshadowed by the impact of making the Regulations clearer.
41. If we assume that the changes result in a reduction of between 10 per cent and 20 per cent in applications, this is equivalent to between 140 and 540 applications per year. **This will result in a saving to employers of up to £1.6 million and to the exchequer of up to £0.5million each year.**
42. Changes in terms and conditions: If there is no TUPE transfer, the new employer can essentially determine the terms and conditions of new employees, subject to market conditions. We assume that the average total employment package is worth 110 per cent of gross wages. On average this would be about £382 per week.¹⁰ If, but for the application of TUPE, the service provision change would lead to the employees in the new workforce having a remuneration package worth 15 per cent less than the employees in the old workforce (who would be mostly different individuals), this would mean a 'loss' of about £3,000 per employee per year. It was assumed above that, if TUPE applied, the new service provider would reduce the total workforce by 25 per cent. We now further assume that if TUPE did not apply, the new service provider would reduce the workforce by 30 per cent – in other words, that the application of TUPE would, mainly as a result of the transfer of redundancy payments liabilities, act as a marginal disincentive on the new service provider to reduce the size of the workforce. The additional costs falling to the transferee as a result of the extension of scope would thus be: a) the full cost of the remuneration package, i.e. £382 per week, for 5 per cent of the old workforce; and b) the difference between the old remuneration package and the new, i.e. 15 per cent x £382 =£57 per week, for 70 per cent of the old workforce. **This totals between £17 million and £39 million¹¹ each year.** This is a direct transfer from the new employer to the employees. All or part of it may have an influence on the price of the contract, and so effectively be 'passed back' to the transferee.

⁹ This is an estimate of the median cost of an employment tribunal to an employer. This includes the cost of legal services as well as the cost of staff time. The estimates are based on information from the Survey of Employment Tribunal Applications 2003 and the Annual Survey of Hours and Earnings 2004 (available at www.statistics.gov.uk)

¹⁰ Source: Annual Survey of Hours and Earnings 2004. Average (median) gross weekly earnings for full and part time workers (including overtime) in United Kingdom is £346.9. 110% of this is £382.

¹¹ £57 per week x 52 weeks x 8,000 to 19,000 employees affected x 70% = £17.4 million to £38.7 million.

43. Information and consultation: In the case of a TUPE transfer the old employer has to inform and consult employee representatives. For those extra 350 to 790 businesses that will now fall under TUPE Regulations this would have cost implications. We assume that the consultation process takes three days of management and worker representative's time. This includes a consultation meeting as well as discussions before and after. We estimate the daily cost of a manager's time to be about £152 and that of an employee representative about £85.¹² The total cost per business will therefore be about £710¹³. This will bring the costs to all businesses to **£0.3 million to £0.6 million each year.**

44. Summary of costs and benefits: Taking together all the quantifiable costs and savings identified above gives total additional quantifiable costs to business of a maximum of **£9.5 million to £24.3 million each year.** Table 1 gives a breakdown of how this figure is derived.

1. Summary of costs and benefits of extending the scope of the legislation

	Annual benefits (£m)	Annual Costs (£m)
Firms		
Redundancy payments	6.4-14.5	
Tribunal applications	1.6	
Terms and conditions		17-39
Information and consultation		0.3-0.6
Total net impact		9.5-24.3
Individuals		
Redundancy payments		6.4-14.5
Terms and conditions	17-39	
Total net impact	10.8-24.1	
Exchequer		
Tribunal applications	0.5	

45. It should be noted however that the assumptions used in this analysis have – as explained in the appropriate paragraphs – consistently understated the savings and overstated the costs that will flow from the change. It is therefore likely that the true additional quantifiable costs associated with the change will be at the lower end of this range, i.e. a maximum of around £10 million per annum. This must also be viewed in the light of the fact that there will be other, unquantifiable but nonetheless significant, benefits and savings resulting from the change, as discussed in paragraphs above. It is likely that these will more than offset the estimated maximum £10

¹² Median weekly rate for managers is £583.2, source Annual Survey of Hours and Earnings 2004. Therefore daily cost of managers time is £583.2 x 1.3 /5 = £151.63. Weekly cost of employee representatives time is £327.6. Therefore daily costs of employee reps time is £327.6/5 x 1.3 = £85.18.

