

**TRANSFER OF UNDERTAKINGS
(PROTECTION OF EMPLOYMENT)
REGULATIONS 1981**

GOVERNMENT PROPOSALS FOR REFORM

DETAILED BACKGROUND PAPER

**EMPLOYMENT RELATIONS DIRECTORATE
DEPARTMENT OF TRADE AND INDUSTRY
SEPTEMBER 2001**

URN 01/1158

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Introduction

1. This document sets out detailed background information and analysis in support of the proposals contained in the Government's consultation document on reform of the Transfer of Undertakings (Protection of Employment) Regulations 1981 (as amended) (SI 1981/1794) – commonly known as the TUPE Regulations.
2. The Government's proposals have been developed in informal discussions with some of the main representative organisations of employers, employees and other interested parties, in line with the Government's social partnership philosophy, and the considerable progress already made on the main issues of principle to be addressed in the amendment of the Regulations.
3. The Government's intention to amend this legislation was first made clear in the *Fairness at Work* White Paper (Cm 3968), published in May 1998. This stated:

4.32 As the business world becomes more open and competitive, the pressures on businesses to slim down through redundancies, more flexible contracting-out arrangements, or to develop through merger and acquisition will intensify. The Government has already consulted on new arrangements governing the provision of information and consultation when redundancies are planned or a business is to be transferred, and on the protection of employment when a business is transferred. The existing provisions have been widely criticised and the Government intends to amend them. Employers will in future have clearer obligations to inform and consult recognised trade unions or, in their absence, other independent employee representatives. Where businesses are transferred, the law will strike the right balance between safeguarding employees' existing rights and enabling businesses to adapt to changing circumstances.
4. The amendment of the provisions governing employers' information and consultation obligations has already been achieved by way of new regulations – the Collective Redundancy and Transfer of Undertakings (Protection of Employment) (Amendment) Regulations 1999 (SI 1999/1925), made on 7 July 1999¹. This background paper is concerned with the Government's proposals for delivering the promised more general reform of TUPE. The new Regulations are to be made under powers in section 2(2) of the European Communities Act 1972 and, if appropriate, section 38 of the Employment Relations Act 1999. Subject to careful consideration of all responses received, the Government envisages laying the Regulations before Parliament in the summer of 2002, following further consultation on the detailed drafting. There will be a period of grace before the new Regulations come into effect, to allow interested parties an opportunity to familiarise themselves with their contents in advance. Once the new Regulations have come into effect, the Government will keep the position under review to ensure that they are operating effectively.
5. Comments on the Government's proposals should be sent by 15 December 2001 to:

Mrs Pat Wright
Employment Relations Directorate
Department of Trade and Industry
UG067
1 Victoria Street
London

¹ A minor correction to the provisions introduced by these Regulations was effected by the Transfer of Undertakings (Protection of Employment) (Amendment) Regulations 1999 (SI 1999/2402), made on 1 September 1999.

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or by e-mail to pat.wright@dti.gov.uk.

Further copies of this paper, and copies of the consultation document itself, can be obtained from the Employment Relations website (<http://www.dti.gov.uk/er>) or from the DTI publications order line at EC Logistics by telephoning 0870-1502-500 or faxing 0870-1502-333.

For information on consultation on the TUPE Regulations in Northern Ireland, please contact William Caldwell at:

Employment Rights and New Deal
Room 301
Adelaide House
Adelaide Street
Belfast BT2 8FD

Comments

If you would like to comment on the way the Government's consultation on these proposals is being handled (as opposed to the proposals the consultation document outlines), please write to the DTI consultation co-ordinator, Andrew Dobbie, at: -

Departmental Regulatory Impact Unit,
Department of Trade & Industry,
1 Victoria Street,
London SW1H 0ET

Versions of the consultation document in Welsh or large print or on tape

A Welsh language summary of the consultation document is available from Mrs Pat Wright at the address above. We can also provide large print and taped versions of the consultation document on request – please contact Mrs Pat Wright for these.

Background

6. The TUPE Regulations were originally introduced in order to implement the EC Acquired Rights Directive (77/187/EEC) (sometimes known as the Business Transfers Directive), adopted in 1977. They provide, briefly, 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 transferor (i.e. the current employer) under or in connection with those contracts (other than certain rights and obligations under occupational pension schemes) pass automatically to the transferee (i.e. the new employer);
- employees of the transferor or of the transferee may not be lawfully dismissed in connection with the transfer unless the dismissals are for economic, technical or organisational reasons entailing a change in the workforce (generally referred to as ETO reasons) and the employer has acted 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.

The employees concerned therefore become employees of the transferee, but under the same terms and conditions (except as regards certain rights under occupational pension schemes) as applied to them as employees of the transferor, and are treated as if they had been the transferee's employees all along.

7. The Regulations have been amended on a number of occasions since their introduction. They are available in their current form from HMSO stockists.

8. In 1994 the European Commission issued a proposal to revise the Directive. Negotiations on that proposal proceeded slowly, however, owing partly to the difficulty of reaching the required unanimity amongst Member States and partly to a delay in the European Parliament giving its opinion

9. The Government made it a social affairs priority for the UK Presidency of the EU Council during the first six months of 1998 to bring to a successful conclusion the negotiations on the Commission's proposal. The DTI issued a public consultation document (URN 98/513) dated December 1997 seeking the views of interested parties on the objectives that the UK ought to be pursuing. These views were then taken into account in the course of the negotiations.

10. Member States' unanimous agreement to the text of the new Directive resulting from the negotiations was secured on 4 June 1998, and the new Directive was formally adopted on 29 June 1998. A consolidated version of the Directive was adopted in 2001. The full text of this is published in the *Official Journal of the European Communities*

11. Amongst other things, the revised Directive gives Member States clear options to:

- allow (but not require) independent workers' representatives to negotiate changes to terms and conditions in order to save jobs when the undertaking of an insolvent employer is transferred (just as they can in cases of insolvency where no transfer is involved);
- provide that, in order to save jobs when the undertaking of an insolvent employer is transferred, the transferor's outstanding debts in relation to the employees do not pass to the transferee;
- ensure that the transferor notifies the transferee of all the rights and obligations that will be transferred in a relevant transfer (so far as they are or should be known to the transferor); and
- include occupational pension rights within the terms and conditions that pass from the transferor to the transferee in a relevant transfer.

Proposals

A. General objectives

12. The Government considers that the TUPE Regulations are based on a positive principle – the coupling of flexibility for business with fairness for employees. If made to work effectively, they should assist the smooth management of necessary change, in both the private sector and the public, by securing the interests and commitment of the employees affected. They should promote a co-operative, partnership approach toward business restructuring and public sector modernisation. They should help create a level playing field in the business acquisitions market and the business services sector. They should give everyone a stake in improving labour market flexibility and competitiveness.

13. The Government's underlying aim in amending the Regulations is to ensure that they operate effectively for all those whose interests depend on them: the employers and contractors

whose businesses they help shape; the clients and local authorities who use them as a framework for contracting; and the employees whose rights they safeguard. The Government believes that the revision of the EC Directive has provided a much sounder basis for securing this than would otherwise have been the case.

B. Scope of the legislation

14. 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.

15. The new Article 1(1) of the revised Directive gives for the first time an explicit definition of a transfer of an undertaking:

- (a) This Directive shall apply to any transfer of an undertaking, business or part of an undertaking or business to another employer as a result of a legal transfer or merger.
- (b) Subject to subparagraph (a) and the following provisions of this Article, there is a transfer within the meaning of this Directive where there is a transfer of an economic entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary.
- (c) This Directive shall apply to public and private undertakings engaged in economic activities whether or not they are operating for gain. An administrative reorganisation of public administrative authorities, or the transfer of administrative functions between public administrative authorities, is not a transfer within the meaning of this Directive.

16. Although the recitals to the revised Directive state that this does not in any way change the scope of the original, as progressively interpreted by the ECJ in a succession of test cases, the Government considers that it is valuable in helping to ensure that the legal position is more widely recognised and accepted than in the past. It is notable that the ECJ has itself made reference to the wording of the new definition in its judgments in more recent cases under the Directive. (See, for instance, *Hidalgo and others* [1999] IRLR 136.) The Government intends essentially to adopt this definition in the new Regulations.

17. This alone, however, may be insufficient to address the problems that have arisen in this regard. The Government has no wish to disturb the present position in cases where one private sector employer simply sells or otherwise disposes of part or all of an undertaking or business to another; disputes in such cases are relatively uncommon even under the current provisions. Nor does it intend to apply the legislation to completely new areas such as takeovers by share transfer (in which the identity of the employer and the rights and obligations of the parties to the employment relationship remain legally unchanged). It does however consider that there may be a case for taking further measures in two particular areas – transfers within public administration and service provision changes – that have in the past been particularly frequent sources of dispute.

Transfers within public administration

18. In the case of *Henke*² the ECJ held: “The reorganisation of the structure of public administration or the transfer of administrative functions between public administrative authorities does not constitute a ‘transfer of an undertaking’ ... The Directive sets out to protect

² *Henke -v- Gemeinde Schierke und Verwaltungsgemeinschaft “Brocken”* [1996] IRLR 701.

workers against the potentially unfavourable consequences for them of changes in the structure of undertakings resulting from economic trends at national and Community level ... [The term 'business' does not encompass] activities involving the exercise of public authority. Even if those activities had aspects of an economic nature, they could only be ancillary." The terms of this judgment have been reflected in the definition of a transfer in the new Article 1(1) of the Directive.

19. It is uncertain how widely or narrowly the effective restriction of scope of the Directive in relation to transfers within public administration is to be construed. Domestic case law – for instance the Scottish Employment Appeal Tribunal (EAT) decision in *Dundee City Council -v- Arshad* ((S) EAT 1204/98) – suggests that it excludes from the legislation's application only a relatively limited range of situations involving the transfer of entities pursuing non-economic objectives within the public sector. Nevertheless, the issue has still to be fully tested in the tribunals and courts. The Government's policy is that employees in public sector organisations should be treated no less favourably than those in private sector organisations when they are part of an "organised grouping of resources" that is transferred between employers. It has therefore considered the possibility of providing for the UK's domestic legislation to apply to the administrative reorganisation of public administrative authorities and to the transfer of administrative functions between public administrative authorities in the same way as it does to the transfer of private sector businesses where there is a change in the identity of the employer. It has concluded, however, that – particularly in view of the uncertainty attached to the meaning of the relevant wording in the Directive, and also the difficulty of framing a general definition of the public sector that would be clear and precise in law – this would not be the most appropriate way in which to achieve its policy objective.

20. **The Government therefore proposes to address this issue through:**

- **applying its Statement of Practice *Staff Transfers in the Public Sector*; and**
- **where appropriate, and subject to prior consultation with interested parties, ensuring that TUPE-equivalent protections are afforded to affected employees:**
 - **in case-specific legislation, where that is the vehicle for effecting a particular transfer within public administration; or**
 - **by regulations under section 38 of the Employment Relations Act 1999³ on an *ad hoc* basis in other cases or classes of cases falling outside the Directive's scope.**

21. Copies of *Staff Transfers in the Public Sector* are available by telephone from 020 7276 1638, by e-mail request from pgreasley@cabinet-office.x.gsi.gov.uk or from the website www.cabinet-office.gov.uk.

22. Regulations under section 38 of the 1999 Act have already been made in one specific case: the Transfer of Undertakings (Protection of Employment) (Rent Officer Service) Regulations 1999 (SI 2511/1999) provide appropriate TUPE protections for clerical and other support staff transferring from local authorities to the Rent Officer Service Agency established by the Department of the Environment, Transport and the Regions on 1 October 1999.

³ Section 38 of the Employment Relations Act 1999 empowers the Secretary of State to make provision by statutory instrument, subject to the negative resolution procedure, for employees to be given the same or similar treatment in specified circumstances falling outside the scope of the Acquired Rights Directive as they are given under the UK's implementing legislation in circumstances falling within the scope of that Directive.

Service provision changes

23. There has in the past been uncertainty over the Regulations' application in cases where:

- a party enters into an ongoing arrangement with an outside organisation (either directly or via an intermediary) for that organisation to perform service activities, where the same or essentially the same activities have previously been performed in the same or essentially the same manner “in-house” – generally referred to as “contracting-out” or “outsourcing” of a service; or
- a party has entered into an ongoing arrangement with an outside organisation (either directly or via an intermediary) for that organisation to perform service activities, whether or not the same or essentially the same activities were originally performed “in house”, and on that arrangement's termination (for whatever reason) the party in question (or, where relevant, the intermediary):
 - enters into a new ongoing arrangement with a different outside organisation – often following a “competitive tendering” exercise – for that organisation to perform the same or essentially the same activities in the same or essentially the same manner; or
 - starts to perform the same or essentially the same activities in the same or essentially the same manner “in-house” – generally referred to “contracting-in” or “insourcing” of a service.

For convenience, these types of changes are all referred to below as “service provision changes” and the party (or, where relevant, the intermediary) on behalf of whom the activities are performed as the “client”. An “ongoing arrangement” for these purposes is taken to mean an arrangement consisting in practice of more than a single contract made in contemplation of the performance of a specific task; so it is not considered to be a service provision change if a party enters into an essentially new or “one-off” arrangement with an outside organisation.

24. It is well established that the Regulations can in principle apply in relation to service provision changes. Whether or not any such change does actually constitute a relevant transfer of an undertaking depends – under the principles established by the ECJ in its seminal judgment in the *Spijkers* case⁴ – on the particular factual circumstances. The key question is whether or not there is a transfer of (in the words of the revised Directive) “an economic entity” – i.e. “an organised grouping of resources which has the objective of pursuing an economic activity” – that “retains its identity” in the process. The difficulty of answering this question in service provision change cases is the root cause of most of the problems that have arisen in this regard in the past.

