TRANSFER OF UNDERTAKINGS: THE TENSION BETWEEN BUSINESS RESCUE AND EMPLOYMENT PROTECTION IN CORPORATE INSOLVENCY

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ABBREVIATIONS

Journals

Am Bankr Inst L Rev	American Bankruptcy Institute Law Review
CLJ	Cambridge Law Journal
CMLR	Common Market Law Review
CFIL	Company Financial & Insolvency Law Review
CFIL	Company Financial & Insolvency Law Review
Col L Rev	Columbia Law Review
CLP	Current Legal Problems
ECFR	European Company and Finacial Law Review
EIRR	European Industrial Relations Review
EL Rev	European Law Review
Int'l Insol. Rev.	International Insolvency Review
ILJ	Industrial Law Journal
IRLR	Industrial Relations Law Review
Insol Law	Insolvency Law
ICLQ	International and Comparative Law Quarterly
JBL	Journal of Business Law
LMCLQ	Lloyds Maritime & Commercial Law Quarterly
MaastJECL	Maastricht Journal of European & Comparative Law
MLR	Modern Law Review
NLJ	New Law Journal
N Ir Legal Quarterly	Northern Ireland Legal Quarterly
OJ	Official Journal of the European Communities
Tex L Rev	Texas Law Review
Va L Rev	Virginia Law Review
Wash ULQ	Washington University Law Quarterly

Law Reports

All ER	All England Law Reports
BPIR	Bankruptcy and Personal Insolvency Report
BCC	British Company Law Cases
BCLC	Butterworths Company Law Cases
CMLR	Common Market Law Reports

EWCA Civ	Court of Appeal (Civil Division)
ER	English Reports
ECR	European Court Reports
ICR	Industrial Cases Reports
IRLR	Industrial Relations Law Reports
Lloyd Rep	Lloyd's Law Reports
NSWLR	New South Wales Law Report
QB	Queen's Bench
WLR	Weekly Law Reports

ABSTRACT

Where a business becomes insolvent and its rescue is predicated on a going concern sale or transfer to another employer, there is a tension between employee protection and the rescue of insolvent but viable businesses. There is a consensus that employees deserve protection when the business that employs them becomes insolvent and is transferred to another employer on a going concern basis, yet extensive levels of employee protection can jeopardise going concern business sales by increasing the level of liabilities assumed by the purchaser. Business rescue and employee protection goals of insolvency law and employment law respectively are not inevitably incompatible. Opinions are divided, however, on the best means for achieving compatibility. This thesis uses theory to establish how the tension between these goals may be addressed.

There is a perception that the European-derived provisions concerning the protection of employees' rights, in the context of insolvent business transfers, are inimical to the rescue culture in the United Kingdom. While the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) are necessary in ensuring that employees' rights are not walked over during transfers of insolvent businesses, it is equally important that policy makers take into account the fact that the rescue and continuity of such businesses would yield a better result for the employees, in terms of job security, than would be the case if they are liquidated. Accordingly, legislation which seeks to protect the rights of employees in insolvency should first contribute to the rescue of insolvent businesses. Using theory as a tool for explanation, this research argues that it was in a bid to contribute to rescues of insolvent businesses that the Acquired Rights Directive (ARD) and TUPE were amended at the European and UK national levels. Theory helps in explaining how the changes made have struck the appropriate balance between employee protection and business rescue and offers normative justifications for these policies in the context of going concern transfers of insolvent business.

CHAPTER ONE

INTRODUCTION AND OVERVIEW ON THE RESEARCH

1.1 Introduction

The relationship between the employees and the company they work for is 'symbiotic'[1] in nature: the employees need the company to attain their economic needs just as the company needs the employees for its day to day functioning. Both benefit from each other. Thus, neither the company nor the employees should exert too much pressure on each other if the long term survival of the relationship is to be guaranteed.

The firm and the shareholder value maximising principle, gained prominence at a time when access to large pools of finance capital was considered the most important new resource to be mobilized.[2] However, the purpose of the modern firm is, arguably, no longer to serve the interests of its shareholders. The firm has become a place of social relationships enabling the organisation of the worker's economic life.[3] Companies develop and grow based on the accumulated know-how and experiences of their employees.[4] Today, employees represent the most important asset of every company[5] due to the human capital contributions they make in a company. The employees' skills, *inter alia,* are considered strategic and critical assets in the modern firm.[6]

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1 'Symbiosis' is a term in biology. A 'symbiotic relationship' is a term commonly employed to explain the relationship between two entities that depend on each other to survive and prosper. It is therefore a mutually beneficial relationship for the parties (employees and the company in the context of this research). The point here is that there is a positive-sum gain from cooperation between the employees and the company they work for.

2 Adolf Berle and G Means, *The Modern Corporation and Private Property,* (Transaction Publishers, New Brunswick 1991) 3; A Berle, 'Modern Functions of the Corporate System' (1962) 62 Col L Rev 433, 437; Alfred Dupont Chandler, *The Invisible Hand: The Managerial Revolution in American Business*, (Belknap Press, Cambridge, MA 1977); Mark J Roe, *Strong Managers, Weak Owners*: The Political Roots of American Corporate Finance (Princeton University Press Princeton NJ 1994).

3 J E Stiglitz,`Employment, Social Justice and Societal Well-being' (2002) 141 Int'l Labour Rev.

4 Edith Penrose, *The Theory of the Growth of the Firm* (Basil Blackwell, Oxford 1959).

5 Michael Armstrong, *A Handbook of Personnel Practice* (4th edn., Kogan Page, London 1991).

6 Peter Drucker, *Managing in Turbulent Times,* (Harper and Row, New York 1980); Lester C Thurow, *The Future of Capitalism,* (W Morrow & Co, New York 1996).

The law regulating business transfers is indispensable for protecting the employees' acquired rights, especially in the context of insolvency. The sale of a business on a going concern basis is also desirable because it preserves value in comparison to an asset sale. Therefore, it offers the best returns for creditors as well as job security for many employees. However, the legal pitfalls of such a law, and the adverse effects it could have on employees' job security generally, cannot be overemphasised. Regulations that protect employee rights in business transfer situation could deter the purchase and rescue of insolvent businesses due to associated employee liability concerns.

It follows that any law which is aimed at safeguarding the rights of workers, especially in situations where the company employing them is insolvent, and its business is transferred (wholly or in part) as a going concern to third party purchaser, should be flexible and capable of contributing to the rescue of such a business.[7] Otherwise, a law that was intended to protect the interests[8] of the employees (jobs wise) could become self-defeating if its strict application were to imperil the continuous survival of the insolvent business.[9] This is because where the business cannot be sold all the employees engaged by the insolvent business will lose their jobs.

The purpose of this chapter is to introduce the subject of the research to the reader. This chapter provides the background to the research and outlines the

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7 Anneli Loubser, 'The Interaction between Corporate Rescue and Labour Legislation; Lessons to be Drawn from the South African Experience' (2005) 14 Int'l Insol. Rev. 57-69.

8 In general terms, 'an interest is a demand or desire or expectation which human beings either individually or in groups or associations or relations seek to satisfy, of which, therefore, the adjustment of human relations and ordering of human behaviour through the force of a politically organised society must take into account.' Roscoe Pound, *Jurisprudence* (West Publishing Co., St. Paul, Minn 1959). Employees have various kinds of interests in insolvency. An employee has both a right and an interest to be paid contractually agreed wages and benefits. When employees invest firm-specific human capital in the firm, their contribution, it has been argued, ranks in importance as, or even more important than, the shareholders' investment of finance capital. See Wanjiru Njoya, 'Employee Ownership and Efficiency: An Evolutionary Perspective' (2004) 33 (3) ILJ 211-241. It follows that the employees have a legitimate expectation (that non-insolvency law may not specifically protect) that the investment they have made in the firm will be protected and their contribution to it rewarded, perhaps, by continuity of employment when the firm is sold (solvent or insolvent) as a going concern to a third party purchaser. See Donald R Korobkin, 'Employee Interests in Bankruptcy' (1996) 4 Am Bankr. Inst. L Rev. 5-34; Richard Parr & Nicola Benett, 'The Rescue Culture v Collective Employment Rights' (2005) 18 (10) Insolvency Intelligence 156-157; Simon Whelan & Leon Zwier, 'Employee Entitlements and Corporate Insolvency and Reconstruction' (2005)<http://cclsr.law.unimelb.edu.au/research-papers/Protection%20of%20employee%20entitlements%20_final_1.pdf> accessed 5 May 2010.

9 Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Rescue and "One Unholy Mess"' [2000] CFIL 249-71; Wanjiru Njoya, 'The Interface between Redundancy and TUPE Transfers' (2003) 32 (2) ILJ 123-128.

focus of the investigation. The aim is to contextualise the conflict between employment protection and the 'rescue' of insolvent businesses or undertakings arising when such a business or undertaking is transferred as a going concern[10] in the United Kingdom (UK). Overall, the research is focused on the problems posed to business rescues in the UK by the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). These Regulations implemented the European Union's Acquired Rights Directive (ARD) on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of a transfer of an undertaking, business or part of a business, into the UK domestic law. The chapter also sets out the hypothesis, the objectives and the analytical legal scholarship adopted in the research as well as the overall structure of the research.

1.2 Background

Corporate insolvency[11] is a phenomenon that is inherent in every market economy.[12] Insolvency is a business misfortune that is non-selective and non-respecter of size. Both big and small businesses alike are prone to it. Insolvency traverses all sectors of the world's economies. There is no sector of an economy

[10] For the avoidance of confusion, the term 'going concern sale' as used in this thesis does not refer to liquidation which denotes the conversion of the company's assets into cash by means of sale as the phrase is commonly used in US and some other jurisdictions. Rather, it refers to the sale of the undertakings or businesses of a company with all of its assets intact which may then continue under new ownership and management, but free from its debts. Thus, the going concern transfer of a business must also be treated, as a matter of law, as implying neither a supply of goods, nor a supply of services. For further exposition, see J. Armour, A. Hsu and A. Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) 5 ECRF 148.

[11] The term 'insolvency' has wide usage with different connotations. In one sense it could be used to refer to when the assets of a company are less than its liabilities- 'balance sheet' insolvency. Insolvency laws in most jurisdictions permit inference to be drawn that a debtor is insolvent when it is unable to pay its debts as they fall due. Insolvency as a term is not just a descriptor of a company's financial condition it is often also used as a cipher for formal proceedings. Though there may be times when the term will be used interchangeably in reference to formal proceedings and inability to pay debts, the term 'insolvency' as used here refers strictly to the 'balance sheet' test of insolvency. See e.g. Roy Goode, *Principles of Corporate Insolvency Law*, (3rd edn., Sweet & Maxwell, London 2005); J Armour, 'What has the Financial Crisis Taught Us about Insolvency Law' in E Vermeulen *et al* (eds) *Met Recht: Liber Amicorum for Theo Raaijmakers* (Kluwer Rechtswetenschappelijke Publicates, The Netherlands 2009) 2.

[12] Bruce G Carruthers & Terrence C Halliday, *Rescuing Businesses: The Making of Bankruptcy Law in England and the United States* (OUP, Oxford 1998) 1.

that may be said to be more susceptible to the phenomenon than the others. As long as credit[13] is involved in the economy, any company can become insolvent.

Credit is of outstanding significance in the modern economic system of the world.[14] Credit plays a vital role in business finance.[15] In the corporate world, the bulk of the world's trading activity carried out by companies is conducted through the use of credit.[16] While credit is useful in commerce, it also has its down side. Credit gives rise to debt. Arguably, without credit there will be no debt. Debt[17] is the result of the extension of credit. Credit allows one party (creditor) to provide money or other resources to another party (borrower) without the latter reimbursing the former immediately. Rather, the party borrowing the money or resources will defer, or arrange either to repay or return the resources at a later date. This is how debt is generated in the process and the borrower becomes technically, the debtor.[18] Thus, credit establishes the relationship between the creditor (lender) and the debtor (borrower) in the corporate world.

It has been opined that 'credit and debt are created and destroyed simultaneously.'[19] The connotation of this statement is simply that since the granting of credit by one party means the assumption of a debt by another, the repayment of the debt effectively extinguishes the credit.[20] Unfortunately, debts are not always repaid by debtors when they become due or on demand. Thus, in a society where businesses rely on credit, there is always the risk that those who

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[13] Credit may take the form of loan credit - in which one party advances money to another party on terms of repayment, or sales credit - in which case goods, services or other things are supplied by one party to another on the basis of payment at a later date. See Goode (n 11) 2.

[14] Sir Kenneth Cork in his report referred to credit as the 'lifeblood of the modern industrialised economy.' See particularly *Report of the Review Committee on Insolvency Law and Practice* (Cmnd 8558, 1982) CH. 1, para 10

[15] Vanessa Finch, *Corporate Insolvency law: Perspectives and Principles* (2nd edn, CUP, Cambridge 2002) 69; Mrityunjoy Banerjee, *Business Organisation: An introductory Analysis* (Asia Publishing House, Bombay 1964) 112- 13.

[16] Professor Roy Goode has stated unequivocally that: 'A world without credit is impossible to imagine.' See Goode (n 11) 2.

[17] A debt is a liquidated claim. It is a claim for an amount which is ascertained or can be readily and easily ascertained without difficulty. See *O'Driscoll v Manchester Insurance Committee* [1915] 3KB 499. For the different types of debts in the context of insolvency, see Insolvency Rule 1986, r. 13.12(1).

[18] Goode (n 11).

[19] S Joseph, 'The Importance of Finance and Credit in the Economy' (2010) <http://shodhganga.inflibnet.ac.in/bitstream/10603/334/9/09_chapter1.pdf> accessed 03 January 2012.

[20] ibid.

are owed money (creditors)[21] by a debtor company will suffer some setbacks when the company becomes unable to pay its debts on the due date.[22] There are many reasons why a company may become unable to pay its debts as they fall due.[23] Insolvency, however, is a factual assessment of the company's financial state taken as a whole. This is because a company may be experiencing financial difficulties without being technically insolvent. However, financial difficulty is often a precursor to a company becoming eventually insolvent while inability to pay debts as they fall due[24] means that the company is insolvent.[25]

Under the English insolvency law, there are two basic tests for determining the insolvency of a company. These are the 'balance sheet' and the 'cash flow' or 'commercial' tests.[26] The basic 'balance sheet' test of insolvency considers whether the company has negative assets - that is whether its assets are worth less than its liabilities. Under this test, a company is deemed insolvent if it is proved to the satisfaction of the court that its assets are insufficient to discharge its liabilities, 'taking into account its contingent and prospective liabilities.'[27] However, the Court of Appeal (CA) has reinterpreted the test for balance sheet insolvency under section 123(2) of the Insolvency Act 1986 in one of its recent **judgments** on

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[21] This also applies to the employees who may be owed back pay when the company becomes insolvent. The concept of deferred payment also applies to their pensions which may be threatened by insolvency as well. Sometimes, employees could also have deferred pay plans in which part of their pays are deferred and invested through a trust arrangement, and returned with any interest at the employee's option such as resignation or retirement. This could be affected by the company's insolvency.

[22] Finch (n 15) 9. Various literatures suggest that the risk may be greater with small companies because the directors are more likely to be the controlling shareholders. Professor Keay opines that it is obvious that risk-taking by Directors will always occur especially in closed corporations where the directors are also the owners. Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 MLR 665- 669. See also A keay, *Company Directors' Responsibilities to Creditors* (Routledge, 2007) 183. In large corporations however, the view is that because management is generally separated from ownership and based on the potential consequences for misbehaviour, UK companies' directors may well have a greater incentive to act cautiously to retain their remuneration, reputations and the ability to act as directors of other companies in future since breaches of duty may result in civil penalty action under the applicable sections of the Company Directors Disqualification Act 1986. See Helen Anderson, 'Theory and Reality in Insolvency: Some Contradictions in Australia' (2009) Company and Securities Law Journal <http://www.clta.edu.au/professional/papers/conference2009/AndersonCLTA09.pdf> accessed 20 April 2012. See also Company Directors Disqualification Act 1986, ss. 1- 6.

[23] On this see further, John Argenti '*Corporate Collapse: The causes and Symptoms'* (McGraw-Hill, London 1976) 26-33. See also Finch (n 15).

[24] Professor Roy Goode articulates that the phrase 'as they fall due' is suggestive of a continuous succession of debts rather than a calculation of debts existing on any particular day. Goode (n 12) 96. See also the case of *Bank of Australasia v Hall* [1907] 4 CLR 1514, 1528.

[25] Insolvency Act (hereafter 'IA' for convenience) 1986, s. 123.

[26] IA 1986, s. 123 (1) (e).

[27] IA 1986, s. 123 (2).

the matter. In *BNY Corporate Trustee Services Limited v Eurosail-UK 2007-3BL PLC & Ors,*[28] the CA was of the view that it is wrong that a company should be deemed balance sheet insolvent in every situation where its liabilities happen to exceed its assets. The CA's decision has the implication that courts will not determine balance sheet insolvency by solely making technical calculations off the balance sheet. Rather, the courts will ask if the company has reached 'the end of the road'. Thus, in the instant case, *Eurosail* was not insolvent within the meaning of the Insolvency Act, even though its financial statement and management account revealed net liabilities of 75 million and 135 million respectively.

The cash flow perspective on insolvency takes into consideration factors such as the company's present and anticipated cash resources, other means available to the company to satisfy its liabilities or pay its debts as they fall due, other non-cash resources that could be realised either by sale or by secured borrowing and when these resources can be realised to meet those liabilities.[29] Put differently, the courts would have to take into consideration not only factors such as the company's debts currently due and payable, its expected cash flow, its realisable assets and its potentials for securing borrowings to make up for the short fall in cash pending when this can be remedied,[30] but also debts expected to be due in the future.[31]

A company's insolvency has ramifications. It is a misconception to think that the insolvency of a company has consequences only for the debtor company and its creditors. This is because the insolvency of a company touches on numerous

[28] [2011] EWCA Civ 227.

[29] *Southern Cross Interiors Pty Ltd v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213, 224 (Palmer J).

[30] *Quick v Stoland Pty Ltd* (1998) 29 ACSR 130 (Emmett J).

[31] *Re Cheyne Finance plc,* [2008] 1 BCLC 741. The Court's decision *Re Cheyne* contradicted its earlier position in *High Berry Ltd v Colt Telecom* [2003] BPIR 324 where it would not allow 'tentative and shaky peering into the middle distance' when attempts were made to establish cash flow insolvency of a company in administration. However, it is pertinent to point out that the factual backdrop that led to the decision in *Re Cheyne* was very different to that of *Colt Telecom*. *Cheyne* was a structured investment vehicle (SIV) experiencing cash flow difficulty and whose future liabilities and the asset pool with which to meet them was, without some kind of refinancing, fixed. *Cheyne* was, or was about to become unable to pay its debts to creditors whose claims against it were required to be paid in priority as contemplated by section 123 of the Insolvency Act of 1986. Therefore, in *Cheyne* the phrase 'as they fall due' gave the assessment its future element. But such an assessment was however, fact sensitive since inability to pay its debts as they fall due had to be shown on the 'balance of probabilities' implying that the company's inability to pay was more likely than not. See Tim Crocker & Nicholas Herrod, `Knowledge: Meaning of "unable to pay debts as they fall due"' (2008) Allen & Overy, <http://www.allenovery.com/AOWEB/Knowledge/Editorial.aspx?contentTypeID=1&c> accessed 17 August 2008.

interests and these interests simultaneously co-exist.[32] It has been asserted that the particular communities or interests that the insolvency system should recognise are those with a substantial nexus to the debtor.[33] In the UK, as in most other jurisdictions, the interests that may be deemed as having a substantial connection to the company would include the management (who may be displaced functionally by an external manager during insolvency proceedings), the company's creditors (who may not be paid in full what they are owed by an insolvent company), the shareholders of the company (who may not receive dividends and most importantly lose their investment) and the employees of the insolvent entity who, in addition to being owed back wages may potentially lose their jobs.[34]

1.3 Context and theory

The modern company is a means of organising economic life.[35] It is a principal factor in economic organisation through its mobilisation of property interests in an economy.[36] An economy is a spatially limited and social network where goods and services are exchanged according to demand and supply between participants by a medium of exchange with a credit or debit value accepted

[32] Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (YUP, New Haven 1997) 19.
[33] ibid.
[34] Frisby (n 9)
[35] A Berle and G Means, *The Modern Corporation and Private Property,* (Transaction Publishers, New Brunswick 1991) 3; A Berle, 'Modern Functions of the Corporate System' (1962) 62 Columbia Law Review, 433, 437.
[36] By property in this context is meant productive property- i.e. 'property devoted to production, manufacture, service or commerce, and designed to offer, for a price, goods or services to the public from which a holder expects to derive a return'. See Berle and Means (n 34a) above. At the level of a corporation, productive property may be divided into two layers: that fraction which, though not managed by active owners, is administered to yield a return by way of interest, dividends or distribution of profit, and a second layer dominated and controlled by the representatives and delegates of passive owners whose decisions and true position vis-a-vis these properties have elicited the much documented ownership and control debates in corporate governance literature. See generally, Wendy Carlin, 'Ownership, Corporate governance, Specialization and Performance: Interpretation of recent evidence for the OECD countries' in Jean-Phippe Touffut (ed.) *Does Company Ownership Matter?* (Edward Elgar, Cheltenham 2009); Brian R Cheffins, 'Corporate Ownership and Control: British Business Transformed' (OUP, Oxford 2008); Margaret M Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (The Brookings Institution, Washington DC 1995); Christos N Pitelis, 'The Separation of Ownership and Control in the Theory of the Firm: A Reappraisal' (1986) 4 International Journal of Industrial Organisation, 69-86; Mauro F Guillen, 'Corporate Governance and Globalization: Arguments and Evidence against Convergence' (1999) <http://knowledge.emory.edu/papers/839.pdf> accessed 03 March 2012.

within the network.[37] Economic activity - the supply of all goods and services - in every economy is made possible mostly through the vehicular means of companies. The goods produced, and the services rendered by companies are in turn made possible through the combined resources of the various stakeholders or 'team members' that make up the company. Team members include the shareholders and the employees, *inter alia,* who provide the capital for the team production and the labour needed to convert capital into goods and services needed in an economy respectively.[38]

It has been opined that the purpose of all economic activity is, or at least ought to be, the enhancement of the economic well-being[39] of the individuals. Two of the key indices often used to measure human well-being are job satisfaction and job security.[40] There is also the notion that economic structures that are able to achieve these particular purposes are more desirable than those incapable of so doing.[41] What this suggests in effect is that a prime consideration in the carrying on of industry should be the enhancement of the well-being of the men and women engaged in it. It follows therefore that a good and balanced industrial policy is one which gives equal weight of considerations to the welfare of the employees as it does the making of profits for companies. This is also the type of policy which, when the need arises, can subordinate the profit-making goal to the welfare of the company's stakeholders, especially the employees of the company.[42] While this philosophy appears to be one shared by virtually all politicians in every country, in practice, the policies pursued by them often do not reflect a commitment to bringing this aspiration to fruition.[43]

Most policies championed by politicians are usually antithetical to the above ideology. Most industrial policies favour having a flexible labour market which

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[37] Alfred D Chandler, Jr., Scale *and Scope: The Dynamics of Industrial Capitalism* (HUP, Cambridge, MA, 1990).

[38] See e.g. John D Rockefeller, Jr, discussing the two as partners in his seminal essay: 'John D Rockefeller, Jr, On Labour and Capital' published in the New York Times (January 9, 1916) <http://query.nytimes.com/mem/archive-free/pdf> accessed 29 October 2012. See also A A Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization, (1972), 62 Am Econ. Rev. 777; Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction', (1998-1999) 24 Journal of Corp. Law 743, 745; Blair and Stout 'A Team Production Theory of Corporate Law' (1999) 85 Virginia L Rev. 247.

[39] 'Well-being' in the context used here refers to remunerative employment, fair wages, reasonable working conditions, job security and other employment associated incentives for the employees.

[40] See e.g. I M D Little, *A Critique of Welfare Economics* (OUP, Oxford 1957) 6.

[41] Stiglitz (n 3).

[42] Rockefeller, Jr (n 38).

[43] Stiglitz (n 3).

enhances profit making. Although policies that push for 'labour market flexibility'[44] are beneficial to the employers and the company in general, these tend to operate to the disadvantage of the workers.[45] For example, an economic policy that advocates that management prioritise the interests of providers of capital by working to ensure that this group maximises its wealth without having just regard to the rights of the employees, trivialises, or completely discounts the human capital contributions made by the employees in the joint venture.[46]

It is no exaggeration to say that for a large percentage of the world's population, work or employment of some kind is very important.[47] For the individual, while not being gainfully employed would raise concerns of a subsistence nature, losing a job would be of even greater concern for several reasons.[48] For the individual, job loss is not just about the loss of income; it is also about the loss of that individual's sense of self-esteem.[49] Beyond this, job loss and unemployment are associated with a myriad of problems and pathologies.[50] Research has shown that job loss could lead to alcoholism, increase the rates of suicide, divorce,[51] and

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[44] The term 'labour market flexibility' is used here to refer to the ease with which workers and employers can negotiate mutually advantageous labour contracts so that remuneration, working conditions and workforce size can fluctuate with the least possible interference. For an analysis of the four dimensions that comprises labour market flexibility, see Howard Reed, 'Flexible with the Truth? Exploring the Relationship between Labour Market Flexibility and Labour Market Performance. A Report for the TUC' (2010) <http://www.tuc.org.uk/extras/flexiblewiththetruth.pdf> accessed 22 May 2012.

[45] Mark Anner & Teri Caraway, 'International Institutions and Workers' Rights: Between Labour Standards and Market Flexibility' (2010) 45 (2) Studies in Comparative International Development 151- 169.

[46] T Donaldson and L Preston, 'The Stakeholder Theory of the Corporation – Concepts, Evidence and Implications' (1995) 20 (1) Acad. Mgt. Rev; M L Wachter & J E Harris, 'Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange: (1975) 6 Bell Journal of Econs. 250; Drucker (n 6).

[47] See OECD: 'The Role of Employment and Social Protection: Making Economic Growth more Pro-Poor' (2009) Policy Statement, Dac HigH-level meeting 27–28 May 2009 <http://www.oecd.org/dataoecd/63/9/43514572.pdf> accessed 13 August 2011.

[48] Rheyanne Weaver, 'Emotional Effects of Job Loss' (2010) <http://www.empowher.com/depression/content/emotional-effects-job-loss> accessed 8 February 2012.

[49] Richard H Price, 'Psychological Impact of Job Loss on Individuals and Families' (1992) 1 (1) Current Directions in Psychology Science 9-11; Leslie Hossfeld, 'The Economic and Social Impact of Job Loss in Robeson County, North Carolina 1993-2003' (2004) 2(2) Sociation Today <http://www.ncsociology.org/hossfeld.htm> accessed 01 July 2011.

[50] Stiglitz (n 3) 9-29.

[51] J Gruber, 'The Wealth of the Unemployed' (2001) 55 Industrial and Labour Relations Review, 79-94; C. Ruhm, 'Are Workers Permanently Scarred by Job Displacements?', (1991) 81 American Economic Review, 319-23; A H Stevens, 'Persistent Effects of Job Displacement: The Importance of Multiple Job Losses' (1997) 15 Journal of Labour Economics, 165-88; M Stephens, 'The Long-Run Consumption Effects of Earnings Shocks' (2001) 83 The Review of Economics and Statistics 28-36. See also Stiglitz (n 3).

crime,[52] especially in countries that do not have a social security safety net for the unemployed.[53] From this perspective, it is important that policy-makers pursue employment law policies that can keep workers in their jobs (at least in cases where there are no grounds for fair dismissals) rather than those that facilitate their dismissals and put them back in the job market.