¹³ (£152 + £85) x 3 = £710.

million per annum quantifiable costs, so that, overall, the effects of the measure will be positive for business and for the operation of the market as well as for the affected employees. This is certainly the strong view of consultation respondents closely involved in the service-contracting sector – including for example the Business Services Association, which represents many private sector contractors for services. The contracting industry in general strongly supports the measure to extend the scope of the Regulations.

46. Employees would benefit by about £11 million to £24 million each year (see Table 1 for details).
47. The following sections address specific Regulations where there are potential cost and benefit issues arising.

Notification of employee liability information

48. The consultation document dealt with the flow of information from the transferor to the transferee regarding the transfer of employment liabilities.
49. At present, there is no legal obligation on the transferor to pass any information to the transferee. Under the revised Regulations, however, the transferor will be obliged to give the transferee information about the employees who are to transfer, and all the associated rights and obligations towards them. The information will need to be provided at least fourteen days before the transfer, or, if special circumstances mean that that is not reasonably practicable, as soon as reasonably practicable thereafter. If the details change between the time they have first been notified to the transferee and the actual completion of the transfer, the transferor has to inform the transferee.
50. In light of responses to the 2005 consultation, the Regulations have been amended to identify the main categories of information which should be supplied. These include the age and the employment particulars of each transferred individual. As much of this information is already collected by employers under other information obligations, this should reduce the administrative burden on the transferor. Simplifications have also been made to the means of transferring data: the Regulations now allow for the non-written notification of the information, as long as such other forms of communication can be accessed by the transferee.
51. The intended effect of the measure is to increase transparency for the transferee as well as for the employees, and to reduce the number of cases in which the transferee feels obliged to seek commercial indemnities from the transferor to afford cover against exposure to unforeseen liabilities. In cases where no commercial indemnities are or would be agreed, the measure will protect the transferee, and indirectly its employees, against acquiring such unforeseen liabilities

and suffering adverse consequences –including potentially, in extreme cases, insolvency – as a result. The measure also aims at increasing competition as it introduces a strong disincentive to hide any relevant information about a business to be transferred. This might have an effect on the price of a business. If there were significant unusual liabilities toward employees this would reduce the price. This benefit to the transferee would be a cost to the transferor. We cannot quantify this effect, but assume that it would mainly support the functioning of the market.

52. We assume that even at present, in the absence of a legal requirement, equivalent information is already in most cases (90–95 per cent) made accessible in writing to the transferee. The benefit of the measure in those cases will thus be to increase security for the parties against the risk that the information provided may be incomplete or inaccurate, and to reduce the need for commercial indemnities (which can be time consuming and costly for the parties to negotiate and agree). In the other 5-10 per cent of cases – i.e. 240 to 1,100 transfers per annum¹⁴ - the new measure will have the additional effect of causing the transferor to incur costs through time spent identifying the information and writing it down.
53. In the Partial RIA that accompanied the public consultation document we assumed that this would not take more than one day of management time. In light of the simplifications discussed above we now assume that the time needed is reduced by one-quarter. At a daily cost of £152 for senior management this would cost up to **£0.125 million each year in total for all transfers.**¹⁵

Dismissal by reason of a transfer of an undertaking

54. The consultation document raised the issue of the circumstances in which transfer-related dismissals may be lawfully made for economic, technical or organisational reasons entailing a change in the workforce (ETO reasons), and indicated that the Government intended to change the wording of the Regulations in order to clarify the legal position. There has been no change to that position.
55. This aspect of the current Regulations has been subject to uncertainty. We would expect the clarification to reduce the number of disputes over this issue and so save businesses and employees the costs arising from such disputes, including in some instances the costs of contesting court and tribunal cases (and the associated costs to the Exchequer).

¹⁴ These are 5 to 10% of the 4,800 to 11,000 transfers (including TUPE transfers under new regulations) taking place every year.

¹⁵ Calculation: $240 \times 0.75 \times £152 = £27,360$ to $1,100 \times 0.75 \times £152 = £125,400$.