25. In the *Suzen* case⁵, the ECJ held that no transfer of an undertaking occurs if a service provision change is arranged so that “... there is no concomitant transfer from one undertaking to the other of significant tangible or intangible assets or taking over by the new employer of a major part of the workforce, in terms of their numbers and skills, assigned by the [old employer] to the performance of the contract”. This means that, in the labour-intensive services sector, clients and contractors have in some cases been able to avoid the application of the legislation simply by ensuring that such a change does not involve the transfer of a major part (in terms of numbers and skills) of the affected workforce. In the *ECM* case⁶, the Court of Appeal held that

⁴ *Spijkers -v- Gebroeders Benedik Abattoir* [1986] 2 CMLR 26.

⁵ *Suzen -v- Zehnacker Gebäudereinigung GmbH Krankenhausservice* [1997] IRLR 255.

⁶ *ECM (Vehicle Delivery Service Ltd) -v- Cox* [1999] IRLR 559.

an employment tribunal was entitled to have regard as a relevant circumstance to the reason why employees of the transferor had not been taken on by the transferee in deciding whether or not a transfer of an undertaking had taken place. This interpretation has been followed in a number of subsequent cases⁷ and may be of some assistance to employees in cases where abuse is alleged. However, the EAT, in its judgments of 18 April 2000 in the *Willer*⁸ and *Barnes*⁹ cases, also said:

In any event, if the “reason why the employees were not appointed ... ” is to be left to be considered as a factor by the employment tribunal, the interpretation and the weight must also be for them. Is subjective intention or motive, or objective purpose or effect to be judged? It may be difficult if not impossible to differentiate – if it is relevant to do so – between a decision not to take on any staff because it is desired to avoid, or not to trigger, the 1981 Regulations, a decision not to take on any staff with the effect that the 1981 Regulations do not apply and a decision that, because it is not intended to take on any staff, the 1981 Regulations do not apply ... On the one hand there will no doubt be scrutiny by the employment tribunal of the transaction, on the other hand the fact that there is *not* a transfer, because *no* transfer of staff, cannot itself lead to a conclusion that there *is* a transfer.

26. The Government has said in its consultation document that it would welcome views on whether or not additional measures, going beyond the requirements of the Directive, should be taken to improve the Regulations’ application in relation to service provision changes, and if so what form they should take. Views are invited on whether there should be:

- a) **separate legislative or administrative measures introduced by individual government departments specifically for the parts of the public sector within their responsibility, underpinning the policy in the Statement of Practice *Staff Transfers in the Public Sector*; or**
- b) **a general extension of the Regulations’ own scope in relation to service provision changes for public and private sectors alike.**

27. If the approach described at point b) above were to be taken, the Government would envisage making provision to the effect that:

- **if:**
 - **a service provision change (defined as described above) is to take place; and**
 - **prior to the change, there are employees assigned to an organised grouping the principal purpose of which is to perform the service activities in question specifically on behalf of the client concerned;**
- **then:**
 - **the employees assigned to the organised grouping shall be treated in the same way as in cases where the TUPE Regulations normally apply; and**

⁷ Including (1) *RCO Support Services Ltd* (2) *Aintree Hospital Trust -v- Unison & Others* EAT 28.6.00.

⁸ *Mr J Willer & others -v- ADI (UK) Ltd.*

⁹ *Mrs L Barnes & others -v- Whitewater Leisure Management Ltd.*

- **the party with responsibility for provision of the service before the change shall be treated as the transferor and the party with responsibility for provision of the service after the change shall be treated as the transferee.**

28. This would be a wide extension of scope in relation to service provision change cases, ensuring that – other than in exceptional circumstances (e.g. where there was no organised grouping before the event) – the Regulations applied comprehensively in relation to such cases, regardless of the particular facts. One attraction of this approach is that it would arguably increase the likelihood that, from the outset, all concerned normally knew where they stood. The party that took on the responsibility for provision of the service would also become automatically responsible for the employees assigned to the organised grouping (whose continuity of employment would be preserved) and for any outstanding liabilities toward them; and the employers, employees and employees’ representatives concerned would have obligations and rights equivalent to those that arise in the event of a relevant transfer of an undertaking under the Acquired Rights Directive. Given that there would also be a requirement on the transferor to notify the transferee of all such liabilities where they were or ought to be known about at the time of the transfer (see section D below), this could then be properly planned for and taken into account.

29. An added advantage is that this would help to ensure that contract bids were made on a comparable basis and so promote competition, in line with for example the Government’s Best Value framework for local authority services. It would remove a significant disincentive for potential bidders, and particularly smaller firms, to become involved in service contracting. For affected employees, too, the extended protection would have considerable advantages in establishing where obligations toward them rested and ensuring that they received appropriate protection when affected by service provision changes. It would also help to ensure that the principles set out in the Government’s Statement of Practice *Staff Transfers in the Public Sector* (see above) were fully observed within local government and other parts of the public sector outside central government (where it can be directly enforced).

30. The way the new provisions would be framed – in particular, the precondition of an organised grouping with the principal purpose of performing service activities specifically on behalf of a particular client under an arrangement consisting in practice of more than a “one off” task-specific contract – would be intended to ensure that the extended protection did not normally apply in cases where clients were buying in services “off the shelf” in the same way as they might buy in goods. The employees who perform the activities comprising such “commodity services” – including for example the arrangement of conferences, the undertaking of printing work, the giving of consultancy advice and the carrying out of plumbing repairs – typically do so on an *ad hoc* basis on behalf of a number of their organisation’s clients (either concurrently or successively) and are relatively unlikely to be at risk of redundancy if one of those clients is lost. The Government would have no wish to extend the legislation’s coverage beyond that of the Directive itself in such cases.

31. In cases where the arrangement between the client and the outside organisation entailed the provision not only of a service but also of goods, the extended protection would apply only where the former was the predominant aspect and the latter an ancillary one¹⁰. Thus the extended protection would not normally apply where the arrangement entailed, say, the provision of computer equipment with associated IT advice or the provision of photocopiers with on-call maintenance support, as in cases such as these, even in the relatively unlikely event that a dedicated, organised grouping is responsible for both, the provision of the goods rather than the

¹⁰ The distinction between arrangements entailing solely or predominantly the provision of services and arrangements entailing solely or predominantly the provision of goods would be analogous to the position under EU public procurement requirements (although in that case, unlike here, the distinction is generally based solely on the relative value of the two aspects).

performance of the service activities is normally its principal purpose. The extended protection *would* normally apply, by contrast, where the arrangement entailed, say, the provision of packaging materials in conjunction with a packing service or the provision of food and drink in conjunction with a catering service, as in cases such as these the converse is normally true.

32. There are however three arguable drawbacks to this approach. The first is that it envisages the introduction of a number of new criteria for the application of the Regulations, and this would be bound to lead to some disputes. The Government would aim to minimise the potential for new uncertainty by ensuring that the relevant aspects of the Regulations were as precisely drafted as possible, but inevitably some doubt would remain as to the exact limits of the extended protection.

33. The second arguable drawback is that there would clearly be some cases, albeit relatively uncommon, in which the activities comprising a service that might otherwise be regarded as a “commodity service” *were* performed by a dedicated, organised grouping on an ongoing basis – either under a succession of discrete but similar task-specific contracts, so that the arrangement was in practice an ongoing one, or under a single over-arching contract. This could occur either where the client was a large business with a frequent and/or heavy demand for the service in question or where the provider organisation was a small one established specifically to meet a particular client’s needs. For such cases to fall within the coverage of the extended protection might be seen by some as inappropriate. Against this, however, it should be noted that they could potentially fall within the coverage of the TUPE Regulations (and the EC Directive) already. Where service provision changes took place in such circumstances it would arguably be reasonable for affected employees to have the same protections as in other cases. The Government has considered the possibility of introducing a specific exception to the general rule in respect of services of a professional nature – such as legal, banking, accountancy and consultancy services – but has concluded that this would be an essentially arbitrary distinction that would pose difficulties of interpretation. The application of the legislation rarely arises as an issue or a source of dispute in such cases in at present, and there seems no reason to believe it would do so in future, even if the extended protection were introduced.

34. The third arguable drawback is that there would remain some potential for the application of the Regulations to be intentionally avoided through services being redesigned – so that the activities or the manner in which they were performed were no longer the same or essentially the same following a change of contractor, and the definition of a “service provision change” as described above was not met. The Government has considered the possibility of introducing a general “anti-avoidance” provision to make such arrangements unlawful, but has decided on balance that this would be inappropriate, in part because the risks of stifling legitimate innovation in the pursuit of efficient and effective service provision outweigh the risks of abuse¹¹.

35. The Government has considered a number of other options for alternative approaches toward setting the scope of the Regulations in this regard, but has concluded that none of these would be workable in practice. **Views are invited on the proposed approach described above. Suggestions for any other workable approaches would also be welcome.**

C. Occupational pensions

36. Rights, powers, duties and liabilities in respect of continuing membership of occupational pension schemes were excluded from the coverage of the original Acquired Rights Directive and do not transfer under TUPE. Accrued rights in an occupational pension scheme are however covered by the Directive and are protected in the UK under pensions regulations. Where TUPE

¹¹ This is similarly reflected in an exception to the application of the Cabinet Office Statement of Practice.

applies, therefore, the only rights excluded from the otherwise automatic transfer of employees' terms and conditions are rights to continuing active membership of an occupational pension scheme, where such a right existed prior to the transfer.

37. The Government's policy is that former public sector employees transferred to the private sector should continue to have pension provision made for them. The Government considers the current legal position is not certain and that there is at present a risk of claims of constructive dismissal where the transferor does not require the transferee to provide broadly comparable pension rights after the transfer. Central guidance to government departments and local authorities lays down that the transferee employer in transfers from such public sector bodies is generally required to offer transferred employees occupational pension provision "broadly comparable" to that afforded by the transferor. Whether or not the "broadly comparable" condition is met in any particular case is assessed according to established criteria by the Government Actuary's Department (GAD). The Treasury has reaffirmed this policy in a note entitled *Staff Transfers from Central Government: A Fair Deal for Staff Pensions*, and GAD has set out its approach in a Statement of Practice entitled *Assessment of Broad Comparability of Pension Rights*¹². The legal position has never been directly tested in the courts, however, and the risk of successful legal challenge has apparently been widely discounted in the private sector. In this one respect of pension terms, therefore, private sector employees, unlike public sector employees, may still in practice find themselves in a significantly worse position after a transfer than they were before it.

38. The Government considers that the uncertain legal position is unsatisfactory, and that in implementing the revised Directive – which, at Article 3.4, gives Member States a clear option in this regard – legal certainty should be achieved. There are a number of possible ways in which this could be done. One would be simply to provide that ongoing occupational pension rights are not transferred to the transferee, extinguishing any arguments along the lines discussed above. The Government is not attracted to this, however. Other possible approaches would be:

- a) amending the TUPE Regulations so as to provide that ongoing occupational pension rights are not transferred to the transferee, but preserving the current public sector policy by way of separate legislative or administrative measures introduced by individual government departments specifically for the parts of the public sector for which they are responsible; or**
- b) amending the TUPE Regulations to provide a degree of protection for occupational pension rights on transfer, for public and private sector employees alike.**

The Government would welcome views on this issue.

39. If the approach described at b) above were to be taken, the Government would aim to strike a balance between protecting the rights of transferred employees and minimising additional burdens on private sector employers that could, if they were too onerous, deter them from continuing to run occupational pension schemes or setting up new ones, or from participating in transfers.

40. Providing for continuing occupational pension rights to be fully preserved across a transfer in exactly the same way as other rights and obligations arising from the contract of employment or employment relationship would not meet this aim: given the wide diversity in the nature of contribution levels and detailed benefit structures of occupational pension schemes – the majority of which are tailored to suit the priorities, needs and circumstances of particular

¹² Both of these documents are reproduced as annexes to the Cabinet Office Statement of Practice *Staff Transfers in the Public Sector*, details of which are given in section B above.

businesses and have evolved over time – it would be impracticable for transferee employers to replicate exactly the pension schemes of transferor employers.

41. A requirement on the transferee to provide a pension scheme “broadly comparable” to that provided by the transferor would afford greater flexibility, but in practice could still mean that the transferee had to create a new pension scheme for transferred employees. The test of “broad comparability” applied by GAD in transfers out of central Government requires that the new employer’s scheme should be not materially detrimental overall to any identifiable member of staff in terms of their accrual of future pension benefits. Consequently quite small differences in the structure of benefits, which commonly occur between different employers’ schemes, can be enough to prevent two schemes being certified as “broadly comparable”. A TUPE regime that effectively required employers involved in transfers to establish and maintain multiple occupational pension schemes for a single workforce, including separate schemes for quite small numbers of employees, would not, in the Government’s view, be satisfactory.

42. The Government therefore considers that any new requirement for continuing occupational pension rights to be protected across a TUPE transfer would have to be subject to a test less stringent than the one of “broad comparability” that it applies, and will continue to apply as a matter of policy, in the public sector. The Government has identified a number of possible options that would satisfy this condition, the most attractive of which are described below. None of these options would require the transferee to set up an occupational pension scheme in a case where the transferor did not provide such a scheme for the employees in question. It would of course remain open to transferees to afford transferred employees more generous provision than required. In addition, the Government would continue to apply a policy of requiring the more stringent test of “broad comparability” in transfers involving public sector staff, and would give consideration to underpinning this by separate legislative or administrative measures for particular parts of the public sector if the removal of any risk of claims of constructive dismissal significantly increased problems of enforcement outside central government.

43. Whichever option was pursued, the Government would propose to provide also that transferees were permitted to pay transferred employees adequate alternative compensation in exceptional circumstances where it is not reasonably practicable for them to meet the new requirements that would otherwise apply. This would be in line with current practice under the Government’s policy for the public sector and would allow for that practice to be continued. Such exceptional circumstances might arise, for example, where only a very small number of employees were involved in the transfer and the transferee was either unable to arrange a pension scheme for them, or could do so only at disproportionate cost. The compensation might perhaps take the form of a pay adjustment on the basis of an actuarial certificate.