Unfortunately, in relation to economic policies, the voices of commercial and financial interests are often louder, and hearkened to, more than that of labour (employees).[54] The adverse effects on employees of the economic policies advocating a flexible labour market are aggravated by the main instrument used in the construction of market-based economies. In market-based economies, companies are fundamentally contract-based[55] Rather than promoting fair bargains between parties, contract produces inequalities and power asymmetries between the employer and the employee with the former always having the upper hand.[56] An employment relationship based on contract does not offer protection to the interests and rights of the employee during a going concern business transfer in a free market economy.[57]

Upon the transfer of an undertaking on a going concern basis and in the absence of protection under employment law, continuity of employment would be at the discretion of the transferee. To remedy these types of problems, the potential role of the government in each state becomes of paramount importance. At the minimum, the government can assist in enforcing minimum labour standards that would help in the protection of the employees' rights especially in situations where the business they work for becomes insolvent and is transferred as a going

[52] K L Papps and Rainer Winkelmann, 'Unemployment and Crime: New Evidence for an Old Question' (1999) <http://www.nuffield.ox.ac.uk/users/papps/unemployment.pdf> accessed 01 March 2012. See also I Ehrlich, 'Participation in illegitimate activities: A theoretical and empirical investigation' (1973) 81 Journal of Political Economy 521-565; G S Becker, 'Crime and punishment: An economic approach' (1968) 76 Journal of Political Economy 169-217.

[53] Rebecca Parry and H Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 Journal of Corporate Law Studies 113-141.

[54] Stiglitz (n 3) 25.

[55] Janet Dine, 'Post-Concession Company Models in Potential European Company Law' Paper Presented at Leeds University Centre for Business Law and Practice on: Directors Duties and Shareholder Litigation in the Wake of the Financial Crisis, (September 20, 2010) <http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/dine-post-concession-company-models.pdf> accessed 12 March 2012.

[56] P Davies and M Freedland, *Kahn Freund's Labour and the Law* (3rd edn., Stevens, London 1983) 14-26; Simon Deakin & Wanjiru Njoya, 'The Legal Framework of Employment Relations' (2007) Centre for Business Research, University of Cambridge Working Paper No. 349 <http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.167...> accessed 04 April 2012

[57] J Schregle, 'Comparative Industrial Relations: Pitfalls and Potential' (1981) Int'l L. Rev. 26-27.

concern to another employer. This will, theoretically, provide a modicum of industrial peace by ensuring that the employees' rights are safeguarded from infringement by the employers.[58] This could be done through the enactment of legislation either at the national level by the governments of individual states, or at the supranational level (where the state is a member of a regional organisation) as there is with the European Union (EU) in Europe.[59] However, in looking to government intervention by way of legislation protecting employees' rights during transfers, we have to bear in mind what the 'evil effects'[60] of legislation are. It has been contended that legislation aimed at making a change in an existing system sometimes worsens the problem it was meant to address.[61]

It is hardly contestable that for an employee, security in the job he or she actually holds is very important. A secure job is an essential part of an employee's 'long-term economic security'.[62] However, in an attempt to provide job security for workers, especially in situations involving transfers of insolvent businesses, through legislation, the continuous existence of the insolvent business employing the worker could be imperilled.[63] The point here is that employee rights may in one context hamper company reorganisations which is not what this research is about. In the context of this research however, employee rights may also hamper business rescues. Onerous employment liabilities imposed on employers by protective labour legislation (such as TUPE) could deter purchasers and hamper the rescues of insolvent businesses. It is with all these considerations in mind that we must analyse the positives, as well as the negatives, of the EU-induced Transfer Regulations in the UK.

[58] Mary Ann S Bartlett, 'Employees' Rights in Mergers and Takeovers-EEC Proposals and the American Approach,' (1976) 25 Int'l & Comp. L Q 621, 626.

[59] See e.g. the various European Union labour related Directives such as the Acquired Rights Amendment Directive (Directive 2001/23/EC), Redundancy Directive (Directive 98/59), insolvency Directive (Directive 2002/74) etc all of which set minimum standards on certain employment-related issues for Member states to follow.

[60] Albert V Dicey, *Lectures on the Relationship between Law and Public Opinion in England in the Nineteenth Century,* Richard Vande Wetering (ed) (New Liberty Fund Book, Indianapolis, 2008) 182 <http://files.libertyfund.org/files/2119/Dicey_1456_LFeBk.pdf > accessed 11 May 2011.

[61] Ronald H Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law & Economics 44.

[62] S Deakin and G Morris, *Labour Law* (3rd edn., Hart Publishing, Oxford 2005) 569.

[63] Frisby (n 9); Armour, Hsu & Walters (n 10).

1.3.1 The case for employment protection during transfers of insolvent undertakings

In the past three decades most European countries have witnessed profound changes in labour markets. Organisations in all sectors of EU economies are engaged in continual restructuring [64] to increase productivity, lower unit production costs and improve product and service quality.[65] Whilst forms of restructuring may vary from sector to sector, the overall outcome is greater adoption of advanced technology, the introduction of new working practices (e.g. 'non-standard' work practices like part-time and temporary employment as opposed to standard work practice undertaken by employees with permanent employment contracts and working full-time for a single employer).[66] Sometimes, firms transfer their entire production activities, or some aspects of the production, to lower cost localities inside and outside the EU.[67]

A related tendency has been for large businesses to focus on a core of essential functions and to outsource the remainder. In some other cases (especially when the business is insolvent), the whole or part of the business or undertaking of the company may be sold to a third party purchaser on a going concern basis. Structural changes on this scale raise understandable issues of social concern. They are often accompanied by high levels of unemployment and job insecurity for the workers. At an individual level, unemployment and job insecurity are a source of considerable personal economic insecurity.[68] At the EU level, the anticipation that a lot of business restructurings would occur in the post-common market era, and concerns over the potential effects that these would have on the

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[64] Corporate restructuring could take a number of forms. It could take the form of portfolio restructuring which could either add or excise certain aspects of a company's undertaking from its business. It may take the form of organisational restructuring involving a change from a functional whole to a business unit structure or it may come in the form of financial restructuring usually aimed at altering the company's capital structure. See G B Stewart and D M Glassman, 'The motives and methods of corporate restructuring, part 2' (1988) 1 Journal of Applied Corporate Finance, 79-88; P A Gibbs, 'Determinants of Corporate Restructuring: The Relative Importance of Corporate Governance, Takeover Threat, and Free Cash Flow' (1993) 14 Strategic Management Journal 51-68.

[65] Marie- Laure Morin & C Vicens, 'Redundancy, Business Flexibility and Workers' Security: Findings of a Comparative European Survey' (2001) 140 Int'l Labour Rev. 45.

[66] Oliver Hyams, *Employment Aspects of Business Reorganisation* (OUP, Oxford 2006).

[67] M Sako, 'Outsourcing and Offshoring: Key Trends and Issues' (2005) Said Business School Oxford <http://ssrn.com/abstract=1463480> accessed 01 October 2011. See also D Van Gorp, P K Jagersma and Motoko Ike'e, 'Offshoring in the Service Sector: A European Perspective' (2006) <http://ssrn.com/abstract=896708> accessed 23 October 2011.

[68] Lord Wedderburn, *The Worker and The Law* (3rd edn., Penguin, Harmondsworth 1986); M Weiss, 'Individual Employment Rights: Focusing on Job Security in the Federal Republic of Germany' (1998) Nebraska Law Review 67, 82-100.

workers, necessitated the enactment of laws to protect the rights of European employees during business transfers in the Member States.[69]

Employees working for UK businesses enjoy, in addition to contract rights, a wide range of statutory rights.[70] These are general rights such as the right to a written statement setting out certain basic terms and conditions of employment (especially those not covered in the employment contract),[71] the right not to be unfairly dismissed;[72] the right to compensation if made redundant[73] and the right to continuity of employment where a business is transferred to a third party purchaser as a going concern and the latter voluntarily keeps an existing employee of the transferred business.[74] There are also formal constraints (laws) offering employment protection to employees by placing restrictions on an employer's ability to hire workers on non-standard contracts. This is because non-standard employment contracts also give the employer the flexibility needed to easily dispense with the employees at will. The aim is to give workers some degree of job security.

If the employees are statutorily protected when their corporate employer is solvent, there may be a valid argument over the desirability of statutory protection when the employer is insolvent. From the perspective of employees, this is because they have numerous interests in an insolvency setting that deserve protection. Also, there is the argument that certain problems confronting employees only arise specifically due to the insolvency of their employer.[75] For example, when a company is insolvent, the prospect of payment of wages diminishes. The literature on corporate insolvency also reveals that personal and social costs of insolvency often fall disproportionately on the employees.[76] There is the perception that employees cannot hedge against the risks associated with corporate collapse. Unlike the shareholders and the creditors of an insolvent

[69] Bob Hepple, 'Workers' Rights in Mergers and Takeovers: The EEC Proposals' (1976) 5 ILJ 197; S Hardy and N Adnett, 'Entrepreneurial Freedom versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam (1999) 9 Journal of European Social Policy 127.

[70] It has been opined that the existence of protective labour legislation is in itself testament to the fact that employment relationships entered into between the employee and the employer is an unequal one. Thus, the primary role of labour law is to counteract the inequality or asymmetry in bargaining power that is inherent in the employment relationship. Davies and Freedland (n 56).

[71] ERA 1996 s.86 (2)

[72] ERA 1996 s. 94

[73] ERA 1996 s. 139 (1)

[74] ERA 1996 s. 218

[75] Korobkin (n 8).

[76] Whelan & Zwier (n 8).

company, employees cannot diversify their investment portfolios. Employees are also not able to bargain for security when they contract to join the company.[77] Employees make a contribution of firm-specific human capital investments to the company. The firm-specific nature of these investments restricts their mobility and uses in other industries.[78]

In the context of insolvency, financially distressed businesses often tend to see employees as the 'sacrificial lamb' for remedying their financial situations. For most insolvent businesses employees constitute a reducible cost and an easy way out of their financial predicaments.[79] Sometimes, when a company is insolvent the need might arise for it to sell its business or part of it. In such situations, the employees are usually seen as the 'soft target' in terms of costs cutting and as a way of making the business attractive to prospective buyers.[80] Moreover, a business transfer under the common law was not in the employee's interest. The transfer of a business operated to terminate all extant employment relationships

[77] Janis Sarra, 'Creditor Rights and the Public Interest: Restructuring Insolvent Corporations' (University of Toronto Press, Toronto 2003); Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee Claims' in Paul .J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, Hampshire 2008); Finch (n 13);M Gronow, 'Insolvent corporate groups and their employees: The case for further reform' (2004) Legal Studies Research Paper No.130, Melbourne Law School <http://ssrn.com/abstract=81424> accessed 27 January 2011; M Blair, 'Firm-Specific Human Capital and Theories of the Firm', (2003) Georgetown University Law Center, Business, Economic and Regulatory Policy Working Paper No.167848 <http://papers.ssrn.com/abstract=167848> accessed 27 January 2011; Vanessa Finch & Sarah Worthington, 'The Pari Passu Principle and Ranking Restitutionary Rights' in F. Ross (edn) *Restitution and Insolvency* (London, 2000) 4; Korobkin (n 8); John Amour & S Deakin, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) University of Cambridge CBR Working Paper (No. 204) <http://www.cbr.cam.ac.uk/pdf/wp204.pdf> accessed 11 September 2009.

[78] Armour and Deakin (n 77) above.

[79] Mark A Rothstein *et al*, *Employment Law* (West, St. Paul, 1994) 589. See also Kevin J Delaney, *Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to Their Advantage* (University of California Press, California 1999) 1-2 in which the author demonstrates how an otherwise solvent company could strategically makes use of the bankruptcy laws for the specific business purpose of cost cutting. Delaney documents the case of Continental Airlines, (*Re Continental Airlines,* 177 B.R. 475 (D. Del. 1993), one of the top ten carriers in the United States that claimed bankruptcy protection when the union resisted plans to cut labor costs. Three months after emerging from bankruptcy, the Airline abrogated its labour contracts with its unions. It cut hourly wages, reduced salaries and broke continuity of service of its employees. Under Section 1113 of the US Bankruptcy Code, companies are allowed to ask a court to reject union contracts as part of their reorganization. Section 1113 is not used in all bankruptcy cases. However, when it is used, it is usually a last resort by the debtor. In a similar vein, American Airlines has adopted the same approach as Continental Airlines and has filed for Chapter 11 bankruptcy. The Airline which is seeking to cut 13, 000 jobs and terminate employee pension plans as part of cost-cutting strategy claims that it was forced into bankruptcy because of cost disadvantages it faced compared to rivals that had already gone though bankruptcies adding that it needs contracts that would allow it the greater flexibility and lower staffing levels that other carriers have.

[80] Rothstein (n 79) above.

between the employee and the employer.[81] In effect, what this means is that where a business was sold to a new owner (and because there was no statutorily enshrined right to continued employment), the transferee (new owner) was not obliged to take on any of the transferor's employees. The transferee was also free to 'cherry-pick' which of the employees he or she wished to retain post-transfer of the business.

Equally, where the transferee took on an employee, no obligation was placed on him or her to take on that employee on the same terms and conditions of service as he or she enjoyed with the transferor employer. In fact, quite often, the opposite was the case. Transferees who voluntarily retained some of the transferor's entire workforce often re-engaged the employees on inferior terms and conditions. These types of injustices that the common law visited on the employees during transfers of undertakings could justify laws on employee protection.

The problem is that for the employees to be afforded adequate protection, in the context of job security during transfers of undertakings, legislation would have to be enacted. A sure, but very controversial, way of achieving job security for the employees of an insolvent transferor would be to place certain stringent legal restrictions on the management's freedom to dismiss employees with ease when seeking to transfer an insolvent business on a going concern basis. This tends to be the approach adopted by the EU and, by extension, the UK as demonstrated in chapters 4 and 5 of this thesis.

The transfer of undertakings in Member States of the EU is legislated at the European level through the Acquired Rights Directive (ARD) enacted in 1977 and revised in 1998 and 2001 respectively. The main purpose of this special regime is to safeguard the rights of the employees when the business or undertaking employing them is transferred to a new owner. In effect, the ARD is social legislation aimed at safeguarding jobs for the employees.[82] Member States have implemented the ARD into their respective national laws. In the UK, the ARD has

[81] *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014 (HL).
[82] Gavin Michael Barrett, 'Delivering a Community Employment Law: A Tale of Two Mechanisms' (2007) CLPE Research Paper No. 19/2007 <http://ssrn.com/abstract=996087> accessed 9 March 2011; A Garde, 'Recent Developments in the Law of Transfers of Undertakings' (2002) 39 Common Market Law Review 523; A Garde, 'Partial Harmonisation and European Social Policy: A Case Study on the Acquired Rights Directive' (2002) 5 Cambridge Yearbook of European Legal Studies 173.

been implemented through the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) initially in 1981 and revised in 2006.

TUPE applies to transfers of solvent and insolvent undertakings or businesses. In relation to the protection of the employees' rights during business transfers, the TUPE Regulations have proved to be a very effective law. TUPE mitigates or neutralises the effects of transfers of undertakings on the employees. The Regulations establish for the employees, *inter alia,* the right to continued employment on substantially the same terms and conditions as those originally agreed with the previous employer before the business transfer occurred.[83]

In relation to insolvent business transfers, this practice is perhaps, recognition that 'in certain situations, employees may have property-like claims'[84] on the company. That is to say, employees have interests which transcend the terms of their employment contracts in the company.[85] The adoption of a proprietary approach to employee protection is a reflection of the notion of employment security for employees in the business they work for. It is vital that a worker be able to have reliance on job security in a market inundated with the supply of labour in comparison with the demand for it.

The implicit model of the firm is one with management at the top and a more or less fungible 'workforce' at the bottom.[86] In an employment relationship what this means therefore is that the employees are 'weak' while the employers are 'strong'.[87] That is to say, employers have a lot of bargaining power in comparison to the employees. An argument can therefore be made that the protection given to the employees during insolvent business transfers is justified because not only does it take cognisance of the valuable human capital contribution employees make to the business,[88] but it also recognises the valuable long-term relationship

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[83] ARD 1977, Article 3(1) & (2).

[84] Deakin and Njoya (n 56).

[85] ibid.

[86] Wanjiru Njoya, *Property in Work: The Employment Relationship in Anglo-American Firm* (Ashgate Publishing 2007); Deakin and Morris (n 53) 338.

[87] It has to be acknowledged that, given the prevalence of the service economy, the shift from an industrial to service/information and digital economy, there will be situations when much of the value that is tied up in a workforce could, in truth, has considerable leverage.

[88] O E Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (Free Press, New York 1985) 242-3; Margaret M Blair,'Firm-Specific Human Capital and Theories of the Firm', (2003) Georgetown University Law Center, Business, Economic and Regulatory Policy Working Paper No.167848 <http://papers.ssrn.com/abstract=167848> accessed 27 January 2011; Margaret M Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia L REV. 247; Janis

that exist between the employees and the businesses or companies they work for.[89]

However, there is the perception that the ARD and TUPE-style protection of UK workers during transfers of insolvent undertakings 'over-deter' purchasers and so undermine the prospects for successful going concern sales. The potential effects of these regimes on entrepreneurship have been the subject of various academic analysis and criticisms.[90] A transferee might be reluctant to honour obligations that originate from the previous employment relationship. He or she might prefer to make unbridled choices in relation to the running of the undertaking. From the transferor's perspective, the fewer the hindrances to the successful transfer of the

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Sarra, Creditor Rights and the Public Interest: Restructuring Insolvent Corporations' (University of Toronto Press, Toronto 2003); Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash ULQ 1031; K Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997); E Warren, **'**Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L Rev. 336-387; Donald R Korobkin, 'Employee Interests in Bankruptcy' (1996) 4 Am. Bankr. Inst. L Rev; D Korobkin 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Colum. L Rev. 717; Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741; Jacob Mincer, 'Investment in Human Capital and Personal Income Distribution' (1958) Journal of Political Economy.

[89] O E Williamson, M L Wachter & J E Harris, 'Understanding the Employment Relationship: The Analysis of Idiosyncratic Exchange' (1975) 6 Bell Journal of Economics 250; Deakin and Njoya (n 56); Deakin & Morris (n 52); Njoya (n 86).

[90] John McMullen, 'An analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' [2006] 35 ILJ 113; Hugh Collins, 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144; Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Rescue and "One Unholy Mess"' [2000] CFILR 249; J Amour and S Deakin, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE', (2001) University of Cambridge CBR Working Paper (No.204); Amie J Ahanchian, 'Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision' (2002) 2 Journal of International and Comparative Law at Chicago-Kent **29-59**; V Shrubsall, 'Employment Rights and Business Transfers: Changes to the Acquired Rights Directive' [1998] Web Journal of Current Legal Issues 1 <http://webjcli.ncl.ac.uk/1998/issue5/shrubsall5.html> accessed 28 January 2011; Marlene Frank, 'The Rights of Employees in the Event of the Employer's Insolvency: A comparative Approach to the Rights of Employees During Restructuring in the United States and Europe' (2005) 1 New Zealand Postgraduate Law E-Journal 7; A L DaSilver, 'Directive 77/187: The EEC's Attempt to Protect Employees upon the Sale or Transfer of Businesses' (1998) 11 B. C. Int'l & Comp. L. Rev. 147; Bob Hepple, 'New Approaches to International Labour Regulation', (1997) 26 ILJ (4) 353-66; Bob Hepple, 'Workers' Rights in Mergers and Takeovers: The EEC Proposals' (1976) 5 ILJ 197; 'Community Measures for the Protection of Workers against Dismissal' (1977) 14 Common Mkt. L. Rev. 489; Jo Hunt, 'Success at Last? The Amendment of the Acquired Rights Directive' (1999), *European Law Rev.* 215; Mary Ann S Bartlett, 'Employees' Rights in Mergers and Takeovers-EEC Proposals and the American Approach,' (1976) 25 Int'l & Comp. L. Quarterly (3) 621-50; Mark Jeffery, 'European Union Developments: European Labour Laws Relating to Business Restructuring' (2003) 24 Comp. Labour Law & Policy Journal, 670; David Pollard, 'Insolvent Companies and TUPE' (1996) 25 ILJ 191, 194; Malcolm Sargeant, 'Business Transfers and Corporate Insolvencies-The Effect of TUPE' (1998) 14 (No.1) ILP 8. See also Sandra Frisby, 'A Preliminary Analysis of Pre-Packaged Administrations: Report to The Association of Business Recovery Professionals' (2007) <http://www.r3.org.uk/.../press/preliminary_analysis_of_pre-packed_administrations.pdf> accessed 22 June 2011.

undertaking, the less likely it is that the purchase price that will be paid for it will be affected. Any burden transferred to the purchaser is likely to be reflected in how much the transferee is willing to pay. These types of issues, if not carefully handled, could derail, what otherwise could have been successful rescues of insolvent businesses resulting in job losses for the employees.

1.3.2 The tension between employment protection and rescue of insolvent businesses

In the UK, insolvency does not necessarily spell the legal demise of all legal persons since rescue is a core policy objective of English insolvency law.[91] Although the English insolvency regime expressly prioritises corporate rescue,[92] in reality, business rescue is far more common.[93] Insolvency law provides a menu of options for rehabilitating distressed but economically viable companies helping them avoid winding-up. One way of doing this is through a going concern sale or transfer of the whole or part of the undertakings of the company to a new owner.[94] Some of the advantages of a going concern sale over piecemeal sale include facilitating the continuation of the business. A sale is an important mechanism to induce the redeployment of the assets of an insolvent company to better uses.[95] A partial business sale may offer the debtor company an opportunity to solve its debts and illiquidity problems by freeing it from its debts.[96]

However, the transfer of an undertaking in the UK has a number of mandatory legal consequences. Not only is there an automatic and obligatory transfer of all relevant employees and their contracts of employment, but there is also a statutory requirement that all debts owed to all transferring employees and all other liabilities in relation to them and arising in the employment relationship must transfer to the transferee.[97] This statutory protection accorded to employees

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[91] Insolvency Act 1986, Schd. B1 para. 3 **(a)**.
[92] ibid.
[93] Sandra Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' 67 MLR (2), 247-272; Rebecca Parry, *Corporate Rescue* (Sweet & Maxwell, London 2008).
[94] Lynn M LoPucki & J W Doherty, 'Bankruptcy Fire Sales' (2007), UCLA School of Law, Law and Economics Research Paper Series, 5 research paper No. 07-07 <http://ssrn.com/abstract=980585> accessed 22 October 09.
[95] Michael Jensen, 'Corporate Control and the Politics of Finance' (1991), 4 Journal of Applied Corporate Finance 13.
[96] LoPucki & Doherty, (n 94).
[97] TUPE 2006, Reg. 4(2).

also applies to the employees where the company they work for becomes insolvent and is transferred as a going concern to a third party purchaser. This rule, whilst beneficial to the employees, could inhibit the rescues of insolvent businesses.

The sale or transfer of an insolvent business or undertaking inevitably triggers an interaction between several bodies of laws. The transfer of an insolvent business is conducted under corporate or commercial law, peculiar insolvency matters are addressed exclusively by insolvency law while matters affecting employees in the context of a business transfer are governed by employment law (TUPE). However, it is the interaction between employment law and insolvency law that is of relevance to this thesis. The rescue of insolvent companies is an objective of insolvency law [98] just as the protection of employment is the objective of employment law. The interaction between these two sets of laws is inevitable when a company becomes insolvent. The down side to this interaction is that employment protection and business rescue objectives conflict with each other. In insolvency, and especially where the transfer of the company's undertaking is inevitable, employment legislation seeks to maintain the employees' existing employment status with the business, whereas the employer is intimately concerned with how to sell the business with minimal impact of any labour encumbrances on the sale price, so as to maximise the going concern value of the business. These two divergent aspirations often 'collide' with each other during transfers of insolvent undertakings.

To rescue a financially distressed business, some jobs might have to be sacrificed. But TUPE limits the employer's ability to do this. It impinges on managerial decision-making powers. TUPE reduces, rather than increases, entrepreneurial freedom.[99] On the other hand, while the employees benefit from its protection, the TUPE-type protection may deter rescuers of insolvent undertakings. If the business cannot be rescued, ultimately it is the employees that will suffer. The closure of the business means job losses for the employees. From this perspective, it can be argued that there is tension between an economic rationale that demands greater business flexibility on the one hand, and a social

[98] In administration proceedings for example, the administrator of a company is statutorily required to perform his functions primarily with the objective of 'rescuing the company as a going concern.' IA 1986, Schd. B1 para. 3(1) (a).
[99] Hardy and Adnett (n 69); Jeffery (n 90) 670.

rationale calling for a certain degree of job security for workers on the other hand.[100] The argument here is that while the social policy underlying both the ARD and the TUPE Regulations, aimed at providing statutory protection to EU employees during transfers of undertakings and other forms of restructurings was able to strengthen the social rights of EU and UK workers respectively, they failed to increase entrepreneurial freedom.[101] It seems that trade-offs would have to be made if an effective balance between these policies' goals is to be struck.

1.3.3 Business rescue and employment protection: striking a balance between policies' goals

The uncertainty in the dynamics of every economy is indicative of the fact that the consequences of any policy cannot be predicted with absolute certainty.[102] For this reason, all decision-making must take into account potential problems that policies could engender.[103] Thus, every policy structure, whether of a state or an organisation, must always take into account the downside of any policies which cannot be reversed or easily amended. A policy or law should at least be amendable. In the case of the 1977 ARD, when it became evident that the regime was having negative effects, not just on business rescues but ultimately, also, on the employees, the beneficiary of the regime, it was amended, first in 1998 and then in 2001 to remedy these.

In a similar vein, the TUPE Regulations which implemented the ARD into UK law have also been amended by the government to incorporate the changes made by the 2001 ARD. The changes introduced into these regimes have, arguably, struck a balance between the employment protection goals of employment law on the one hand and the rescue of insolvent companies' goal of UK insolvency law on the other.

1.4 Research hypothesis

The hypothesis underlying the study is that while employees deserve protection in insolvency generally, and during the transfer of an insolvent business as a

100 Morin & Vicens (n 64) 45.
101 Hardy and Adnett (n 69) 127; Jeffery (n 90) 670.
102 Stiglitz (n 3).
103 ibid.

going concern specifically, employment protection should not be allowed to frustrate the 'rescue culture' in the UK.

Obviously, cases where the business rescue objective conflicts with the employee protection objective may produce dilemmas for judges since both objectives cannot be achieved simultaneously. This presents a '*hard case*'[104] scenario for courts and tribunals. Trade-offs would have to be made if both objectives are to co-exist. This inevitably involves a compromise among individual goals and objectives in pursuit of the overall welfare of all affected interests. But which of the policies will be sacrificed on the 'altar' of decision making? It is the tension between business rescue and employment protection in corporate insolvency that this thesis seeks to explore. The thesis makes use of theory to analyse the EU's effort to grapple with this problem. The thesis also seeks to show how the UK courts and legislature are grappling with the tension between business rescue and employee protection in the context of insolvent business transfers.

1.5 Research objectives

1. To explore the interaction between insolvency law and employment law during insolvent business transfers.

2. To evaluate the problems posed by employment protection legislation to the rescue of insolvent businesses or undertakings in the UK.

3. To ascertain whether the adoption of the purposive approach to the interpretation of EU-derived employment legislation is helpful or detrimental to the 'rescue culture.'

4. To offer normative justifications for the different policies implicit in transfers of undertakings through the lens of theory.

1.6 Analytical legal scholarship

The research, which is library-based, uses several legal sources for its data. These consist of primary and secondary legal sources. Primary sources of law

[104] Ronald Dworkin, *Taking Rights Seriously,* (G. Duckworth, London 1977) 85.

consist of statutes, legislation (UK and European), and judicial decisions, policy and consultation documents, reports of legislative proceedings (e.g. Hansard). Secondary sources of law comprise law reports, case summaries, legal monographs, law journals, and writings of scholars.[105] Sources are collected both electronically, via Nottingham Trent University's (NTU) linked electronic data bases such as Westlaw, Lawtel UK, LexisNexis, Heinonline, and in hard copies available in NTU library and other accessible UK Libraries.