56. There were 1,428 transfer-related unfair dismissal cases brought by employees to employment tribunals in 2003/04¹⁶, either as a main or other jurisdiction. This is 0.5 per cent of all employees affected by a transfer. This is about the same as the general proportion of all employees making a tribunal application. Therefore even though we expect a reduction, this is likely to be modest. We assume about 5 per cent, or about 70 cases.
57. An employment tribunal case costs business on average £3,000. A reduction of 70 cases would therefore reduce costs to employers by about £0.2 million each year. There would be additional benefits: a reduction in uncertainty over when transfer-related dismissals can be lawfully made would also give employers the ability to make people redundant etc, where necessary, with more confidence, and therefore reduce risks and transaction costs around transfers. These are important benefits but it is not possible to quantify them.

Changes to the terms and conditions of employment affected employees

58. The consultation document also raised the issue of transfer-related changes to the terms and conditions of affected employees and, again, indicated that the Government aimed to clarify the legal position. The Government has now reaffirmed its view that there should be greater scope in the new Regulations for the transferee to be able to vary contracts after the transfer for an economic, technical or organisational reason connected with the transfer.
59. The effects of this increased clarity and flexibility in the Regulations will be to:
- reduce the number of disputes over this issue and so save businesses and employees the costs arising from such disputes, including in some cases the costs (and the costs to the Exchequer) of contesting court and tribunal cases;
 - give employers the confidence to negotiate changes to terms and conditions, and potentially gain improvements in business efficiency (for example, more logical payment systems with lower administration costs), in some cases where they would otherwise have refrained from doing so because of the perceived legal risk;
 - reduce a perverse incentive for employers to make transfer-related dismissals, and attempt to rely on the ETO defence in any resulting unfair dismissal claims, simply in order to be able to

¹⁶ The official figure for TUPE related unfair dismissal cases may underestimate the actual figure as some of these cases may be filed under other unfair dismissal cases. We do not know the size of this effect. Source of official data: ETS annual report 2003/04

offer the employees re-engagement on new terms and conditions (and thereby achieve changes by the 'back door'); and

- reduce employers' risks and transaction costs associated with transfers.

60. These benefits would be significant, but are unquantifiable.

Application of the legislation in relation to insolvency proceedings

61. The consultation document discussed the situation of an insolvent business. It indicated that the Government had decided to take advantage of two new derogations in this regard in the revised Acquired Rights Directive.

62. The Regulations have been revised to provide that, in transfers of businesses in certain types of formal insolvency proceedings:

- the debts that, but for the transfer, would have been met by the Secretary of State for Trade and Industry from the National Insurance Fund under the insolvency payments provisions of the Employment Rights Act 1996, will in future remain with the insolvent transferor and still be met by the state in this way even though a transfer has occurred (although debts outside the categories or in excess of the amounts covered under the insolvency payments provisions will transfer as at present); and/or
- employers and employees may (subject to certain specified safeguards) agree transfer-related changes to the terms and conditions even where there are no ETO reasons that would render them potentially lawful in any event.

63. The intended effect of taking up these derogations is to support the 'rescue culture' by reducing burdens on the transferee. This will create an additional incentive to rescue a business, or parts of it, reducing the proportion of insolvent businesses that are simply wound-up and saving at least some of the jobs of their employees. It will also increase the chances of a rescued business remaining viable after the transfer.

(i) Pre-existing debts not passed to transferee

64. The benefits to business and to employees flowing from the first of the two changes described above will be achieved at the cost of some deadweight expenditure falling to the National Insurance Fund.

65. Under the insolvency payments provisions, employees of formerly insolvent businesses may claim from the state, up to eight weeks' arrears of wages and up to six weeks' arrears of holiday pay, subject to a statutory upper limit on the amount of a week's pay that may be taken into account for these purposes, plus certain other amounts

that are largely irrelevant in the present context.¹⁷ If, however, the business is rescued and transfers to a solvent transferee, then – under the current TUPE Regulations – the transferee has to pay any wages or holiday pay owed to the transferred employees and the state is relieved of this liability. Under the new Regulations, where businesses in certain specified types of insolvency proceedings are concerned (these types of insolvency proceedings being dictated by the scope of the derogation in the Directive), the state will continue to pay the debts that it would have paid in the absence of a transfer, even though a transfer has occurred. We estimate that this will result in an increase in payments for the state in this category of about 12 per cent. This is equivalent to about £6.6 million per annum.¹⁸ See Annex C for details of calculations. These will be benefits for the transferee.