Option 1

44. The Government is committed to encouraging a wider choice in pension arrangements for individuals and providing alternatives to the state second tier pension, currently the State Earnings Related Pension (SERPS). Employers who offer a salary-related – also known as defined benefit – occupational pension scheme have since 1978 been able to contract-out of the state scheme. The Government provides rebates to National Insurance contributions from employers and employees to cover the cost of the the state scheme rights given up, and the state loses the liability to provide benefits in future years. This arrangement was extended to money purchase – also known as defined contribution – schemes in 1988. The legislation that supports contracting-out provides a reasonable degree of security for scheme members in respect of their pension rights and thus encourages membership. Option 1 looks to maintain the provision of contracted-out pensions across a TUPE transfer and also to suggest analogous arrangements in respect of contracted-in schemes. Options 1a, 2 and 2a below take a similar approach.

45. Under Option 1, if the transferor offered either a contracted-out salary related scheme (COSR) or a contracted-out money purchase scheme (COMP), then the transferee would be required to offer a scheme of the same type. If the transferor offered a contracted-in scheme, then the transferee would be required to offer some form of occupational pension scheme that was Revenue-approved but with no specified form or level of benefits.

46. In a COSR to COSR transfer the transferee would not have to match the old scheme in terms of accruals, widow's/widower's benefits and so on. It would be sufficient that the scheme satisfied the reference scheme test (RST) for contracting-out, as certified by the actuary to the scheme in accordance with GN28 – one of the Ministerially-approved mandatory guidance notes (GNs) issued by the Faculty and Institute of Actuaries. In a COMP to COMP transfer the requirement would be that the minimum payment levels had to be made to the scheme as required under contracting-out legislation.

47. The advantages of this option are that it would involve no new actuarial certification and would fit with the existing requirements set out in the contracting-out legislation. The impact on employers would be minimal in cases where the transferee already had in place a scheme of the relevant type. One disadvantage however is that transferred employees would be at risk of a substantial reduction in benefits if before the transfer they were in a contracted-out scheme providing benefits well in excess of the minimum requirements for contracting-out. Where COSR schemes were concerned this risk would be limited and much lower than currently faced. Where the transferor provided a COMP scheme with high employer contributions it would, however, be possible for the transferee to satisfy the Regulations by providing one with only the minimum contributions. For transferred employees who were formerly in contracted-in schemes with a generous level of benefits, the potential downside could be even greater.

Option 1a

48. A variation on Option 1 would give greater comfort to employees at the expense of greater complexity and cost to employers. Under Option 1a, in a COSR to COSR transfer the transferee's scheme would still have to meet the RST but would also be required to offer benefits that were, say, no more than 10% lower than those under the transferor's scheme. For COMPs a similar approach could be adopted. A requirement could be placed on the transferee to make contributions at a rate no less than the total contributions to the transferor's scheme, less the employee's contributions to the transferee's scheme. For contracted-in schemes a broadly similar approach could be taken.

49. The advantage of this approach is that it would lessen the disadvantage that transferred employees were liable to suffer in cases where the benefits offered under the transferor's scheme were well above the required level. A new GN would probably be required.

Option 2

50. Under this option the transferee would still be required to offer a contracted-out occupational pension scheme if the transferor offered one, but could switch from COSR to COMP or *vice versa*. Accruals in the transferor's scheme would nevertheless remain subject to current pensions legislation and restrictions where appropriate. If the transferee wished to offer a scheme of the opposite type to that offered by the transferor then the actuary might have to certify that overall the new scheme would provide broadly equivalent benefits. Contracted-in schemes would be dealt with as under Option 1.

51. This would give transferees greater flexibility than Option 1 and assure employees of a similar level of protection to that Option. It would entail additional actuarial work being carried

out in some cases where transferees chose to take advantage of the greater flexibility. In establishing broad equivalence an actuary would have to follow a GN; a new one would need to be drawn up specifically for this purpose, although GN28 might serve as a useful basis. It would be for transferees to decide on a case by case basis whether or not any additional costs involved outweighed the advantages to be gained from switching from one type of contracted-out scheme to the other; it would of course remain open to them to take the alternative approach of offering the same type of scheme as the transferor, in which case all the advantages of Option 1 would apply.

Option 2a

52. A variation on Option 2 would be to incorporate a “safety net” for employees analogous to that suggested in Option 1a.

Option 3 – standard benefit approach – all occupational pension scheme types

53. Under this option, the transferee would be able to choose whether to offer a salary-related or a money purchase scheme, irrespective of the nature or level of benefits afforded by the transferor, provided that the scheme met a prescribed benchmark. For salary related schemes the benchmark might be the same as for COSRs – in other words, the RST. COSRs would thus automatically meet this test, assurance being provided through the regular actuarial certification already required. Contracted-in salary related schemes could also meet the test in principle, but this would probably need to be subject to some form of new actuarial certification requirement in order to give scheme members sufficient assurance. For money purchase schemes a minimum contribution level could be specified. This could be a certain proportion, 10% for instance, of relevant earnings – that is, earnings between the lower and upper earnings limit.

54. For both salary-related and money purchase schemes it is envisaged under this option that the employer’s and employees’ contribution rates should be commensurate with, but not necessarily identical to, those under the transferor’s scheme, subject to a minimum level. It would however be possible to allow for the employees to be obliged to contribute at a higher rate than under the transferor’s scheme if given an additional sum of money conditional on it being used for this purpose.

55. The advantage of this option is that it would, in the Government’s view, ensure a reasonable level of pension benefits for transferred employees in all cases where the transferor provided a scheme. If the benefits under the transferor’s scheme had been relatively generous, the affected employees would be left at risk of some overall worsening of their entitlement. If, on the other hand, they had been relatively modest, the affected employees would enjoy an overall improvement in provision. This option would however present some difficulties and other issues that needed to be addressed. In setting a minimum contribution level, for instance, an age-related scale of contributions might be considered appropriate. In addition, a new GN would probably be needed to cope with transitions from defined benefit to defined contribution schemes.

Option 4 – equivalent value approach

56. Option 4 envisages the introduction of a requirement for the benefits under the transferee’s scheme to be of a similar value to those under the transferor’s scheme. If both the transferor and the transferee had a defined contribution scheme, actuarial certification might not be required. Instead the transferee could be required to give the necessary assurance to the scheme members as regards the level of contributions payable. If the transferor had a defined benefit scheme and the transferee a defined contribution scheme, an actuarial assessment of the standard contribution rate of the former could be used as the basis for establishing the contribution rates to the latter. The standard contribution rate could be assessed by the actuarial methods set out in existing guidance – GN26 – although, again, a new GN would probably be needed specifically

for this purpose. If both the transferor and the transferee had a defined benefit scheme, a form of actuarial certification might again be required to give an adequate degree of assurance to the affected employees. A GN would also be needed to cover the case where the transferor had a defined contribution scheme and the transferee a defined benefit one.

57. The main advantages of this option are that it would afford considerable flexibility in terms of the type of pension arrangements offered by the transferee but at the same time assure transferred employees of a level of provision not far removed from that under the transferor's scheme. The downside is that in some cases employees could still suffer an erosion of benefits (particularly where affected by a succession of transfers), although in others they could enjoy an enhancement. As mentioned, this option would also entail the probable need for actuarial certification in some cases and preparation of a new GN.

58. **The Government would welcome comments on:**

- **the relative merits of the various options discussed above; and (given that these are not exhaustive)**
- **any alternative approaches that might be taken, e.g. allowing for the transferee in some circumstances to make alternative arrangements – such as contributing to group personal pensions or stakeholder pensions – rather than provide an occupational pension scheme.**

59. **If provisions relating to the transfer of occupational pension rights were to be introduced, the Government would envisage bringing these into effect at a later date than the other reforms proposed in its consultation document (while still including them within the same set of Regulations) as it considers that employers and others concerned would in this instance need a longer “period of grace” to prepare themselves to meet the new requirements.**

The *Frankling* case

60. In the *Frankling* case¹³, the EAT found that certain age-related payments to which an employee would become entitled on redundancy under terms and conditions applicable in the National Health Service did not pass across in a TUPE transfer because the benefits in question:

- arose under legislation rather than under a contractual obligation on the employer to pay them to the employees; and
- fell within the occupational pensions exclusion in the Directive and the TUPE Regulations.

The same issues have subsequently arisen in the *Beckman* case¹⁴, and the High Court has referred them to the ECJ for a preliminary ruling.

61. **The Government's policy is that, whatever ruling the ECJ makes in *Beckman* on the issues first raised by the *Frankling* decision, benefits of this kind should pass across in a TUPE transfer. It therefore proposes to make specific provision to this effect in the**

¹³ *Frankling -v BPS Limited*.

¹⁴ *Beckman -v- Dynamco Whicheloe*.

amended Regulations. (Even if the ECJ's ruling in *Beckman* proves to be in line with the *Frankling* decision, Article 8 of the Directive permits Member States to introduce provisions that are more favourable to employees than the Directive itself requires.)

D. Notification of employee liability information

62. Article 3.2 of the revised Directive gives Member States a new option to introduce provisions requiring the transferor to notify the transferee of all the rights and obligations in relation to employees that will be transferred – so far as those rights and obligations are or ought to be known to the transferor at the time of the transfer. Responses to the DTI consultation document issued at the beginning of 1998 on the revision of the Acquired Rights Directive indicated that interested parties in the UK are overwhelmingly in favour of the introduction of such provisions.

63. **The Government therefore proposes to take advantage of the new option by providing that:**

- **the transferor in a prospective transfer of an undertaking is required to give the transferee written notification of all the rights and obligations in relation to employees that are to be transferred;**
- **if any of the rights or obligations in question change between the time that such notification of them is given and the completion of the transfer, the transferor is required to give the transferee written notification of the change;**
- **both these types of notification may be given in more than one instalment, but every instalment must be given:**
 - **in good time before the completion of the transfer; or**
 - **if special circumstances make this not reasonably practicable, as soon as is reasonably practicable and in any event no later than the completion of the transfer.**

64. As regards remedies for breach of these new requirements, the Government has considered the possibility of providing for the transferee to seek an award of damages against the transferor from a civil court, but is concerned that this might be unworkable in practice as – given that whether or not the transferor had correctly notified would not affect the actual transfer of liabilities – it might be difficult for the transferee to demonstrate a quantifiable financial loss.

65. Another possibility might be to make provision to the effect that:

- **in any legal action brought by an employee against the transferee in relation to a liability arising from rights or obligations not notified in accordance with these new requirements:**
 - **the transferee may apply to the court or tribunal to have the transferor joined to the proceedings;**
 - **the court or tribunal shall apportion liability between the transferor and the transferee on a just and equitable basis, having regard to the damage suffered by the employee and the relative responsibility of the parties; but**
 - **it will be a valid defence for the transferor to show that the rights or obligations in**

question were not ones that it knew about or ought to have known about at the time of the transfer.

66. Provision for the transferor to be made jointly liable with the transferee in the specified circumstances would involve the use of the Member State option in Article 3.1 of the Directive, which states (*inter alia*):

Member States may provide that, after the date of transfer, the transferor and the transferee shall be jointly and severally liable in respect of obligations which arose before the date of transfer from a contract of employment or an employment relationship existing on the date of the transfer.

Where the transferor was wholly responsible for a liability – for instance, an award of compensation for sex discrimination that passed across in a transfer but was not notified in accordance with these new requirements – the tribunal would be entitled to find, based on the facts before it, that the transferor’s level of contribution should be 100%.

67. The disadvantage of this approach is that it would give the transferee a route of redress only if one or more of the employees actually took legal action against him or her. This would be unlikely to occur in a case where, for instance, the terms and conditions of the transferred employees were more generous than the transferor had suggested in the pre-transfer notification.

68. Suggestions would also be welcome for any other possible approaches toward remedies.

69. Provided that effective remedies were in place, the introduction of these new provisions should ensure that transferees were entitled to full, accurate information about the liabilities toward employees that they were taking on, and so were well placed to meet those liabilities. This would be of benefit not only to the employees who transfer but also to the transferees themselves. It would help to ensure transparency in the transfer process and to prevent instances of sharp practice – such as where, shortly before a transfer is completed, the transferor changes the terms and conditions and/or the composition of the workforce assigned to the undertaking in question, to the disadvantage of the transferee. In addition, it would promote competitiveness by removing a significant disincentive to some businesses – particularly those, such as small firms, that may have insufficient bargaining power to negotiate equivalent contractual safeguards – becoming involved in transfers in the first place.

70. It would be open to the transferor to give the notification either directly or indirectly. This means that in the case of a service provision change it could be transmitted via the client¹⁵. In practice, compliance with these new requirements would be likely to become part of the normal pre-transfer dealing process, reinforcing current good practice based on due diligence and extending it to second and subsequent generation contracting.

71. In service provision change cases where the notification was transmitted via the client, the transferor would no doubt wish to negotiate appropriate commercial indemnities or other contractual safeguards – given that the transferor would suffer the legal consequences of any failure to comply, even if it was the client who had fallen down in passing the notification on to the transferee. The transferor might even be content (subject to any data protection or confidentiality considerations) for the client to make the relevant information available to all prospective transferees in the tendering process, not just to the successful bidder at the end of that process, to ensure that bids could be made on a “level playing field” basis; but again this

¹⁵ The terms “service provision change” and “client” have the same meaning in this section of the document as in section B above. The terms “transferor” and “transferee” should be taken to encompass the parties treated as such in the case of a service provision change.

would remain a matter for negotiation and agreement between them. One relevant factor in a retendering case would probably be whether or not the prospective transferor wished to bid to retain the contract, in which event the disclosure of the information to other bidders at the tendering stage could be to its disadvantage. It would however remain open to the client to require any new contractor to enter into an agreement to disclose the relevant information at the end of the contract term.

