

1. MANAGEMENT SUMMARY

1.1 DISCLAIMER

The information in this document is based on our understanding of the current TUPE regulations. However, the exact application of TUPE is a particularly difficult area of law; judgements have frequently been contradictory and the consensus opinion of how to apply TUPE changes frequently. The reader should not seek to rely solely on the contents of this document and should seek an independent legal opinion to verify any conclusions reached herein.

1.2 SUMMARY

Surprisingly, there exists a lack of clarity as to when TUPE does and does not apply. It has become a heavily litigated area of employment law in recent years and there has been a series of inconsistent case law on the subject.

In deciding whether a transfer is a ‘relevant’ one (i.e. one to which TUPE applies), two questions arise¹:

- Is there a ‘stable economic **entity**’ that is capable of being transferred? (Where the main assets used in the business or service are people rather than tangible assets, tribunals will look at whether or not there is an “organised grouping of people” to decide whether or not there is an entity)
- Will the economic entity retain its identity after the transfer in question?

TUPE may apply to the transfer of an IT function in the following ways:

- When a company contracts out its IT function to a contractor, there may be a transfer of employment liabilities from the company to the contractor
- When the contractor loses a contract either through competitive tendering or simply by termination of the agreement, there may be a transfer of employment liabilities from the outgoing contractor to the incoming contractor
- When a company decides to transfer back in-house part or all of an IT function from a contractor, there may be a transfer of employment liabilities from that contractor to the company

However, TUPE may not apply to:

- Transfers of a contract to provide goods or services where this does not involve the transfer of a business or part of a business

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If a significant number of the tangible and intangible assets (such as computer hardware, contracts, goodwill and labour) are being transferred, then TUPE may well apply. The logic is that the **entity** has retained its identity after the transfer. However, subsequent cases have decided that the mere transfers of the same **activity** (for example, the provision of IT services) are grounds enough to trigger TUPE.

This has been justified on the basis that some activities are labour intensive and do not involve any significant assets. It would be too easy, therefore, for a contractor to avoid the regulations simply by not taking on the workforce and subsequently arguing that the business has not retained its identity after the transfer.

2. AN INTRODUCTION TO TUPE

The normal position when an employee stops working for one employer and starts work for another, is that a completely new contract of employment comes into being. The effect of TUPE is to change this position where there is a "transfer of an undertaking". In those circumstances, the effect of the TUPE Regulations is that the employee is – for most purposes – treated as if the contract with his old employer continued with the new employer. There are some exceptions to this, notably in the area of Pensions. This is important for a number of reasons. For example, certain employment law rights (e.g., against unfair dismissal or rights to redundancy payments) normally only apply if an employee has worked for an employer for a certain period of time. If TUPE applies, the time with the old employer counts when calculating for how long the employee has been employed. TUPE cannot be excluded by contract.

The TUPE Regulations were introduced to implement the EC Acquired Rights Directive. One of the purposes of the EC Acquired Rights Directive was to harmonise laws across Europe, with the result that European countries were obliged to change their own laws to meet the requirements of the Directive. The UK affected this through the TUPE Regulations. The UK is obliged to interpret TUPE in line with the provisions of the Acquired Rights Directive – in effect, to take into account both UK and EU law on the subject.

2.1 WHAT IS A RELEVANT TRANSFER OF AN UNDERTAKING?

Although TUPE will apply in a wide range of situations, there may be some circumstances when it does not apply. In deciding whether a transfer is a ‘relevant’ one (i.e. one to which TUPE applies), two questions arise¹:

- Is there a ‘stable economic entity’ that is capable of being transferred? (Where the main assets used in the business or service are people rather than tangible assets, tribunals will look at whether or not there is an “organised grouping of people” to decide whether or not there is an entity)
- Will the economic entity retain its identity after the transfer in question?

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According to the CIPD, to decide if there is a stable economic entity that is capable of being transferred, the factors to consider include¹:

- Is the type of business being conducted by the transferee (incoming business) the same as the transferor's (outgoing business)?
- Has there been a transfer of tangible assets such as building and moveable property (although this is not essential)?
- What is the value of the intangible assets at the time of the transfer?
- Have the majority of employees been taken over by the new employer?
- Have the customers been transferred?
- What is the degree of similarity of the activities carried on before and after?

If the answer to all (or in some cases several of) the above questions is 'yes', it is safe to assume that there has been a transfer of a stable economic entity.

2.2 IN WHAT SITUATIONS DOES TUPE APPLY?

According to the DTI², by way of broad guidance, TUPE has been found to apply to:

- Mergers
- Sales of businesses by sale of assets
- A change of licensee or franchisee
- The gift of a business through the execution of a will
- Contracting out of services
- Changing contractors
- Where all or part of a sole trader's business or partnership is sold or otherwise transferred

However, TUPE does not apply to:

- Transfers by share take-over
- Transfers of assets only (for example, the sale of equipment alone would not be covered, but the sale of a going concern including equipment would be covered)
- Transfers of a contract to provide goods or services where this does not involve the transfer of a business or part of a business

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- Transfers of undertakings situated outside the United Kingdom (although these may be covered by the regulations of other member states)

The law on relevant transfers in the case of contracting out and changes of contractors (including reversion to “in house” provision) for activities such as security, catering, refuse-collection, IT services and cleaning, which are mainly dependent upon manpower rather than assets or goodwill, has been particularly problematic.