66. It is anticipated that insolvent businesses will be easier to sell with one level of debts less. We assume that the measure will increase the preservation rate of businesses in the specified types of insolvency proceedings by between 2 and 3 percentage points. This compares with the current average preservation rate for all insolvencies of about 30 per cent.¹⁹ This implies an increase in the number of insolvent businesses rescued through TUPE transfers of between 240 and 360 per annum.²⁰
67. The 240-360 additionally rescued businesses would have between 4,900 and 7,300 employees.²¹ Not all of these would keep their jobs. We assume that about 50 per cent (2,400 to 3,700) of them would do so.
68. The rescue of 240 to 360 additional businesses per annum would benefit the taxpayer. Benefits would include savings in redundancy payments (only between 2,400 to 3,700 employees would claim such payments from the National Insurance Fund), reduced levels of unemployment payments to those who would otherwise not have been able to find another job, and future tax payments. The latter are the consequence of a successful business. In every individual case these benefits would be significant for the jobholder. Overall we cannot quantify these benefits.

(ii) Transfer-related changes to terms and conditions

¹⁷ For detailed information please see www.dti.gov.uk/access/job_1/pl718/insolv2.htm

¹⁸ The Insolvency Service paid about £56 million in compensation for arrears in pay and holiday pay. 12 per cent of this is about £6.6 million.

¹⁹ Source: R3 (2004) *12th Corporate Insolvency Survey*. Available at www.r3.org.uk/publications

²⁰ Relating this to the number of insolvent business (in the relevant categories) being sold or partly sold as an ongoing concern of around 3,000 the increased rescue of between 240 and 360 enterprises seems reasonable.

²¹ There are 1.22 million businesses with employees in the UK with 24.8m employees. If the employee distribution of the rescued businesses is the same as for the population of businesses as a whole then this would mean between $(240 \times 24.8m / 1.22m) = 4,879$ and $(360 \times 24.8m / 1.22m) = 7,318$ employees in additional rescued businesses.

69. Under the second of the two changes impacting on the transfer of insolvent businesses, transfer-related changes to the terms and conditions of employment of affected employees would be lawful, even in the absence of ETO reasons, if:
- they were agreed between the transferor or the transferee and appropriate employee representatives;
 - they were designed to safeguard employment opportunities by ensuring the survival of the undertaking; and
 - they were not otherwise contrary to UK law (e.g. the National Minimum Wage Act).
70. This measure would have the effect of increasing flexibility for the transferee and would thereby support the 'rescue culture' that the Government is keen to foster.
71. The main benefit for employers would be that there would be the potential to secure agreement to less favourable terms and conditions and enable businesses to be rescued in cases where unaffordable terms and conditions were responsible, or partly responsible, for their becoming insolvent in the first place. The terms and conditions of employees include a large area of benefits apart from pay, such as holiday entitlement, additional maternity and parental leave, company cars etc. If the annual net value for the benefits were to be reduced by £100 for all the employees involved in this type of transfer, benefits to the transferee would be up to £ 3 million per annum.²² These would be costs to the employees.
72. The benefit for employees would be that in some cases they would keep their jobs where otherwise they would have lost them. The same principle applies as under the first of the two measures in this area. The benefits to employees would be reduced by any worsening in their terms and conditions. The benefits for the taxpayer would be similar to those under the first measure.

Equity and fairness

73. The Regulations will affect employees in a number of ways. They will increase protection for employees when subject to a transfer of services provision, they will increase certainty when subject to any TUPE transfer and they will increase the chance of keeping a job when the firm that they work for becomes insolvent. Any distributional impacts will depend of the proportions of certain groups (low income, ethnic minorities, women) that are affected.
74. The extension of TUPE to certain types of service provision changes is likely to have an impact on employees in catering, cleaning, security and certain types of computer related services. On the whole

²² This is £100 times the estimated number of employees that are currently transferred to another company as a result of insolvency.

these are made up of workers that earn below average wages, both on an hourly and a weekly basis²³. Giving these workers some protection will have a positive equity impact, firstly through the protection of their incomes and secondly through the increase in their labour market attachment.