The research adopts an interdisciplinary approach in that it draws upon law and economics literature as well as doctrinal insolvency and labour law materials from different jurisdictions to inform context. This approach permits a proper understanding of the policies underpinning insolvency and employment laws and the tradeoffs between business rescue and employment protection in the legal sense. Law and economics literature provide insights into insolvency law through competing normative theories on the subject.[106] Theories such as the Creditors' Bargain Theory[107], the Team Production Theory[108] and the Authentic Consent Model,[109] inter alia, all have implications for insolvency law, especially as regards business rescue and employment protection. Though all of these theories support an insolvency system that fosters rescue, they give differing weight to employee interests in insolvency. The labour law theories reveal a fundamental conflict of interests that is central to businesses in all capitalist society.[110] They are, however, agreed that employees deserve protection in insolvency because they make firm-specific investments in the company.[111]

In respect of the analytical technique used, standard legal methods that are capable of best achieving the aims of the research are applied. Methods such as legal analysis, legal reasoning, legal or statutory interpretation techniques, and judicial precedent are used to analyse primary legal sources.

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[105] I McLeod, *Legal Method,* (Palgrave Macmillan, New York, 2005).
[106] R Goode (n 11) 41.
[107] Thomas H Jackson, *The Logic and Limits of Bankruptcy,* (HUP, Cambridge, MA 1986); D G Baird & T H Jackson, 'Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 UCLR 97.
[108] Blair & Stout (n 38a & 38b).
[109] Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application,* (London, OUP 2005).
[110] H Collins, K D Ewing & A McColgan, *Labour Law: Texts and* Mate*rials*, (2nd edn, Hart Publishing, Oxford, 2005)1.
[111] Korobkin (n 8) 5-34.

Legal analysis in the context of this thesis denotes how cases are viewed and how they might pertain to other legal matters.[112] It involves identifying the legal question or the issue being debated, the rule governing the issue, the material facts relevant to the rule and then determining how the rule applies to the issue at hand.[113] Legal reasoning techniques are used in order to reconstruct the mental processes of policymakers and to provide insights into the reasoning of judges in reaching decisions in 'hard cases'[114] involving laudable but conflicting policy issues.[115] The notion is that the law is not arbitrary. Law exists to serve certain social ends. Rules derived from cases draw their justification from the fact that following them promotes some desirable ends. It follows that when rules conflict, judges resolve the conflict by considering the purposes that those rules were meant to serve in addition to evaluating their relative desirability.

The use of legal and statutory interpretation techniques in analysing and construing legislations and statutes is informed by the understanding that the language in which legal prescriptions or norms are usually formulated can sometimes be obfuscatory or indeterminate.[116] Legal rules are normally expressed in general terms. For this reason, they have been described as rules having an 'open texture.'[117] This in turn has rendered legal rules capable of interpretation in more than one sense.[118] It has been argued that 'determination of ambiguity is the linchpin of statutory interpretation.'[119]

Legal interpretation in law denotes the process by which the substantive object of the law is creatively developed and how a problematic meaning can be

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[112] Lee Epstein & Gary King, 'The Rules of Inference' (2002) 69 University of Chicago Law Review 1–133.

[113] Lee Epstein, William M Landes & Richard Posner, 'Why (And When) Judges Dissent: A Theoretical and Empirical Analysis' (2011) 3 Journal of Legal Analysis (1) 101- 137.

[114] H L A Hart, *The Concept of Law,* (Clarendon Press, Oxford, 1961).

[115] Richard Posner, *How Judges Think* (HUP, Cambridge 2008); William M Landes & Richard A Posner, 'Rational Judicial Behaviour: A Statistical Study' (2009) 1 Journal of Legal Analysis 775–831; Richard S Higgins & Paul H Rubin. 'Judicial Discretion' (1980) 9 Journal of Legal Studies 129–138.

[116] Hart (n 114).

[117] ibid.

[118] K Kress, 'Legal indeterminacy', (1989) 77 California Law Review, 235.

[119] Ward Farnsworth, Dustin F Guzior & Anup Malani, 'Ambiguity about Ambiguity: An Empirical Inquiry into Legal Interpretation' (2010) 2 Journal of Legal Analysis (1) 257 300.

simplified for a better understanding.[120] It also implies an understanding of the underlying rules and principles in a legal system and of policy considerations likely to influence the courts and tribunals when deciding 'hard cases.'[121]

Statutory interpretation involves the application of different judicial principles or rules of statutory interpretation. These include the use of linguistic argument, systematic argument and purposed-based argument. Linguistic argument denotes the identification of definitions and operational criteria that enable key terms in legislation to be applied[122] while the latter implies arguing from precedents to concrete cases; logical and conceptual argument. These are arguments premised on general principles of law and which inform the reason behind the design of many laws.

The purpose-based argument or purposive approach requires courts and tribunals to interpret statutes or to base their arguments on the substantive purposes that lie behind each legislation. This is often referred to as the 'legislators' intent' argument - an argument predominantly based on what the intent of the legislators was, or could have been, in formulating the law. In applying this approach, the judge's aim is to determine the mischief or defect which the statute in question set out to remedy and make a ruling that would effectively remedy such a mischief or defect. The intent of the legislator usually resides outside the law itself.[123]

The use of judicial precedent is informed by the fact that precedent decisions reveal the ways in which past conflicts have been authoritatively resolved. Put differently, precedents represent past situations where competing factors were considered against one another and how a view of their relative importance was taken. Precedent reveals preferences amongst different purposes and how pending and further disputes could be resolved by such preferences. However,

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[120] M Bodig, 'Legal Interpretation, Intentionalism, and the Authority of Law' (2006) 2 University of Aberdeen, College of Arts and Social Sciences, <http://ssrn.com/abstract=1099433> accessed 8/12/2009.

[121] Dworkin (n 104) 85.

[122] Elina Paunio and Susanna Lindroos-Hovinheimo, 'Taking Language Seriously: An Analysis of Linguistic Reasoning and Its Implications in EU Law' (2010) 16 European Law Journal (4) 395-416; Hanneke Van Schooten, 'Law as Fact, Law as Fiction: A Tripartite Model of Legal Communication' in Anne Wagner, Wouter G Werner, Deborah Cao (eds.) *Interpretation, law, and the construction of meaning: collected papers on Legal Interpretation in Theory, Adjudication and Political Practice* (Spinger, The Netherlands 2007).

[123] N MacCormick & R S Summers, *Interpreting Statutes: A Comparative Study,* (Dartmouth Publishing, Aldershot, 1991).

not all precedents are binding.[124] While decisions of lower courts, for example, cannot bind, decisions of the Supreme Court bind all lower courts in the UK.

In relation to the European Union (EU), the European Court of Justice (ECJ) is the highest court in the EU. Based on the doctrine that EU law supremacy means that the UK courts have to follow and or implement EC rulings on EU law, the UK's Supreme Court is not exempt. However, the ECJ is not an appeal court, it is a referral court. The ECJ is the referee between Member States, institutions and individuals in disputes relating specifically to EU law. Its judgements can affect both Member States and individuals. The ECJ makes its rulings binding on states and their citizens through the principles of EU law known as 'direct effect' and 'supremacy' which the court established in the seminal cases of *Van Gend en Loos v Nederlandse Administratie der Belastingen*[125] and *Flamingo Costa v ENEL*[126] respectively. Through these principles the ECJ has gained powers that were previously the reserve of the nation states.[127]

1.7 Structure of the thesis

The thesis is structured in eight chapters. Chapter 1 (which is the current chapter) has introduced the subject of the research by laying out the context and theory underpinning the study. Chapter II presents an analysis on the ideological divide that exists amongst insolvency scholars and considers how the different theories proposed by them have shaped the understanding of the underlying problems of corporate insolvency. It then situates UK insolvency system within the extant insolvency law theories.

Chapter III traces the genesis of EU social policy which culminated in the enactment of the ARD in 1977. Chapter IV considers the ARD specifically, why it was adopted, how the regime operates, its effects on the employees and on insolvent transfers. The last part of the chapter considers how the ARD was implemented in the UK. Chapter V explores how a business transfer was regulated in the UK before the advent of the Transfer Regulations. It then

[124] R Cross, *Precedent in English Law* (4th edn, Clarendon Press, Oxford 1991).
[125] Case 26/62, [1963] ECR 1
[126] Case 6/64 [1964] ECR 585
[127] Paul Craig and Grainne de Burca, *EU Law: Text Cases and Materials* (5th edn., OUP, Oxford 2011).

considers the first generation TUPE Regulations which implemented the ARD into UK law.

Chapter VI looks at the effects of applying the TUPE regime to transfers of insolvent undertakings. It notes that because no balance was struck between employment protection and business rescue, the Regulations tended to be self-defeating in the context of insolvent businesses. Chapter VII explores how the revisions made to both the ARD and TUPE legal regimes in 2001 and 2006 respectively have struck a balance between the rescue of insolvent businesses' objective of insolvency law and the employment protection goal of employment law. Here the research seeks to demonstrate how the law has shifted in the attempt to resolve the tension between rescues oriented insolvency law and employment law. Chapter VIII offers normative justifications on the policies underlying the rescue culture and employment protection during transfers of insolvent undertakings and then concludes the study.

1.8 Definition of key terms in the thesis

Rescue culture: Granted, winding up is the ultimate fate of most insolvent companies, not all insolvency result in liquidation. Following the introduction of the company voluntary arrangement (almost always within the administration procedure) and the revamped administration procedure itself, by the Enterprise Act 2002, the expectation was that there would be greater scope for business rescues via restructuring and reorganisation where the business was deemed economically viable and has good prospects of being returned to profitability. Thus, 'rescue culture' as used in this thesis is concerned with the preservation of the business of an insolvent company, not the company itself.[128]

Business rescue: The term 'business rescue' in the context of this thesis refers to the going concern sale of an insolvent company's undertaking or business which will then enable the undertaking or business sold to continue the same operation under new ownership and management free from its debts.[129]

[128]See further Hunter Muir, 'The Nature and Functions of a Rescue Culture' (1999) JBL 491. For the origin of the term, see *Powdrill v Watson* [1995] 2 AC 394 (Lord Browne-Wilkinson)
[129] See further J Armour, A Hsu & A Walters, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings: A Report Prepared for the Insolvency Services' (2006) <http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96...rep..> accessed 20 April 2012.

The European Union: The European Union (EU) as it is known today started life as the European Economic Community (EEC). Thus, depending on the stage of European integration and the changes made to the name of the original European Economic Community, the abbreviations EEC, EC and EU are used as appropriate to the context in this thesis. In a similar vein, terms such as the Acquired Rights Directive are abbreviated to either ARD or 'the Directive' throughout the thesis. The Transfer of Undertakings (Protection of Employment) Regulations is shortened in most places to the acronym TUPE or the terms the 'Transfer Regulations or 'Regulations' are used for convenience. However, where specific mention is made to either the 1981 or to the revised 2006 Regulations, TUPE 1981 or TUPE 2006 are used.

Social policy: The term social policy in the context of EU law covers legislation on health, welfare, free movement of persons etc. However, social policy as used in thesis refers specifically to EU- derived employment/employee protection legislation in business transfer situations resulting in a change of employer.

1.9 The law as stated in the thesis

The law stated herein are, according to sources available to me as at April 30, 2012.

The next chapter explores the various theories of insolvency law with a view to identifying which of the extant theories can be applied in explaining the existing tension between employee protection and business rescue in business transfers in the context of insolvency.

See also what Lord McIntosh of Haringey said concerning objective 'B' of the paragraph 3 Schedule B1 of the Insolvency Act 1986 provisions:

> Rescuing businesses is exactly the kind of outcome that the second objective is ...intended to recover. If it is not reasonably practicable to rescue the company, selling the constituent businesses as going concerns will almost always be the next best thing...the effect of the provisions as drafted will cover and give priority to business rescues.

Hansard, HL Deb 29 July 2002, vol 638, col 768

CHAPTER TWO

CORORATE INSOLVENCY: THEORETICAL PERSPECTIVE

2.1 Introduction

A theory is a logical explanation for why something is the way it is, or why it does what it does. The objective of this chapter is to consider some of the theories that have been applied by scholars in their attempts to explain the phenomenon of corporate insolvency. The various theories that will be analysed will provide the lens through which to analyse, interpret and offer normative justifications for legislative prescriptions made outside of insolvency law (through employment law) to protect employees during transfers of undertakings or businesses taking place in the context of insolvency, and whether this legislation could inhibit the rescues of such undertakings or businesses.

In relation to insolvency law theories, there are two main strains. These two strains originally characterised as 'economic' and 'social' arguments are currently referred to in the literature as 'Proceduralists' and the 'Traditionalists'.[1] These two camps discussed in section 2.3 below, hold completely different and opposing ideological views on corporate insolvency. It will be argued in this chapter that the reason for the ideological divide between the above two schools of thought, in relation to corporate insolvency law, is because no one theory is universally accepted as the best explanation of the phenomenon of corporate insolvency. While these two camps agree that employees deserve protection in insolvency, they have divergent views on the approach to be used for the attainment of that goal. These differences stem from the belief underpinning each theorist's view on what the legitimate province of insolvency law is, or ought to be.

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[1] This taxonomy is traceable to the writings of Professor Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale L.J 573, 576–79; Donald G Baird, `The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Leg. Stud. 127,133. See also Edward J Janger, 'Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design' (2001) 43 Ariz. L Rev. 559, 566; Ziad Raymond Azar, 'Bankruptcy Policy, Legal Heritage, and Financial Development: An Agenda for Further Research' (2008) 24 (2) Emory Bankr Devs Journal 382 – 466. Charles W Mooney, Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure' (2004) 61 Wash & Lee L Rev. 931.

It is intended to show in this chapter that, depending on which school of thought or theory that insolvency policy-makers in a state subscribe to, employees of insolvent employers may, or may not, enjoy strong protection during transfers of insolvent undertakings in that state.

2.2 The role of theory in this thesis

A company is a nexus of interests. Even in the solvent state of a company the interests of its stakeholders are sometimes at odds with each other. The most common conflict in the company is usually characterised as the struggle between labour and capital.[2] The intractable nature of this conflict led one commentator to observe that:

> To make peace between the working-man and his employer grounded in justice and stamped in perpetuity is the great social problem of the age. Whoever succeeds in doing this will more worthily earn a title to perpetual remembrance than any victor in battles.[3]

In all corporate relations, so goes the argument, ultimately labour and capital share a common interest in the successful achievement of production of goods or services in an enterprise through the combination of inputs from both factors of production.[4] While this observation may be correct, this type of cooperation is, however, never 'conflict-free'. Moreover, the chances for a successful partnership between labour and capital are potentially higher during the solvent state of the company than in its insolvent state. In fact, even in the solvent state of a company, where labour and capital partner[5] to produce goods or services jointly, there are always the problems of sharing and fairness. The bone of contention has always

[2]Hugh Collins, K D Ewing & A McColgan, Labour Law: Texts and Mate*rials*, (2nd edn., Hart Publishing, Oxford 2005) 1; Bruce G Carruthers & Terence C Halliday, *Rescuing Business: The Making of Bankruptcy Law in England and the United States* (OUP, Oxford 1998) 303.

[3] Albert S Bolles, *The Conflict Between Labour and Capital* (Elibron Classics Series, 2002) 17.

[4] A A Alchian & H Demsetz, 'Production, Information Costs, and Economic Organization,' (1972) 62 American Economic Review; Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction, (1999) 24 Journal of Corp. Law 743; Blair and Stout, 'A Team Production Theory of Corporate Law' (1999) 85 V L Rev. 247; Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2003) UCLA Law School Research Paper No. 3-12 <http://ssrn.com/abstract=397801> accessed 12 December 2009; Collins *et al* (n 1)1.

[5] John D Rockefeller, Jr, discussing the two as partners in his seminal essay: 'John D Rockefeller, Jr, on Labour and Capital' published in the New York Times (January 9, 1916) <http://query.nytimes.com/mem/archive-free/pdf> accessed 21 October 2011. Blair & Stout (n 4b).

been determining what would amount to a fair sharing. This is because in practice, no sharing method or formula is considered just by either labour or capital. The reason for this is because traditionally labour seeks to receive the highest price possible available to it while capital on its part seeks to maximise the returns on its investment. The problem is that for the owners of capital to achieve their goal, the suppliers of labour would not be able to achieve theirs. Conversely, paying the highest price available for labour will also cut into the profits of those who own capital.[6]

Stakeholders' conflict in the life of a company is not restricted to when the company is solvent. It appears that conflicts of interest in corporate relationship between labour and capital become irrefragably accentuated upon the occurrence of insolvency. Corporate insolvency is very intricate. It is a scene of conflict. The interests of the stakeholders with various degrees of economic interests in an insolvent company are complex and not easily categorised.[7] On insolvency, the interests of the stakeholders do not always converge[8] for the reasons discussed in chapter 1.

Stakeholders in the context of an insolvent company or business may be defined as those with various economic interests in the company or business, or those whose investments are at risk in the insolvent entity.[9] The divergences of interests usually create a tension between them.[10] Conflicts in insolvency are inevitable due to the expansive reach of the laws especially as regards legislatively mandated priorities and other classic areas of insolvency such as transaction avoidance. Insolvency is also contentious because of the policy-rich norms implicated.[11] In the context of this thesis, a typical example of a policy implication would be the requirement of the transfer of contracts of employment of the employees of an insolvent undertaking on the same terms and conditions to the transferee.

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6 Collins *et al* (n 2).
7 Janis P Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*, (University of Toronto Press, Toronto 2003) 57.
8 Carruthers & Halliday (n 2) 1-8.
9 Sarra (n 7) 58.
10 Sarra (n 7); carruthers & Halliday (n 2).
11 John Pottow, 'Procedural Incrementalism: A Model for International Bankruptcy' (2006) John M Olin Center for Law & Economics, University of Michigan <http://www.law.umich/centersandprograms/olin/papers.htm> accessed 12 January 2010.

Insolvency induced conflicts are not, however, without solutions. This is why there are laws put in place in every jurisdiction to regulate and address the concerns of all those affected by corporate insolvency. However, these solutions are not always acceptable to all stakeholders. This is because any solution proffered is likely to work in favour of a particular constituency's interests against that of another. In such circumstances, the continued existence of such a policy or law would have to be justified normatively.

In relation to this thesis the question may be posed regarding why legislation such as the ARD and TUPE continue to exist despite the general perception that they hinder rescues of insolvent businesses in the UK.[12] A logical explanation in answer to this type of question may require a theory. This is where the role of theory as a tool for logical explanation[13] comes in. A Theory is a logical explanation for why something is as it is, or does as it does.[14] It is, arguably, through the lens of theory that conflicts such as the tension between business rescue and employment protection arising during transfers of insolvent undertakings (due to the policies designed to actualise these differing objectives) can best be explained.

The purpose of the theory chapter in this thesis, therefore, is to explain why employment protection legislation (despite its perceived adverse impact on the rescue culture) continues to operate side by side with the insolvency policy on business rescue in the UK. Theories will also be used to explain the diminution of the rights of the employees which has been achieved through the revisions made to the ARD and TUPE respectively. It will be argued that these changes were necessary for striking an effective balance between the rescue of insolvent businesses and employment protection. However, as in every other field of academic enquiry, theorists do not always agree with each other, this is why we have different theories on the same subject matter. As an area of academic enquiry, insolvency is not exempt from differences of opinions. Accordingly,

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[12] Hugh Collins, 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144-158; S Frisby, 'TUPE or not TUPE: Employee Protection, Corporate Rescue and one Unholy Mess' (2000) 4 CFILR 249-271; John Armour, Adrian Walters & Audrey Hsu, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings' (2006). <http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96...rep..>accessed 20 April 2012.

[13] Karl Popper, *Conjectures and Refutations: The Growth of Scientific Knowledge* (Routledge, London 1963).

[14] Charles V Reynolds, *Theory and Explanation in International Politics,* (Martin Robertson, London 1973).

there is no unison of opinion on which of the extant insolvency theories accurately explains the phenomenon of insolvency. Thus, no one theoretical model currently available for explaining the concept of corporate insolvency is capable of being all things to all people. There are distinct differences and similarities in all insolvency theories (at least, for those presented in this thesis). The lack of consensus in opinion is perhaps a product of the ideological differences that exist amongst the different schools of thought on the subject matter. The problem with having several theories on a subject matter, however, is that the ideological content of theories could sometimes cut against their practical utility. This does not detract from the fact that these theories all have practical applications, one way or the other, to the problems of corporate insolvency.

Before considering the extant insolvency theories available for explaining the phenomenon of corporate insolvency, it is important to first sketch out the two most important ideologies that drive these various theories. It is acknowledged that the approaches examined below are not the only ones available for use in considering insolvency. Indeed, other approaches exist with their own distinct merits but they are yet to have any direct and serious practical impacts on the day-to-day insolvency work.

2.3 The ideological divide

Corporate insolvency has generated much tension between stakeholders of insolvent companies globally. Insolvency has also generated more questions than there are answers to them. Two of the most recurrent issues that have continued to elicit and dominate normative insolvency debates between the different schools of thought (discussed below) are usually framed in the questions: what is the legitimate province of insolvency law? Whose interests should insolvency law serve? These questions mirror two of the most intractable problems that lie at the heart of insolvency law namely: how to balance the interests of an insolvent debtor in a fresh start against those of its creditors who wish to be paid and, how to balance the interests of competing creditors with claims against the debtor's assets that, in most cases, is often not enough to satisfy the claims of all the creditors.[15]

[15] See Roy Goode, *Principles of Corporate Insolvency Law* (3rd edn, Sweet & Maxwell, London 2005) Ch. 2. On the notion of 'fresh start', see generally Thomas H Jackson, 'The Fresh-Start Policy in

Insolvency is problematic because it obliges the law to choose. When a company is in formal insolvency proceedings, there is usually not enough money to go round. In such circumstances, the law must choose whom to pay. The law's decision on who should bear the risk and who should be protected means that there will always be winners and losers in an insolvency setting.[16] There have been engaging debates, both in the academic literature and in practitioner commentaries, regarding the best way to address the above issues. The debates which have spanned several decades have so far failed to generate a consensus. These debates which, arguably, have influenced court opinions and legislative enactments in most jurisdictions, are really about the social policies underlying the insolvency process.[17] The bulk of the debates have been generated in the American bankruptcy literature by bankruptcy scholars there because the US has a much more extensive history of bankruptcy restructuring.[18] '

At the hub of the problem of lack of consensus is a theoretical split among the different ideological camps'.[19] These theorists have different ideologies[20] regarding the problems generated by insolvency and often disagree on how these might be addressed. According to Professor Douglas Baird, the normative debates on insolvency philosophy and policy tend to be contested mostly between two major schools of thought. Professor Baird has labelled these schools of thought as 'Proceduralist' and 'Traditionalist.'[21] The essence of their

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Bankruptcy Law' (1985) 98 Harv. L. Rev. 1393; Charles G Hallinan, 'The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretative Theory', (1986) 21 U Rich L. Rev. 49; Charles Jordan Tabb, 'The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate', (1990) 59 Geo. Wash. L. Rev. 56. For the origin of the term 'fresh start', see the American cases of *Local Loan Co. v Hunt*, 292 U.S. 234, 244 (1934) and *Williams v United States Fidelity & Guaranty Co*., 236 US 549, 554–55 (1915).

[16] Philip Wood, *Principles of International Insolvency Law* (Sweet & Maxwell, London 1995) 1; Carruthers and Halliday (n 2).

[17] Christopher W Frost, 'Bankruptcy and Social Welfare Theory' (2001) Paper presented at the Association of American Law Schools' Workshop on Bankruptcy<http://www.aals.org/profdev/bankruptcy/frost.html> accessed 16 December 2008. On the notion that the views of these two camps influence bankruptcy decision making by courts and policymakers in the US, see Mark Bradshaw, 'Comment: The Role of Politics and Economics in Early American Bankruptcy Law' (1997) 18 Whittier L Rev 739.

[18] Goode (n 15) 41-42.

[19] Samuel E Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policies through the Lens of Theories' (2011), 32 (4) Company Lawyer 99, 101.

[20] The term 'ideologies' is used in this thesis to denote the shared frameworks of mental models that groups of individuals possess that provide both an interpretation of insolvency and a prescription as to how problems associated with insolvency generally should be resolved.

[21] Baird (n 1) 133. Professor Roy Goode and other commentators on insolvency theory have also affirmed that the debate is primarily between these two camps. See generally Goode (n 17) 41-42; Janger (n 1); Azar (n 1); Mooney, Jr (n 1).

disagreement[22] revolves around the contending theories of insolvency law to which each of the two camps subscribe. These two camps are not agreed on what the substantive goals of insolvency law are, or ought to be. Each camp is adamant that its model of explanation accurately explains and justifies or legitimises the extant legal provisions on insolvency.[23]

In sum, the main difference between them concerns whether insolvency should be used to advance the goals of stakeholders other than creditors. Proceduralists see insolvency as a procedural mechanism to distribute the debtor's assets, based on non-bankruptcy entitlements and in an economically efficient manner. Traditionalists, on the other hand, support rules designed not just to enhance and allocate an insolvent firm's value among existing entitlement holders. For them, insolvency rules should be able to protect parties other than creditors who are likely to have been particularly harmed by the debtor's insolvency but who might not be entitled to any of its value under normal collection or priority rules. The various attempts made by various theorists to address these issues have resulted in the myriad of theoretical possibilities currently available for the resolution of insolvency generated conflicts.[24] These are considered below.

2.4 Insolvency theories: background

To articulate and communicate their views on insolvency, theorists need a platform. This platform is usually provided by theories. The normative[25] views of

[22] Professor Alan Schwartz has noted that :

> A disagreement between scholars can take three forms: First, there can be disagreement about the state of the world. In law and economics, this disagreement commonly takes the form of contesting the assumptions that underlie a model. Second, there can be disagreement about the norms that do or should apply to the case under study. Third, there can be disagreement about the analysis. In this third category, the issue is whether a scholar's conclusions follow from his premises.

See Alan Schwartz, 'Bankruptcy Contracting Reviewed' (1999) Faculty Scholarship Series. Paper 1090 <http://digitalcommons.law.yale.edu/fss_papers/1090> accessed 28 April 2012.

[23] Rizwaan Mokal, for example, claims that his Authentic Consent Model is capable of not just explaining, but justifying why certain provisions are the way they are in insolvency law. See Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, Oxford 2005).

[24] Pottow (n 11).

[25] These views are normative because they merely prescribe things or express opinions to be preferred or valued. Insolvency theorists use normative theories to plead their causes and to convince others to join them or to subscribe to their views. These theorists devote themselves to identifying and defining relationships between logical classes, between means and ends, or cause and effect. It is common for every normative theory to contain descriptions. Also, for a normative theory to be

the 'Proceduralist' and the 'Traditionalist' schools of thought on insolvency matters are usually articulated through various contractarian insolvency theories. These theories which are either 'exclusive' or 'inclusive' in terms of the interests to be considered in formal insolvency proceedings are akin to the earliest 17th and 18th centuries Social Contract theories developed by the likes of Thomas Hobbes (1588 – 1679),[26] John Locke (1632-1740)[27] and Jean Jacques Rousseau (1712-1778).[28] These early social contract models had, in various ways, 'half-envisaged some historical accord amongst primitive people for cohabiting within their respective societies[29] in a so-called "state of nature."'[30]

According to Thomas Hobbes, a government was necessary because human beings were, in what he characterised as a 'state of nature.' In this 'state of nature' men competed with each other for the scarce resources. Hobbes opined that because the abilities of human beings were on a par equal, it led them to be natural enemies. Hobbes gave three main reasons why people quarrel with each other: competition, diffidence and glory.

For Hobbes, as long as there was no central power or authority to keep people in control, there will be perpetual competition and squabbling amongst them. This is the condition that Hobbes referred to as a 'state of war.' Thus, Hobbes equated the state of nature or the original state (where no central power to keep human beings from competing and quarrelling with each other existed) with the state of war which lacks control and orderliness. What this implies is that without a central controlling authority, each person seeks his own self-interest.[31] Given the nexus of interests in a company, and without the imposition of a collectivised debt collection regime, corporate insolvency would be like the 'state of war' scene painted by Hobbes.

The two fundamental elements of a social contract are the characterisation of the original state or position and the rationality[32] of the contractors. In contemporary

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convincing, it must generally contain elaborate descriptions of real world conditions. See further, L J R Herson, *The Politics of Ideas: Political Theory and American Public Policy,* (Waveland Press, 1984).