Whilst it is usually clear that the original out-sourcing is a TUPE transfer, the position with subsequent (“second-generation”) transfers of such service contracts (i.e. the public authority or company which outsources either takes the contract back in house, or takes it back from the first contractor and awards it to a different contractor) has been contradictory.

The tendency has been to treat second-generation transfers as coming within TUPE provided that there is an identifiable economic entity being transferred, as opposed to merely an activity. Where the main assets used in the business or service are people rather than tangible assets, the usually accepted test is to look at whether or not there is an “organised grouping of people” to decide whether or not there is an entity.

This usually implies some degree of structure in the way the group is managed and its work is organised. Where part of an undertaking is transferred, only employees who are attached to that part will transfer to the new employer. This can be difficult to decide for employees who work across more than one area of the organisation. In this situation it is necessary to decide to which part of the organisation the employee is assigned – whether or not he carries out all (or at least most of) his work in that particular part.

3. APPENDIX – RECENT EUROPEAN CASE-LAW³

In the case of Schmidt in 1994, a German bank decided to outsource the cleaning of one of its branches where one employee, Christel Schmidt, had previously undertaken the cleaning. Ms. Schmidt was offered more money to work for the new contractors, but refused to accept certain changes to the contract terms that were proposed by the contractors. She was subsequently dismissed. The European Court of Justice (ECJ) decided that the Acquired Rights Directive (effectively, TUPE) was capable of applying to these facts. This meant that the transfer of a contract for the provision of services was capable of constituting a "transfer of an undertaking", even if no assets are transferred.

However, the ECJ took a more cautious approach in the 1997 Ayse Szen case. The court held that, for TUPE to apply, there has to be a transfer of significant tangible or intangible assets or the transfer of a major part of the workforce in terms of numbers and skills. One could conclude from this case that, where there are no assets, intangible or tangible, the question of whether an outsourcing amounts to a transfer under TUPE will depend on whether the new contractor is willing to take on a majority of the workers. One of the potential problems with this test is that it leaves scope for abuse by employers: there is a danger that new contractors may keep on only a minority of existing employees (or none of them) in order to avoid the effects of TUPE.

3.1 ECJ REFERRALS SINCE AYSE SZEN

The 1997 decision in Ayse Szen has meant that establishing whether TUPE applies in outsourcing situations has become increasingly complicated. There is no hard and fast rule dictating whether TUPE applies to outsourcings; each case must be examined individually.

The ECJ has endorsed the application of the Ayse Szen test not only in cases of 'primary' outsourcing (where a service is initially contracted out from a business) but also to 'secondary' outsourcings. In the cases of Hidalgo & Ziemann, the court said that the Directive could apply where the initial or a subsequent contractor passes the contract onto some other contractor ('secondary' outsourcing). However, in these cases, the court stated that the Directive would only apply where there was a transfer of an economic entity. *The court effectively defined "economic entity" for these purposes as an organised grouping of people and/or assets enabling an economic activity with a specific objective to be carried out.* The same test was applied in the 1998 cases of Vidal, Santner and Montana to the reversion "in house" of a service. The result was that, where no assets could practically transfer (e.g. a cleaning contract), the incoming contractor could effectively control the application or otherwise of TUPE by deciding which of the transferor's employees to retain.

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3.2 THE UK APPROACH SINCE AYSE SÜZEN

The UK employment tribunals have followed the decision in Ayse Süzen in a number of decisions in the UK, including *Betts v Brintel Helicopters Ltd* (1997). In the *Betts* case, the UK Court of Appeal concluded that the transfer of assets, or of the majority of the workers, was necessary, even at the 'primary' outsourcing stage, if TUPE was to apply. For a time it seemed, therefore, that an incoming contractor which was not taking on assets could avoid TUPE by deciding not to take on the major part of the workforce but, instead, by "cherry picking" the better employees. However, in recent cases the UK Court of Appeal has taken a pragmatic approach, and has effectively broadened the ruling in Ayse Süzen. It held in *ECM (Vehicle Delivery Service) Limited v Cox* [1998] that there could be a TUPE transfer in a contracting-out situation where employees are assigned to the undertaking before the transfer and those jobs remain after the transfer, but are undertaken by others. Where an economic entity is labour-intensive, the existence of a TUPE transfer will depend on whether or not the workforce was taken on – a transfer will be found to take place where the principal reason for not taking the workforce on was to avoid the application of TUPE.

In the subsequent 1998 case of *Magna Housing Association Ltd v Turner*, the Appeal Tribunal again took the view that Süzen provided no protection for incoming contractors keen to avoid the application of TUPE. In that case, Magna Housing Association Ltd had employees involved in grounds maintenance work. They were employed 'in house'. Magna then decided to contract out the maintenance work and employees were given a very short time to decide whether they wanted to work at Magna for the new contractors. The employees came back 24 hours later (after expiry of the short time period set) with the decision that they wanted to remain with Magna working for the contractors. The new contractors informed them that the offer of employment was no longer available and they were subsequently made redundant. The tribunal decided that the issue of whether employees should have been taken on cannot be resolved by simply looking at whether they were in fact taken on. A successful appeal was made based on the decision in the ECM case.

The previous cases suggest an extension of the principles laid down in Süzen to cover a wider range of outsourcing situations. However, in sharp contrast to these recent trends, the UK Employment Appeal Tribunal strictly applied the decisions in Süzen and *Betts* in the 1999 case of *Beck & others v North East Lincolnshire Council*. In this case, a contractor providing refuse collection services only hired a minority of the previous contractor's workforce. TUPE was held not to apply to the transfer.