Small firms impact test

75. The Regulations will affect small firms, like all firms, in several ways. The extension of scope to certain service provision changes that are not considered as TUPE transfers will allow them to bid for contracts in a more certain environment. The requirement for notification of employee liability for all TUPE transfers will increase transparency at a modest cost to some transferors. The clarification of when ETO reasons for redundancy and when changes to terms and conditions of employment can apply, will reduce the number of tribunals and reduce uncertainty. And lastly the changes in relation to insolvency proceedings will increase the chances of rescue.
76. The question that we need to answer for the Small firms impact test is whether small firms are likely to be affected disproportionately by these changes to the regulations. To answer this question the Small firms impact test draws on the following:
- our assessment of the relative numbers of small firms that are involved in TUPE transfers which involve a straight purchase;
 - how many small firms are likely to be involved in transfers of services;
 - the rescue rate of small firms after an insolvency;
 - evidence on implementation costs for small firms;
 - responses from small firms to our previous formal consultation;
 - informal discussions with small firms and organizations that represent small firms amongst others.
77. We do not have any figures on the number of small firms that are currently involved in a TUPE transfer which involves a sale or management buy-out. However, anecdotal evidence suggests that small firms are less likely to be involved in transfers and in particular are less likely to be the transferee.
78. In terms of transfers of service provision (private sector to private sector), we have looked at the proportion of small firms in the

²³ In the UK the average (median) gross hourly rate (excluding overtime) in 2004 for kitchen and catering assistants was £5.13, for cleaners and domestics £5.33, for security guards/related occupations £6.75, for database assistants and clerks was £7.22. Source Office of National Statistics, Annual Survey of Hours and Earnings 2004. Available at www.statistics.gov.uk

affected sectors (cleaning, catering, security and some computer related activities) and compared this with the population of small firms in all sectors. The result shows that small firms are not overly represented in these sectors²⁴.

79. However, surveys have shown that preservation rates in the case of an insolvency are lower the smaller the company²⁵. This is probably not surprising as small firms are more likely to be subject to compulsory liquidations, where preservation rates are low. There is also some concern about the prevalence of insolvency amongst small firms. These statistics would tend to support a view that small firms stand to gain most from changes in the regulations whereby the National Insurance Fund takes on the debts to employees (up to the normal limits) where there is a buy-out.
80. Consultation has revealed no particular concerns from small firms.

Competition assessment

81. We have applied the Competition Filter and this did not reveal any concerns overall. However that is not to say that these measures will have a neutral effect on the markets for transfers generally, changes in service provisions, rescues and on the labour market. We have outlined these impacts in the text. This section summarizes the impacts.
82. The overall effect on the market for transfers would be positive as it would
- increase transparency by improving information on the extent of employee liabilities;
 - clarify the circumstances under which it is lawful to make transfer related dismissals for ETO reasons;
83. There would also be improvements to the workings of the market for service provisions such as cleaning and catering by increasing the certainty of when a transfer is a TUPE transfer and when it is not. This would encourage more and possibly smaller bidders for service provision tenders by giving them a greater understanding of their potential liabilities.
84. Extra protection for employees in the service provision markets would maintain the overall value of their terms and conditions. This could be seen as anti-competitive in that it acts a barrier to new entrants, who are prepared to work for less. One could argue that this will give some existing employees some extra market power, resulting in wages that are uncompetitively high. On the other hand

²⁴ Of the affected sectors 96% are small firms employing between 1 and 49 employees, compared with 97% for all sectors. Source: Small Business Service

²⁵ Source: R3 (1992) *A decade of change* (10th annual company survey). Available at www.r3.org.uk/publications

redundancy can serve to weaken the labour market attachment of workers resulting in a shrinking of the labour supply.

85. The market wages for the types of workers that the extension of the legislation is designed to protect are at present above the minimum wage, but not by much. Maintaining minimum standards at work is important in maintaining incentives for those that are out of employment.
86. Our conclusion is that although there may be some short-term costs in terms of reduced labour market flexibility, in the longer term these measures will act to prevent a reduction in the labour supply and are hence on balance positive.

Enforcement, sanctions and monitoring

87. Enforcement continues to be through the Employment Tribunals and the courts.

Implementation and delivery plan

88. The revised draft Regulations will be laid before Parliament in late 2005, to come into effect on 6 April 2006. To assist understanding and implementation, the Department will also publish guidance on the revised Regulations.