[26] Thomas Hobbes, *The Leviathan*, (first published 1651, Penguin 1985).

[27] John Locke, *Two Treatises of Government* (Awnsham Churchill, 1690).

[28] Jean J Rousseau, '*The Social Contract or Principles of Political Rights*' (GDH Cole tr, London 1973).

[29] Etukakpan, (n 19).

[30] Hobbes (n 26).

[31] Hobbes (n 26).

[32] The rational choice framework posits that individuals know what is in their self-interest and are therefore compelled to act accordingly. See Douglass North, 'Economic Performance through Time'

normative contractarian theories, (implying theories seeking to ground the legitimacy of government or theories that claim to derive a moral ought), the original position[33] (referred variously in the literature to as the initial situation, the initial bargaining position,[34] or the state of nature[35]) which in bargaining theory is referred to as the 'no agreement position,' represents the starting point for a fair, impartial agreement. This is defined as the situation or position to which the individuals in a prospective contract will ultimately return if they fail to reach an agreement amongst them.

There is no clear and exact picture that can accurately describe what the state of the 'original situation' is like. It may be more or less hostile, more or less social, depending on what the particular theorist considers to be a true representation of 'human nature' in the absence of rules of justice. Crucial to all contractarian theories, however, are the notions of scarcity and co-operation. The argument is that there may be scarcity of resources or motivation for competition in the original situation. For social contractarian theorists, competition reflects 'ubiquitous scarcity'[36] while scarcity induces fear of the depredations of others.[37] It is further contended that where there is scarcity of resources in any situation, the situation can only be remedied or ameliorated by the affected parties co-operating with each other. The point here is simply that scarcity impresses upon persons the need to co-operate with each other because there is some potential for gains from social interaction and co-operation.[38]

Social contract theories also require the existence of the institution[39] of rules to guide the formation of agreements. Institutions form the incentive structure of every society. Since rules precede the contract, there must be some source of prior moral norms, whether natural, rational, or conventional. The first rule that is

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(1993) The Sveriges Riksbank Prize in Economics Sciences lecture in Memory of Alfred Nobel (December 9, 1993).

[33] John Rawls, *Political Liberalism* (Columbia University Press, New York 1996) 255-58.

[34] David Gauthier, *Morals by Agreement*, (OUP, Oxford 1986) Ch 2.

[35] Hobbes (n 26).

[36] North (n 32).

[37] Jan Neverson, *The Libertarian Idea* (Temple University Press, Philadelphia 1988) 148.

[38] Co-operation as between the different classes of creditors of the insolvent is the basis on which the collective notion of insolvency law for solving the potential collective action problem in insolvency derives.

[39] Douglas North has defined institutions as 'humanly devised constraints that structure human interaction.' These comprise of formal and informal constraints. Formal constraints are made up of rules, laws, constitutions while informal constraints are made up of norms, conventions, and self-imposed codes of conduct. North (n 32).

normally prescribed is that there must be no force or fraud in the making of the agreement. No one is to be 'coerced' into an agreement by the threat of physical violence.[40] Coercion negates the principles of free agreement and is no different to the 'state of nature' for the party coerced or threatened by coercion.[41] Thus, any agreement reached under such circumstances lacks security.[42]

The major difference between traditional social contract theories and contemporary contractarianism, however, is that whilst traditional social contract notions were predicated on consent (implying that human beings had basic normative autonomy over themselves before consenting to enter into the social contract),[43] contemporary contractarianism on the other hand, contemplates a thought experiment through which the requirements of practical rationality can be discovered.[44] This denotes the self-conviction of the individual that his or her situation could be worse-off if he or she does not enter into the agreement or if he or she is unwilling to co-operate with the others.

It is important to remember however that not all agreements will be concluded the way one might ordinarily have wanted them to be concluded. Yet even though such an agreement or co-operation may not entirely be favourable to the interest of the person in question, he or she would still be better off co-operating with others since, in the absence of any agreement or co-operation, the individual in question could end up being worse-off.

2.4.1 The social contract heuristic and corporate insolvency

When the social contract heuristic is applied to corporate insolvency analysis, 'a thought experiment' entails that contractarian theorists seek to explain what are the basic rules that may be chosen in a hypothetical contract to regulate contentious matters arising in insolvency situations. It also entails finding the rules that would be rational for self-interested parties to accept as condition precedent

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[40] A Cudd, 'Contractarianism' (2008) in E N Zalta (ed.) *The Stanford Encyclopedia of Philosophy* <http://plato.stanford.edu/archives/fall2008/entries/contractarianism/> accessed 21 December 2010.

[41] This, impliedly, is the distinction between the past economic system of Hobbs and Rousseau's era which was based on coercion (slavery and feudalism) and modern day capitalism which is based on consent (i.e. bargain/contract).

[42] Gauthier (n 34) D Gauthier, *Moral Dealing: Contract, Ethics, and Reason*, (Cornell University Press, Ithaca 1990).

[43] B Ackerman, *Social Justice in the Liberal State*, (YUP, New Haven, CT 1980) 66.

[44] Gauthier (n 34 & n 42).

for partaking in such a contract.[45] On the other hand, the notion of scarcity articulated by social contract theorists may be likened to the situation where the debtor's assets are insufficient to meet the claims of all its creditors. From the creditor's perspective, the shortage of resources (on the debtor's side) to meet all of their claims not only informs, but also accentuates the need for co-operation amongst them so as to effectively address the collective action problem that may arise when their common debtor is in formal insolvency proceedings. The co-operation of the stakeholders must be voluntary and not coerced.

The type of social contract entered into by the stakeholders of a company in insolvency may be likened to what Jean Hampton calls the 'alienation contract.'[46] Hampton's heuristic, and as it applies to insolvency law, may be construed as a type of contract in which all stakeholders in insolvency proceedings decide to voluntarily 'alienate their rights' to adjudicate on all their insolvency-related disputes and self-help approaches to a central authority for debt enforcement on the conviction that it is the best, and perhaps the only, way to maintain decorum or orderliness in the proceedings, given what the consequences of the alternative (i.e. self-help and a run on the company's property) will be for all of them.[47] That is, they alienate their rights to individual debt enforcement to a 'dominant protective' body of all the creditors in return for future benefits.[48]

However, unlike the fear of the depredation of others often advanced by proponents of earlier social contract theories as the reason for this type of co-operation,[49] the reason given for co-operation by the stakeholders in insolvency is that there is mutual benefit to be derived from being subject to a 'collective debt enforcement' arrangement, as against 'self-help' or individual debt enforcement measures. Thus, from the insolvency perspective, it is by focusing on the motivation of co-operation for mutual advantage, rather than on the fear of the

[45] For Social Contract theories in general, see John Rawls (n 21) 258; Rousseau (n 19); Samuel Freeman, *Justice and the Social Contract* (OUP, Oxford 2007) 17. See also F D'Argostino, 'Contemporary Approaches to the Social Contract' [2008] *Stanford Encyclopaedia of Philosophy* <http://www.plato.stanford.edu/entries/contractarianism-contemporary/> accessed 7 October 2009.
[46] Jean Hampton, *Hobbs and the Social Contract Tradition*, (CUP, Cambridge 1988); *Political Philosophy* (Westview Press, 1996).
[47] ibid.
[48] Robert Nozick, for example, argues that a free society should allow people to alienate rights of self-government to a dominant protective association. For Nozick, 'the comparable question about an individual is whether a free system will allow him to sell himself into slavery.' To this question, Nozick's response is: ' I believe that it would.' See Robert Nozick, *Anarchy, State and Utopia* (Basic Books, New York 1974) 331.
[49] Neverson (n 37) 148.

depredations of others, that a more inclusive and positive contractarian insolvency theory emerges.

2.5 Select insolvency theories: analysis

There are as many theoretical approaches grappling with explaining the structure of insolvency law as there are writers in this area of law.[50] These 'complex and nuanced' approaches, proposed under various nomenclatures, have yielded four main different ideologies. These may be characterised as debt collection; rehabilitation; effective corporate governance in the turnaround of insolvent firms and market approaches to insolvency.[51]

Some of these theories are discussed briefly below while the last three will be given extensive treatment in this chapter. The reason for this is because these three, apart from having the four elements listed above, represent the exclusive views of the Proceduralist and the inclusive views of the Traditionalist schools of thought. Specifically these three theories are among the insolvency theories that are able to clearly mirror the tension between the policies underpinning business rescues and employee protection in corporate insolvency which is the subject of research of this thesis.

2.5.1 Communitarianism

The main argument presented by Communitarian theorists is that insolvency law should not focus solely on protecting the private rights of the creditors.[52] Communitarianism therefore advocates that a balance be struck between the interests of the creditors and those of the other stakeholders of an insolvent company. These include the interests of non-creditor stakeholders such as the employees and the community at large.[53] One of the core theses of communitarianism is that the economic life of a region in which the insolvent business is located should be an important consideration in the design of

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[50] Peter Walton, 'When is Pre-Packaged Administration Appropriate? - A Theoretical Consideration' Paper Presented at the Nottingham Trent University International Insolvency Conference 2010. http://www.ntu.ac.uk/nls/news_events/insolvency_conference/conference_papers/index.html accessed 27 October 2011.

[51] Sarra (n 7)) 51.

[52] ibid.

[53] Kathryn R Heidt, 'The Automatic Stay in Environmental Bankruptcies' (1993) 67 Am. Bankr. L.J 69; Sarra (n 7).

insolvency law. According to these theorists, for insolvency law to operate in a way that will be of benefit to the community at large, the rescue of the business, where possible, or at least, an orderly liquidation where the survival is impracticable, are important factors that policy makers the world over ought to take into account when designing insolvency laws.[54] This type of argument can be buttressed by pointing to a country such as France, where insolvency law was reformed in 1985 and 'expressly given the task' as claimed, 'of rescuing an insolvent enterprise, preserving employment and eliminating liabilities.'[55]

2.5.2 Value-Based Theory

The value-based theory, which is the brain child of Donald Korobkin,[56] is an attempt to offer a rich and full exposition on why bankruptcy[57] law emerged as a system with the varied structures and dimensions that it possesses. Korobkin's value-based theory disapproves of the idea of taking the debtor as a pool of assets (i.e. dead property). Rather, he prefers the debtor to be considered as having a personality and a dynamic potential. According to Korobkin, these are important because like a 'natural' (human) debtor, a legal (corporate) debtor is a moral, political and social actor. Korobkin notes:

> A corporation, whether in or out of financial distress, is more than [a bankrupt individual]. The law of corporate reorganization developed as a corrective to a bankruptcy jurisprudence that would have ignored a financially distressed corporation's dynamic potential. It reflected a means of bringing the corporation's dynamic personality into public view and regulating not merely its economic division, but the playing out of its moral, political and social values.[58]

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[54] See e.g. Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997).

[55] See Axel Flessner, 'Philosophies of Business Bankruptcy Law: An International Overview' in Jacob S Ziegal (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press, Oxford 1994) 19, 22.

[56] Donald R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Colum. L. Rev. 717.

[57] The terms 'bankruptcy' and 'insolvency' are used interchangeably in this thesis. While 'bankruptcy' is the terminology used by American scholars in the American jurisdiction to denote both personal and corporate bankruptcies, a distinction exists in the UK jurisdiction. In the UK, the term 'bankruptcy' is used only to denote a situation where a natural person is unable to pay his debts, while a company's inability to meet its financial obligations is commonly referred to as 'insolvency.'

[58] Korobkin (n 56) 745.

The value-based theory juxtaposes the debtor's estate to a human life arguing that just as the decision on what is good for a natural being cannot be made once and for all, given the dynamics of life, there exists no fixed answer to what is a 'good' and 'all encompassing' solution to a company's financial distress since every financial distress is in a specific historical context with unique questions of its own. For Korobkin, bankruptcy law should not merely be a response to the collective action impasse. Its goal should be to address the problems of financial distress and create conditions, or provide a context, for a discourse in which values or participants may be rehabilitated into a coherent and informed vision of what the enterprise shall exist to do.[59]

2.5.3 Multiple Value Approach

There is also what has been described as the multiple value or eclectic approach.[60] This approach calls for the recognition of the interests of those who are not directly creditors alongside the interests of direct creditors. At the forefront of this school of thought is Professor Warren who has been very vocal in her criticism of the Creditors' Bargain Theory (CBT), discussed below, for being too narrowly focused and its attempt to use collectivism to justify insolvency systems as a whole.[61]

2.5.4 The Creditors' Bargain Theory

Basic corporate law theory, in the solvent state of a company, is premised on the shareholder primacy norm which makes the board of Directors (during the solvent state of the company), accountable to the shareholders as the primary risk bearers. However, when the company becomes insolvent, the shareholders' primacy norm is, or should be, supplanted, according to most literature and case-law on insolvency, by the creditors' primacy norm.[62]

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[59] ibid. 789.

[60] Vanessa Finch *Corporate Insolvency Law Perspectives and Principles* (2nd edn, CUP, Cambridge 2009) 40.

[61] Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 Uni. Chi. L Rev. 775, 800; Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L Rev. 336-387.

[62] See e.g. *Kinsela v Russell Kinsela Pty Ltd* [1986] 4 NSWLR 722; *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 CA (Civ Div) at 252–253; *Brady v Brady* [1989] AC 755 HL.

One of the predominant theories on insolvency is the *Creditors' Bargain Theory* (CBT).[63] The CBT was first proposed by Thomas Jackson in an article he published in 1982.[64] The creditors' bargain heuristic, as further developed by Jackson,[65] sometimes in collaboration with either Douglas Baird[66] or Robert Scott,[67] employs a neo-Rawlsian contractarian notion to explain and justify the structure of corporate insolvency law. From inception, the CBT generated heated debates within corporate insolvency law circles and became the focus of attention[68] which made it the most influential law and economics theory on corporate insolvency.

The CBT's aim is to provide a normative theory of what bankruptcy law should be. It explains the normative validity of corporate insolvency by reference to a hypothetical preference that creditors would express *ex ante* the extension of credit in advance of the debtor's insolvency.[69] The theory assumes that the essential features of the insolvency system were not chosen by the creditors themselves, but that these features were imposed on them instead. The CBT is used as a model to explain that when a single debtor having multiple creditors becomes insolvent its creditors are potentially going to have a 'collective action' problem that would require a solution.[70] It is reasoned that because the

[63] This was true until recently when the standard Jacksonian account of bankruptcy as a solution to a collective action problem among similarly situated creditors whose self-interest and collective interest are easily identifiable and homogenous began to come under serious attack from within the law and economics movement. See generally, James W Bower, 'Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Policy and the Elementary Economics of Failure' (1990) 84 Mich. Law Rev., 2097-2150; Stuart C Gilson 'Transactions Costs and Capital Structure Choice: Evidence from Financially Distressed Firms', (1996) Journal of Finance; Lynn M LoPucki, & William C Whitford, 'Corporate Governance in the Bankruptcy Reorganizations of Large Publicly-held Companies'(1993) 141 University of Pennsylvania Law Review, 669-800; E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 333, 338; R J Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain, and Corporate Liquidation' (2001) 21 Legal Studies, 400, 443; Mokal (n 23).

[64] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860.

[65] Thomas H Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 Stan. L Rev. 725; Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986)

[66] See e.g. D Baird & T H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chicago L. Rev. 97.

[67] T H Jackson & R Scott, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Virginia L. Rev. 155.

[68] Warren, (n 61a) 775; Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 Uni. Chi. L Rev. 815

[69] Jackson (n 65b).

[70] Jackson (n 65b) Douglas G Baird, 'A World without Bankruptcy' (1987) 50 Law & Contemp. Probs. 173. There is indeed, a substantial literature which questions whether a serious collective action problem exists in the first place and, if so, of just what it must necessarily consist and if the problem is

insolvency of the corporate debtor renders it unable to meet all of its financial liabilities to its creditors in full, this might trigger a 'race to collect' amongst its various creditors. Given the diversity of interests implicated in the company's financial distress, the individual incentives of each creditor are to act in a way that will be self-beneficial but detrimental to the best and overall interests of the creditors as a group. Consequently, only those creditors who are 'strong' (in the sense of the contractual and statutory entitlements which are already in place) and are able to press their claims early enough would be paid in full (if paid at all), leaving those creditors 'slow off the blocks' potentially with nothing. This creates a scenario reminiscent of the 'survival of the fittest' conundrum in the Hobbesian world in which resources are scarce. Scarce resources and different objectives, *a la* Hobbes, make for the possibility of conflict. In the absence of social and political institutions enforcing certain standard patterns of behavior in human beings, individuals would have to strive to survive. Scarcity 'forces' human beings to compete with each other for the available resources in a disorderly manner (see discussion in section 2.4 above).

Ex-ante, the creditors would see individual self-help as a serious problem militating against their ability to recoup their respective investments in the insolvent company and would accordingly agree that their individual self-interests would be best served if each and every one of them was to surrender their individual rights of debt collection in exchange for a collective enforcement forum where a joint debt action against their common debtor can be enforced.[71] As a solution, Jackson proposed that the creation of a mandatory collective remedy (which mirrors the terms of an idealised multi-creditor contract to co-operate), would be justifiable as a means of overcoming the collective action impasse.

What Jackson is saying in effect is that there is a notional agreement amongst the creditors of an insolvent company, which comprises terms that they themselves would consent to before any of them entered into contracts with a company. The terms of the agreement reached by them deal with how their respective claims should be treated, in the unfortunate event of the company becoming insolvent.

adequately defined, just how adjusting priorities among creditors addresses it. On this see e.g. Barry E Adler, 'A World without Debt' (1994) 72 Wash. U. L. Q 811-827; Adler, 'Financial and Political Theories of American Bankruptcy' (1999) 45 (2) Stanford L Rev 31-346.

[71] Historically, creditors realised that the one-on-one private creditors' remedy of seizure and sale was adequate only in cases where the debtor had plenty of valuable assets left to be seized.

The creditors are then compelled to share the company's remaining assets by the imposition of a collective and compulsory regime.

A collective debt forum, in Jackson's view, would avoid the premature termination of the debtor's business through liquidation. That is, it eliminates the wasteful and potentially inefficient liquidation of the company's assets by individual creditors. According to Jackson, a collective debt forum will not only preserve any going concern surplus by making on behalf of the creditors, a single and all-encompassing decision regarding the manner in which value can be maximised in disposing of the debtor's business but would also reduce strategic costs.

The 'policing' of the debtor on an individual basis is, for Jackson, administratively inefficient and may lead to a nil return to the particular creditor if other creditors get to the debtor's assets first before him or her. It is Jackson's view therefore that 'a single inquiry into recurring collection questions is likely to be less expensive than the multiple inquiries necessary in an individualistic remedies system.'[72] What Jackson appears to be saying here is that an individualistic system of debt enforcement puts a premium on 'racing' for the debtor's assets given that the desire and determination of each and every creditor to recover debt would trigger a 'race to the courthouse' even at the slightest inkling that the company is operating in the vicinity of insolvency.

Co-operation amongst the creditors in a collective proceeding would ensure that no costly and duplicative monitoring of the common debtor's solvency individually by the creditors is borne. Co-operation enhances administrative efficiencies and makes for the maximisation of the debtor's overall economic value since the debtor's assets may be worth more if kept together in either a going-concern liquidation or reorganisation.[73] A collective regime, Jackson opines, is also advantageous for risk-averse creditors.[74] It would ensure that they get a better return on their investments than would otherwise be possible in the individualistic system. Jackson believes that these types of creditors would rather prefer a lower, but more certain return, on their investments, to a higher, but riskier and uncertain return.

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[72] Jackson (n 64a) 866;Jakson (n 64b).

[73] Jackson (n 64a) 866-68.

[74] On the notion of risk aversion, see Robert Pindyck and Daniel Rubinfeld, *Microeconomics* (4th edn, Prentice Hall, N J 1997) Ch. 5.

For Jackson *et al,* the actual collective forum in real life, characterised by the automatic stay, duplicates the effects of this hypothetical *ex ante* negotiation and therefore prevents any costs that real-life creditors would be expected to incur in negotiating a moratorium on claims in expectation of the possible insolvency of their common debtor.[75]

To ensure orderly proceedings, payment of debts must be done in accordance with the terms upon which each creditor agreed its pre-insolvency entitlements with the debtor.[76] This means that a collective forum would also ensure that claims are entertained in a rational and orderly manner as against what obtains in the individualistic debt collection regime. Under the individual collection system claims are met, not in the order in which they arose, but in the order in which they are brought. Every creditor will try to be the first in line to collect payment from the debtor. The effect is that some creditors may not receive anything at the end of the day.

Added to the above is the informational advantage of a collective forum. It is reasoned that any creditor who does not partake in the collective forum could end up with nothing since he or she may not learn in good time of the debtor's financial distress and could as a result lose the race to collect what is due to him or her. To achieve all of the above results, the way forward, according to the Creditors' Bargain heuristic, is to view the debtor's assets as a common pool to be used for the satisfaction of the debtor's pre-insolvency liabilities or financial obligations to only those creditors with legal rights to those assets.

Jackson's hypothetical creditors sit behind a Rawlsian 'veil of ignorance'[77] which ensures that in bargaining they have no knowledge as to their own individual characteristics. They operate nescience of whether they are secured or unsecured creditors, suppliers, lenders or employees creditors. Such creditors would agree to the wealth maximisation model of collective and compulsory insolvency procedures because it would be of mutual advantage to them.

[75] Jackson (n 64b).

[76] There are obvious exceptions to this rule such as the limited rights of preferential creditors under Schd. 6 of the Insolvency Act 1986. Criticisms have been levelled against the CBT for not dealing adequately with distributional issues in insolvency. Mokal (n 23) 69.

[77] See Jackson (n 65) 17, referring to the work of Rawls: *A Theory of Justice* (revised edition Oxford University Press, Oxford 1999) in which the phrase first appeared. Both Rizwaan Mokal and Donald Korobkin have cast aspersions on Jackson's claim that the creditors' bargain theory is an application of Rawls' methodology. See Mokal (n 23) 61-62; D G Korobkin 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993) 71 Texas Law Review 541.

On what the legitimate province of insolvency law is, or should be, Jackson and his collaborators insist that insolvency law should limit itself to addressing issues arising in insolvency only. One of such issues usually posited by these scholars as representing insolvency law's core mission is the allocation of a debtor's property (or the value of a debtor's property) to the holders of claims and interests in the property only.[78] Regarding who can partake in the collective forum, these theorists tenaciously hold the view that insolvency exists, primarily and exclusively, for the benefit of the creditors of the insolvent.[79]

Though Jackson and his collaborators acknowledge the existence of other interests in insolvency, they are adamant in maintaining that when a company becomes insolvent, the creditors' interests should take primacy over all other interests. To them, the interests of any other constituency should be considered only to the extent that the particular members of those groups are creditors with enforceable legal rights against assets of the insolvent company under non-insolvency law.[80] The basis for the primacy of the creditors' interests in insolvency derives from what these theorists believe is insolvency law's core role: to maximise recoveries for parties with non-insolvency legal entitlements relating to financially distressed debtors.

The basis of this contention is premised on the argument that since, at the heart of a bankruptcy case, the legal entitlements relating to a debtor (defined primarily as 'claims' against a debtor, and in some cases, the interests of a debtor's equity security holders)[81] are determined and vindicated, the most fundamental function of bankruptcy law therefore is to serve the interests of a debtor's creditors in much the same way as civil procedure vindicates the interests of parties with legal entitlements who seek judicial relief or satisfaction via civil litigation.[82]

In spite of its prominence and dominance, the CBT has not enjoyed a trouble-free reign as the leading theoretical model for analysing corporate insolvency. A lot of

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[78] James W Bowers, 'Security Interests, Creditors' Priorities and Bankruptcy' (1999) Louisiana State University Law Centre,<http://www.scribd.com/.../security-interest-creditors-priorities-and-bankruptcy->accessed 30 February 2010.
[79] Jackson (n 64b) 860 and (n 51) D G Baird, 'A World without Bankruptcy' (1987) 50 Law & Contemp. Probs. 173.
[79] See Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741, 769.
[80] Jackson (n 64b).
[81] Bowers (n 78).
[82] Mooney, Jr (n 1).

critical 'salvos' have been fired at both the theory and its proponents in recent times.[83] These criticisms (some of which are evident in the discussions of the theorists considered below) have come, as would be expected, from scholars in the Traditionalist camp, and still within the economics, or law and economics paradigm. Therefore, there are arguments among different flavours of economists or economically inclined lawyers.[84]

2.5.5 The Authentic Consent Model

The very idea that anyone could discover a coherent 'deep structure' of corporate insolvency has been described as an exercise in futility.[85] After examining the defining features of the CBT: the role of self-interest, consent, as well as its *ex ante* position, Rizwaan Mokal is of the view that the CBT can neither explain nor legitimise the coercive collective liquidation regime. He questions_how the CBT identifies the proposition it claims all creditors would consent to in an insolvency scenario. Mokal objects to what he describes as:

> ...the narrow concerns of the CBM[86] which restricts participation in the *ex-ante* agreement to those who have contracted for legal rights to the debtor's assets once insolvency has occurred.[87]

Evidently, Mokal is merely restating the concerns expressed by the communitarian, multiple approach and team production (see below) theorists that

[83] In his review of Thomas Jackson's book, *The Logic and Limits of Bankruptcy Law*, David Gray Carlson commented that 'Thomas Jackson has written an unremittingly dreadful book.' See D G Carlson, 'Philosophy in Bankruptcy' (1987) 85 Mich. L Rev. 1341-1389. See further V Countryman, 'The Concept of Voidable Preference in Bankruptcy' (1985) 38 Vand. L Rev. 713, 823-5, 827; J L Westbrook, 'A Functional Analysis of Executory Contracts' (1989) 74 Minn. L Rev. 227, 251; T A Sullivan, E Warren & J L Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (OUP, New York 1989) 256.

[84] Corporate insolvency law is one area of law to which economic analysis is now being applied. The basis for applying economics approach to legal analysis rests on the assumption that those involved with the legal system act as rational maximisers of their individual satisfaction. Another argument in the law and economics literature is that applying economics to legal analysis can help in designing more efficient reforms of the legal system. See e.g. Richard A Posner, 'The Economic Approach to Law' (1974-75) 53 Tex. L. Rev 761 -4. Legal analysis through the lens of economics has revealed that the legal system itself has from time always been strongly influenced by a concern with promoting economic efficiency. See J W Hurst, *Law and Social Process in United States History* (Da Capo Press, New York 1972) 4.

[85] Carlson (n 83) 1389. Carlson argued at page 1341 that Jackson's book is unhelpful in solving hard and interpretative problems. He added that the book will no doubt find 'some admirers among people who think that bad law-and-economics is better than no law-and-economics...'

[86] Note that Mokal uses the terms 'Creditors' Bargain Model' - acronymed 'CBM' whereas the terms 'Creditors' Bargain theory' is used in this thesis. This has been acronymed the 'CBT'.

[87] Mokal (n 23) 69.

the CBT is too narrow and exclusive in the interests it takes into account in insolvency. To remedy this, Mokal has developed an alternative model for insolvency analysis which he labels: the Authentic Consent Model[88] (ACM) based on the notion that all principles of corporate insolvency law can be meaningfully tested.

2.5.5.1 Premise of the ACM

Contractarian theories of insolvency assume that insolvency proceedings will be collective. Collectiveness requires that all creditors should have a say in the process or at least have their interests fairly protected. But in the real world, concerns have been expressed by some real life creditors about how the proceedings operate to deny them a voice in insolvency proceedings. The CBT is a contractarian theory but under the type of agreement it proposes, not all classes of creditors can have a say in actual insolvency proceedings. Mokal believes that his ACM offers a voice to all creditors in insolvency. As a model for explaining insolvency, the ACM involves a movement away from traditional *contractarianism*[89] to a *methodological contractualism* approach of analysis and justification of the provisions of insolvency law. A distinction exists between the two as shown below.

2.5.5.2 Distinction between Contractarianism and Contractualism

By way of distinction, contractarianism, which evolved from the Hobbesian social contract ideas (discussed above), is different from contractualism in that unlike the latter, it is not trust-based. Contractarianism holds the view that persons are primarily self-interested. When applied to the company, contractarianism sees the company essentially as a 'nexus of contracts' among those that constitute it (i.e. its directors, shareholders, creditors, employees, etc.). These explicit and implicit contracts reflect the parties' efforts to maximize their respective

[88] ibid.