72. The Government would welcome views on the possibility of making the transmission of the notification via the client in service provision change cases a requirement rather than simply an option for the transferor. One possible disadvantage of doing so is that it would oblige the transferor to disclose to a third party information that it might wish to keep restricted for reasons of commercial confidentiality.

73. The giving and receiving of notifications under these new requirements would not commit the parties to going ahead with the proposed change in business arrangements to which the notifications referred. Nor would any failure by the transferor to meet the requirements affect the actual transfer of rights or obligations.

E. Dismissal by reason of a transfer of an undertaking

74. Article 4.1 of the Acquired Rights Directive, which has undergone no substantive amendment, states:

The transfer of an undertaking, business or part of the undertaking or business shall not in itself constitute grounds for dismissal by the transferor or the transferee. This provision shall not stand in the way of dismissals that may take place for economic, technical or organisational reasons entailing changes in the workforce ...

This provision is implemented in Regulation 8 of the current TUPE Regulations. Regulation 8(1) makes a dismissal automatically unfair under the unfair dismissal provisions of the Employment Rights Act 1996 (subject to the normal qualifying conditions, including one year's continuous employment) where "the transfer or a reason connected with it is the reason or principal reason" for the dismissal. Regulation 8(2) then provides an exception from this general rule in those cases where "an economic, technical or organisational reason entailing changes in the workforce..." – generally referred to as an ETO reason – is "the reason or principal reason" for the dismissal. In such cases the dismissal may be fair or unfair, depending on whether or not the employer has acted reasonably in treating that reason as sufficient to justify it.

75. The Government recognises that uncertainty has attached to the interpretation of Regulation 8, leading to cases before the employment tribunals and the higher courts. A number of these cases have focused on the relationship between Regulation 8(1) and Regulation 8(2). A particular issue has arisen as to whether dismissals for a reason connected with the transfer – Regulation 8(1) – and dismissals for an ETO reason – Regulation 8(2) – are two mutually exclusive categories or whether the latter are a subset of the former¹⁶. The Government considers that ETO reasons should properly be seen as a subset of reasons connected with the transfer. If this were not the case, the ETO exception in the Directive would be essentially superfluous, as it would be clear in any event that the Directive could have no impact on changes completely unconnected to a transfer. **The Government proposes to improve the drafting of these provisions in the new Regulations, in particular by making clear that ETO reasons are a subset of reasons connected with the transfer.**

¹⁶ See for instance the Court Appeal's judgments in *Warner -v- Adnet* ([1998] IRLR 394) and *Whitehouse -v- Charles A Blatchford & Sons Ltd* ([1999] All ER (D) 414) and the EAT's decision in *Kerry Foods Ltd -v- Mr A Creber & others* ([2000] IRLR 10).

F. Changes to the terms and conditions of employment of affected employees

76. Another key element of the Acquired Rights Directive is the protection it affords to affected employees' terms and conditions of employment. Article 3(1), which again has undergone no substantive amendment, provides:

The transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer shall, by reason of such transfer, be transferred to the transferee.

77. The ECJ held in the *Daddy's Dance Hall* case (*Foreningen af Arbejdsledere i Danmark -v- Daddy's Dance Hall* [1988] IRLR 315) that:

- Employees cannot waive the rights conferred upon them by the mandatory provisions of the Directive, even if the disadvantages for them of such a course of action are offset by advantages so that, overall, they are not left in a worse position. Nevertheless, the Directive does not preclude an alteration in the employment relationship agreed with the new proprietor of the undertaking insofar as such an alteration is permitted by the applicable national law in cases other than transfers of undertakings.
- The benefit of the Directive, therefore, can be invoked to ensure only that affected employees are protected in their relations with the new employer in the same way as they were in their relations with the original employer, pursuant to the laws of the Member State concerned.
- The relationship can be altered with regard to the transferee within the same limits as with regard to the transferor, on the understanding that in no case can the transfer of the undertaking itself constitute the reason for this alteration.

78. The Government believes this conclusion is in line with the employment protection aims of the Directive and the principle – reflected in UK employment legislation, including Regulation 12 of the current TUPE Regulations – that employees cannot “contract out” of rights afforded to them by mandatory provisions of EC Directives. It nevertheless recognises that there has been some uncertainty in the UK as to the circumstances in which a change in terms and conditions can be validly made.

79. This uncertainty arose partly out of the EAT's decision in the *Wilson* case (*Wilson v St Helens Borough Council* [1996] IRLR 541). Initially an employment tribunal had held that where there was an ETO reason for varying employees' terms and conditions at the time of a transfer, then the variation was effective. The EAT however disagreed and held that the Regulations and the Directive preclude even consensual variation of terms and conditions if the reason for the variation is the transfer. The EAT considered that the ETO defence applied strictly to dismissals only; therefore the only circumstance in which a variation could be agreed was where the operative reason was not the transfer.

80. The Court of Appeal subsequently heard the *Wilson* case together with the *Meade* case (*Meade and Baxendale v British Fuels Ltd*), in which there were related issues concerning variation and dismissal at the time of a transfer. In its judgment ([1997] IRLR 505), it found for the employer in *Wilson* but for the employees in *Meade*. This was on the basis that what was crucial in each case was the real reason for the variation: in the *Wilson* case the reason was the survival of the transferee, not solely the transfer, but in the *Meade* case, the transfer was the sole reason for the variation, which was therefore ineffective.

81. In order to clarify the position the UK attempted during the negotiations leading up to the adoption of the revised Directive to secure an amendment to Article 3(1) explicitly providing that it does not stand in the way of changes to terms and conditions made in accordance with national law and practice for economic, technical or organisational reasons, as opposed to changes made by reason of “the transfer itself”. Other Member States, however, considered this to be so plainly the correct interpretation of the Directive that any such clarification would be superfluous.

82. The House of Lords has since upheld the judgment of the Court of Appeal in the *Wilson* and *Meade* cases ([1998] 4 All ER 609, [1998] 3 WLR 1070). Lord Slynn, delivering the judgment, said in the key relevant passages¹⁷:

I do not accept the argument that the variation [in terms and conditions] is invalid only if it is agreed on as a part of the transfer itself. The variation may still be due to the transfer and for no other reason even if it comes later. However, it seems that there must, or at least may, come a time when the link with the transfer is broken or can be treated as no longer effective...

...

If the transferee cannot safely agree terms to bring his new employees into line with existing employees' standard terms and conditions, that will discourage employers from taking over new businesses or lead to the transferee dismissing transferred employees.

...

[In the *Wilson* case, the changes in terms and conditions] were for an economic or organisational reason and entailed a change in the workforce since the number of employees ... was considerably reduced, whether or not the ETO defence can strictly be relied on in the present circumstances. The staff had the option of staying with [the transferor] or going to [the transferee] on the new terms to give effect to these economic and organisational reasons. In the circumstances, the industrial tribunal and the Court of Appeal were entitled to find that the transfer of the undertaking did not constitute the reason for the variation. It was a variation of the terms of employment ‘to the same extent as it could have been with regard to the transferor’. [The latter words quoted from the ECJ’s judgment in *Daddy’s Dance Hall*.]

83. **The Government proposes to improve the operation of the Regulations by making clear that they do not preclude transfer-related changes to terms and conditions that are made for an ETO reason – that is, an “economic, technical or organisational reason entailing changes in the workforce”.** The lawfulness of such changes will then clearly depend only on the normal considerations that would apply irrespective of a transfer – such as the consideration that unilateral imposition of such changes by an employer would constitute a breach of contract

G. Application of the legislation in relation to insolvency proceedings

84. Article 5.1 of the revised Directive, reflecting case law on the original Directive (in particular, the ECJ’s decision in *Abels* [1987] CMLR 406), indicates that unless Member States provide otherwise (which the Government does not propose to do for the UK) the normal safeguards for employees against transfer-related changes to terms and conditions and transfer-related dismissals do not apply where “the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation

¹⁷ *Obiter dictum*.

of the assets of the transferor and are under the supervision of a competent public authority (which may be an insolvency practitioner authorised by a competent public authority).” Procedures for which the Insolvency Act 1986 provides that fall within this description in the UK¹⁸ include in particular compulsory winding-up and bankruptcy, and possibly also creditors’ voluntary winding-up.

85. Article 5.2 of the revised Directive gives Member States two new options in cases where its requirements are applied in relation to “insolvency proceedings ... under the supervision of a competent public authority (which may be an insolvency practitioner determined by national law)”. Procedures that fall within this description in the UK include in particular administration, company and individual voluntary arrangements and creditors’ voluntary winding-up, but not administrative or any other receivership or members’ voluntary winding-up.

86. The two new options are to provide that:

- in cases giving rise to protection for employees at least equivalent to that provided for in situations covered by the EC Insolvency Directive (80/987/EEC), the transferor’s pre-existing debts toward the employees do not pass to the transferee; and/or
- employers and employee representatives may, exceptionally, agree changes to terms and conditions of employment by reason of the transfer itself, provided that this is in accordance with national law and practice and with a view to ensuring the survival of the business and thereby preserving jobs.

87. The underlying aim of these options is to allow Member States to promote the sale of insolvent businesses as going concerns. This is in line with the “rescue culture” that the Government aims to promote. If either or both of the options were taken up, there could be expected to be some increase in the number of insolvent businesses transferred to begin afresh under a different employer rather than closed down and liquidated with all the employees being made redundant.

Providing for debts toward employees not to pass to the transferee

88. If the first option were to be taken up, any of the transferor’s pre-existing debts toward employees that were within the categories and statutory upper limits on amounts guaranteed under the insolvency payments provisions of the Employment Rights Act 1996¹⁹ would fall to be met not, as at present, by the transferee but by the National Insurance Fund (with the Secretary of State becoming a creditor by subrogation in the insolvency proceedings). The provisions in question would need to be amended accordingly, amongst other things to ensure that employees who retained their jobs under the transferee could qualify for insolvency payments, whereas at present only those who have been dismissed may do so.

89. In respect of debts over and above those that could be met in this way, the new Regulations could provide either:

- that they passed to the transferee – in which case the positive effects of taking up this option in terms of promoting the rescue of insolvent businesses would be somewhat reduced, but

¹⁸ England and Wales, Scotland and Northern Ireland have different insolvency regimes; the types of procedures referred to in this section are those in England and Wales, but analogous types exist in Scotland and Northern Ireland.

¹⁹ Both the types of insolvency proceedings covered and the categories of debts guaranteed under the UK provisions are more extensive than required under the Insolvency Directive itself.

where transfers did occur the affected employees would have a relatively high degree of protection; or

- that they did not pass to the transferee – in which case the transferee would be able to take over with a “clean slate” but, if there would have been a transfer in any event, the affected employees may in practice recover less of the money owed to them than they would under the current provisions (given that it would normally be less likely to be obtainable from any remaining assets of the insolvent transferor in the insolvency proceedings than from the solvent transferee).

The Government considers that, on balance, the first of these two possible approaches would be preferable.

90. One disbenefit of exercising this new Member State option is that it would result in some additional public expenditure on insolvency payments from the National Insurance Fund in the circumstances where there would have been a transfer (either with or without dismissals) in any event. However, these additional costs would be very modest by comparison with total expenditure on redundancy and insolvency payments in any given year.

91. It should also be noted that even in these “deadweight” cases exercising the option could still be expected to have some beneficial effect, in that it should improve the rescued business’s chances of succeeding under the transferee employer and avoiding a subsequent further insolvency situation. There would, moreover, be offsetting public expenditure savings gained from exercising the option – including, for example, savings in benefit payments that might otherwise have to be made from the National Insurance Fund to employees who lost their jobs when their employers’ businesses were liquidated.

92. The benefits for employees, employers and the economy as a whole of exercising this option are expected to outweigh substantially the disbenefit of some relatively modest additional “deadweight” costs in insolvency payments from the National Insurance Fund (which would in any case be offset by other savings). The Government therefore proposes to provide that where insolvency proceedings within the Article 5.2 derogation have been opened in respect of a transferor, any outstanding debts toward employees either:

- **fall to be met from the National Insurance Fund, if they are within the categories and statutory upper limits on amounts guaranteed under the insolvency payments provisions of the Employment Rights Act 1996; or**
- **pass to the transferee, as at present, if they are not.**

Providing for changes by reason of the transfer to be made to terms and conditions of employment by agreement between the parties

93. The Government considers that the arguments in favour of exercising the second of the two options are even more clear cut, and that – provided adequate safeguards are in place for the employees affected – the consequences of doing so should be entirely positive. It would effectively give employers and employee representatives the same freedom to negotiate in transfer cases as in other cases where changes to terms and conditions may be agreed with a view to securing the survival of an insolvent business and the consequent saving of jobs.

94. The Government therefore proposes to provide that where insolvency proceedings within the Article 5.2 derogation have been opened in respect of a transferor, changes by reason of the transfer itself (i.e. changes for which there is no ETO reason that would render them potentially valid in any event) may be lawfully made to the terms and

conditions of employment of affected employees if:

- **they are agreed between either the transferor or the transferee and appropriate representatives of those employees;**
- **they are designed to safeguard employment opportunities by ensuring the survival of the undertaking or business or part of the undertaking or business; and**
- **they are not otherwise contrary to UK law (e.g. the National Minimum Wage Act).**

95. The definition of “appropriate representatives” used for these purposes would be consistent with that used for information and consultation purposes (Regulation 10 of the current TUPE Regulations). That is:

- if there is an independent trade union recognised for collective bargaining purposes in respect of employees of the description in question, representatives of that trade union; or
- in any other case, either (at the employer’s choosing):
 - employee representatives appointed or elected by affected employees of the description in question otherwise than for these purposes, who (having regard to the purposes for and the method by which they were appointed or elected) have authority from those employees to agree changes to terms and conditions on their behalf; or
 - employee representatives elected by affected employees of the description in question for these particular purposes, in an election satisfying requirements identical to those applying for information and consultation purposes (Regulation 10A of the current TUPE Regulations).