Post implementation review

89. Monitoring the effectiveness of the legislation will take place through the talking to stakeholders, monitoring tribunal statistics, data from baseline surveys and case law developments. Officials will also monitor insolvency statistics and any reports into look into the rescue of insolvent companies.

Summary

90. The Government has consulted widely on a number of changes to the Transfer of Undertakings (Protection of Employment) Regulations 1981. The proposed changes are likely to have an impact on employees, firms and the Exchequer. The quantifiable costs and benefits are outlined in Table 2.

2. Summary of costs and benefits of changes to TUPE Regulations

	Annual benefits (£m)	Annual costs (£m)
Firms		
Extension of scope		9.5-24.3
Employee liability information	0.13	
Dismissal by reason of a transfer	0.2	
Insolvency	3	
Individuals		
Extension of scope	11-24	
Insolvency		3
Exchequer		
Insolvency		6.6

91. There will also be unquantifiable benefits to firms and individuals deriving from the increased certainty that the changes to the Regulations will bring, and the increased chances of a successful rescue after insolvency.

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Parliamentary Under Secretary of State

for Employment Relations and Consumer Affairs

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Annex A

Of 2,191 workplaces surveyed in WERS 98, there had been 312 changes in ownership. These were disaggregated into 8 categories which were not mutually exclusive.

A1. Takeovers over the last 5 years

	Number of workplaces	% of changes
Agreed takeover	110	35.2
Takeover/merger formally opposed	2	0.6
Sold by parent organisation	63	20.2
Ex public sector, now privatised/denationalised	9	2.9
Management buy out	31	9.9
Buy out by employees	0	0
Change in partners/major shareholders	86	27.6
Other	36	11.5

Source: Workplace Employee Relations Survey 1998, Department of Trade and Industry

For TUPE-related transfers we include 'sold by parent organization' and 'management buy out'. This means that up to 94 of the 312 changes of ownership could be relevant. This equates to 4.3 per cent of those surveyed, or about 1 per cent per annum. These questions were only asked of workplaces with 25 or more employees. Anecdotal evidence shows – as would be expected – that small firms are less likely to be involved in transfers. We assume therefore that those affected comprise: between 0.1 per cent and 0.5 per cent of businesses with 1-9 employees; between 0.5 per cent and 0.9 per cent of businesses with 10-19 employees; and 1 per cent of businesses with 20 or more employees.

A2. Total number of businesses in UK, by number of employees

	Number of businesses by number of employees	Number of employees (000s)
1 - 4	802,860	1,733
5 - 9	215,260	1,403
10 - 19	112,780	1,515
20 - 49	59,015	1,790
50 - 99	17,740	1,234
100 - 199	9,155	1,270
200 - 249	1,855	413
250 - 499	3,770	1,315
500 +	4,485	13,326
1 or more	1,207,995	23,618

Source: Small Business Service: Small and Medium sized Enterprises in the UK 2003 (<http://www.statistics.gov.uk/>)

Table A3 takes the numbers of businesses and employees in each firm size band and multiplies this by the expected proportion of transfers to get an estimate of the number of businesses and employees affected by a TUPE transfer each year.

A3. Number of businesses and employees affected by a TUPE transfer each year

	Number of businesses	Number of employees
1- 9	1,020 – 5,090	3,140 – 15,680
10 - 19	560 – 1,020	7,580 – 13,640
20 and over	960	193,480
total	2,540 – 7,070	204,200 – 222,800

Source: DTI estimates. Figures may not add up due to rounding

Details of calculations due to changes in service provision in the private sector.

The following outlines details of the estimates of the number of firms and employees in service sectors which are likely to be affected by the extension of TUPE.

B1. Number of firms and employment in sectors affected

Industry Sector	Number of businesses	Numbers in employment	Number of employees*
Canteens and catering	4,695	214,000	211,000
Investigation and security services	3,760	155,000	153,000
Industrial Cleaning	10,355	372,000	365,000
Software consultancy and supply	23,710	299,000	286,000
Maintenance and repair of office, accounting and computer machinery	1,230	16,000	16,000
Total	43,750	1,056,000	1,031,000

Source: Office of National Statistics (www.statistics.gov.uk) * DTI estimate taking into account the likely number of non-employees

We assume that the firms in these sectors are providing services for other companies, mainly in the private sector. These services are provided under contracts which will be periodically reviewed and as a result service providers may change, or may even be brought in-house. By making assumptions of the average duration of contracts and the chances of a change in provider after expiry of a contract, we come to an estimate of the number of firms and employees that are affected each year.