[89] As noted earlier, despite its dominance as a theory for explaining insolvency, the CBT has not gone unchallenged. There have been several manifestations of the desire to counter especially Jackson's claims that his Creditors' Bargain Theory is an application of Rawls's methodology. In 1993, Donald Korobkin constructed a self-consciously Rawlsian alternative to the CBT. See particularly Donald Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993), 71 Tex. L Rev. 541. While Mokal's ACM sets off in the same direction or follows a similar route as Korobkin's model, aboth however encapsulate radically disparate visions of the role of insolvency law. Both models also reach very different conclusions.

economic self-interests under contractarianism. Thus, each of these parties which constitute a particular company will, at any given time, seek to 'opportunistically' maximise their profit from the company without giving due regard to what the effects of doing so might be on the other parties.[90]

A typical illustration of how and when the 'selfish' wealth maximisation pursuit of stakeholders manifests in corporate insolvency would be where a contractor decides to terminate a contract whose continued existence the contractor knows is not just beneficial, but essential for the continuation of the financially distressed company. By terminating the contract, the contractor in question obtains a benefit, but his benefit is to the detriment of other constituencies because they have been deprived of a valuable contract. If in the real world this was the case, in defence of the contractor's behaviour, contractarians could still argue that the type of wealth maximisation pursued by the contractor (in the scenario painted above) approximates to the contractual terms upon which at the time credit was extended, and which the parties to the credit agreement (i.e. the creditor and the debtor) would have agreed should govern their rights should the debtor become insolvent in the future.[91]

Contractarians believe however, that a rational assessment by the contractor of the best strategy for maximising its individual self-interests will impress upon the actor the need to act morally (where the moral norms are determined by the maximisation of joint interests), and lead the contractor to consent to a central and unbiased regulating authority for the general good. In other words, individual actors are sometimes 'forced' to co-operate out of what may be referred to as 'enlightened self-interest' but still within a moral universe where the other co-operating parties are merely a means to a better end for each and every one of them. Exponents of *contractarianism* argue that individuals are motivated to accept morality, first, because they are vulnerable to the depredations of others, and second, because they can all benefit from co-operation with others.[92]

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[90] David Gauthier, *Moral Dealing: Contract, Ethics, and Reason*, (Cornell University Press, Ithaca 1990); J Rawls, *A Theory of Justice*, (HUP, Cambridge, 1971); Rawls, *Political Liberalism,* (Columbia University Press, NY, 1993); Korobkin, (n 89)

[91] Robert K Rasmussen 'An Essay on Optimal Bankruptcy Rules and Social Justice' (1994) 1 University of Illinois Law Review 1.

[92] Narveson (n 37) 148.

On the other hand, contractualism, which derives from Jean Jacque Rousseau's idea of a social contract, and which has been propagated by the likes of Kant[93], Scanlon[94] and Rawls[95] etc., is an ethical theory hinged on the notion of the equal moral status of persons. It is used to reflect the view that morality is predicated on contract or agreement. Contractualism argues that what people do or the way they behave in any given business relationship is determined by the agreement reached between them. It is reasoned that the general 'will' is what individuals will jointly 'will' if a perspective that they all are free and equal can be adopted. Proponents of Contractualism opine that rationality requires that we respect persons, and respect for persons in turn requires that moral principles be designed in a way that they can be justified to each person. According to Scanlon:

> ...an act is wrong if its performance under the circumstances would be disallowed by any set of principles for the general regulation of behaviour that no one could reasonably reject as a basis for informed, unforced general agreement.[96]

If Rawls's idea is applied to corporate insolvency law, an insolvency law theory based on contractualism is that which bases moral obligation on a tacitly implied social contract between hypothetical beings in a setting which demands impartiality. Such a theory seeks principles that all rational and autonomous agents would accept and agree to issues under certain idealised conditions.

Thus, unlike contractarianism in which individuals are motivated to act because of self-interest, it is the standard of morality to which the individuals will be held accountable that drives them to act under contractualism since these standards will have to be publicly justified. In an insolvency scenario, for example, this would mean that a particular constituency, in seeking to maximise its own

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[93] See e.g. I. Kant, *Groundwork of the Metaphysics of Morals,* H.J. Paton's translation, *The Moral Law* (Hutchinson, London 1984).

[94] T M Scanlon, 'Contractualism and Utilitarianism' in Amartya Sen and Bernard Williams (eds.) *Utilitarianism and Beyond,* (CUP, Cambridge,1982) 103-28; Scanlon, *What We Owe to Each Other* (HUP, Cambridge, MA, 1998); 'A Contractualist Reply' (2000) 66 *Theoria (3)*237-245; Scanlon, 'Replies' (2002) 28 *Social Theory and Practice (2)* 337-358; R J Wallace, 'Scanlon's Contractualism' (2002) 112 Ethics (3) 429-470; S Reibetanz, 'Contractualism and Aggregation' (1988) 108 *Ethics* (2) 296-311; David Alm, 'Contractualism, Reciprocity, Compensation' (2008) 2 Journal of Ethics and Social Philosophy .

[95] J Rawls, *A Theory of Justice*, (HUP, Cambridge MA 1971); *Political Liberalism,* (Columbia University Press, NY, 1993).

[96] Scanlon (n 94b) 153.

interests in a bargain with the others, must pursue those interests in a way that it can justify why it did what it did to others who have their own interests to pursue in the bargain too. In sum, contractualism is concerned with what reasons, and forms of reasoning, are justifiable.[97]

2.5.5.3 Contractualism and the ACM

The ACM is a model built on contractualism. Its antecedents, evidently, lie in works by Rawls, Kant and Dworkin. Its proponent claims that this model successfully explains and justifies some of the fundamental features of UK insolvency law, especially the collective regime and the wide-ranging legal practices that buttress this practice.[98] The particular features in question include the *moratorium* on the enforcement of certain claims against insolvent debtor companies, the priority that insolvency laws of most jurisdictions accord to claims stemming from 'fixed' security, the nature of the 'floating' charge, administrative receivership, the administration procedure, the nature and the appropriate place of the *pari passu* principle and the wrongful trading provision of UK insolvency law.

As a model based on contractualism, the ACM is designed to accommodate and reconcile the *substantive* goals of fairness with the *procedural* goals of transaction cost efficiency[99] in corporate insolvency. Efficiency is a procedural and not a substantive goal of law since it cannot, and does not on its own confer justification on any part of law. As a procedural goal of law, efficiency is indispensable because once a set of substantive goals of that law has been externally specified, efficiency can be used to judge between the available schemes for implementing them.[100]

2.5.5.4 Substantive goals of law and the ACM

The substantive goals of law are those goals which bestow justification on that part of the law by advancing all the positive aspects of that branch of law. They not only demonstrate the need for having that law, but they also accentuate the value

[97] Rawls (n 95).
[98] Mokal (n 23).
[99] Reference to efficiency here is to 'productive' efficiency rather than to 'allocative' efficiency.
[100] Rizwaan .J Mokal, 'On Fairness and Efficiency,' (2003) 66 MLR 452; Mokal, (n 23) 24-25.

of having and practicing that *corpus* of legal doctrine.[101] Thus, in the context of corporate insolvency, the *substantive* goals of insolvency law, in Mokal's view, include having a 'just' disposition to all stakeholders in insolvency proceedings.

Just rules must be laid down precisely because, in real life, the individuals in an insolvency setting are characteristically either strong or weak, or helpless. For these reasons, just rules are needed to regulate insolvency, as it would be both unfair and unjust to allow the strong or the powerful (this would be secured creditors/banks) to overwhelm and exploit the weak (e.g. employees or unsecured creditors) in insolvency proceedings.[102] Justice within the ACM framework *redresses bargaining advantages* while the creditors' bargain model merely *reflects* them. The ACM-type justice demands the treatment of all stakeholders in insolvency as equals. This means that co-operation should be facilitated amongst them as moral equals. It also means that equal concern and respect should be shown to the interests of each and every party affected by issues peculiar to insolvency.

Co-operation in the ACM's context means that those confronted by a set of issues peculiar to insolvency should co-operate, accept, and be guided by certain rules and procedures laid down to govern insolvency.[103] To put this in context, reference to *issues peculiar* to insolvency is reference to the 'dormant' social, commercial, and legal circumstances unique to a company, and which are triggered only when it becomes insolvent.[104] In the UK for example, the ranking of creditors, adoption of contracts of employment by the administrator and the *pari passu* distribution, etc. are issues that arise in the life of a company only when it is insolvent. Although the obligatory transfer of the employee's contract of employment, on the same terms and conditions, the transfer of certain debts owed to them and the transferor's rights and other liabilities to the transferee, is not a rule of insolvency law and is not only applicable to transfers of insolvent

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[101] Paul Milgrom and John Roberts, *Economics, Organization & Management* (Prentice-Hall, New Jersey 1992), 22-30.

[102] Rizwaan J Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain, and Corporate Liquidation' (2001) 21 Legal Studies 400, 414.

[103] Ibid. 420.

[104] Ibid. 416.

businesses,[105] the problems this employment law practice pose to going concern business transfers are peculiar to insolvency.[106]

The co-operation envisaged by the ACM, in relation to issues peculiar to insolvency, has to take place on terms that would be reasonably acceptable to each party participating in the insolvency proceedings, provided everyone else accepts them likewise. The reason for demanding the observation of these principles is because the justification for having a particular branch of law, its condemnation or rejection, is based on the extent to which the law in question promotes or detracts from the moral equality of all those to whom it applies. Non observance of these principles could lead to a breach of the right to equal concern and respect for all parties likely to be affected by the insolvency proceedings. These reasons provide the basis for the ACM advocating that we deal fairly with the interests and expectations of those whose economic interests would, in different ways, be affected by insolvency. Comparatively, the position taken by the ACM is totally at variance with that of the CBT which canvassed the prioritisation of the interest of the company's creditors with legal rights to its properties to the exclusion of all non-right holders' interests.

2.5.5.5 Procedural goals of law and the ACM

The procedural goals of law, on the other hand, are standards or ideals of the way and manner in which laws are implemented in order to attain their substantive goals.[107] The apparent scarcity of social resources makes it a central procedural goal of virtually all parts of a legal system to endeavour to implement its substantive goals in a way that minimises waste as much as possible so as to be able to maximally implement its substantive goals. Thus, in the case of corporate

[105] No distinction is made in the TUPE Regulations 2006 between a solvent business transfer and an insolvent business transfer. According to Regulation 3 (1) (a), TUPE applies to:

> 'a transfer of an undertaking, business or part of an undertaking or business situated immediately before the transfer in the United Kingdom to another person where there is a transfer of an economic entity which retains its identity.'

[106] The transfer of employees' contract terms and other rights and liabilities is not particularly problematic when the business transferred is solvent. However, in insolvency, and in a going concern business transfer, the transfer of contract terms, rights and liabilities need to be handled differently and carefully if the continuous survival of the insolvent business is to be guaranteed.

[107] Mokal (n 102).

insolvency law, for example, its *procedural* goals would be tested against the extent to which it has provided a means for a fair scheme of co-operation between the stakeholders. The ACM methodology provides the means for investigating whether principles are wasteful, or whether they are productively efficient in the procedural sense of achieving more output with the same amount or even less input.[108] For example, the ACM methodology would be useful in assessing the efficiency or otherwise of the use of default rules in transfers of insolvent undertakings regarding employees' contracts.

Perusal of the ACM reveals that it is not so different from the CBT discussed above. The two are similar in the sense that both models are underpinned by the Rawlsian philosophy of a hypothetical consent. Both are agreed that in determining the legitimate entitlements of parties, it is most appropriate to ask what these parties would consent to in an appropriately defined hypothetical bargain. The key difference however, is that while the ACM is a contractualist theory and is based on a 'justice as reciprocity' principle, the CBT, as a contractarian theory, is a 'justice as mutual advantage' theory.[109]

In other words, unlike the contractarian bargain which is based on justice as mutual advantage principle[110] (which some maintain is a fatally flawed theory of justice because it is too exclusive)[111] the ACM's contractualist bargain is driven by considerations of equal mutual respect and reciprocity. Reciprocity acquires a different connotation in this context. It implies not making demands of others that, if one were required to meet the same demands, one would be unable to meet reasonably. What a justice-as-reciprocity theory simply says is that to act in a way

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[108] See Rizwaan J Mokal, `Contractarianism, Contractualism, and the Law of Corporate Insolvency' (2007) Singapore Journal of Legal Studies < http://ssrn.com/abstract=1074745> accessed 12 October 2009.

[109] Mokal (n 23) 81.

[110] Under the principle of 'mutual advantage', a rule for action, a policy, or an action is judged right if it serves the advantage of all concerned. In the context of insolvency, mutual advantage simply implies that the best way for a party to secure its self-interest is to secure the general mutual interest through establishing or maintaining general order. See David Hume, 'An Enquiry Concerning the Principles of Morals,' in L A Selby-Bigge and P H Nidditch (eds) David Hume: *Enquiries Concerning Human Understanding and Concerning the Principles of Morals,* (OUP, Oxford 1975) 195. See further various works by R Hardin, 'Altruism and Mutual Advantage' (1993) 67 Social Service Review *(3); One for All: The Logic of Group Conflict* (Princeton University Press, Princeton 1995) Chs. 4 & 5; 'Magic on the Frontier: The Norm of Efficiency' (1996) 144 U. Penn. L. Rev. 1987-2020.

[111] See e.g. Peter Vanderschraaf, 'Justice as mutual advantage and the vulnerable' (2011) 10 Politics, Philosophy & Economics 119-147.

that can be justified to others, we must adopt principles no one can reasonably condemn or reject.[112]

Given the fact that in the life of a company, insolvency is a rather remote event at the time when the contracts are bargained, the ACM requires all principles that will govern insolvency-related issues to be selected from its 'choice' or 'original' position. What this implies is that all stakeholders are deemed to be 'dramatically ignorant,' (meaning that they are deprived of any knowledge of personal attributes). It is reasoned that their lack of knowledge on what their interests and positions will be in the queue upon the insolvency of the corporate debtor would make each of them incline to act in an economically rational manner and according to a single set of criteria.[113]

The ACM-type contract is akin to the Rawlsian contract which is aimed at setting a general social framework for a liberal society, rather than seeking to determine moral principles. In order to achieve principles of justice (i.e. fairness to all), and to reflect his commitment to liberal neutrality, Rawls places his parties to the agreement behind a 'veil of ignorance', which ensures that they are deprived of knowledge of key facts about their own identities. Similarly, by placing his parties to the hypothetical agreement in this 'veiled' or 'choice' position, Mokal argues that they would anticipate various conceptions of the good that might come their way and would therefore be in a position to provide, rationally, the means through which such conceptions would be pursued via their choice of insolvency principles. In other words, being in a position of 'dramatic ignorance' allows what is 'good' to be agreed upon rather than to be imposed on the stakeholders.

Noting the importance of the 'choice position' further, Mokal cites the 'automatic stay' on enforcement of claims as one of the principles in insolvency that parties would choose to put in place. The model also demonstrates that because of the construction of the 'choice position', and the constructive attributes of the parties bargaining in that position, not only would the principles that will eventually be chosen be fair and just, but that, since these principles would have been chosen

[112] T Nagel, *Equality and Partiality,* (OUP, London 1991).

[113] Charles Mooney has stated unequivocally that *ex ante* hypothetical bargain theories of insolvency law, however colourfully painted, packaged and presented, are susceptible to the objection that they amount to little more than an argument that thoughtful, interested, objective and neutral lawmakers would arrive at the same conclusions about insolvency as their proponents. Mooney's comments were directed at Donald Korobkin's theory of value. See Mooney (n 82) 966.

by them in exercise of their autonomy, the implementation of the principles so chosen will also be efficient. In essence, the ACM's choice position is simply a means of ensuring that any given set of legal practices can be tested in terms of whether it is selective or non-selective, fair or unfair on those that the legal practices affect.[114] However, for a set of principles or rules to be fair to those it will affect, the ACM stresses that there must be consistency in their application.

The key difference between the ACM and the CBT, in relation to the interests insolvency law should cater for, is that unlike the latter, it is not only those constituencies with direct financial concerns in the insolvent company that fit the `affected parties' description in the ACM. Rather, the 'affected party' tag covers any person, irrespective of how remote, but who *can show that its interests are affected in a way peculiar to corporate insolvency*. Consistent with this view, the ACM is therefore a more inclusive theory since it makes for the participation of parties such as managers, shareholders, employees and all creditors (voluntary or involuntary) of the firm, which the Creditors' Bargain model excludes.

Conscious however of the danger of over-stretching the 'affected party' label, presumably for pragmatic rather than principled reason, the ACM rejects the view canvassed by Professor Korobkin that the: '...problem of financial distress affects virtually all persons in society... As a result, all persons in society should have representation in the choice of principles'[115] for being too wide and open-ended regarding those whose interests insolvency law should cater for. The difficulty that such an 'all inclusive' approach faces, it has been opined, is ascertaining how courts will weigh these interests against each other or against those of the creditors specifically.[116] However, to have an inclusive regime will be welcomed by a constituency such as the employees. This is because it would mean that their interests will be accounted for in the overall scheme of insolvency proceedings.

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[114] Mokal (n 23) Ch. 3. Recall at the very beginning of the analysis on the ACM when it was noted that the model is built on the notion that all principles of corporate insolvency law can be meaningfully tested.

[115] Korobkin (n 56) 554.

[116] See Barry S Schermer, 'Response to Professor Gross: Taking the Interest of the Community into account in Bankruptcy- A Modern Day Tale of Belling the Cat' (1994) 74 Wash. U. L. Q.1049.

Differences of opinion regarding the extent of interests to be considered in insolvency notwithstanding, it is evident that Mokal and Korobkin are agreed on one point: that the creditors' interests are not the only interests that insolvency law should take into account when a company is insolvent. Mokal is not the only theorist advocating for insolvency law to cater for a wider set of interests. Other theorists before him have made similar calls in the past,[117] and more are still convinced that corporate insolvency affects several interests that deserve to be given equal weight of consideration as are the creditors' interests.

2.6. The Team Production Theory of Bankruptcy Reorganization

Dissatisfaction with the Creditors' Bargain paradigm for insolvency analysis has continued unabated. This has given rise to several theories put forward to explain insolvency law. Professor Lynn LoPucki[118] has made a very important contribution to theories of insolvency law. By applying the team production theory of corporate law prevalent in the law and economics literature,[119] to bankruptcy reorganization of public corporations, LoPucki has developed a normative and alternative theory for analysing insolvency law. However, before turning our focus to the team production theory of bankruptcy reorganization (hereafter TPT for convenience), and its implications for business rescue and employment protection in the context of insolvent business transfers, it is important to first explore the origin of the theory.

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[117] See generally Warren (n 43) 775-814; (n 54) 336-387; Gross, (n 36); Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17 Oxford Journal of Legal Studies (2) 227-251; Finch (n 55).

[118] LoPucki, (n 75) 769. For avoidance of confusion, the word 'reorganization' is spelled with a 'z' in the American way when reference is made specifically to the full title of LoPucki's theory, but in the analysis the English spelling of 'reorganisation with a 'g' is maintained.

[119] See e.g. A A Alchian and H Demsetz, arguing that the firm does not own all its inputs. The defining characteristic of the firm locates in a team use of inputs and a centralised position of some party in the contractual arrangements of all other inputs. Resource owners increase productivity through cooperative specialization. Alchian and Demsetz (n 4) 777-78: 18 years later, Professor Alfred Chandler lent support to this view when he noted that the modern industrial firm is 'a collection of operating units, each with its own specific facilities and personnel, whose combined resources and activities are coordinated, monitored and allocated by a hierarchy of middle and top managers.' See A. D. Chandler, Jr., Scale *and Scope: The Dynamics of Industrial Capitalism* (Belknap Press, Cambridge, MA, 1990) 13. In is contemporary form, the idea of the firm as a constituent group or team which combine resources to achieve team production and which deliberately cedes control or delegates ultimate authority over both the direction of the enterprise and the distribution of rents and surplus among team members to the corporation's board of directors is articulated by Blair and Stout. See in particular Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction' (1998-1999) 24 Journal of Corp. Law, 743, 745; 'A Team Production Theory of Corporate Law' (1999) 85 V. L. Rev. 247.

2.6.1 TPT: ideological superstructure

The antecedent of TPT lies in the team production theory of corporate law,[120] which in turn owes its origin to the earlier concepts of 'team production' in the economics literature.[121] The team production theory of corporate law in its current form and, in contemporary law and economics literature, owes its development to Margaret Blair and Lynn Stout.[122] The theory has significant normative implications for legal debates on corporate governance and, (as would be shown later), the governance of corporate insolvency.

The team production theory of corporate law offers an alternative approach to the principal-agent explanation model of corporation law.[123] It sheds more light on several pivotal doctrines and issues in corporate law that have plagued corporate governance and which the agency heuristic as a model of explanation could not satisfactorily explain. The theory sheds light on doctrines such as the requirement that public corporations should be managed by a board of directors rather than by the shareholders themselves directly. It illuminates, *inter alia,* the meaning and function of a corporation's legal personality, the rules of derivative suit procedure and the substantive structure of directors' fiduciary duties, and the highly-limited nature of shareholders' voting rights etc. It takes a completely different view on what is traditionally seen as the *raison d'être* of the firm and what corporate law in general is meant to, or ought to, accomplish.

The team production theory of the firm challenges two recurrent themes in corporate law literature. First, it opposes the view that the main goal of the firm is, or ought to be the maximisation of wealth for its shareholders. For decades, the literature on corporate governance was inundated with the view that the economy is driven by a single ideology: that the purpose of the firm was to increase the

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[120] Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction' (1998-1999) 24 J. Corp. L. 743; 'A Team Production Theory of Corporate Law' (1999) 85 V. L Rev. 247.
[121] Alchian & Demsetz (n 4); Chandler (n 119)
[122] Blair & Stout (n 119).
[123] Adolf A Berle & Gardiner C Means, *The Modern Corporation and Private Property* (Transaction Publishers, 1932); Eugene F Fama & Michael C Jensen, 'Separation of the Ownership and Control' (1983) 26 Journal of Law & Economics 302; Michael C Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, (1976) 3 J. Fin. Econ. 305; Milton Friedman, 'The Social Responsibility of Business is to increase its Profits' New York Times, (September 13, 1970), Section 6 (Magazine) 32; . E M Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 Harv. L Rev. 1145, 1148; Peter Drucker, *Concept of the Corporation,* (Transaction Publishers, 1993); Thomas A Kochan and Saul A Rubinstein, 'Towards a Stakeholder Theory of the Firm: The Saturn Partnership' (2000) 11 Organizational Science, 367, 368; D G Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporation Law 277, 293.

profits it delivered to its shareholders.[124] Although, there were a few voices shouting from the margins that the corporation should consider its obligations to the society at large,[125] wealth maximisation for the shareholders continued to be the abiding goal of many a firm for several decades.[126]

However, it seems that the stakeholder theory, proposed as an alternative model to find an answer to the question of what the real objective of the firm is, or should be, has not only grown significantly in popularity in the last two decades,[127] but has gained widespread acceptance too.[128] Recent developments in some 'Anglo-American jurisdictions'[129] (particularly, the introduction of the 'enlightened stakeholder value' in UK company law, and the enactment of 'constituency statutes' in most US states)[130] point to the fact that the dominance and popularity of

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[124] See e.g. Milton Friedman, 'The Social Responsibility of Business is to increase its Profits' New York Times, September 13, 1970, Section 6 (Magazine) 32; David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians and the Crisis in Corporate Law' (1993) 50 Washington & Lee L. Rev. 1373, 1374; L Mitchell, 'Groundwork of the Metaphysics of Corporate Law' (1993) 50 Washington & Lee L. Rev. 1477, 1485; L Fairfax, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (2006) 31 Journal of Corporation Law 675, 676; G Crespi, 'Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace' (2007) 32 Journal of Corporation Law, 383, 386.

[125] See e.g. E M Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 Harv. L R 1145, 1148; Peter Drucker, *Concept of the Corporation,* (Transaction Publishers, 1993); Thomas A Kochan and Saul A Rubinstein, 'Towards a Stakeholder Theory of the Firm: The Saturn Partnership' (2000) 11 Organizational Science, 367, 368; D G Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporation Law, 277, 293.

[126] One of the key arguments often advanced in support of shareholder primacy is that shareholders are residual claimants and that as such, they have the greatest stake in the outcome of the corporation. J Macey, 'Fiduciary Duties and Residual Claims; Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1999) 84 Cornell L Rev 1266, 1267. It follows that since they are residual claimants, the business should be run for their benefit while the corporation is solvent. See F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (HUP, Cambridge Mass, 1999) 36-39.

[127] Andrew Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2009) <http://ssrn.com/abstract=1498065> accessed 27 January 2012.

[128] Michael Jensen notes that the stakeholder theory has been endorsed by many professional associations, special interests groups, and governmental organisations and even the British government. M C Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' in M Beer and N Nohira (eds) *Breaking the Code of Change* (Harvard Business School Press, 2000). In its 'Principles of Corporate Governance' published in 1999, the OECD urged board directors to take into account interests of stakeholders. Others have pointed to the acceptance of the model by pointing out that even traditional pro-business publications such as the Financial Times are in support of a stakeholder model of corporate governance. See E Sternberg, 'Stakeholder Theory Exposed' (1996) 2(1) The Corporate Governance Quarterly 4-18.

[129] The term 'Anglo-American' is often used by legal, economic and political scholars, to refer to those countries or jurisdictions that have similar legal regimes or tradition that are based on the English common law. See Andrew Keay (n 127) above. Thus, the term 'Anglo-America jurisdiction' is used here to refer specifically to the UK and the US, whose legal regimes are based on the English common law.

[130] Keay (n 127).

the shareholder value doctrine may be beginning to wane.[131] While some have, boldly and unequivocally, declared the shareholder primacy theory dead,[132] others have simply opined that, based on the arguments against it, the shareholder paradigm should not survive: 'it should be overtaken by another position.'[133]

Team production theorists of corporate law, exemplified in Margaret Blair and Lynn Stout, who obviously are not shareholder value or shareholder primacy acolytes, contend that the shareholder primacy theory of the firm is flawed since the shareholders are evidently not the only group that contributes specialised inputs to corporate production.[134] The firm, they opine, is an aggregate of 'interests' comprising, but not limited to, shareholders, creditors (secured and

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[131] There is the view that the recent introduction in the UK, for example, of the concept of enlightened shareholder value into company law in the form of section 172 of Companies Act 2006, which now requires directors to balance the interests of the various stakeholder of the corporation when making decisions, is indicative of the UK's preparedness to embrace stakeholder value in relation to the management of corporations. S Kiare, 'At Cross Roads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road should the United Kingdom Take?' (2006) 17 Int'l Corp & Comm L. Rev 329. See also the views of Cynthia and Conley that:

> The expanded social and environmental disclosure mandate in the UK, seen within the context of changes in institutional investor legal regulation, norms and behaviour, is evidence that a British "enlightened share value" corporate governance theory is coming to occupy a unique third position between the American shareholder wealth--maximizing position and the continental stakeholder model. ...
>
> ...even in the United States, where market pressures have advanced the concept of shareholder primacy to a greater extent than in other countries, stakeholders' interests are starting to be articulated with more vigor and efficacy within the corporation... Here too, the global CSR movement is blurring the edges of the traditional shareholder-- stakeholder distinction.

Cynthia A Williams and John M Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Contract' (2005) 38 Cornell Int'l L.J 493, 493 & 500. For some other scholars who share a similar view on the shareholder – stakeholder dichotomy, see generally S William, 'The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties' (1991) 21 Stetson L. Rev 163; E Orts, Beyond Shareholders: Interpreting Corporate Constituency Statutes' (1993) 61 Geo Wash L Rev 14; E Adams & J Matheson, 'A Statutory Model for Corporate Constituency Concerns' (2000) Emory LJ 1085; k Hale, 'Corporate Law and Stakeholders; Moving Beyond Stakeholder Statutes' (2003) 45 Arizona L. Rev 823; B McDonnell, 'Corporate Constituency and Employee Governance' (2004) 30 William Mitchell Law Rev 1227.