96. In non-union cases, in order for the agreement to be effective in varying the contracts of employment of the individual employees represented, it would have to be in writing and the employer would have to have given the employees in question the text of it in advance of it coming into effect, along with such guidance as they might reasonably require in order to understand it fully.²⁰

97. Representatives for the purposes of agreeing changes to terms and conditions would be given rights equivalent to those enjoyed by representatives for information and consultation purposes. Those who participate in the election of such representatives would also be given equivalent rights. The same individuals could potentially act as representatives for both purposes – provided that, in non-union cases, they had authority from their constituent employees in both respects.

Potential misuse of insolvency proceedings

98. The new Article 5.4 of the revised Directive requires Member States to “take appropriate measures with a view to preventing misuse of insolvency proceedings in such a way as to deprive employees of the rights provided for” in the Directive. Such “misuse” could potentially occur if unscrupulous employers were able to bring about an insolvency situation in relation to which the new flexibilities applied when it was inappropriate to do so, either because administrative or other receivership or members’ voluntary winding-up (in relation to which the legislation will remain fully applicable) would be a more suitable procedure or because they could continue to

²⁰ This is consistent with provisions relating to workforce agreements in the Working Time Regulations 1998.

trade without entering into a state of insolvency at all.

99. The UK has, in the Insolvency Act 1986 (as amended by the Insolvency Act 2000), enacted a number of provisions aimed at preventing abuses from occurring in the course of insolvency proceedings. One of these requires proceedings to be under the control and supervision of persons authorised to act as “insolvency practitioners”. Authorisation is granted only to persons who are fit and proper to act as such and who satisfy conditions as to their qualifications. It can be withdrawn if their conduct falls short of the standard required. The UK has also, in the same Act and in the Company Directors’ Disqualification Act 1986 (as amended by the Insolvency Act 2000), enacted provisions intended to protect the public from malpractice in the course of insolvency procedures and in the conduct of companies generally. Such provisions include those that enable investigations and prosecutions to take place following reports of suspected malpractice and orders to be made disqualifying persons from acting as directors or in other capacities connected with the management of companies. Such orders may be made on the basis of unfitness to act, whether those persons have been the subject of criminal prosecution or not. They run for between two and fifteen years. All identified cases of serious misconduct are pursued and particular emphasis is placed on serial offenders who operate “phoenix” companies. Further, if a company’s money and assets have been deliberately put out of the reach of its creditors, there are provisions that can be used to recover them. There are also restrictions on the reuse of a failed company’s name. If they are ignored, the directors can be prosecuted and made personally liable for the company’s debts.

100. The Government considers that these existing safeguards are sufficient to meet the new requirement in Article 5.4 of the Directive.

Hiving down

101. Regulation 4 of the current TUPE Regulations provides that where a receiver, administrator or liquidator transfers from an insolvent company part or all of that company’s business to a wholly owned subsidiary – a process known as hiving down – there is no relevant transfer at that stage and the operation of the Regulations is effectively suspended until such time as another party acquires the subsidiary by share transfer or purchases the undertaking as a going concern.

102. The purpose of this provision was to promote the sale of insolvent businesses by allowing for the employees, and any debts toward them, to remain the responsibility of the insolvent parent company. It has however fallen into disuse since the House of Lords’ judgment in the *Litster* case (*Litster -v- Forth Dry Dock and Engineering Company Ltd* [1989] IRLR 161) made clear that where employees are dismissed by reason of a relevant transfer the transferor’s debts toward them still pass to the transferee even if the dismissals took place in advance of the transfer. The High Court confirmed in its judgment of 20 January 2000 in the case of *Re Maxwell Fleet and Facilities Management Ltd (in administration) (No. 2)* that the *Litster* principle applies in hiving down cases.

103. The Government believes that in the light of the *Litster* judgment, and of its intention to take advantage of the two new optional derogations in Article 5.2 of the Directive, the existing provision relating to hiving down no longer serves any useful purpose. It therefore proposes to remove this provision.

H. Continuity of employee representation

104. Article 6(1) of the Directive contains the following requirement:

If the undertaking, business or part of an undertaking or business [subject to a transfer] preserves its autonomy, the status and function of the representatives or of the

representation of the employees affected by the transfer shall be preserved on the same terms and conditions and subject to the same conditions as existed before the date of the transfer by virtue of law, regulation, administrative provision or agreement, provided that the conditions necessary for the constitution of the employees' representation are fulfilled.

...

105. To make explicit that UK legislation is fully in line with this requirement, the Government proposes to provide expressly that the effect of union recognition declarations made by the Central Arbitration Committee (CAC) under the provisions introduced by the Employment Relations Act 1999 is appropriately preserved across a transfer.

106. Article 6(1) contains, in addition, the following provision:

If the undertaking, business or part of an undertaking or business does not preserve its autonomy, the Member States shall take the necessary measures to ensure that the employees transferred who were represented before the transfer continue to be properly represented during the period necessary for the reconstitution or reappointment of the representation of employees in accordance with national law or practice.

107. A situation in which a transferred business did not retain its autonomy could arise where, for instance, a relatively small, independently managed business became – following a transfer – a department of a larger business with its own existing management structure. If the transferor and transferee had different employee representation arrangements – for instance, if the transferor recognised a union but the transferee did not – there might be a period of time following the transfer when the employees would lose their representation. **The Government would welcome views as to whether or not any new measures might usefully be introduced in the UK in the light of this new provision; and, if so, what form they might take.**

108. Article 5(1) also gives Member States a new option to introduce provisions ensuring continuity of employee representation in cases where a transferor employer is in liquidation. The Government does not propose to take this up.

I. Information and consultation of employee representatives

The revised Directive

109. The provisions on information and consultation of employee representatives in the revised Directive differ from those in the original Directive in three minor respects. First, the date or proposed date of the transfer has been added to the list of items of information required to be given; secondly, employers must now be specifically denied the possibility of using as an excuse for failure to meet their information and consultation obligations the fact that the decision resulting in the transfer was taken by a controlling undertaking (such as a parent company)²¹; and thirdly, in cases where there are no employee representatives through no fault on the employees' part, the employer must be under an obligation to give the employees concerned individually, in advance of the transfer, the information that would otherwise have had to be given to the representatives.

110. The Government proposes to amend the Regulations as necessary to remove any possible doubt that they comply fully with the first and second of these new

²¹ This brings the position into line with the parallel provisions in the Collective Redundancies Directive.

requirements. (The third is already clearly met in the existing provisions.)

Employee liability information

111. The Government has also considered the possibility of placing the transferor under an obligation to give the employee representatives a copy of any information notified to the transferee under the new duties set out in section D above. This could potentially be of assistance not only to the employee representatives themselves but also to the employers involved, as the representatives may be able to identify any inadvertent errors or omissions in the information given. On the other hand, it may be that in some cases the transferor would regard parts of the information given to the transferee as commercially sensitive and would prefer not to share it with employee representatives. There might also be data protection implications. **The Government would welcome views as to whether or not a provision of this kind should be introduced.**

J. Employers' Liability Compulsory Insurance

112. The Employers' Liability (Compulsory Insurance) Act 1969 (ELCI) requires private sector employers carrying on any business in Great Britain to insure themselves against liabilities to employees for bodily injury or disease arising from their employment. The Employers' Liability (Defective Equipment and Compulsory Insurance) (Northern Ireland) Order 1972 makes equivalent provision in Northern Ireland. On 16 May 2000 the Court of Appeal held in the joined cases of *Martin* and *Bernadone* (*Martin -v- Lancashire County Council* and *Bernadone -v- Pall Mall Services Group and others*) that such liabilities, like other liabilities arising from the employment relationship, automatically pass from the transferor to the transferee in a TUPE transfer. This accorded with the Government's own view of the legal position under the Regulations and the Directive. The Court also held that the benefit of the insurance cover bought by the transferor in compliance with ELCI similarly passes across in a transfer, so that the transferee is able to call on that cover to meet any such liabilities incurred while the business was in the hands of the transferor.

113. The Government considers that, in the light of the Court of Appeal's judgment in these cases, the legal position is satisfactory as far as transfers between private sector employers are concerned: the transfer of the benefit of the insurance cover bought by the transferor ensures that the transferee can comply with ELCI requirements in relation to liabilities incurred pre-transfer. There remains, however, a problem as far as transfers from public sector employers to private sector employers are concerned; public sector employers are generally exempted by ELCI from the requirement to effect insurance cover and, other than in exceptional cases where they have insured themselves on a voluntary basis, there is no cover to transfer.

114. The Government therefore proposes to introduce provision for the transferor and transferee to be jointly and severally liable for liabilities to employees for injury or disease arising from their pre-transfer employment in those cases where the transferor was a public sector employer exempt from ELCI.

115. This would involve a use of the Member State option in Article 3.1 of the Directive (see section D above). Under a system of joint and several liability, the employee or former employee to whom the liability was owed would be able to choose whether to take action against the transferor or the transferee or both. In practice it is likely that the choice would be strongly influenced by the consideration of which party was best able to pay. A party who was a sole defendant in such an action would have the possibility of joining others who were jointly liable in respect of the same liability. Alternatively, if judgment was given against a sole defendant, that defendant might be able to recover a contribution from others who were jointly liable in respect of the same liability. Liabilities would be apportioned in line with the provisions of the Civil Liability (Contribution) Act 1978.

K. Territorial extent etc

116. The Government proposes to:

- **remove the current limitation of rights under the TUPE Regulations to employees who ordinarily work in the UK; but**
- **retain the effect of the current provision restricting seafarers' ability to qualify to cases where the ship on which they are employed is registered as belonging to a port in the UK, they are ordinarily resident in the UK and the work is not wholly outside the UK.**

117. This would bring the position into line with that under other aspects of the employment rights legislation, in relation to which similar amendments were made by the Employment Relations Act 1999. In future, whether or not an individual working outside the UK could potentially qualify for rights under the Regulations would depend (except in the case of seafarers) on the normal operation of international law.

118. Regulation 2(2) excludes “the transfer of a ship without more” from the Regulations’ coverage. “Ship” has been interpreted in case law as meaning a ship and its crew. The Government considers that where there is a transfer between employers of a ship and its crew as part of a business, the Regulations do in principle apply. **As some uncertainty has arisen over this point, the Government proposes to amend the Regulations to make their intended meaning clear.**

L. Pre-determination procedure

119. The Government recognises that many employers would welcome the introduction of a procedure whereby uncertainty as to the Regulations’ applicability in relation to a prospective change in business arrangements could be resolved in advance, while there was still an opportunity for them to revise their plans if necessary and ensure that they fully complied with the relevant requirements, by obtaining a quick judicial decision from an employment tribunal²². Such a procedure could also be of direct benefit to the employees and employee representatives involved, in that it would help to establish at an early stage where obligations toward them would rest in the event that the change in question went ahead. It could, moreover, contribute toward reducing post-change disputes over these issues.

120. The Government is not opposed in principle to the idea of introducing a “pre-determination” procedure of this nature, but has serious concerns regarding its practicability and potential for abuse. Abuse could occur, for instance, if employers came to use the procedure as a matter of course, simply in order to gain an authoritative “rubber stamp” for their proposals, or even as a cheap substitute for obtaining their own legal advice. This would constitute an unacceptable additional burden on the tribunal system. A possible solution might be to limit the procedure to cases where a dispute had arisen or where the question as to the Regulations’ applicability was a genuinely marginal one. Whether or not these criteria were met would often be open to debate, however, and it is likely that each application would still require some expert scrutiny, perhaps by a tribunal chairman, in order to decide the point. Potential transferor and transferee employers who wished to make use of the procedure in a case where no dispute had

²² In cases before the civil courts, Part 24 of the Civil Procedure Rules (formerly Order 14A of the Rules of the Supreme Court) already provides a procedure whereby a party can obtain judgment in certain circumstances without proceeding to a full trial. This procedure has occasionally been used to obtain judgment in cases concerning the applicability of the TUPE Regulations. This remains a possible avenue for employers to pursue where appropriate.

arisen could conceivably collude in order to “manufacture” one. And in a case where a genuine dispute existed – for example, a service provision change where the old contractor considered that the Regulations applied and the new contractor disagreed – it is questionable whether or not either of the employers involved would regard it as being in their best interests to have the matter quickly determined by a tribunal.

121. A further consideration is that a procedure designed to settle disputes between employers would sit oddly with the tribunals’ main remit to determine complaints by employees about alleged infringement of their employment rights. It could, admittedly, be argued that the underlying purpose of the pre-determination procedure would be to ensure that no such infringement occurred (or that any infringement that had already occurred was swiftly addressed), and that it was therefore consistent with the Regulations’ employment protection aims²³. The procedure could nevertheless be criticised on grounds of unfairness if it did not afford a role to employees and employee representatives who might be affected by the prospective change – and it is not immediately apparent how such a role could be incorporated. There would, at a minimum, have to be some mechanism by which aggrieved employees or employee representatives could challenge tribunal decisions made under the pre-determination procedure, which would reduce the usefulness of such decisions as a means of achieving certainty.

122. There is, in addition, the more general point that a decision under the pre-determination procedure could continue to be relied upon only if the facts on which it was based remained valid. It would always be open to an aggrieved employee or employee representative, in bringing a subsequent complaint under the Regulations, to argue that the earlier decision was no longer binding on the tribunal as the employers involved had changed their plans in some respect by the time the transfer actually took place, or that the undertaking in question had not retained its identity in the hands of the purported transferee. In cases where the employers involved were genuinely in dispute, the one that was unsuccessful at the pre-determination stage could subsequently change some aspect of its plans with the specific aim of invalidating the tribunal’s decision. Decisions under the pre-determination procedure would also have to be subject to appeal, on a point of law, to the EAT and the higher courts (and potentially to the ECJ).