B2. Estimate of number of firms and employees affected by extension to TUPE

	Low scenario	High scenario
Duration of an average contract for services	5	4
Chances of contract expiring in year (%)	20	25
Chance of change in service provider after expiry of contract (%)	30	40
Chance of change of contract per year (%)	6	10
Number of firms affected each year	2,625	4,375
Number of employees affected each year	62,000	103,000

Source: DTI estimates

Details of calculations from changes in relation to insolvencies

The table below shows changes to the case load of the Insolvency Service as a result of pre-existing debt not passed to the transferee. Although company liquidations are not within the scope of the legislation, they are already covered by other legislation. For voluntary arrangements and administrations we assume that only in the case of a partial recovery would the Insolvency Service need to pay pre-existing debt. The partial recovery rate for these types of cases is 40 per cent of all recoveries. Receiverships are not covered.

C1. Impact of changes to Regulations on the Insolvency Service

Type of insolvency	Covered under the legislation?	Numbers (average over three years)	Recovery rate	Numbers of cases picked up by insolvency service now	Numbers picked up by insolvency service after new Regs
Company liquidations	N	5,824	10%	5,824	5,824
Creditor voluntary liquidations	Y	9,083	10%	8,175	9,083
Voluntary arrangements	Y	663	76%	159	361
Administrations	Y	2,241	76%	538	1,219
Receiverships	N	1,326	76%	318	318
Total				15,011	16,800

Source: DTI (data on insolvencies) 2002 to 2004, and R3 12th Corporate Insolvency Survey (data on recovery rates)

The estimates show that the insolvency service would have a 12 percent increase in its caseload.²⁶

²⁶ $16,800/15,011 = 1.12$ or 112 per cent.

Annex D – Detailed note on the rationale for, and impact of, the extension of scope in relation to service provision changes

Rationale for the extension of scope

1. At present, in some cases where a service provision change takes place – i.e. a contract to provide a client with a service is: a) awarded to a contractor; b) re-let to a new contractor on subsequent re-tendering; or c) ended with the bringing ‘in house’ of the service activities in question – uncertainty arises as to whether or not the TUPE Regulations apply. This is due to conflicting and unsettled case-law on the scope of the Regulations and of the EU Acquired Rights Directive. The uncertainty centres mainly on service provision changes involving labour-intensive, blue collar services – e.g. office cleaning, workplace catering, refuse collection – where the new contractor declines to take over a major part of the existing workforce from the old contractor. There are essentially two competing views in the case law on the existing legislation. On one view, failure to take over a major part of the existing workforce in a case such as this conclusively avoids the application of the legislation – so that its application is essentially ‘voluntary’. On the other view, such a failure may point toward the conclusion that the legislation does not apply, but is only one factor to be weighed up in the overall assessment, along with other factors such as, in particular, what the new contractor’s motive was for failing to take over the workforce (which can be difficult to assess). In the absence of further ECJ jurisprudence to resolve this case law conflict, it is a moot point to what extent the Directive and the Regulations already apply to the category of ‘problem cases’ described above.

2. This uncertainty has a number of negative consequences. If the new contractor fails to take over a major part of the existing workforce from the old contractor and maintains that TUPE does not apply, but the old contractor and/or the employees or their representatives disagree, all parties concerned – the two clients, the contractor and the employees – are left ‘in limbo’ until the dispute is resolved, which can often be achieved only months later through legal action. If the new contractor ultimately succeeds in the argument that TUPE did not apply, the old contractor is landed with a large unanticipated redundancy liability toward his or her former employees, many of whom may be left without jobs. If, on the other hand, the tribunal or court finds that TUPE did apply, the old contractor’s workforce will be entitled to return to their jobs or – more realistically, given that the new contractor will usually, by this point, have taken on a new workforce in order to carry out the contract – to claim unfair dismissal, landing the new contractor with a large unanticipated compensation bill.