[132] See e.g. R Edward Freeman, 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4 Business Ethics Quarterly 409, 413.

[133] Keay (n 127).

[134] Margaret M Blair, *Ownership and Control: Rethinking Corporate Governance For The Twenty First Century* (The Brookings Institute, Washington DC, 1995) 229; Margaret M Blair & Lynn A Stout, 'Team Production in Business Organizations: An Introduction' (1998-1999) 24 Journal of Corp. L 743; 'A Team Production Theory of Corporate Law' (1999) 85 V. L. Rev. 247.

unsecured), employees and managers.[135] The employees, for example, make firm-specific human capital contributions to the firm. Human capital has been identified as the most important asset in the modern firm.[136]

Second, there is an assumption in contemporary corporate law scholarship that the central economic problem addressed by corporation law is how to reduce agency cost by ensuring that managers and directors continue to remain as loyal agents of the shareholders despite the latitude granted them by the latter on decision making.[137] Team production theorists reject this view and argue instead that the central economic function of the public corporation is primarily to address the *team production problem* that arises when a number of individuals invest firm-specific resources resulting in the production of non-separable goods.

Blair and Stout aver that team production problems arise when three conditions are met. The first condition is that economic production requires a team. That is, production requires the combined inputs (e.g. of time, money and other resources) of two or more persons. These persons include the shareholders, creditors, directors, managers, employees, and other potential corporate stakeholders who in the future may commit firm-specific resources to the firm.[138] The second condition is that some of the resources combined or invested by the team members for the production must be 'team-specific.' This means that the

[135] Using the 'nexus of contracts' metaphor to explain corporate relationship in a slightly different way, others have argued that the corporation should be seen as 'a number of complex, private, consensual transactions or contract-based relations, either express or implied' consisting of different types of relationships expressed in terms of voluntary association with the corporation by the different persons that comprise it. See e.g. Keay (n 127); F Easterbrook and D Fischel, 'The Corporate Contract' (1989) 89 Colum L. Rev 1416, 1412; J R Boatright, 'Contractors as Stakeholders: Reconciling Stakeholder Theory with the Nexus-of-Contracts Firms' (2002) 26 (9) Journal of Banking and Finance 1837-1842; T Donaldson L E Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications' (1995) 20(1) Academy of Mgt. Rev. 65-91; K R Conner, 'A Historical Comparison of Resource-based Theory and Five Schools of Thought Within Industrial Organization Economics: Do We Have a New Theory of the Firm?' (1991) 17(1) Journal of Mgt. 121-154; R E Freeman and W M Evan, 'Corporate Governance: A Stakeholder Interpretation' (1990) 19(4) The Journal of Behavioural Economics 337-359; R E Freeman and R A Philips, 'Stakeholder Theory: A Libertarian Defense' (2002) **12 (3)** Business Ethics Quarterly 331-349; H Hansmann, *The Ownership of the Firm* (HUP, 1996).

[136] Luigi **Zingales**, 'In search of New Foundations' (2000) 55 Journal of Finance 1623, 1632. See also M Blair and L Stout, 'Specific Investment: Explaining Anomalies in Corporate Law' (2006) 31 Journal of Corporation Law, 719, 738.

[137] See e.g. Adolf A Berle & Gardiner C Means, *The Modern Corporation and Private Property* (Transaction Publishers, 1932); Eugene F Fama & Michael C. Jensen, 'Separation of the Ownership and Control' (1983) 26 Journal of Law & Economics 302; Michael C Jensen & William H Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, (1976) 3 J. Fin. Econ. 305.

[138] See Lynn M Stout, 'Bad and Not-So-Bad Arguments for Shareholder Primacy' (2002) 75 S. Cal. L Rev. 1189, 1195-96.

resources have significant higher value when used specifically by the team for its production than if they were committed to their next best use. The third condition is that the gains (economic 'rent') resulting from team production has to be joint or non-separable. This makes it difficult to attribute any particular portion of the gains to the contribution of a single team member at any time.[139]

Team production problem, according to Blair and Stout, is not a pre-investment problem *per se;* rather it is a post-investment problem. It is after the three conditions discussed above have been met that team production problem may arise. What is characterised as team production problem is simply a problem of fair sharing of the proceeds from the joint effort of the team members. It is opined that after the team resources have been jointly invested, team members face the dilemma of how best to share the gains accruing from the joint production. In such situations team members may find it difficult or impossible to draft explicit contracts distributing the output of their joint efforts fairly amongst themselves. Supposing they agree *ex ante* to a sharing formula or rule that will divide the gains equally among them, such a formula may potentially be plagued with the problem of *shirking* (used in this context to mean an absence of optimum efforts on the part of individual team members for the success of a joint project). Equally, should the team members decide to wait and share team production gains *ex post,* they will, on the other hand, have to contend with the problem of wasteful *rent-seeking* (implying internal squabbling and misapplication of available production resources which in turn would reduce the overall wealth available for distribution among them).

Thus, shirking and rent-seeking exposes some of the team members, who have made firm-specific investments in the company to the opportunistic behaviour of other team members. There is the notion that if this type of behavior on the part of some team members is allowed to continue, it could reduce, or completely erode any economic gains generated by team production effort eventually.[140] These problems are compounded by the fact that team members are unable to draft explicit contracts capable of distributing the 'rent' of their joint efforts according to an individual's contribution and merit. As a solution to this conundrum, team members might seek *extra-contractual* means of protecting themselves, failing which the preferred alternative would be to relinquish control over their

[139] Blair & Stout (n 134) 743.
[140] Blair & Stout (n 134) 745.

enterprise to an independent third party.[141] This third party is to be entrusted with the responsibility of representing the respective interests of the team members and allocating rewards among them as fairly as is practicable.

Two cogent reasons have been advanced by Blair and Stout for delegating ultimate decision making authority on business governance and distribution of production rents and surplus among team members to an independent board. First, the team members intend that all of them should have a share in the rents and surplus resulting from the production. This constituent group believes that only an independent and neutral board will divide the rents and surplus among them fairly based on individual members' contributions.

The second reason given for delegation of authority is that team members are vulnerable. Their vulnerability makes them unable to effectively protect the firm-specific investments that each of them has made in the enterprise[142] whether by 'direct contracting, personal trust, or reputation.'[143] Therefore all stakeholders decide through the vehicle of the team production contract that the best thing to do is to give up control over those resources to a board of directors whom they see as an impartial arbiter for their own benefit and protection.

It is not uncommon for employees and managers to make the kind of investments mentioned above in a company in the hope that, in the long run, the firm will reward them for their efforts with a raise in wages or salary, job security and even promotions.[144] But the Blair and Stout team members do not rely on the board of directors alone to reward them. Individual members of the team may, and do sometimes, negotiate and agree to a contract with the firm guaranteeing them some minimum share in the team production.

The type of contract agreed to will, however, vary according to who the team member in question is. For example, a creditor might negotiate with the firm for the right to be paid interest on principal, the repayment of principal on demand as well as the right to discontinue and withdraw investment under specified circumstances (e.g. default or breach of a loan agreement). For the customer, it could be the right to be granted legally binding warranty promises. The

[141] In this case: the Board of Directors.
[142] Margaret M Blair & Lynn A Stout, `Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 Wash. U. L. Q. 403, 416.
[143] LoPucki (n 79).
[144] Blair & Stout (n 134) 743, 745.

executives of the firm might negotiate for 'commensurate' salary for work done, stock options, severance pay, etc.[145]

In addition to these legal rights, team members would expect other forms of compensations from the firm which are non-legal entitlements (see below). For the executives these could be extra bonuses, club membership etc. For lending banks, it could be the continuation of lending rapport, with or without, the best lending terms being made available to the creditor firm. In a similar vein, the employees would expect to be paid above-market wages and benefits (even if this will mean shifting costs on to other team members such as the creditors by reducing payments of money owing to them). The employees will also expect to be provided job security in old age, sickness, during reorganisations or during the sale of the firm, or of its business (whether solvent or insolvent) as a going concern to a purchaser. This could, for example, justify continued employment of some employees even though, economically, the firm knows that it is inefficient to do so. For the customers, it might be demand for product support or extension of that support beyond stipulated contractual and cost- effective time-span. The firm could justify its action on grounds of customer goodwill.[146]

The provision of these additional rewards is dependent on several factors. These include each member's actual contribution to team production, production requirements and the success enjoyed by the firm at the time. Blair and Stout are quick to point out that these additional compensations do not, however, carry legal rights. What this means is that where the firm cannot provide them, team members cannot therefore litigate against it for failure to provide them. But because team members do not see compensations as a gift, but rather as an entitlement, it is possible that the firm's failure to provide these things would nonetheless be construed by the team members as a betrayal. This could cause low morale and lead to disaffection towards the firm in particular, and team production in general.

The team production model carries important normative implications for legal and popular debates over corporate governance, because its core tenet is that maximizing shareholder wealth should not be the principal goal of corporate law. Shareholders are just other team members of the production team. Thus, directors

[145] LoPucki, (n 79) 751.
[146] ibid.

of corporations should seek to maximize the joint welfare of all the firm's stakeholders, which include shareholders, managers, employees, and possibly other groups such as creditors or the local community, all of whom contribute firm-specific resources to corporate production. Professor Lopucki has adapted this stakeholders' approach to corporate law analysis and incorporated the idea into the model of insolvency law analysis he labels 'team production theory of bankruptcy reorganization' which is analysed below.

2.6.2 Applying the team production heuristic to bankruptcy analysis

Building on the team production theory of corporate law, Lynn LoPucki has developed a team production theory of bankruptcy reorganization (TPT). TPT turns the existing contractarian and the dominant Creditor's Bargain theory upside down. With the TPT, corporate insolvency ceases to be seen through the CBT's lens as a regulation imposed by government on the stakeholders. It instead becomes a contract term to which they agree to subordinate their legal rights for the preservation of the going concern in the business instead.

Like the CBT which it strives to disprove, TPT is contractarian. It is contractarian because its account is based on mutual self-interest. It looks at those forms of co-operative behaviour that are mutually advantageous for self-interested parties in an insolvent company to engage in. But unlike the CBT, which is based on a hypothetical contract, TPT is based on putative actual contracts. LoPucki claims that his model '... is an empirically testable hypothesis regarding the actual bargain among the constituent groups...' that makes up 'the public corporation'.[147] By this Professor LoPucki means that the theory is grounded on actual contracts entered by team members. However, the theory is also normative as it asserts that actual contracts should be enforced on efficiency grounds.

TPT starts by identifying the institutions that are economically efficient and makes assumptions that contracting parties would choose these institutions. Under TPT the company is seen as an aggregation of participants (designated as team members) who combine their resources in a production unit. The reason given for this team approach to production is because the contracting parties realise that they cannot achieve the business results they desire if they seek those results

[147] ibid. 744.

separately and individually rather than by doing so as a team. Team production results from the joint resources and efforts of the constituent groups that make up the team. Thus, the resources used in team production do not, in an economic (as distinct from legal) sense, all belong to one person.[148]

The basis of team productivity is mutual trust. The emphasis on mutual trust is what sets TPT apart from other contractarian theories such as the CBT (mutual advantage), in which trust is seemingly lacking. Thus, TPT is based on the hypothesis that team members deliberately delegate the ultimate decision making authority over the company and the distribution of rents and surpluses among them to the board of directors on trust. The reason for doing this is because it is difficult for these matters to be dealt with through explicit contracts.

Regarding the interests that should be taken into consideration in insolvency, LoPucki asserts that a collective insolvency proceeding should account for the rights of all stakeholders because in addition to contributing value to the company, these parties also have various degrees of economic interests in it. LoPucki is of the view that the CBT is nothing more than a bargain that ensures that, in the event of insolvency, the creditors would be well positioned to control outcomes so that they can get everything from the debtor's estate. This is why the theory is creditor focused.

TPT is agitating for the inclusion and consideration of the employees' interests as stakeholders in a company. Employees make human capital contribution to firms. Thus, in relation to the employees and their importance to firms, TPT is merely echoing the view that suppliers of labour deserve to have their claims considered in the same way that suppliers of capital do in corporate insolvency.[149] An argument may be made that after all, the value of a company's commodity and or of its services, *a la* Karl Marx in his labour theory of value, is ultimately derived from the labour used to create that commodity.[150] In a business (highly dependent

[148] Alchian & Demsetz (n 4) 777-95.
[149] David Milman, 'Priority Rights on Corporate Insolvency' in Alison Clark (ed.) *Current Issues in Insolvency Law* (Stevens, London, 1991) 57.
[150] Karl Marx, *Capital: A Critique of Political Economy Volume 1: The Process of Capitalist Production*, (Samuel Moore & Edward Aveling translation) Frederick Engels & Ernest Untermann (eds) (Charles H. Kerr and Co, Chicago, 1909) Ch. 1.

on skills, knowhow, services etc. as opposed to capital assets), these investments are arguably wrapped up in its goodwill and going concern values.[151]

It is an objective of the team production contract to permit the debtor company to be reorganised when the need arises and to ensure that it continues to trade during insolvency. The debtor should carry on business if the total benefits accruable to team members from continuing to trade exceed those that would accrue in liquidation. The point here is that reorganisation should occur when it is beneficial to team members as a group and not when it is only beneficial to the interests of the creditors as canvassed by the CBT.

The CBT is a model built on the notion that, upon the occurrence of insolvency, if the company continues to operate, it should be owned by the creditors. This means that the interests of other team members, such as the employees, the consumers, the community in which the company operates, etc., would all have to play second fiddle to those of the creditors, since consideration of non-creditor interests, according to the creditors' bargain theorists, is economically inefficient. For CBT, the employees are not, in a strictly legal if not economic sense, the owners of the insolvent company since they have no substantive rights against its assets. For this reason the creditors, who, in their view are the 'legal' owners of the company during insolvency, are at liberty, for example, to close it down without considering the interests of the employees if doing so will enable them to maximise their wealth.[152]

TPT favours continuity of employment. The theory's position is that the team production contract has to continue in force during bankruptcy reorganisation. This is because team members intended it to be that way at the time they contracted to join the firm. The continuity of the firm, or of its business, requires that, at least, some of the team should remain in place and carry on production during a reorganisation exercise. What this means in the context of insolvency reorganisation is that nothing prevents the firm from making adjustments to the team if necessary. For example, the management may need to be fired and replaced by the team. Also, if reorganisation takes the form of a sale of the firm's business on a going concern basis, the firm is not prevented from firing some, but not all, of its employees in order to be able to continue trading.

[151] Gross (n 54).
[152] Jackson (n 64b) 25.

Regarding the question of redistribution in insolvency, LoPucki does not see this as a case of 'robbing Peter to pay Paul'. Put differently, redistribution is not the 'Robin Hood'[153] of corporate relationship which 'robs' holders of legal rights of their wealth and gives this to non-rights holders such as the employees, as the creditors' bargain theorists would have us believe. Rather, redistribution is seen as one of the objectives of the team production contract. For LoPucki, redistribution in the context of insolvency is simply a way of honouring the commitments that the company made to the team members in order to entice them to join the team.

For LoPucki, and in relation to the employees' team members, the fulfilment by the company of its pre-insolvency legal obligations to them in a going concern transfer of its business should not be affected by its insolvent status. The firm should honour its obligations to them due to the firm-specific human capital investments the employees make in the company. The rationale for this is that while the team members were contracting to join the company, they had mandated the company (technically through the board) to honour its commitments to the employees' team members even in insolvency as the employees, unlike the creditors' team members, are unable to protect their investments in the firm in other ways.

What this implies is that, the team production theory accepts, for example, that in bankruptcy, the creditors' or the shareholders' non-bankruptcy entitlements may be altered and wealth may be redistributed to other team members. Thus, in relation to the employees' team members, the fact that the firm is insolvent should not prevent it from honouring its team production obligations to them. Rather, the firm should honour these obligations even if it means having recourse to the use of bankruptcy law to reduce its formal obligations to other team members (such as the creditors) in order to meet its legal obligations to the employees team members because of the firm-specific investments they have made in the firm. Granted, in honouring its commitments to the employee-team members, for example, the company might be portrayed as antagonising the creditor-team members in respect of their formal claims since it might require actions to be

[153] Robin Hood was a heroic outlaw in English folklore. Legend has it that he used to steal from the rich and give to the poor. The origin of the legend is claimed by some to have stemmed from actual outlaws, or from ballads or tales of outlaws. See e.g. Howard Pyle's 1883 novel: The Merry Adventures of Robin Hood.

taken, such as using insolvency law to alter the latter's priorities and reducing the company's formal obligation to them which they might not approve of.

Under the TPT, it is not considered that meeting of its obligation to the employee-team members by the insolvent company would destroy the rights of the other constituencies or team members with legal rights against the company's assets. These groups (i.e. creditors and shareholders) were, in fact, party to the original team production agreement or contract which directed that the company' s board should honour its team production obligations to the employee-team members even when it is insolvent because of the latter's very valued firm-specific human capital contributions to the firm.

In spite of the seeming tension between the team members whose formal rights may be reduced in insolvency, the company continues to represent them as fiduciaries *vis-a-vis* their team production entitlements. [154] The issue on redistribution, it is submitted, needs to be approached with great care. One wonders, for example, if secured creditors' rights were reduced in insolvency to allow for redistribution to other aims, whether doing so would lead to an increase in the cost and availability of finance.

What the Team Production Theory of corporate bankruptcy is advocating is simply that the interests of all those affected by insolvency should be heard and their concerns addressed. Bankruptcy policy should take into account the distributional impact of business failure on all stakeholders (team members). This would apply to those with a direct financial interest in the failed company as well as those with non-financial claims but still an interest in the on-going business.[155] There is the view that the shareholder primacy theories encourage managers to treat non-owner stakeholders such as the employees as mere means to the ends of the shareholders.[156]

[154] LoPucki (n 79) 764.

[155] Professor LoPucki is not alone in calling for such a forum and role for insolvency law. See e.g. E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 336, 354-55; Nathalie D Martin, 'Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In' (1998) 59 *Ohio St. L. Rev.* 429; A Flessner 'Philosophies of Business Bankruptcy Law: an International Overview' in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency* Law (Clarendon Press, Oxford 1994) 27. On why bankruptcy might not be redistributional, see Ronald J Mann, 'Bankruptcy and the Entitlements of the Government: Whose Money is it anyway? (1995) 70 NYU L Rev. 993.

[156] R E Freeman and W M Evan, 'Corporate Governance: A Stakeholder Interpretation' (1990) 19(4) The Journal of Behavioural Economics 337-359.

2.7 Relevance of theory to insolvency law

Insolvency law provides a bundle of diverse legal entitlements for the different categories of stakeholders that comprise the insolvent company. It also institutes rules to govern how these entitlements should[157] be honoured when the company is insolvent and is in formal insolvency proceedings.

Insolvency law theories seek to analyse, *inter alia,* what these rules are, what each of the parties comprising the firm would have bargained for, if they were given a chance, before their dealings with the company. Theories also seek answers to what legislative scheme would maximise the welfare of each and every constituency that comprise the insolvent company. For example, if we see insolvency as loss sharing device which should alter or revise original contractual entitlements of the parties in light of current facts, then some social welfare theory would be needed to provide a basis or normative justification for redefining those entitlements.[158]

The theoretical and philosophical bases for insolvency law provide a useful lens through which to critically analyse all forms of legislative protection[159] given to all parties affected by insolvency or the values held by these parties.[160] Thus, insolvency theories illuminate our understanding of insolvency law. Ultimately, the purpose of the debates or arguments based on competing values, as articulated by Korobkin, 'is to compare the relative strengths and weaknesses of plausible arguments, and not to find a clear winner.'[161]

2.7.1 Relevance of CBT

The CBT has been very influential as a model for bankruptcy analysis. It has even been given legislative cognizance in some jurisdictions. Creditors bargain is a

[157] The word 'should' is indicative of the fact that a normative assertion is being made. What this means in essence is that the obligations should be honoured only when doing so will be efficient.
[158] Frost (n 17).
[159] Helen Anderson, 'Theory and Reality in Insolvency Law: Some Contradictions in Australia' (2009) 27 Company and Securities Law Journal 506-523 http://www.clta.edu.au/professional/papers/conference2009/AndersonCLTA09.pdf accessed 10 March 2012.
[160] Elizabeth Warren, Bankruptcy Policymaking in an Imperfect World (1993) 92 Mich. L Rev 336; Donald R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Colum. L Rev. 717.
[161] Donald R Korobkin 'The Role of Normative Theory in Bankruptcy Debates' (1996) 82 IOWA L Rev. 75, 108-9.

useful way of theorising or thinking about technical issues, and broad issues of bankruptcy and corporate reorganisation generally. Its contribution to bankruptcy law in general is better appreciated if we ask ourselves the questions: Why don't we just let individual creditors exercise their remedies? Why have bankruptcy proceedings?

The CBT becomes useful by arguing in the context of insolvency that, if human beings are rationally self-interested, they would co-operate knowing that they would be better off through collective action than by grabbing assets of the debtor individually. Let us assume the situation that a debtor is experiencing financial difficulty (i.e. its liabilities exceed its assets), and that it has two creditors which it has granted separate loans of £50, 000 each. The insolvent business is worth £80, 000 if sold as going concern and £60, 000 if broken up and sold piecemeal. If an individual creditor seizes the debtor's assets, that creditor will collect its £50, 000 whereas the second creditor would only get £10, 000. There is an assumption that creditors are risk adverse and so there is a 50% chance of even getting the £50, 000. However, if both creditors were to co-operate with each other, then they would get £80,000 when the business is sold as a going concern.

The 'co-operate' or 'defect' hypothetical (that is, the individual versus collective enforcement action problem) is essentially the game theory's 'prisoners' dilemma'-type problem that arises in insolvency. In other words, when a common debtor is insolvent and its assets are potentially not enough to meet its obligations to all of its creditors, there is inevitably a problem of co-operation and competition for the available assets. This is also a problem of choice between selfish behaviour and socially desirable altruism.[162] The point here is not that self-help or individual enforcement action which is to the benefit of the particular individual is morally wrong, nor is a collective enforcement action that would benefit others at the expense of the individual (if he or she were to act alone), always morally required. However, in the prisoner's dilemma game, both parties would prefer the outcome with the altruistic moves to that with the selfish moves.

[162] See Steven Khun, 'Prisoner's Dilemma' (2007) in Edward N Zalta (ed.) *Stanford Encyclopedia of Philosophy* <http://plato.stanford.edu/entries/prisoner-dilemma/> accessed 28 March 2011. See also Ian Ayres & Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale Law Journal 87. The 'prisoners' dilemma' is the direct opposite of Adams Smith's 'Invisible Hand' theory which holds that self-interested action often forces individuals to act against promoting common good rather than work towards it. See Adam Smith, *The Wealth of Nations* (1776) Book IV Ch. 11.

This is what Jackson is implying in his creditors' bargain theory. Like the prisoners' dilemma, the CBT helps us to understand what governs the balance between co-operation and competition in corporate insolvency.

Jackson has posited several reasons why it pays for the creditors to co-operate in insolvency. Cooperation between creditors, according to the CBT, would reduce strategic costs. This means that the collective procedure would, for example, save costs on monitoring to ensure the other persons are not grabbing assets, checking at the court to see if anything has been filed, etc. Adopting the CBT model would also increase the pool of assets (aggregate value) and prevent premature termination of insolvent but viable businesses. It will also make for greater administrative efficiencies. The value of the debtor's assets will be determined in bankruptcy court rather than in separate debt collection activities.

Jackson justifies bankruptcy as a mandatory term with the argument that individual creditors do not trust each other. A mandatory regime serves to prevent one creditor from trying to 'pull a fast one' on the others. In real world, none will deny that there are shifting creditors in a business, so agreement to stop strategic behaviours would be difficult to negotiate. Therefore, it is better to have this as a mandatory term that all creditors have no choice but to abide by. This, according to Jackson, is in the creditor's self-interest to have this procedure in place rather than a free-for-all asset grab procedure with creditors of unequal abilities.

The implication of CBT for insolvency law generally is that the law should control strategic behaviour undermining bargain once the debtor is insolvent. An example would be fraudulent preference,[163] that is, a payment to, or advantage conferred on, one creditor in fraud of the rights of other creditors by an insolvent debtor. Here one creditor is given a preference and paid out when other creditors are not.

The second idea behind the CBT is that the law should not create strategic incentives to resort to bankruptcy where it is not to the collective benefit of the creditors. Although this point can be related to bankruptcy laws in most

[163] Insolvency Act 1986, s. 239. See also *Barber v CI Ltd* [2006] BCC 927. For a contrary view on the court's decision in that case that a payment susceptible to a challenge as a preference can also be challenged as a transaction at undervalue under s. 238, see Look Chan Ho and Rizwaan Mokal, 'Barber v CI –Preference Equals Undervalue? (2006) <http://ssrn.com/abstract=929566> accessed 02 May 2012.

jurisdictions in terms of raising an issue about strategic incentives in their respective bankruptcy systems, it is a problem commonly associated with jurisdictions such as the US and Canada where there is a 'two-tiered' bankruptcy law. The differences in state and federal (in the case of US) or federal and provincial laws (in Canada) offer strategic incentives for forum shopping, (in the US), and for a secured creditor to put a firm into bankruptcy (in Canada), not for collective reason, but for example, to reverse the established priorities.[164]

However, it is the CBT's central idea: the assumption that creditors bargain is solely for ensuring that those with legal right to assets should be taken account of, i.e. to maximise creditor's pre-existing interests and return that elicits debate. The position taken by Jackson in relation to the distribution of the debtor's property would, in practice, require insolvency law to take all creditors' pre-insolvency agreed rights as it finds them, honouring both powers and limitations under non-insolvency law without modifying or making alterations to them.[165]

[164] In Canada, for instance, under provincial legislation Personal Property Security Act (PPSA first enacted in Ontario in 1967. All other Canadian common law jurisdictions have since followed) s. 30(7), a security interest is subordinate to a person who is the beneficiary of a deemed trust under the Employment Standards Act 2000 s. 40(1) and s. 136 (1)(d), i.e. every employer holds vacation pay in trust, and the money that represents that vacation pay will trump a security interest (a super priority). However, under s. 136 of the Bankruptcy and Insolvency Act 1985, there is a list of preferred creditors, and under s. 136 (1)(d) there is a preference for wages, salaries, commissions, compensation, to the extent of $2000 which includes vacation paid, and then says 'subject to the rights of secured creditors', so that the vacation pay in bankruptcy, the preference for it, comes after the secured creditor has exercised their rights in relation to the property of the debtor. So that in bankruptcy, the employee has a lower priority than they do under the provincial legislation.

[165] Creditors' bargain theorists' query: if bankruptcy has an important policy role in balancing the various interests, and if wider interests (workers, community) are to be taken into account in bankruptcy reorganisation, why restrict this to bankruptcy? Many firms close without going through bankruptcy. What's special about bankruptcy? Special rules create incentives for strategic behaviour e.g. repudiation of collective agreement/contract. CBT's argument is that if a firm cannot repudiate collective agreement when experiencing financial problems, then why should bankruptcy change this? This should be dealt with openly through general legislation, not under the cover of bankruptcy policy. See e.g. ; Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 Uni. Chi. L. Rev. 815; Douglas G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 (1) The Journal of Legal Studies 127-147; T H Jackson, [165] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860; Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986); D G Baird & T H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chicago L. Rev. 97.