123. In the light of the foregoing considerations, the Government does not propose to introduce any “pre-determination” procedure.

²³ Provision for a matter to be referred to a tribunal by an employer, rather than an employee, would not be entirely unprecedented either; see, for instance, section 11(2) of the Employment Rights Act 1996.

DRAFT REGULATORY IMPACT ASSESSMENT (RIA)

1. TITLE: AMENDMENT OF THE TRANSFER OF UNDERTAKINGS (PROTECTION OF EMPLOYMENT) REGULATIONS 1981 -REGULATORY IMPACT ASSESSMENT

2. Objectives, Purpose and Intended Effect

2.1 *Issue*

The Transfer of Undertakings (Protection of Employment) Regulations 1981, commonly known as the TUPE Regulations, implement the EC Acquired Rights Directive and safeguard employees' rights when the business in which they work changes hands between employers. The Government is committed to amending them in order: a) to improve and simplify their operation, remedying widely recognised shortcomings and reducing the potential for disputes and litigation; and b) to implement a revised version of the Directive adopted in June 1998 following successful negotiations under the UK Presidency. This Regulatory Impact Assessment (RIA) considers the potential impact of a detailed package of proposed amendments drawn up for public consultation.

2.2 *Objective*

If made to work effectively, the TUPE Regulations should:

- assist the smooth management of necessary change, in both the private and the public sector, by securing the interests and commitment of the employees affected;
- promote a co-operative, partnership approach toward business restructuring;
- help create a level playing field in business acquisitions and in contracting operations in the business services sector;
- give everyone a stake in improving competitiveness.

The underlying aim of the package of proposed amendments is to ensure that the Regulations operate effectively for all those whose interests depend on them: the employers and contractors whose businesses they help shape; the clients and local authorities who use them as a framework for contracting; and the employees whose rights they safeguard.

2.3 *The problem/risk assessment*

The Regulations are widely regarded, by all groups whose interests are affected by them, as less than satisfactory in their present state. Failure to address their shortcomings would be contrary to the Government's commitment to review and where necessary reform outdated and deficient regulation that imposes undue burdens on business. 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. The proposals that form the subject of this RIA have been developed by DTI and colleagues in other departments in informal discussions with some of the main representative organisations of employers, employees and other interested parties, in line with the Government's social partnership philosophy.

The main proposals set out in the consultation document are, briefly, to:

- adopt the definition of a transfer of an undertaking in the revised Directive and, in relation to transfers within public administration and within the business services sector, consider proposals for additional measures;
- consider options for providing a degree of protection for employees' ongoing occupational pension rights on transfer;
- require transferor employers to provide relevant employee liability information to transferee employers;
- make minor amendments to clarify the operation of the provisions relating to transfer-related dismissals and changes to terms and conditions of employment;
- take advantage of two new derogations in the revised Directive to provide greater flexibility in the Regulations' application in relation to transfers of insolvent businesses, thereby increasing the number of such businesses that are rescued as going concerns; and
- ensure that employees in an undertaking transferred from the public sector to the private remain appropriately protected as intended by the Employers' Liability (Compulsory Insurance) Act 1969 (and equivalent Northern Ireland provisions).

3. Benefits and Costs

3.1 The proposal relating to transfers of insolvent businesses could be expected to result in some increase in public expenditure on insolvency payments from the National Insurance Fund, offset by savings elsewhere, including in benefit payments to employees who would otherwise have lost their jobs on the insolvency of their employer's business. The net increase would depend upon other factors, including in particular the general state of the economy, but would be no more than modest by comparison with total expenditure on insolvency payments.

3.2 The main benefit of the proposal relating to transfers of insolvent business would be a reduction in the number of job lost due to insolvency by increasing the number of rescues.

3.3 The only *significant* increased costs to business would arise if certain of the options relating to occupational pension rights were pursued. Most of these costs are transfers to employees and can therefore not be seen as economic costs. Other individual proposals would lead to comparatively small costs which would be either benefits to the other party in the transfer or to the employees. One-off costs in the form of administration costs to employers would arise from the proposal on the notification of employee liability information. The package, taken together, should provide greater safeguards for employees in transfer situations. There will also be benefits for business as the information flow is improved. In total a net positive effect on business, the public sector and the economy as a whole is likely, especially when the non-monetised benefits are included.

4. Number of transfers

4.1 The RIA considers the different aspects of the proposals individually. Some of the assumptions are common. These include:

- We use direct survey evidence to establish the likely number of workers and undertakings to be affected. For this we use the Workplace Employee Relations Survey 1998 (WERS98). This survey questioned workers, managers and employee representatives in over 3,000 workplaces across the country. Some 2,191 managers of workplaces with 25 or more

employees were asked whether there had been a change in ownership in their workplace over the past five years. 312 responded 'yes', and of those, 96 implied that a private sector to private sector TUPE transfer was involved.¹ This means that over a period of five years, 4.3% of undertakings were involved in TUPE related transfers, or approximately 1% of undertakings 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% and 0.5% of businesses with 1-9 employees; between 0.5% and 0.9% of businesses with 10-19 employees; and 1% of businesses with 20 or more employees.

- A total of between 2,000 to 8,000 businesses with between 150,000 to 180,000 employees will be affected.²

5. Proposals with possible cost implications

Service provision changes

5.1 While the Regulations affect all sectors there has in the past been considerable uncertainty in cases where contracting-out, re-letting or contracting-in of business services (a “service provision change”) has occurred. The consultation document canvasses views on the possibility of extending the Regulations’ scope in relation to service provision changes. The more detailed background paper discusses for a possible approach toward achieving such an effect.

Proposal

5.2 The proposal would entail new provision being made to the effect that:

- if:
- a service provision change (as described above) is to take place; and
- prior to the change, there are employees assigned to an organised grouping the principal purpose of which is to perform the service activities in question specifically on behalf of the client concerned;
- then:
 - the employees assigned to the organised grouping shall be treated in the same way as in cases where the TUPE regulations normally apply; and
 - the party with responsibility for provision of the service before the change shall be treated as the transferor and the party with responsibility for the provision of the service after the change shall be treated as the transferee.

The proposal aims to ensure that all parties normally know where they stand.

Numbers affected³

5.3 The main impact of the proposal would probably be on local government clients for

¹ This question was asked only in workplaces with 25 or more workers. The takeovers included in the analysis include “sold by parent organisation”, “ex public sector” and “management buyout”, Source WERS 98, see Annex 1 for details. It has to be pointed out that WERS 98 was not a survey conducted to answer TUPE related questions.

² See Annex 1 for details.

³ See Annex 2. for details

services, and on the contractors providing those services, although there will also be an impact on business clients and contractors operating purely in the private sector. The statistics available do not allow us to identify directly the number of companies affected. We therefore prepare an approximate estimate including only firms in real estate, renting and business activities. There will be some others such as catering firms, for example, which belong to the industry “Hotel and Restaurants”. We assume that a majority of businesses in this sector are not the type of firms likely to be involved in service provision changes. On the other hand the real estate, renting and business activities industries will include some groups that are less likely to be involved in such changes. The two effects should balance each other.

5.4 To establish the number of firms and employees affected we apply the same methodology as for the effect of the changes on all sectors. Annex 2 provides the details. We assume that between 500 and 2,000 businesses employing between 17,000 and 23,000 employees in this industry will be affected each year.⁴

Extension of current Regulations

5.5 The proposal would extend the scope for the application of the legislation. It is estimated that there is a total of 500 to 2000 TUPE transfers in this industry each year affecting between 17,000 and 23,000 employees.²⁴ We assume that 50% will already apply the full TUPE Regulations even if they do not have to. The large number of public service institutions involved in this make this assumption reasonable. This leaves between 250 and 1000 employers and between 8,500 and 11,500 employees.

5.6 We assume that between 40% and 60% of these would be clear TUPE cases under the current Regulations. The proposal would therefore increase the scope of the regulation to between 100 and 600 establishments with between 3,400 and 6,900 employees.

5.7 Costs and benefits to the affected employers and employees arise from redundancy payments, employment tribunals applications, changes in the terms and conditions and consultation and information.

5.8 We would appreciate comments from all those consulted as to whether the underlying assumptions can be considered as reasonable.

a) Redundancy

If TUPE applies the new employer would have to meet redundancy payment costs to employees made redundant. This is a shift in costs of £ 1.2-2.5 million from the transferor to the transferee (old to new employer).²⁵

b) Number of tribunal applications

Currently there are 1,087 unfair dismissal applications per annum under TUPE.²⁶ The industry analysed here (part of the service sector) takes up about 25% of all establishments. Hypothetically this means that the sector contributes 250 of the tribunal cases. We assume

⁴ These businesses form a subgroup of the total number of firms affected by the amendment of the regulation. In the following analyses regarding the different aspects of the proposals the total number of firms (between 2,000 and 8,000) and employees (150,000 and 180,000) will apply.

²⁴ See Annex 2 for calculation

²⁵ We assume an average duration of employment of 3 years. We further assume that 50% of the workforce is kept. The calculation is therefore: $3400 * £ 240 * 3 * 0.5 = £ 1.2$ million, $6,900 * £ 240 * 3 * 0.5 = £ 2.5$ million. This is based on the assumption that employers only pay the statutory minimum. Of £ 240 per week. They may chose to pay more.

²⁶ Source: Employment Tribunal Service

that the broadening of the scope of the TUPE regulation would increase the number of tribunals by not more than 100 per annum. This would cost employers up to £0.2 million and the taxpayer (ETS) up to £0.1 million.²⁷ Successful employees would benefit by the award. The average award for unfair dismissal is £2,744.²⁸ On average about 12% of applications are successful. We assume that the rate is higher in this case, 20%. Employees therefore benefit by up to £0.1 million.²⁹

c) Changes in terms and conditions

If there is no TUPE transfer the new employer can determine the terms and conditions of new employees. We assume that the average total employment package is worth 110% of the wage and non-wage costs. On average this means about £460 per week.³⁰ If the transfer leads to a reduction of 10% of the remuneration package this means a loss of about £2,400 per employee per year. For all employees the loss would be between £8 million and £16.5 million per year when TUPE is not applied. The proposal therefore improves employees' position by this amount. Applying the assumption that 50% of employees are taken over the costs to the new employer (transferee) would be between £4 million and £8 million. 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 undertaking transferred.

d) Information and consultation

In the case of a TUPE transfer the old employer has to inform and consult employee representatives. For those 100 to 600 establishments which will now fall under the TUPE Regulations this would have cost implications. We assume that the consultation process takes 3 days of management time costing up to £0.4 million.³¹ In addition to this there are costs due to time spent by the employee representatives consulted on the issue.³² We assume that representatives take an additional half a day (given that where representatives were union officials the consultation would be subsumed within their normal duties). This includes a consultation meeting as well as discussions before and after. Between 200 and 1,200 employee representatives would have to be consulted using each 4 hours.³³ The total costs would be up to £ 0.1 million.³⁴ The total consultation costs are therefore up to £0.5 million.

Effects of the amendment of the Regulations

²⁷ Calculation: $100 * \text{£ } 540 = \text{£ } 54,000$ for ETS rounded to £ 0.1 million, and $100 * \text{£ } 2,000 = \text{£ } 0.2$ million for employers

²⁸ Source: ETS Annual Report 2000/01

²⁹ The average award for unfair dismissal cases is £ 2,744. This may be an overestimate for TUPE cases. $20 * \text{£ } 2,744 = \text{£ } 49,540$ rounded to up to £ 0.1 million.

³⁰ Source: NES 2000 for income data. Value of 7 benefits for part-time employees about £ 560 per year in 1999/00. Source: RIA Part-time workers regulation. This excludes another 15 benefits. Adjusting for full time leads to a benefits worth about £ 1,200 per year. A further adjustments for 15 additional benefits to an annual values of about £ 2,000. This is equivalent to 10% of gross weekly wage.

³¹ One hour of manager's time costs £ 26, a day costs therefore £ 208. For 100 establishments this means total costs of £ 20,800. For 600 establishments: $6 * \text{£ } 20,800 = \text{£ } 124,800$.

³² Men full time £ 453 per week (55% of workforce): $\text{£ } 453 / 40 = \text{£ } 11.32$

Women (full time 337 per week (45% of workforce): $\text{£ } 337 / 40 = \text{£ } 8.43$

Women part time £ 108 19 hours per week (40% of all women employees): $108 / 19 = \text{£ } 5.68$

$\text{£ } 11.32 * 0.55 + 0.45 (\text{£ } 8.43 * 0.6 + \text{£ } 5.68 * 0.4) = 6.23 + 3.3 = 9.53$ or £ 10 per hour. Multiplied by 1.3 to account for non-wage labour costs.

³³ Employee representatives are consulted. In some undertakings this will just be one person in others one for every type of employee. Where a union representative is consulted this person would have time off for union duties. We therefore assume that 2 people per undertaking are consulted.

³⁴ $200 * 4 * \text{£ } 13 = \text{£ } 10,400$ and $1,200 * 4 * \text{£ } 13 = \text{£ } 62,400$

Costs and benefits

5.9 The proposed new provisions relating to service provision changes will have to be seen in relation to all businesses. The sectors affected constitute about 25% of all industries in terms of number of businesses with one or more employees. Costs and benefits will be allocated accordingly.

5.10 If all businesses in the sector in question were affected, the total costs and benefits to transferee, transferor and employees would be 25% of all costs and benefits of the amendment. In fact, however, only a minority of businesses in the sector would be affected, as only a proportion would be involved in service provision changes in any given year and, of these, many would be clearly covered under the Regulations as they stand.