3. In addition, the possibility of avoiding the application of the legislation by failing to take over a major part of the existing workforce creates a perverse incentive for contractors to bid for contracts on this 'non-TUPE' basis, so that they can undercut competitors by taking on a new workforce on inferior terms and conditions. This tends to place the focus of the competition on the question of which contractor can keep labour costs to the lowest level, rather than which contractor can deliver the best management and the greatest efficiency savings.

4. The rationale for the extension of scope is that it will establish in the Regulations themselves that (other than in certain exceptional circumstances) they do apply in the 'problem cases' described above, reducing significantly the number of instances in which uncertainty arises in practice. This will help all parties to know where they stand from the outset and avoid unnecessary disputes and employment tribunal and court proceedings.

Anticipated impact of the extension of scope

5. The extension of scope will ensure that service provision changes are (except in certain exceptional circumstances) clearly covered by TUPE. The new contractor will thus be obliged to take over the existing workforce from the old. In general, therefore, contractors will no longer be able to bid for contracts on the basis that they could carry them out with a new workforce on poorer terms and conditions. The estimated cost of the proposed measure (see Annex B) mainly represents the difference between the TUPE-protected terms and conditions of the existing workforce and the inferior terms and conditions that the newly-recruited workforce would otherwise have had in this minority of 'problem cases'. These costs would be offset by savings.

6. The application of the Regulations in such cases will not prevent the making of genuine redundancies for 'economic, technical or organisational reasons entailing a change in the workforce' (ETO reasons), e.g. where the new contractor considers that the contract could be carried out with fewer employees. Where there is a surplus of staff, the responsibility for carrying out the redundancy selection exercise (which will naturally have to be done on a fair basis), making the dismissals and paying any redundancy payments due will generally fall to the new contractor – who can, however, be expected to have been aware of the surplus when bidding for the contract, and to have factored these associated costs into the bid. If the new contractor is simply concerned about the competence or efficiency of employees transferring from the old contractor, these issues can be addressed through training and development and, if necessary, inefficiency action. Transfers should not, in the Government's view, be used as a device for removing underperforming employees 'by the back door'.

7. As far as service employees are concerned, the comprehensive application of TUPE in such cases will reduce insecurity and help to 'take the fear out of transfer'. This can be expected to smooth the transfer process, improving workplace relations and partnership and promoting business flexibility.

Competitiveness considerations

8. The extension of scope will not, in the Government's view, adversely affect competitiveness in the service contracting market. On the contrary, it will go a long way towards removing a perverse market distortion and creating a 'level playing field' for contract bids, increasing fairness and transparency. Responsible contractors who bid for contracts on the basis that they can deliver improved management and efficiency will no longer be at risk of being undercut by 'cowboys' who bid on the basis that they can slash labour costs. The Government wishes to discourage such 'low cost, low quality' competition.

9. Although there is perhaps an argument that contractors should take steps to protect themselves, through commercial indemnities or other means, against incurring redundancy liabilities on the loss of a contract, or of becoming involved in a legal dispute not of their own making, this does not always happen in practice. It is also something with which small firms, with little in-house expertise and limited bargaining power, are particularly ill-equipped to cope. Maintaining the status quo would thus perpetuate a disincentive for small firms to become involved in bidding for service contracts, at odds with the Government's 'think small first' philosophy. Even where well-advised contractors do negotiate commercial indemnities, this adds to the transaction costs. The comprehensive application of TUPE in service provision change cases will reduce these costs.

10. A contractor bidding for a service contract will not normally have a large surplus workforce that it can readily assign to that contract if successful. The choice it faces, as things stand under the existing Regulations, is normally between taking over a major part of the existing workforce or recruiting a new workforce from scratch. The extension of scope will in most cases close off the latter option for the minority of contractors who would prefer to take it. This will not disadvantage the sitting contractor in the bidding for the contract, as all bidders will have to work on the basis that the existing workforce will continue to carry out the contract on their established terms and conditions, with no wholesale redundancies being necessary.

11. Contractors and their representative bodies, along with many clients for services, strongly supported the extension of scope in their replies to the 2001 public consultation document, and in other informal representations. There is, in addition, no evidence to suggest that the

similar approach already being taken as a matter of policy in the public sector – by virtue of the Cabinet Office Statement of Practice *Staff Transfers in the Public Sector* and, in local government, the extended legal protections introduced under powers in the Local Government Act 2003 – has had any adverse effect on competitiveness within public service contracting.