A counter argument is that there is a significant change when a company in formal bankruptcy proceedings. That is, bankruptcy is a very different situation. Thus, there are a lot of complex issues which make it appropriate to balance or consider interests that would not be taken into account otherwise. But the question then becomes who is paying for this? If you take these issues into account, there must be a cost of doing so. Is the cost to be taken away from secured creditors, which will reduce their interest? The response would be that in the long run, the creditors don't bear the

This is because to alter the rule within a bankruptcy context, in Jackson's view, would amount to wealth distribution or the creation of a set of entitlements in bankruptcy that is at variance with those that exists outside of bankruptcy and would therefore encourage forum shopping.[166]

While this is the approach taken by creditor-friendly jurisdictions, it is submitted that it is a capitalist philosophy of bankruptcy derived from the shareholders' primacy orientation of corporate governance. This approach focuses on the assets of the debtor and those legally entitled to them in insolvency. The CBT accordingly sees the debtor's assets as being subject to the claims of the creditors and therefore belonging to them in insolvency. The problem here is that the model only considers hypothetical *contract* creditors and has therefore failed to consider the legitimate interests of constituencies such as employees, managers, suppliers, their dependents and the community at large who do not qualify, or are not characterised as contract creditors. In effect, this means that the CBT does not view the protection of non-creditor rights or expectations and other public interest objectives such as environmental protection as goals of insolvency law.[167]

Consequently, while a group such as the employees may have their entitlements as creditors taken into account under the CBT, their future as employees of a

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cost; they pass it on to individuals or other corporations in adjusting the terms in which they grant credit. See e.g. Elizabeth Warren, Bankruptcy Policymaking in an Imperfect World (1993) 92 Mich. L Rev 336; Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997).

[166] The argument against non-modification of pre-bankruptcy entitlements is based on an anxiety about forum shopping- i.e. the fear that granting a particular constituency inside bankruptcy greater rights than it would have outside it, would give that constituency an incentive to forum shop in the sense of preferring a bankruptcy to a resolution outside bankruptcy (in the case of the US) under state law. Jackson constructed and argued his model based on the American bankruptcy system. The American bankruptcy system is, unlike those of other jurisdictions of the world, one bankruptcy law for the country. The American bankruptcy system is a hybrid of state law and federal bankruptcy law. Under the *Butner* principle, (*Butner v United States,* 440 U.S. 48 (1979)) Federal bankruptcy courts may not alter or change non-bankruptcy law substantive entitlements in bankruptcy unless bankruptcy policies compel them to do so. Thus, *Butner* stands for the proposition that rights created by state law will be honored unless a specific bankruptcy provision or policy requires differently. See G Marcus Cole and Todd J Zywicki, 'The New Forum Shopping Problem in Bankruptcy' (2009) Amsterdam Center for Law & Economics Working Paper No. 2009-11 <http://www.accf.nl/uploads/postkantoor/aclewp2009-11(1).pdf> accessed 12 March 2012. Thus, dissatisfied parties could seek a more favourable resolution of claims in a federal bankruptcy court than that to which they would be entitled under state law. See Jackson (n 60b).See also Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 Uni. Chi. L. Rev. 815, 822.

[167] Gross (n 54); Warren (n 56) 800-804; LoPucki (n 75) 741, 778.

reorganised, ongoing enterprise is not relevant.[168] The problem with the CBT heuristic is that strict adherence to the rule it prescribes is likely to result in injustice *vis-a-vis* other interests such as the employees. This is because the employees, unlike their creditor counterparts do not hold legal rights in the company's property, but have also made value enhancing contributions to the company by investing firm specific human capital[169] in it which should not be discounted.[170]

Some critics have suggested that variations be made to this theme to take account of hypothetical groups as involuntary creditors[171] comprising tort victims or tax authorities who may be owed money by the debtor even though they did not voluntarily contract with it.[172] Its proponents have simply responded by pointing out that an economic analysis cannot, by definition, consider non–economic matters such as social, moral, political and personal consequences. These debates notwithstanding, the point remains that the inherent creditor wealth

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[168] Finch (n 60) 28.

[169] Modern growth theory sees human capital as an important growth factor. Human capital is defined as the stock of competences, knowledge and personality attributes embodied in the ability to perform labours so as to produce economic value. It is the attributes gained by a worker through education and experience. It is a means of production, into which additional investment yields additional output. Human capital is substitutable, but not transferable like land, labour, or fixed capital. For details on human capital see e.g. Jacob Mincer, 'Investment in Human Capital and Personal Income Distribution' (1958) Journal of Political Economy. See also Gary S Becker, *Human Capital: A theoretical and empirical analysis with special reference to Education* (University of Chicago Press, Chicago 1964).

[170] On what the CBT means for employees, see the section on theories and implications for employees below.

[171] The terms 'involuntary creditor' is used here to refer to any creditor who lacks the ability to protect itself *ex ante.* This is usually due to lack of information. For example, while tort creditors do not know that they are, will be, or when they will be injured, environment creditors on their part lack full information about the conditions on private property. Similarly, tax authorities rely on debtors to furnish them with information and may only have the right to question the information so provided years after liability has been created. See Stephen J Lubben and Stephanie Ben-Ishai, 'Involuntary Creditors and Corporate Bankruptcy' (2011) Seton Hall Public Law Research Paper No. 1938599 <http://ssrn.com/abstract=1938599> accessed 10 February 2012. On calls for these categories of creditors to be given priority (even over secured creditors) in insolvency, see Robert Rasmussen, 'Resolving Transnational Insolvencies Through Private Ordering' (2000) 98 Mich. L Rev. 2252, 2269; Lynn LoPucki 'The Unsecured Creditors' Bargain' (1994) 80 Virginia Law Review, 1887, 1896 -1902; Barry Adler, 'A World Without **Debt'** (1994) 72 Wash. U.L.Q. 811, 826; Kathryn R Heidt, 'Cleaning Up Your Act: Efficiency Considerations in the Battle for the Debtor's Assets in Toxic Waste Bankruptcies' (1988) 40 Rutgers L. Rev. 819, 851-63; Heidt, 'Switching Priorities: Elevating the Status of Tort Claims in Bankruptcies in Pursuit of Optimal Deterrence' (2003) Harv. L. Rev. 2541, 2562; Hanoch Dagan, 'Why All Involuntary Creditors Should Be Preferred' (2004) 78 Am. Bankr. L J. 247, 277.

[172] See generally Korobkin (n 51) 717; Mokal (n 20); LoPucki (n 75) 741, 778.

maximisation objective of the CBT has failed to recognise the legitimate interests of many who are not defined as contract creditors. [173]

2.7.2 Relevance of ACM

Regarding the ACM, its notion of justice, and as this relates to insolvency law, connotes that when a company is insolvent, all those affected by issues governed by insolvency law are to be regarded as free, reasonable and equal. The core reason for this proposition is founded on the fundamental idea of fairness espoused elsewhere which holds that:

> It is fair to require people to submit to procedures and institutions only if, given the opportunity, they could in some sense have agreed in advance on principles to which they must submit. [174]

It follows that inherent in the ACM theoretical framework is the objective of fairness: meaning that insolvency laws should be designed so that they are fair to the interests they potentially affect. Fairness in this context connotes that not only must these interests be identified, consulted or allowed a say in the development, formulation or selection of rules and principles that will regulate their rights, interests and obligations during insolvency proceedings,[175] but their opinions on the selection of the governing principles should be accorded 'equal' weight of consideration.

From the above perspective, fairness could imply, for example, that insolvency law need not be a government regulation mandatorily imposed on the parties whose interests it affects without due regard to their concerns. Rather, it should be a set of rules democratically agreed and accepted by all parties whose interest insolvency affect. The insolvency process should be procedurally and substantively fair in spite of the disagreements on the details, for example, regarding whose interests entitle them to partake in the process.[176]

Fairness could also mean having insolvency rules that reduce the risks to parties, especially the unsecured creditors, and the employees, which usually come with

[173] Warren (n 56) 800-804; LoPucki (75) 741, 778.
[174] See T Nagel, 'Rawls on Justice' in Norman Daniels (ed) *Reading Rawls: Critical Studies on Rawls' "A Theory of Justice"* (Stanford University Press, Stanford 1989) 4.
[175] Mokal (n 23) 69.
[176] Finch (n 60) 52 -63.

insolvency. Fairness could also manifest in the form of demanding accountability from the office holders in insolvency proceedings. It could also mean having an insolvency law which places a duty on the office holder (i.e. the Insolvency Practitioner) to perform his or her duties in the interest of the entire body of creditors of the company.[177]

The proponent of the ACM argues that insolvency rules and principles should be fair on all parties notwithstanding their legal wealth, cognitive abilities, and bargaining power as these are all morally irrelevant in framing rules of justice.[178] It should not matter whether the parties in question are secured or unsecured, voluntary or 'involuntary' creditors,[179] managers or employees. Each stakeholder, by ACM's standard, is constructively regarded as being motivated to uphold the fair terms of co-operation amongst equals, provided that each of the other parties to the bargain is also driven by the same motivation. A corollary to this view is that, given that insolvency law only deals with insolvency issues, those *not* affected or unlikely to be affected by these principles must therefore be excluded and denied a say in the selection of the governing principles. The ACM's concept of fairness becomes of great significance when considered against the backdrop of the fact that:

> ...in the absence of sufficient assets to pay all creditors in full, sound, logical and fair insolvency laws are required to ensure an efficient collection, realisation and fair distribution of the debtor's remaining assets.[180]

2.7.3 Relevance of TPT

Turning to how the TPT map unto insolvency law, the idea underlying the theory is that, even though those with non-financial claims have no decisive say ultimately

[177] In the UK, and under the administration procedure, the administrator is to avoid causing the insolvent company 'unnecessary harm' if he or her decides to realise its assets. See IA 1986 Schd B1. para 3 (4).
[178] This re-echoes Korobkin's opinion in his 'value-based account' on corporate insolvency where he argues that bankruptcy law exists to create a context in which both the economic as well as the non-economic values of all parties affected by financial distress may be expressed and sometimes recognised. Korobkin (n 56) 335.
[179] Some have argued that the exclusion of involuntary creditors in insolvency considerations is intentional and for a reason. Bebchuk and Fried, for instance have averred thus: 'It is by now a familiar point in the law review and finance literature that according full priorities to secured claims permits a firm to divert value from its tort creditors. Lucian Ayre Bebchuk and Jesse M Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1996) 105 Yale L. Rev. 857, 883 .
[180] Anderson (n 159).

in the future of the failed enterprise, there should nevertheless be some mechanism whereby those about to lose their money or jobs (such as the unsecured creditors and the employees of the insolvent firm respectively), would have their concerns addressed in the decision making process that potentially affects the future of the enterprise they are part of. Thus, TPT advocates for an inclusive insolvency law that will cater for interests wider than those of the creditors.

Using the American insolvency framework, as basis for buttressing the argument on the existence of other interests in insolvency that deserves consideration, LoPucki points to the statutory authority vested in the bankruptcy court by the Bankruptcy Code to appoint a trustee contrary to the American Chapter 11 'Debtor In Possession' (DIP) practice, for example, in circumstances where the incumbent management commits egregious wrongdoing. LoPucki contends that this is done because such appointment will serve 'other interests of the estate'[181] beside those of the creditors.

There is a global recognition of the existence of other interest in an insolvent business. For example, the United Nations Commission on International Trade Law (UNCITRAL), in its legislative guide on insolvency law, in addition to noting the importance of treating employees in a special way in insolvency, also notes that:

> In some insolvency laws, the importance of maintaining continuity of employment in priority to other objectives of insolvency proceedings, such as maximization of value of the estate for the benefit of all creditors, is evidenced by a focus on sale of the business as a going concern (with the transfer of existing employment obligations), as opposed to liquidation or reorganizations where these obligations may be altered or terminated.[182]

2.8 Implications of theories for the employees

Given that much of the on-going debate on insolvency policy is essentially about the limit of insolvency law and the interests it should cater for, various theories

[181] 11 U.S.C. s.1104 (b) (2).

[182] See, Yearbook of the United Nations Commission on International Trade Law, (UNCITRAL) 2004, Vol. XXXV <http://www.uncitral.org/pdf/English/texts/insolven/05-80722_Ebook.pdf> accessed 28 January 2011.

considered above, and especially those of the CBT, the ACM and the TPT, have implications for the employees.

It may be possible to glean from these theories whether the core principle of the insolvency law of a given jurisdiction is exclusively wealth maximisation for the creditors or whether it has other inclusive or expansive goals, such as the preservation of the corporate entity, which will in turn benefit other stakeholders such as the employees.[183] Thus, depending on whether policy makers in a given jurisdiction subscribe[184] to the exclusive or inclusive philosophies of corporate insolvency law (which in themselves are a product of the normative choices made by their proponents)[185] the law governing corporate insolvency in a particular jurisdiction will equally reflect how the interests of the stakeholders generally, and those of the employees in particular, are treated in insolvency situations involving the sale or transfer of a business on a going concern basis.

2.8.1 The CBT and the employees

As **a** creditor primacy driven heuristic, the position taken by the CBT implies that certain employee interests would not be considered in insolvency. It follows that the non-contractual expectation of continuity of employment post-transfer of a business that the employees might have, but which insolvency law does not specifically protect, would not be considered by the CBT. It seems that the CBT would resent the TUPE-type protection given to UK employees during transfers of insolvent undertakings (see chapters 5, 6 and 7). For these theorists, TUPE would constitute nothing other than an impediment to the creditors' ability to capture full going concern value from sales of insolvent businesses.

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183 For a critique on the use of bankruptcy for expansive goals, see e.g. C W Frost, 'Bankruptcy Redistributive Policies and the Limit of the Judicial Process,' (1995) 74 N C L Rev. 75, 80.

184 It seems that policy makers pay relatively little attention to the vast theoretical literature that exists in insolvency law. In the UK, and prior to the last two decades, it appears that not many scholars were interested in doing theory-related work in the field of insolvency law. These tendencies are unfortunate because theory is an essential tool of policy making. Ultimately, many policy debates on insolvency rest on competing theoretical visions on the subject. Insolvency theory remains essential for diagnosing all insolvency-related events, explaining their causes, prescribing responses, and evaluating the impact of different policies on stakeholders in insolvency. The gap between theory and policy can be narrowed only when the academic community begins to place greater value on policy-relevant theoretical research works.

185 Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee claims' (2008) in P J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, 2008) 49.

In refusing to consider non-contractual entitlements of the employees, other than their entitlements as creditors in insolvency proceedings, it would appear that creditors' bargain theorists view employees through the classical economic theory of labour lens. This perspective sees labour as an economic transaction between the worker and the employer. In this sense, labour is nothing other than a factor of production with a market value. The employee (labour) offers to carry out work in return for pay and other related remuneration. Therefore, wages for work done is what an employee is entitled to. This economic analysis of 'labour as a commodity' has been attacked and refuted from within the economics school of thought.[186]

The CBT's vision of insolvency and its prioritisation of the creditors' interests over all other interests has tended to discount the fact that employees have other constituent interests in the company that can be impacted by the activity of the company in several ways.[187] It has also disregarded the need to safeguard enterprises in which firm-specific human capital investments are core to its operations. Employees contribute firm-specific human capital to firms. 'Human capital' denotes the skill and knowledge required to do a job which can only be acquired if some investment is committed in time and resources by human beings.[188] Because such specialised skills and knowledge help to enhance productivity in the firm, they are, in practice, considered a very important part of the employment relationship.

Few, if any, will argue that specialised knowledge and skills relevant to a particular enterprise, and the time and efforts invested in achieving the goals of that enterprise, are not assets at risk just as equity capital is, once it has been committed to a given enterprise.[189] The relevance of employees' specialised skills to the employment relationship and the need to protect them is not just borne out of the fact that their acquisitions matter in demarcating what job is

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[186] See e.g. P O' Higgins, 'Labour is not a Commodity' (1997) 26 IL.J 225.

[187] T Donalson & L Preston, 'The Stakeholder theory of the corporation- concepts, evidence, and implications' (1995) 20 Academic Management Review (1) 65-91.

[188] G S Becker, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education* (National Bureau of Economic Research, New York 1964) 21.

[189] Margaret Blair, 'Firm-Specific Human Capital and Theories of the Firm', (2003) Georgetown University Law Center Business, Economic and Regulatory Policy Working Paper No. 167848 <http://papers.ssrn.com/abstract=167848> accessed 30 November 2009; M Blair & L A Stout, 'Director Accountability and the Mediating Role of the Corporate Board,' (2001) 79 Wash. U L Q. 403, 416.

done, by which employee, for a particular firm. Rather, its significance lies, perhaps, in the fact that if a firm has been responsible for financing the training of an employee and that employee who then quits his or her job and takes up another employment with another employer, the capital expenditure of the firm that paid for the employee's training would be (partly) wasted since no further return would be collected on it.[190] To avoid this happening, the firm must strive to retain the services of such an employee even in insolvency and especially in going concern reorganisations. In a similar vein, if a worker who paid to acquire specific training is fired from the job after receiving such training, he or she would be unable to collect any further return on the investment and would suffer a capital loss.

Consequent upon the above examples, the prevailing view is that, in a business where investment in firm-specific skills is important, indifference as to 'whether a firm's labour force always contained the same persons or a rapidly changing group,'[191] can no longer be the case. Rather, in such a business, continuity between the firm and the workers must be valued. Moreover, firm-specific human capital investment in it must be 'embedded in a protective governance structure lest productive values be sacrificed if the employment relation is unwittingly severed.'[192] To do so will require a culture of rescuing businesses, as opposed to a culture of liquidating insolvent firms, which the CBT is not known for.

2.8 2 The ACM and the employees

With regards to the ACM, given that this model preaches showing 'equal concern' and 'respect' for matters affecting all parties with economic interests in an insolvent company, it is safe to imply that it is not adverse to employee protection in corporate insolvency in general and would probably not see anything wrong in protecting employments for them in a going concern business sale.

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[190] The argument made here has to be considered against the backdrop of the fact most, if not all, employees of a firm do benefit from 'on the job training' from the company that employs them. Thus, the company may be said to have invested in the employees in some way.

[191] Becker, (n 79) 21.

[192] See O E Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting,* (Free Press, New York, 1985), 242-43. See also Oliver E Williamson & J Bercovitz, 'The Modern Corporation as an Efficiency Instrument: The Comparative Contracting Perspective' in Carl Kaysen (ed.) *The* American *Corporation Today,* (OUP, Oxford 1996); O E Williamson, M L Wachter, and J E Harris, 'Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange', (1975) 6 Bell Journal of Economics, 250-80.

The ACM's hypothesis that parties reaching an agreement behind the 'veil of ignorance' would be conscious of which category of stakeholder they might turn out to be in the event of their mutual debtor's insolvency would therefore give them the incentive to give *equal* concern to, and respect for interests other than those of the creditors in insolvency. This would entail giving greater protection to constituencies traditionally deemed vulnerable and unable to protect their interests (such as the employees) than to those better able to deal with losses. By implication, the ACM is essentially a model that supports the idea that risks should be redistributed to those best capable of absorbing them as advocated by other welfare insolvency theorists.[193] Given that employee-creditors fall under the category of vulnerable or weak participants in the company,[194] all parties might, behind the veil of ignorance, agree to accord greater *ex post* protection to this class of claimants just in case they end up as members of this particular class of vulnerable creditors in the real world and in an actual insolvency situation.

The ACM's concept of equal respect for the concerns of all those affected by peculiar issues in insolvency would mean that the contracting parties would take into account employees' concerns, such as the continuation of their employment contracts, possibly on the same terms and conditions post-transfer of their mutual debtor to a third party purchaser. They would also think of the possibility of making available some form of social security safety nets for those likely to lose their jobs. Moreover, since it can be assumed that employees would always prefer the business that employs them to be rescued rather than be liquidated, if and when it experiences financial difficulty, the ACM's calculation is that the contracting parties would welcome any law, (whether within or without the insolvency law framework such as the TUPE Regulations), that can protect employment and preserve the continuity of terms and conditions of employment contracts when a company or its business is transferred from one owner to another.

However, the rescue of the company, or of its business, and the continuation of the employment contracts would be dependent on whether it is cost efficient for all parties to do so. That is to say, it would clearly be desirable if, through rescue

[193] See e.g. Nathalie D Martin, 'Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In' (1998) 59 Ohio St. L Rev. 429; Gross (N 36); E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L Rev. 336, 354-55.
[194] See Caruthers & Halliday (n 2).

actions, what is gained is worth more than what would have been lost. While a law such as the TUPE Regulations may be substantively fair when judged under the ACM, it may be procedurally inefficient in that the shifting of costs to the purchaser in a situation where buying the business as a going concern would rescue it could act as a hindrance to the achievement of a substantively fair outcome. Moreover, it is pertinent to bear in mind that the type of change which TUPE induces, which could lead to an improvement in the social protection employees have in insolvent business transfers, could also lead to a worsening of the overall rescue initiative and ultimately imperil the employees' job security.

2.8.3 TPT and the employees

When refined and applied to the UK insolvency system, the team production theory of bankruptcy reorganisation has implications for the employees. There is the view that the particular constituencies that insolvency law should cater for should be those with a substantial connection to the insolvent company.[195] Employees are an integral part of a company. They are vital to the day to day functioning of any company and so have a real and substantial nexus to the company.

TPT gives credence to the claim that the company is an aggregate of interests or is made up of several members. These include the employees. Team members have various economic interests in the company. These interests, which are affected in several ways by insolvency, should be given equal weight of consideration. Unlike Jackson and his creditors' primacy acolytes, LoPucki's view is that no one interest should be privileged over the others.

If it is accepted that the greatest asset of any business lies in its human capital,[196] then it would be safe to say that employees are the most important assets of any business. For this reason, it could be inferred that TPT would support the TUPE-type protection given to the employees in insolvency generally and, particularly in transfers of insolvent businesses resulting in a change in ownership of the businesses. Given that TPT does not subscribe to privileging one interest over the others, it could also be argued that what the theory is advocating is that a balance has to be struck between the interests of the creditors and those of the employees

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[195] Gross (n 54) 19.

[196] Luigi Zingales, 'In Search of New Foundations' (2000) 55 Journal of Finance, 1643.

in insolvency. Although classic labour theory is about balancing, the discussion is generally couched in a language suggestive that the business is solvent therefore the capitalist owners should be in a position to profiteer at the expense of the workers. However, what TPT is advocating is to strike a balance between the interests of the 'weak' (the employees) and the 'strong' (the creditors) team members who are usually pitted against each other in insolvency.[197] Impliedly, this means, for example, that the rescue of an insolvent business may only be pursued if doing so would save jobs and would not detrimentally affect the interests of the creditors too.

The core tenets of TPT reflect some of the arguments expounded through labour law theories in the law and economics tradition on employee protection. There is no denying the fact that employment legislation interferes in so many ways with the parties' right to contract with each other on their own terms. However, the important role played by legislation in business relations cannot be discounted. Those against regulations would argue that companies should be permitted to operate free of regulations. However, there is nowhere in the world in which this ideal holds true. A world in which businesses operate free of regulations is a utopia. The reason is because all states operate a mixed system of market freedom and regulatory control.[198] In fact, regulations which seek to limit the powers of business executives from arbitrary and sometimes abusive usages are an age long practice.[199] Many decades ago, the French philosopher, Montesquieu noted that:

> The freedom of commerce is not a power granted to the merchants to do what they please: this would be more properly its slavery. The constraint of the merchants is not the constraint of commerce. It is in the freest countries that the merchant finds innumerable obstacles; and he is never less crossed by laws, than in a country of slaves.[200]

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[197] Carruthers & Halliday (n 2) 303.

[198] Janet Dine, 'A new look at corporate governance' (2003) 24 Company Lawyer,' 130.

[199] In most cases, TUPE is not about this. But the Regulations do seek to prevent abusive and improper dismissals through scrutiny whether there is an ETO reason for the dismissal.

[200] Baron de Montesquieu, *L' esprit des lois,* (1748) Book 20, Chapter 12, (Thomas Nugent translation: 1751), quoted in Beth A Ahlering and Simon Deakin, 'Labour Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complimentarity?' (2005) ECGI Working Paper No. 72/2006 <http://ssrn.com/abstract=898184> accessed 14 March 2009.

TPT's stance on employee protection reflects the deregulation versus regulation dichotomy in labour law theories.[201] Adherents of regulation argue that the law has to take cognizance of the weak position of the individual employee *vis-a-vis* the position of strength of his employer (by taking into account the need for the worker to be organised in a union in addition to the need for the union to have the freedom necessary to redress any imbalance in the relationship). However, there is usually a caveat, which requires that notwithstanding how fundamental these needs and privileges may be, they must be restricted to what is necessary.[202]

Essentially, what this means is that where workers invest in firm-specific skills (as they do in team production), an appropriate incentive structure should incorporate a degree of protection of the employee against arbitrary treatment by management or vulnerability to management caprice[203] and some guarantee of continuing employment in the life of the company and especially during insolvency resulting in going concern transfers of the company's business to a third party purchaser.[204]

The basis for TPT's support for employees' protection derives, probably, from the recognition that the firm-specific nature of the investments employees make in a company which is insolvent makes it difficult, and sometimes impossible, for them to be redeployed to alternative uses. The firm-specific nature of the human capital investments committed to the firm by the employees renders these investments useless when the employees try to find jobs in industries other than the one they currently operate in.[205] Thus, the acquisition of firm-specific training by an employee, arguably, ties the economic fortune of such an employee to the fate of the firm he or she works for. If the company becomes insolvent and is liquidated, rather than rescued, the employee loses his or her job which is based on his or her particular skill.[206]

Granted, the employee can deprive the company of his or her firm-specific skill when the company is still solvent and his services is still needed by the company

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201 See e.g. F A Hayek, *Law, Legislation and Liberty: The Political Order of a Free People*, Vol. III (University of Chicago Press, Chicago 1979) 144.
202 ibid.
203 M O' Connor, 'The Human Capital Era' (1993) 78 Cornell L Rev 889, 905-917.
204 Simon Deakin & Frank Wilkinson, 'Labour Law and Economic Theory: A Reappraisal' (1998) ESRC Centre for Business Research University of Cambridge Working Paper (No. 92) <http://www.cbr.cam.ac.uk/pdf/wp092.pdf> accessed 29 October 2011.
205 Korobkin (n 56) 745.
206 O' Connor (n 203).

(e.g. by discontinuing to work for it), but it seems there is little or no benefit at all that can be derived from doing so since the skill would, as noted, be firm-specific, meaning in this context that it might have little or no value at all elsewhere.[207] Based on the foregoing analysis, an assumption may be made that TPT would support whatever legal mechanisms (e.g. ARD and TUPE) there are that could be used to protect the human capital contributions of the employees in insolvent companies.

TPT equally recognises that there is a *lacuna* in commercial, contract and insolvency laws as regards the provision of robust employee protection in insolvency situations generally and in going concern business transfer scenarios in particular.

Commercial law enables the insolvent to be given a 'second chance' of survival through a going concern sale to a new owner. However, this branch of law does not cater for employees' issues arising as a result of the sale. While a going concern sale of the business can ensure that some employees keep their jobs, it is arguable that without any mandatory law requiring the buyer to take on the employees in the UK after the sale is completed, the retention of employees by the purchased business would, under common law, be at the discretion of the new owner.[208] Even so, they are most likely to be retained on inferior terms with previous service years not counting.

Contract law on its part provides employees with very few grounds on which to challenge or limit the power of an employer regarding job security in insolvency.[209] Contract law does not provide an avenue for the employees to be able to extract a contract from their corporate employer guaranteeing them both job security during insolvency restructuring and the preservation and the continuation of their contracts of employment on the existing terms and conditions

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[207] Margaret M Blair, 'Firm-Specific Human Capital and Theories of the Firm', (2003) Georgetown University Law Center Business, Economic and Regulatory Policy Working Paper No. 167848 <http://papers.ssrn.com/abstract=167848> accessed 30 November 2009; M Blair & L A Stout, 'Director Accountability and the Mediating Role of the Corporate Board,' (2001) 79 Wash. U L Q. 403, 416.

[208] See e.g. the UK's common law position enunciated in *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014.

[209] M Trebilcock and R Howse, 'Protecting the Employment Bargain' (1993) 43 University of Toronto Law Journal 751, 756.

when their insolvent corporate employer is sold to a third party purchaser on a going concern basis.[210]

Insolvency law on its part has not gone far enough in the above regards. It provides to employees very limited protection during transfers out of insolvency. In the UK as long as the insolvent company remains the employer during the insolvency proceedings, priority creditor status in respect of wages, holiday and related entitlements [211] are the main form of protection available to employees. For any other entitlements, they have to look to general employment law for protection (where they can have recourse to statutory redundancy rights etc.).