5.11 There would be further benefits in terms of increased security for employees and employers in this sector. One effect of exercising this option should be to reduce the number of disputes and lower transaction costs in the event of a transfer.

Occupational pensions

5.12 The consultation document raises the possibility of the Regulations being amended so that they provide a degree of protection for ongoing occupational pension rights on transfer. Currently the Regulations do not provide for the transfer to the new employment of any rights to participate in respect of future service in an occupational pension scheme. (Rights accrued in a transferor employer's occupational pension scheme in respect of past service would be protected by general pension legislation, providing for preservation of benefits or transfer values.) The detailed background paper accompanying the consultation document discusses four suggested options and two further sub-options for introducing a degree of protection for future service pension scheme membership in TUPE.

Intended effect

5.13 The effect of these options would be to:

- offer a reasonable degree of protection for employees; but
- avoid undue new burdens on private sector employers; and
- provide a clear legal basis for employer obligations and employee rights, ending the current unacceptable uncertainty caused by differing interpretations of the interaction between the Regulations and the common law.

Reflecting the current legal uncertainty, practices vary amongst private sector employers as to whether, as a matter of business policy, transferors impose conditions on transferees as regards pension provision; and whether transferees provide, of their own volition, an occupational pension arrangement for staff being transferred from an employment where a scheme was available to them. In the absence of accurate and comprehensive data on existing patterns of behaviour it is difficult to identify accurately the impacts on behaviour of the different options for regulation which are being put forward.

Consultees are invited to give us views about the costs and benefits of the different options. The following sections provide a qualitative analysis as the basis for further work, in the light of consultation responses.

Cost-benefit analysis

5.11. Overall, as a first order effect, the costs to employers of the different options would be of a similar order to the benefits to employees, with the exception of employer administration costs on actuarial certification of new or altered pension arrangements, and costs of ongoing pension administration. An important consideration in selection amongst the various options will be the need to minimise these administrative costs. The total costs and benefits would vary in degree, depending on the regulatory approach adopted. It is not possible to quantify these variations. Crucially, there are no statistics available to show in precisely what proportion of cases employees do in fact lose occupational pension rights specifically by reason of a transfer. Transferee employers may often already provide for pension scheme membership on a basis not far removed from that provided by the transferor, even in the absence of a requirement in the Regulations, for business policy reasons. In many instances this will mean allowing transferred employees to join their existing pension scheme, but without necessarily compensating them for any shortfall in benefits by comparison with the transferor's scheme. Existing occupational pension schemes vary widely. This reflects not only differences in member (employee) contribution rates, but also wide differences in benefit structures:-

- Defined benefit (DB) pension schemes may be based on final salaries or career average salaries, and they may differ in their accrual rate and their lump sum commutation rate, in their normal pension age, in the levels of lump sum benefits and pensions available on the death of the member for surviving spouses, or unmarried partners, or dependent children, in provisions for early retirement and so on. Comparing one DB scheme with another in terms of the value to an individual employee is an exercise dependent on actuarial assumptions, and relatively small differences in benefit structures can mean that, in particular circumstances, the schemes could have materially different values to particular members.
- *Defined contribution (DC) schemes are easier to compare with each other, but it is much more difficult to make comparative valuations between a DC scheme and a DB scheme.*

5.12. Where a transferee employer has a pre-existing pension scheme and transferred staff are admitted to it, a key factor will be the value of that scheme in relation to the pension arrangements offered by the transferor employer. It may represent a significant improvement for transferred staff, or it may amount to a significant detriment.

5.13. The established practice in the public sector is for the transferor employer to require, as a condition of business transfer, that the transferee employer procures the availability of a pension scheme which is 'broadly comparable' to the relevant public sector scheme: that is, for each transferring employee it provides, overall, benefits which are materially at least as good. This usually requires the transferee to establish a new scheme specifically for that purpose, unless one already exists because of previous TUPE transfers from the public sector. There is no evidence that such a rigorous approach is ever followed in the private sector, even where employers are committed to best practice towards employees. For reasons set out in the consultation document the Government does not propose strict 'broad comparability' as a basis for regulating all transfers, because the administrative burden of compliance would be out of proportion to other costs and benefits.

5.14. Cases where transferee employers make no effort to provide any replacement pension arrangement may be relatively rare, but they are not unknown. The evidence is anecdotal. For the purposes of overall cost-benefit analysis a more significant concern may be the lack of data on how existing pensions provisions compare amongst employers most frequently engaged in TUPE transfers, and what therefore is the effect on staff if the transferee employer simply admits them to the current, open pension arrangement for the new employment.

5.15. A complicating factor is that patterns of occupational pension provision are dynamic. Employers may close schemes to new members whilst continuing to run them for existing staff, with new recruits being offered different arrangements. A TUPE-transferred workforce may contain a mix of pension arrangements, with the transferee employer running further different arrangements. No aggregate statistics exist which allow overall estimates of the first order effects on costs and benefits of the different regulatory options; and an important consideration will be the second order effects due to staff turnover (progressively reducing the impact on the undertaking of TUPE protections) and tertiary effects if new regulation affects the behaviour of employers towards new recruits (for instance by militating against provision of occupational pension rights before a TUPE transfer).

5.16. In line with the general approach of the employment rights legislation, the introduction of a requirement for pensions protection in the Regulations would be intended to oblige all employers involved in transfers to follow what is already widely recognised as good business practice, providing a “safety net” for vulnerable employees. Consultees are invited to give views on where the safety net should be pitched so as best to reflect the existing consensus on good practice in the private sector; and so as best to balance protection of existing employees with encouragement of employers to make good pension provision for new recruits.

Identifying Potential Benefits

5.17. Bringing future occupational pension rights to some extent within the coverage of the Regulations could be expected to bring benefits both for employees and for employers involved in transfer situations, and for the economy as a whole. It would promote competitiveness and allow for greater transparency in business acquisitions and service provision changes.

Benefits to employees

5.18. Affording a degree of protection for ongoing occupational pension rights would end the possibility of a total withdrawal of a pension and reduce the risk of a perceived threat of a severe reduction of an important element of employees’ total remuneration package specifically by reason of a transfer.

5.19. Employees stand to benefit from greater certainty and security. To the extent that the new Regulations alter behaviour and prevent exploitation of the existing anomaly, employees would be materially better off. This would be matched by higher employer costs in financing pension entitlements (that is, employers would be denied the opportunity to exploit TUPE transfers arbitrarily to cut pension costs). The degree of protection for employees, and the corresponding degree of constraint on employers, would depend on which option was chosen. The more rigorous options for regulation have the disadvantage of imposing extra administrative costs on employers which are disproportionate compared with employee benefits.

Benefits to employers

5.20. Transferors or, in the case of service contracting, clients, are already able to specify transfer conditions which could protect employee pension arrangements. However this is not always done and potential transferee employers should benefit from greater certainty about statutory protection. Where the workforce enjoys valuable pension arrangements, bidders for contracts which involve a TUPE transfer of that workforce may be concerned about being ‘undercut’ by other bidders proposing to exploit the existing TUPE anomaly. If new TUPE Regulations allowed them to compete on a level playing field, those who provided occupational pension benefits as an integral part of their employee reward strategies as a matter of good practice would no longer be at a disadvantage compared with those who did not. In general, a pensions safety net in TUPE transfers would assist bidders who put a premium on maintaining staff

commitment and motivation through a transfer. An Industrial Relations Service (IRS) study³⁵ commissioned by the DTI confirmed that maintaining “harmonious industrial relations” figured strongly in transferees’ priorities.

5.21. The introduction of such a measure would also relieve private sector transferors and transferees of the risks that the current legal uncertainty imposes as to their liabilities under common law for claims of constructive unfair dismissal.

Benefits to the economy

5.22. Occupational pension schemes already provide an affordable and secure pension for millions of people, but the Government is committed to building on this success by strengthening the legislative framework for such schemes and by encouraging membership of them where possible. If any of the proposed options for amendment of TUPE were to be taken up, this would remove an anomalous opportunity for employers significantly to reduce second tier pension provision and thus effectively place an extra burden on the state scheme, contrary to pensions policy objectives.

5.23. The amendment of the Regulations in this regard would not restrict the ability of the transferee to seek to negotiate and agree with the employees changes to occupational pension rights, including potentially their complete withdrawal, for sound business reasons unconnected with the transfer itself. The fact that such rights would have to be provided initially, and could not be lawfully withdrawn simply because of the transfer itself, could however be expected to lead some who would not otherwise have done so to continue to offer such rights to transferred employees, and possibly to extend them to other existing employees as well.

5.24. More generally, the economy as a whole would benefit from the increased ease and reduced potential for conflict with which business restructuring could be carried out.

5.25. For these benefits to be captured, it is essential to avoid over-regulation which has the perverse effect of inhibiting employers from setting up new occupational pension schemes and which causes those that have already done so to consider closing them down. A more flexible and competitive economy will need to combine widespread occupational pension provision with widespread use of business transfers to restructure services. A proportionate approach to pensions in the TUPE Regulations would be essential to constructing a working interface between these two drivers of long term economic success.

Costs to employees

5.26. There would be no direct cost to transferred employees arising from these proposals, although some of the options would afford greater protections than others for their ongoing occupational pension rights. A disproportionate degree of regulation would threaten to upset employer attitudes towards occupational pensions, reducing the prospects for future employees to participate.

Costs to employers

5.27. Costs of providing pension rights to employees. In some instances, the suggested options would result in transferred employees enjoying better pension rights than would otherwise have been the case. Although these costs would fall to be met by the transferee, they would generally be passed back to the transferor through a lower offer price or bid (or higher required subsidy). The aim of the consultation exercise is to identify an option which would exclude abuse whilst

³⁵ [Copies of the researchers’ report, *Current Treatment of Occupational Pension Rights Under TUPE Transfers*, are available from DTI on request.]

accommodating existing standards of good practice consistent with voluntary occupational pension provision.

5.28. Administration costs. Transferors face the initial cost of providing management and pension information to potential transferees. Where the pension scheme is well run, this information should be readily to hand. Transferees would need to assess the information, which might require taking expert advice. There might also be recurring costs arising from the establishment and administration of new pension arrangements. In general, the transferee could again be expected to factor these costs into the initial offer or bid for the business.

5.29. The level of costs would depend on which of the suggested options described in the background paper was chosen as the basis for achieving the proposed change, and the extent to which this imposed artificial arrangements which would otherwise be unnecessary to safeguard staff and secure their commitment to the transfer.

5.30. Establishment of a new pension scheme or new section in a scheme, could add as much as £5,000 to £10,000 to business costs to cover actuarial certification of its value, and administrative costs. The latter can not be estimated. These are in addition to the costs of financing the accrual of liabilities for pension benefits. Transferee employers who already afford transferred employees a reasonable level of occupational pension rights even in the absence of a requirement in the Regulations could be expected to incur no significant additional costs at all - provided that a sufficiently flexible option was chosen.

Option 1

5.31. Under this option, the transferee would have to match the type of scheme offered by the transferor. So if the transferor had offered a contracted-out salary related scheme (about 20% of all organisations and 37% of all employees with a pension scheme³⁶) or a contracted-out money purchase scheme (about 13% and 7% of employees³⁷), the transferee would have to offer a scheme of the same type. The new scheme would have to pass the reference scheme test for contracting-out in accordance with GN28. It would not have to match the old scheme in terms of precise benefits. If a contracted-in, tax-approved scheme was offered by the transferor, then the transferee's only obligation would be to offer a Revenue-approved scheme (which could be either contracted-in or contracted-out) and the minimum level necessary for contracting-out would not apply. If the transferor provided no occupational pension benefits, the transferee would be under no obligation to do so (contracting-in to the State scheme would apply).

Option 1a

5.32. This variation on Option 1 would limit the risk for employees of suffering a reduction in ongoing occupational pension rights on a transfer to not more than 10%. This has some implications on the costs of administration as well as ongoing costs, because in cases of doubt – where there were significant differences between the transferor and transferee schemes – an actuarial assessment would be required and a new scheme or section could be required. Costs of this option would therefore be higher than costs for Option 1, depending on the differences between the normal pension arrangements of the transferee and those of the transferor.

Option 2

5.33. Under this option the transferee would still be required to offer a contracted-out occupational pension scheme if the transferor offered one, but could switch from one type of contracted-out scheme to another. It would thus afford employers greater flexibility than Option 1 while still giving employees extra protection. The main effect of this, compared with Option 1,

³⁶ DSS Employers' pension provision 1996, page 25

³⁷ There are large differences by size of business. See Annex 4 for details.

would be to avoid a requirement for employers who offer money purchase (DC) plans to new recruits to install or reopen a defined benefits scheme for the purposes of an inward TUPE transfer. Costs to employers should be lower than under Option 1.

Option 2a

5.34. This variation on Option 2 would give transferred employees an additional “safety net” similar to that envisaged in Option 1a. This option may be more expensive than Option 2, depending upon how the safety net were set.

Option 3

5.35. Under this option the transferee could chose which type of occupational pension to offer to transferred employees, subject to meeting certain minimum conditions or “benchmarks”. A key influence on employer costs would be the specification of the benchmarks.

Option 4

5.36. This option envisages the introduction of a requirement for the benefits under the two schemes (transferor’s and transferee’s) to be of an equivalent value. This would involve the highest costs to employers, as – dependent on the degree of leeway allowed – it would be most likely to require the establishment of new defined benefit schemes for the purposes of compliance, in addition to requiring most frequent actuarial certification.

Notification of employee liability information

5.37. The consultation document deals with the flow of information from the transferor to the transferee regarding the transfer of employment liabilities.

Proposal

5.38. The proposal is that the transferor should give written information about all the rights and obligations towards employees to the transferee in good time. If the rights and obligations change between the time they have first been notified to the transferee and the actual transfer the transferee has to be informed of the changes in writing.

Intended effect

5.39. The intended effect of the proposal is to increase transparency for the transferee and thereby to afford increased protection for employees by ensuring that the transferee is well-placed to meet transferred liabilities. The proposal also aims at increasing competition as it introduces a 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 are 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.

Costs and benefits

5.40. There would be significant benefits in terms of increased transparency for the transferee and the employees. We assume that in most cases (90–95%) the information will already be made accessible in writing to the transferee. In those cases where that does not happen currently the transferor would incur costs in the form of time in identifying the information and writing it down. We assume that this would not take more than 8 hours of management time. The notification would have to be applied in all businesses which are transferred, i.e. between 1,900

and 7,600.³⁸ At an hourly rate of £26 for senior management this would cost up to £0.2 million per year.³⁹

Dismissal by reason of a transfer of an undertaking

5.41. The consultation document raises the issue of transfer-related dismissals.

Proposal

5.42. A dismissal is automatically unfair if the reason for it is connected with the transfer of an undertaking. There is an exception to this if the dismissal is for economic, technical or organisational reasons entailing a change in the workforce (ETO reasons). The proposal is to clarify that ETO reasons are a subset of reasons connected with the transfer.

Intended effect

5.43. 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.

Benefits to employees

5.44. There were 1,087 unfair dismissal cases (transfer of undertakings) brought to employment tribunals in 2000/01⁴⁰. This is 0.6% of all employees affected by a transfer. This is more than the general proportion of all employees making a tribunal application (0.5%). If we consider the fact that the transfer of an undertaking is a situation full of potential conflict this difference is small.

5.45. An employment tribunal case costs business on average £2,000. The current 1,087 cases therefore use up resources of £ 2.2 million per year. A reduction to the proportion of tribunals to the whole working population of 0.5% would reduce costs to business by £0.4 million. 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 of affected employees

5.46. The consultation document raises the issue of transfer-related changes to the terms and conditions of affected employees.

Proposal

5.47. The Government proposes to improve the Regulations by making explicit that they do not preclude transfer-related changes to terms and conditions that are made for ETO reasons.

Intended effect

5.48. The effect of this proposal is to increase clarity. We would expect the clarification to reduce the number of disputes over this issue and so save businesses and employees the costs

³⁸ These are 95 % of the 2,000 to 8,000 transfers taking place every year.

³⁹ Calculation: $1,900 * 0.05 * £ 26 * 8 = £ 19,760$ to $7,600 * 0.1 * £ 26 * 8 = £ 159,080$.

⁴⁰ 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 2000/01

arising from such disputes, including in some cases the costs of contesting court and tribunal cases. In addition, greater clarity over the circumstances in which transfer-related changes to terms and conditions can be lawfully negotiated with employees or their representatives could be expected to reduce employers' risks and transaction costs associated with transfers.

Application of the legislation in relation to insolvency proceedings

5.49. The consultation document discusses the situation of an insolvent business. It proposes that two new derogations in the revised Acquired Rights Directive be taken up.

Proposal

5.50. It is proposed that the Regulations provide that, in transfers in certain types of insolvency proceedings:

- the transferor's pre-existing debts toward the employees do not pass to the transferee, if they are met instead from the National Insurance Fund up to the statutory level under the insolvency payments provisions of the Employment Rights Act 1996; and/or
- employers and employees may agree transfer-related changes to the terms and conditions even where there are no ETO reasons that would render them lawful in any event.

Intended effect

5.51. The intended effect of taking up these derogations would be to support the "rescue culture" by reducing burdens on the transferee. This would create an additional incentive to transfer a business or parts of it, saving at least some jobs.

Costs and benefits

5.52. The costs calculated under the options below are deadweight costs. They apply only to firms which are in a formal state of insolvency. The main beneficiary effect is to increase the number of rescues i.e. reduce the number of firms that are wound up. This can be done only at a cost, which under Option 1 would fall to the main extent on the National Insurance Fund. Option 2 would allow for changes to terms and conditions of employees, which would mean that some of the costs would fall onto those employees.

Option 1 (treatment of pre-existing debts – not passed to transferee)

5.53. Under the insolvency payments provisions employees may claim up to eight weeks' arrears of wages plus certain other amounts that are largely irrelevant in the present context⁴¹. In 2000 there were 14,317 insolvencies of companies in England and Wales. These are about 1% of all companies. If we apply the same share to the estimated number of transfers these would mean that between 80 and 140 transfers are transfers of insolvent businesses. Of these between 70 and

⁴¹ For detailed information please see www2.dti.gov.uk/access/job_1/pl718/insolv2.htm

120 are businesses with less than 10 employees⁴². The rest will be larger firms. A total of between 1,200 and 2,000 employees are affected per year.⁴³

Costs to the taxpayer (National Insurance Fund)

5.54. The upper bound on costs to the National Insurance Fund would be £4-7 million.⁴⁴ These would be benefits for the transferee. (This is an upper bound on costs because some types of insolvency proceedings, including in particular administrative receiverships, fall outside the derogation in the Directive, so transfers of businesses in these types of proceedings would not in fact be affected. In addition, clearly not all employees affected would have the maximum eight weeks' arrears of pay owed to them.)

Benefits to employers

5.55. There are benefits to the transferee and the transferor. The business may be easier to sell with one level of debts less. The current preservation rate is 18% (fallen from 20% in the previous year and 30% in the year before that).⁴⁵

5.56. We assume that Option 1 would reduce the rate of company failure by between 1% and 3% and increase the number of TUPE transfers by between 100 and 500 per annum.^{46, 47} We would appreciate comments from the consultees as to whether this assumption is reasonable.

⁴² Data on business in Annex 1 suggest that around 86% of businesses are small; this would give figures of between 68 and 120 with fewer than 10 employees. This table also gives the average number of employees for firms with 1-9 employees as 3.3, and the average number for firms with 10+ employees as 81. This would then give a minimum of $(68*3.3)+(12*81)=1196$. This would give a maximum of $(120*3.3)+(20*81) = 2016$.

⁴³ Small employers (1-9) average 5 employees. For businesses with 10+ a weighted average of 100 employees per business has been calculated.

⁴⁴ $1196 * (£390(\text{average weekly pay excluding NIC}) * 8(\text{weeks}) + 2 \text{ weeks} * £240 (\text{holiday pay})) = 4.3$ million and $2016 * £390(\text{average weekly pay excluding NIC}) * 8(\text{weeks}) + 2 \text{ weeks} * £240 (\text{holiday pay}) = 7.3$ million

⁴⁵ Source: R3 9th survey of business recovery. Preservation rate: number of business surviving insolvency/total number of insolvencies * 100.

⁴⁶ The basis for this assumption is that we estimate a total of between 2,000 and 8,000 TUPE transfers. The assumed increase implies an increase in TUPE transfers of between 5 and 25%. A stronger increase is highly unlikely. Relating this to the number of insolvent business being sold as an ongoing concern (2,800) the increased rescue of between 100 and 500 enterprises also seems reasonable.

⁴⁷ Differences due to rounding.

Benefits to employees

5.57. The 100-500 additionally rescued businesses would have between 1,800 and 9,000 employees.⁴⁸ Not all of these would keep their jobs. We assume that about 50% (1,000 to 4,500) of them would do so. We would appreciate comments from consultees as to whether this assumption is reasonable.

Benefits to the taxpayer

5.58. The rescue of 100 to 500 businesses would benefit the taxpayer. Benefits would include savings in redundancy payments (only between 1,000 to 4,500 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.

Option 2

5.59. Under Option 2, 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).

Intended effect

5.60. This option would have the effect of increasing flexibility for the transferee and would thereby support the “rescue culture” that the Government is keen to foster.

Costs and benefits

Benefits to employers

5.61. The main benefit for employers would be that there would be the potential to reduce terms and conditions and enable businesses to be rescued in cases where over-generous 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 £0.2 million. These would be costs to the employees.

⁴⁸ Calculations of number of jobs saved

We assume that firms with between 1-9 employees employ on average 5 employees. Business with more than 10 employees employ on average 100 employees (weighted average).

$$100 * 0.861 * 5 + 100 * 0.139 * 100 = 1820$$
$$500 * 0.861 * 5 + 500 * 0.139 * 100 = 9,102$$

5.62. 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 Option 1. 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 Option 1.

6. Effects on small businesses

6.1. Small businesses are less likely to be involved in a transfer than larger businesses. This is reflected in the assumptions used to estimate the number of firms affected. The absolute number of small businesses affected is higher than the absolute number of larger businesses. Between 47% and 76% of businesses affected have between 1 to 9 employees. This compares to between 14% and 22% for companies with between 10 to 19 employees. For the business services sector analysed under the change of service provision proposals, these ratios are even more evident. Between 63% and 86% of businesses estimated to be subject to a transfer have between 1 and 9 employees compared with 9% to 16% of those with 10 to 19 employees.

6.2. More than a third (36%) of all businesses with between 1 and 19 employees have an occupational pension scheme. This is only half the share of larger firms with 20 and more employees (70%).⁴⁹ The possibility of additional costs in this regard under the options described in the background paper would arise only if the transferor had a pension scheme. As we would expect small firms mainly to act as transferees to other small firms (e.g. on the passing of a service contract from one small contractor to another) who have the same probability of not having an occupational pension scheme, this would not pose an extra burden overall.

We are interested in the views of consultees regarding the impact on small business.

7. Conclusion

7.1. Overall the total package has potential for net benefits to the total economy. These would consist mainly of the security and increase in pension schemes for transferred employees compared with the current situation. These benefits would be matched by costs to transferees. Further benefits would arise from the increased rescue rate of insolvent business. The latter would have some cost implications for the taxpayer.

7.2. In addition to the benefits that can be quantified we would also expect benefits in the form of increased security and improved information flow. These cannot be quantified. The proposals would also lead to a reduction in employment tribunal applications, which would benefit all involved: employees, employers and the taxpayer (Employment Tribunal Service).

⁴⁹ See annex 3 for details.

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Annex 1

Of 2,191 workplaces surveyed in WERS 98, there had been 312 changes in ownership. These were analysed into 7 categories which were not mutually exclusive.

Table A1: Takeovers over the last 5 years, WERS 98

	Number of workplaces	% of changes
Agreed takeover	110	35
Takeover/merger formally opposed	2	0.6
Sold by parent organisation	63	20.2
Ex public sector, now privatised/denationalised	9	2.9
Management buyout	31	9.9
Buy-out by employees	0	0
Change in partners/major shareholders	86	27.6
Other	36	11.5
Total responses	337	

For TUPE related transfers we include “sold by parent organisation”, “ex public sector” and “management buyout”. This means that up to 103 of the 312 changes in ownership could be relevant. Thus, 4.7% of the workplaces with 25 or more employees could have been involved in a TUPE transfers over the last five years. This equates to approximately one percent per year. These questions were only asked of workplaces with 25 and more employees. We assume that less workplaces with less employees were involved in TUPE transfers.

Table A2: Total number of businesses in UK, by number of employees

	Number of businesses in UK by number of employees	In percent	Number of employees (000s)	Average number of employees
1 – 4	963,615	71%	2,395	3
5 – 9	201,835	15%	1,459	7
10 – 19	109,280	8%	1,533	14
20 – 49	46,955	3%	1,462	31
50 – 99	14,450	1%	1,011	70
100 – 199	8,165	1%	1,131	139
200 – 249	1,570	0.1%	349	222
250 – 499	3,220	0.2%	1,121	348
500+	3,515	0.3%	8,576	2,440
More than 1	1,352,600	100%	19,038	14

Source: Small and medium enterprise statistics for the UK, 1999

Table A 3: Number of transfers – all industries

	Number of businesses	Number of employees
1 – 9	1,165-5,827	5,825 – 29,235
10-19	546 – 1,092	7,644 – 15,288
20 +	778	136,510
Total	2489 – 7697	149,979 – 181,033

Note: Business with 1 – 9 employees between 0.1% and 0.5% will be affected per year

Business with 10-19 employees between 0.5% and 1% will be affected per year

Business with 20+ employees 1% will be affected per year

To calculate the number of employees the number of businesses was multiplied by the average number of employees per business in the size category.

Source: Small and medium enterprise statistics for the UK, 1999

Annex 2

Service provision changes
Real estate, renting and business activities
Table A 4: Numbers affected

	Number of businesses	Number of employees (000s)	Average number of employees
1 – 4	315,650	605	2
5 – 9	34,880	245	7
10 – 19	17,930	251	14
20 – 49	6,585	208	42.5
50 – 99	2,130	151	71
100 – 199	1,315	185	141
200 – 249	250	56	224
250 – 499	500	176	352
500+	460	781	1,698
More than 1	379,700	2,657	7

Source: Small and medium enterprise statistics for the UK, 1999

Table A 5: Number of transfers – Real estate, renting and business activities

	Number of businesses	Number of employees
1 – 9	351 – 1753	850 - 4250
10-19	90 – 179	1255 – 2510
20 +	112	15570
Total	553 – 2044	17675 - 22330

Annex 3

Table A 6: Provision of occupational pension schemes

Size of organisation	Proportion providing
1 – 5	29
6 – 12	47
13 – 19	49
All with 1 – 19	36
20 – 49	66
50 – 99	71
100 – 499	90
500 – 999	92
1000+	99
All with 20+	70

Source: DSS, Employers' Pension Provision, 1998, page 23

Table A 7: Pension provisions and coverage of different types of pension arrangement among larger organisations

Type of provision	Percentage of organisation with each type of arrangement	Percentage of employees in organisations with each type of arrangement
Defined benefit	13	50
Defined contribution	10	21
Top hat	10	15
Closed occupational pension scheme	5	12
Contributions to personal pension scheme	30	21
Group personal pensions	26	23
Any provision	66	89
No provision	34	11

Note: The text refers to:

Contracted-out salary related : defined benefit

Contracted-out money purchase: defined contribution

Contracted-in : others

Source: DSS, Employers' Pension Provision 1998, page 24