Granted, the employees have rights to the various claims noted above under insolvency law, but this body of law does not address what is likely to be the employees' most important concern. If after the opening of insolvency proceedings, a company's business has been rehabilitated and returned to its previous trading status, and is sold subsequently on a going concern basis to a new owner, one of the employees' main concerns, it seems, would be their job security. That is, how to continue their employment contracts (with all the rights 'appurtenant' thereto) with the new employer.

A company is a vehicle for organising economic life.[212] The employees are an important part of that. To achieve this goal, employees' jobs would have to be robustly protected. Given that neither commercial nor contract laws, or especially insolvency law, have provided protection for continuity of employment in transfers involving insolvent firms, the view taken by LoPucki is that this type of protection should, of necessity, be provided to the employees. The theorist recognises that achieving this goal may require the application of a special regulation other than the ordinary rules of contract law. The employment protection '*lacuna*' left by insolvency law is filled, the team production theorist

[210] Janis Sarra, 'Corporate Governance Reform: Recognition of Workers' Equitable Investments in the Firm' (1999) 32 Can. Bus. L J 384; Sarra, (n 185).

[211] IA 1986 s. 175 & Schd. 6.

[212] Adolf Berle and G Means, *The Modern Corporation and Private Property,* (Transaction Publishers, New Brunswick 1991) 3; Adolf Berle, 'Modern Functions of the Corporate System' (1962) 62 Columbia Law Review, 433, 437.

would argue, extraneously by labour law. [213] Labour law fills this gap through the use of labour standards as the basic legal intervention technique. [214]

As a substantive intervention technique for securing justice for employees, legal intervention involves rewriting the resulting bargain reached by parties in working relationships with unequal bargaining power resulting from contract. Usually, this is done through setting minimum wages, maximum hours of work legislation, human rights codes, occupational health and safety laws, employment protection regulations, etc. The protection of employment is mainly what the TUPE [215] legal regime seeks to achieve for employees in transfer situations involving insolvent undertakings or businesses in the UK. With the TUPE Regulations, matters which were once entirely within the sphere of managerial prerogatives or left to collective bargaining are now directly regulated by positive legal rights and duties.[216]

In making the transfer of employees' contracts of employment obligatory in going concern sales of insolvent businesses, TUPE's purpose, (even though the regime has been berated for undermining insolvency institutions and procedures and for having adverse effects on business rescues),[217] is not to prevent office holders from restructuring their businesses and rescuing distressed businesses.[218] Rather, TUPE operates to constrain them from pursuing creditors' welfare at the expense of labour in corporate insolvency. The office holder's capacity to increase creditors' wealth through the reduction of labour costs during insolvent business

[213] This perhaps explains why a regime like TUPE operational in the UK jurisdiction is desirable to guarantee job security to, at least some, employees in business transfer situations.

[214] J Gruber, 'The Wealth of the Unemployed' (2001) 55 Industrial and Labor Relations Review, 79-94; C Ruhm, 'Are Workers Permanently Scarred by Job Displacements?' (1991) 81 American Economic Review, 319-23; A. H Stevens, 'Persistent Effects of Job Displacement: The Importance of Multiple Job Losses, (1997) 15 Journal of Labour Economics, 165-88; M Stephens, 'The Long-Run Consumption Effects of Earnings Shocks' (2001) 83 The Review of Economics and Statistics, 28-36; J E Stiglitz, `Employment, Social Justice and Societal Well-being' (2002) 141 Int'l Labour Rev. (No. 1-2), 9-29, 9; Collins *et al* (n 1); Mary Ann S Bartlett, 'Employees' Rights in Mergers and Takeovers-EEC Proposals and the American Approach,' (1976) 25 Int'l & Comp. L Quarterly (3) 621, 626.

[215] The Transfer of Undertakings (Protection of Employment) Regulations 2006 (2006) SI 2006/246.

[216] Bob Hepple, 'Individual Employment Law' in G S Bain (ed.), *Industrial Relations in Britain* (Blackwell, Oxford 1983) 393.

[217] Sandra Frisby, 'TUPE or not TUPE: Employee Protection, Corporate Rescue and one Unholy Mess' (2000) 4 CFILR 249-271. See also Hugh Collins 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144; David Pollard, (2005) 'Pensions and TUPE', (2005) 34 ILJ 127.

[218] David Burdette, 'Formalities for the Transfer of Insolvent Business: Obligatory Transfer of Employees in South Africa and the United Kingdom' (2007) 3 INSOL International Technical Services Issue, 1.

sales is limited by the extent to which labour law (in this case TUPE) imposes rigidity or allows flexibility to shed workers.

Seen from the above perspective, TUPE arguably, provide a range of institutional arrangements such as mandatory standards which cannot easily be derogated from for the employees, as the weaker team members to protect themselves. This protection, under the team production arrangement, is intended to shield the employees against the pursuit of creditors' wealth maximisation by the board to the disadvantage of the employees' team members. Under team production, the team members (the employees inclusive) deliberately delegate their authorities to the board for the purpose of sharing equitably the rents accruable from their joint resources and team production fairly amongst them according to their individual contributions to the team production. TUPE, it should be noted, only preserves the employees existing rights. It does not grant them rights over and above their existing rights.

In keeping with the dictates of the parent law, (the ARD[219]), TUPE does, however, attach stricter rules to regulate dismissals of employees and variations to contracts of employment terms arising in the context of insolvent business transfers. This, TUPE does through the imposition of conditions which permit dismissals for an economic, technical or organisational (ETO) reason,[220] failing which the dismissal would be automatically unfair. [221] It also requires consultation[222] with designated representatives of the employees before any variations made to the terms and conditions of their employment contracts can be valid.

TUPE is a good illustration of the notion that employees have a claim on the company: a claim that should not be overridden just because a change in the ownership of the business has occurred.[223] In sum, the practice of protecting the rights of the employees and serving jobs, at least for some of them, during transfers of undertakings (as a result of TUPE) aligns with the underlying hypothesis of TPT. TPT posits that when the company is insolvent, its rescue and

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[219] See particularly Art. 4 (1) of the Acquired Rights Directive (2001/23/EC).

[220] TUPE 2006, Reg. 4

[221] *Delabole Slate Limited v Berriman* [1985] IRLR 305 CA.

[222] See TUPE 2006, Reg. 9.

[223] John Armour and Simon Deakin, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) ESRC Centre for Business Research, Cambridge University Working Paper No. 204 <http://www.cbr.cam.ac.uk/pdf/wp204.pdf> accessed 02 May 2012

rehabilitation may warrant the loss of some jobs. However, loss of jobs by the employees should not be at the pleasure of the management and without a valid reason. A rescue effort may affect some jobs but not all since some of the employees will be needed to continue the business post-rehabilitation.

TPT also acknowledges that in insolvency, the team members' legal entitlements may have to be reduced and their rights derogated if rescue of the company's business is to be achieved. TUPE contributes to rescues of insolvent businesses in different ways. The regime allows permitted variations to be made to the employees' contract terms and their dismissals under certain prescribed conditions during transfers of insolvent undertakings (see discussions in chapters 6 and 7).

2.9 Situating UK insolvency law within extant insolvency theories

The purpose of this section is to analyse the philosophy underpinning English insolvency law. The aim is to explore whether the system is debtor-oriented or creditor-biased. This will enable the UK's insolvency system to be properly situated within the extant insolvency theories. It will also provide an opportunity to assess what the consequences of the system could potentially be for both employment protection and business rescues in the UK.

2.9.1 The philosophy underpinning English insolvency law

The philosophy underpinning English corporate insolvency law cannot easily be stated. Apart from the fact that no such philosophy has ever been explicitly articulated,[224] English insolvency law does not appear to show a single underlying policy or philosophy. Enquiries on the legitimate province of corporate insolvency law and the policy basis, both social and economic, for the ordering of insolvency entitlements which, for years, have characterised debates in the United States of America (US), had for a very long period lay dormant in the UK.

In the US (as has been shown above), there exists a rich body of literature proposing various approaches to the problems generated by corporate insolvency, there is in contrast to the US, a dearth of developed comments in the

[224] Goode (n 15) 40.

UK on the theory steering corporate insolvency law. Only scant attention has been paid to insolvency theories in the UK in recent time. In fact, theory-related work in the area of insolvency has only in recent time begun to attract the attention of some scholars in this jurisdiction.[225]

The reason for this, as Professor Roy Goode explained, is due primarily to the pragmatic way in which English law has developed.[226] Academics and practitioners alike in the UK tended to focus their attentions on statutory developments and on case law rather than on developing theoretical frameworks. Pragmatism[227] was the dominant approach in England where the law of bankruptcy and company winding up functioned until very recently without much support from theory or academic exposition. Professor Axel Flessner captures the situation thus:

> It is instructive that until Professor Fletcher wrote his *treatise on insolvency law* in 1990 the law of insolvency in England could be found only in detailed practice manuals, which made the law not easily accessible to non-bankruptcy lawyers, let alone foreign lawyers.[228]

While the American materials or theories on insolvency are helpful, it should be remembered that they are of limited applicability in the UK. This is because the legal system they address is a federal system. The American system, apart from

[225] See however the recent effort by Rizwaan Mokal in developing the 'Authentic consent Model' of corporate insolvency analysis discussed above. Also, Vanessa Finch has made a good effort in her various articles and recent book to address the dearth of insolvency theories by English scholars. Vanessa Finch, 'The Measures of Insolvency Law' (1997) OJLS 227; 'Is Pari Passu Passe' (2000) Insolv. L 194; 'Security, Insolvency and Risk: Who Pays the Price?' (1999) 67 MLR 633; Corporate rescue processes: the search for quality and the capacity to resolve (2010) 6Journal of Business Law 502-521; Finch fn (n 43) above.

[226] Goode, (n 15)).

[227] According to Professor Axel Flessner, 'Pragmatism as an attitude takes bankruptcy law as it is and tries to apply it, case by case, according to business necessities. It is suspicious about comprehensive legislation, and it would rather not produce literature for academics or university instruction.' A Flessner, 'Philosophies of Business Bankruptcy Law: an International Overview' in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency* Law (Clarendon Press, Oxford 1994) 27. The Cork report of 1982 is a prime example of pragmatism in which, for example, the benefits of the IVA was adopted and translated into the CVA, and those of the administrative receivership regime were harnessed into the administration procedure. See Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17 (2) Oxford Journal of Legal Studies, 227-251. On how the pragmatic approach in some aspects of English insolvency law may have diverged from principles in practice, see Sandra Frisby,'Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?' (2011) 64 (1) Current Legal Problems 349-397.

[228] A Flessner, 'Philosophies of Business Bankruptcy Law: an International Overview' in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency* Law (Clarendon Press, Oxford 1994) 27.

being completely at variance with the UK's, has some peculiarities which the UK system does not possess.[229] These features distinguish the American insolvency system from the UK's. However, in order that a coherent insolvency system can emerge in the UK, insolvency law theories and policies would have to be developed alongside the statutory and case law regimes already in place. Theories illuminate policies. They offer normative justifications for laws.

2.9.2 Approaches in other jurisdictions

All market-driven economies require insolvency laws and policies. There is no universally acceptable approach in the design of insolvency laws amongst the various jurisdictions.[230] Put differently, there is no 'one size fits all' insolvency model fitting all countries. Insolvency regimes globally have evolved in very different ways. Based on the different historical heritage or legal origins of countries around the world (i.e. common law or civil law), the substance of insolvency laws varies considerably from one country to another. Different countries have laws focusing on different strategies for dealing with the insolvent corporate entity.

What the above means also is that policy choices on corporate insolvency are not universal. Rather, they are jurisdictional. In fact, given the different institutional and cultural makeup of the different jurisdictions, it would be difficult, if not impossible, to 'parachute' insolvency laws from one country to another and expect them to work in much the same way in the 'importing country' as they do in the country from which they are 'exported.'[231] What is important however is for each of these jurisdictions to have policies and laws capable of dealing with the problems arising in corporate insolvency.

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[229] Andrew Keay & Peter Walton, *Insolvency Law: Corporate and Personal* (2nd edn Jordan Publishing Ltd, 2008) 23.

[230] Philip R Wood, *Principles of International Insolvency* (2nd edn, Sweet & Maxwell, 2007)Gerald McCormark, 'Control and Corporate Rescue – An Anglo-American Evaluation' (2007) 36 International and Comparative Law Quarterly 515-552; Alan Kornberg, 'Insolvency in the UK and the US' <http://fds.oup.com/www.oup.com/pdf/13/9780199579693.pdf>; Samuel E Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory' (2011) 32 Company Lawyer (4) 99, 103.

[231] A Watson, *Law Out of Context* (Athens, Ga., 2000) 1; A. Watson, *Legal Transplants and European Private Law*, vol 4.4 Electronic Journal of Comparative Law, (December 2000) <http://www.ejcl.org/ejcl/44/44-2.html> accessed 30 November 2010; N Foster, 'Transmigration and Transferability of Commercial law in Globalized World' in E Örücü and A Harding (eds) *Comparative Law in the 21st Century (*Kluwer Law International, The Hague 2002) 55-75.

The extant insolvency laws of a given jurisdiction also determine the way that jurisdiction's disposition to addressing insolvency-related problems would be viewed. National insolvency laws often express the policies and priorities of their enacting countries. The specific provisions of these laws reflect different normative value judgements in respect of, for example, which creditors should be accorded priority and the degree of protection that should be extended to secured credit and to employees.[232] Adoption and application of principles underlying a specific regime may also mirror a nation's assessment of the 'moral blameworthiness or lack thereof of a corporation's financial difficulty.'[233] The choices made by a given country would reflect also its preference either for reorganisation or liquidation.[234] But beyond all these, they may also reveal something about that jurisdiction's preference for particular stakeholders[235] based perhaps on the extent of their economic interests in the insolvent entity or on the strength or vulnerability of the particular stakeholder *vis-a-vis* corporate failures.[236]

Virtually all insolvency policies have values underpinning them. Countries have insolvency laws which mirror an underlying 'pro-creditor or pro-debtor' value.[237] The division of corporate insolvency regimes into creditor-oriented and debtor-oriented regimes is done on the basis of a few main legal characteristics. This does not actually portray the entire picture. For example, there is the perception that companies incorporated in the US are more likely to be rescued when experiencing financial distress in comparison to their UK counterparts subject to

[232] A T Guzman, 'International Bankruptcy: In Defense of Universalism' (2000) 98 Michigan Law Review, 2177, 2197-98; Venessa Finch & Sarah Worthington, `The *Pari Passu* Principle and Ranking Restitutionary Rights' in F. Rose (ed) *Restitution and Insolvency* (Mansfield Press, London 2000) 1.
[233] Sarra (n 153) 30.
[234] Bruce G Carruthers and Terrence C Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States,* (OUP, Oxford 1998) 69.
[235] Bob Wessels, 'Current Developments Towards International Insolvencies in Europe' (2004) 13 *Int. Insolv. Rev.* 43, 46.
[236] ibid.
[237] International Monetary Fund (Legal dept.), *Orderly and Effective Insolvency Procedures: key Issues*, (IMF Publication Services, Washington 1999) 1-2. See also Sefa Franken, 'Creditor-and Debtor-Oriented Corporate Bankruptcy Regimes Revisited' (2004), Tilburg University, TILEC Discussion Paper (DP 2004-016)1–40; G McCormack, 'Control and Corporate Rescue – An Anglo-American Evaluation' (2007) 56 ICLQ 1.

the jurisdiction of the English courts. The reason for this is mainly because the US has a debtor-friendly chapter 11 procedure which facilitates rescues.[238]

There is no direct equivalent of this type of procedure in the UK despite efforts by the government to foster a 'rescue' friendly insolvency regime. The administration procedure provided for in the Insolvency Act 1986 very often leads to a legal end for most distressed companies as the assets of most distressed UK companies often end up being sold off piece meal.[239] The point is that, depending on which insolvency school of thought policymakers subscribe to, insolvency laws in different jurisdictions may either be debtor oriented or creditor biased, rescue friendly or not, exclusive or inclusive in respect of the interests to be prioritised during insolvency.[240]

In general terms, the outcome of an insolvent reorganisation can be very different[241] depending on the laws of the country in which the insolvency proceeding is run.[242] The implication is that in many cases different stakeholders in a company may hold the advantage in different jurisdictions. This appears to be the case with the English insolvency regime which has tended to give the creditors the upper hand in insolvency proceedings.

2.9.3 Aligning UK's insolvency law with theories

In practical terms, English insolvency law, arguably, appears to align quite closely with the CBT. In spite **of** the changes made to the English insolvency law framework by the Enterprise Act 2002, it may be argued that the regime remains, to a large extent, creditor-driven. The system justifies collective insolvency

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[238] Scott Simpson and Jay M Goffman, 'Emergency Sales in the US and the UK' in Christopher Mallon and Shai Y Waisman (eds) *The Law and Practice in Restructuring in the UK and US,* (OUP, Oxford 2011) 8. Note however, that even in the US with its debtor protection disposition, in a growing number of cases the courts have held that when a company is in the vicinity of insolvency managerial allegiance must shift from the shareholders to the creditors. See e.g. *Federal Deposit Insurance Corp v Sea Pines Co* (1982) 692 F2d 973, 976-7. See also Gerald McCormark who contends that the US debtor friendly and the UK creditor friendly view is moribund. G McCormark, *Corporate Rescue Law: An Anglo-American Perspective* (Edward Edgar Publishing 2008); McCormack, 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK' (2009) 18 International Insolvency Review 109-133.

[239] Goode (n 15).

[240] Samuel E Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory' (2011) 32 Company Lawyer 99, 103.

[241] Rebecca Parry, *Corporate Rescue* (Sweet & Maxwell, London, 2008).

[242] Gerard McCormark, 'Control and Corporate Rescue–An Anglo-American Evaluation' (2007) International and Comparative Law Quarterly 56 (3) 515 – 551.

proceedings and accords primacy to the secured creditors' interests in insolvency.[243] Professor Fletcher puts it succinctly when he observed that in spite of the changes made to the system by the Enterprise Act 2002, the:

> UK insolvency law has been unable to embrace the "American way" of corporate rescue, with debtor-in-possession as its core principle, but has instead opted for a 'rescue' model in which creditor interests continue to assert a dominant influence.[244]

English insolvency law focuses on the rights of creditors against a particular debtor, and on whether those creditors will be paid the monies that they are legally owed by the insolvent company and what they will be paid - where there is money to make payments.[245]

Until the corporate insolvency law provisions of the Enterprise Act (EA) 2002 became operative in late 2003, English insolvency laws were generally regarded as the most creditor-oriented amongst the European states.[246] This may be due to the fact the UK is a common law country and because creditor contract rights tend to be stronger in common law jurisdictions in comparison to civil law countries.[247] Casting English insolvency law as the most creditor-friendly in Europe was not, however, due specifically to the fact the UK is a common law jurisdiction, it was mainly attributable to the system being both 'judicially'[248] and structurally biased in favour of secured creditors.[249]

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[243] See e.g. IA 1986 Schd. B1, para 3 which directs the administrator to consider the interests of creditors as a whole but not the interests of other constituencies such as employees.

[244] Ian Fletcher, 'UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – The Insolvency Act 2000, The White Paper 2001, and the Enterprise Act 2002' (2004) 5 European Business Organization Law Review, 119-151.

[245] Andrew Keay, 'Insolvency Law: A Matter of Public Interest?' (2000) 51 N. Ir. Legal Q. 509.

[246] Gabriel Moss, 'Comparative Bankruptcy Cultures: Rescue or Liquidations? Comparisons of Trends in National Law-England' (1997) 23 Brooklyn Journal of International Law 115; Nathalie Martin, 'Common-Law Bankruptcy Systems: Similarities and Differences' (2003) 11 American Bankruptcy Institute Law Review 367, 374; S Franken, 'Creditor-and Debtor-Oriented Corporate Bankruptcy Regimes Revisited' (2004) TILEC Discussion Paper, Tilburg University, 9.

[247] See e.g. J Armour, S Deakin, P Lele and M Siems, 'How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor and Worker Protection' (2009) European Corporate Governance Institute - Law Working Paper No. 129/2009. <http://ssrn.com/abstract=1431008> accessed 22 October 011.

[248] Moss (n 246).

[249] J Armour, A Hsu & A Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) 5 ECFR (2).

Judicially, there was a general bias by the courts towards the creditors. There is the view that the judicial bias towards UK creditors in reorganisation insolvencies is a reflection of a general social attitude to debt. This social attitude is reflected in how the courts treat debtors. English courts tend to punish risk-takers, (management) when the risks go wrong, and side with creditors,[250] who stand to gain or lose the most from the reorganisation process.[251] The courts tend to see managers of insolvent companies as gambling with the creditors' money and so deserving to be punished for their indiscretions.[252]

There is the general perception that when a company is insolvent, or near insolvency, the company directors have nothing to lose. Rather, they have much to gain by engaging in speculative investments with the company's resources.[253] The reason why management may undertake overly risky projects, or stall for time in hope that the firm's fortunes will change, is because if the gamble pays off they will probably retain their jobs. While the managers might put their reputations on the line with a failed gamble, they still may not lose much in comparison to, for example, the creditors or the employees' team members.[254] So the punitive stance adopted by courts may be to remind directors that it is incumbent upon them to take heed of creditors' interests when the company is in the vicinity of insolvency. They must resist the temptation to 'bet'[255] the company's future by undertaking risky investments whose remote future benefits are doubtful so as to avoid potential losses to the company's creditors.[256] The

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[250] Moss (n 246).

[251] Barry E Adler and Lawrence Weiss, 'The Debacle of Corporate Bankruptcy' (1992)The Cato Review of Business & Government <http://www.cato.org/pubs/regulation/regv15n3/reg15n3-adler.html> accessed 23 March 2012.

[252] In England, the first recognised piece of legislation in relation to insolvency was the Bankruptcy Act 1542. During this time, bankrupts were seen by the courts as crooks, and the stated aim of the 1542 Act was to prevent 'crafty debtors' escaping the realm. This is no longer the aim of the modern insolvency Act, but the English notion of bankrupts as crooks may have transferred to the way that corporate debtors are seen by courts as well.

[253] Stephen Ross *et al, Corporate Finance,* (7th edn McGraw Hill/Irwin, NY 2002) 428; G McCormark, 'Control and Corporate Rescue-An Anglo-American Evaluation' (2007) 56 *ICLQ* 515, 524.

[254] There is force also in Adler and Weiss' argument that management's incentives create problems. The view is that since management is hired as an agent of the company's pre-insolvency shareholders, to give management an incentive to work hard on the company's behalf, the latter often chooses to compensate managers with shares of the company. So the managers, out of duty or concern over their own holdings, may have interests aligned with those of the pre-insolvency shareholders. See Adler and Weiss (n 251).

[255] J Armour, A Hsu & A Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) ECFR 148, 152.

[256] Andrew Keay, 'Wrongful Trading and the liability of Company Directors: A Theoretical Perspective' (2005) 25 Legal Studies 431.

'punitive' approach taken by courts somehow inhibits management's ability to behave strategically to the detriment of the creditors.

Corporate insolvency strikes at the very heart of two fundamental legal issues: the one substantive, the other procedural.[257] UK insolvency law focuses on the substantive and procedural issues of priority and control. The substantive aspect of English insolvency law is concerned with the order of distribution of assets as a matter of substantive law. This means that there is a pecking order of creditors who get paid back first, second and last when a company is in formal insolvency proceedings. Priority of claims, which is the core argument of the Creditors' Bargain theorists,[258] is largely predicated on pre-insolvency entitlements. However, the English system does have circumscribed redistribution aspects especially in relation to floating charges.[259]

The control of insolvency proceedings is essentially procedural. Structurally, the insolvency system in the UK empowers the secured creditors more than any other stakeholder. It enhances the secured creditors' dominance and control of insolvency proceedings. The primal position occupied by secured creditors within the UK insolvency framework was due to the prominent role the institution of administrative receivership played in the English insolvency system. Prior to the (partial) abolition[260] of the institution of the administrative receivership, English insolvency law adopted an outright contract approach to control.

One of the means by which a secured creditor holding all-encompassing security, granted through fixed and floating charges,[261] used to enforce its security in the

[257] See Rizwaan J Mokal, 'Contractarianism, Contractualism, and the Law of Corporate Insolvency' (2007) Singapore Journal of Legal Studies, <http://ssrn.com/abstract=1074745> accessed 12 October 2009; Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application* (London, OUP 2005).

[258] See e. g. Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP, Cambridge, MA 1986).

[259] John Armour, 'Should We Distribute in Insolvency?' in Joshua Getzeler and Jennifer Payne (eds) *Company Charges: Beyond Spectrum* (OUP, Oxford 2006).

[260] Consequent upon the criticisms levelled against the institution of administrative receivership, the UK government abolished the administrative receivership. Section 250 Enterprise Act 2002 inserts Chapter 1V after Chapter III of Part III Insolvency Act whereby under Section 72A the holder of a qualifying floating charge is no longer allowed to appoint an administrative receiver. However, this is not absolute because section 72A is applicable only to floating charges created on or after 15 September 2003. Holders of floating charges created before that date may still appoint administrative receivers. The abolition does not also foreclose the appointment of an administrative receiver in certain financing transactions exceptions under sections 72B-72G. Also, Section 72A does not preclude appointment of an administrative receiver over fixed charge assets where the asset in question is not a qualifying floating charge.

[261] For the ongoing debates over the desirability of allocating such strong control rights to secured creditors, see e.g. E Warren & J Westbrook, 'Secured Party in Possession' (2003) 22 American

event that the company defaulted on the loan it granted, was by appointment of an administrative receiver.[262] On appointment, the administrative receiver displaced, functionally, the incumbent management of the debtor company. Receivership was purely a debt enforcement mechanism. As an institution of public law, the administrative receivership was purely contractual. Though on appointment the administrative receiver was deemed agent of the company rather than agent of the appointer (bank),[263] the administrative receiver's primary function was to collect in and realise the security to facilitate repayment to the appointing secured creditor. Thus, in spite of its agency status at law, an administrative receiver's primary fiduciary duties were owed to the appointor.[264]

The administrative receiver's control of the company's assets inhibited, to a large extent, actions by other creditors.[265] He or she held the fort while a liquidator waited to move in and liquidate the assets once the lifespan of the administrative receivership was completed. In theory, insolvency reorganisation is supposed to honour creditors' claims while preventing the premature liquidation of a viable company. In practice, the law was not working as it should and appeared tilted toward the creditors to the detriment of the company, other team members collectively and society generally. In sum, the situation did not encourage business rescue. This in turn had adverse effects on employees' job security.[266]

Bankruptcy Institute Journal, 12; D A Skeel, Jr, 'The Past, Present and Future of Debtor-in-Possession Financing' (2004) 25 Cardozo Law Review 1905, L A Weiss and V Capkun, 'Bankruptcy Resolution: Priority of Claims with the Secured Creditor in Control' (2007) American Law & Economics Association Annual Meetings Working Paper <http://law.bepress.com/cgi/viewcontent.cgi?article=1929&context=alea> accessed 19 October 2011.

[262] *R A Cripps & son v Wickenden* [1973] 1 W L.R 944 (Goff J).

[263] For explanation on the agency created by agreement to which the agent is not party see Goode (n 1) 247, 276-277. For judicial authority, see *Gaskel v Gosling* [1896] 1 Q.B. 669 (Rigby LJ), 692-693.

[264] Although the receiver was also duty bound statutorily to pay preferential creditors (or preferential debts as defined by section 386 in Part XII) out of floating charge assets ahead of the bank (see IA 1986, Part III s 40) its duties to the unsecured creditors were limited. Though he was, regarding his work progress, to furnish all creditors within certain prescribed information (IA 1986 ss 46 & 48), a receiver was generally not accountable to unsecured creditors. The receiver was often criticised for lacking concern for the continuity of the company. The receiver was not obliged to maximise the price that he could get for the assets over and above what was necessary to pay the bank and preferential creditors irrespective of the existence of possible courses of action open to him to achieve that. See e.g. *Silven Properties Ltd v Royal Bank of Scotland* [2004] 1 WLR 997.

[265] John Armour and Sandra Frisby, 'Rethinking Receivership' (2001) 21 (1) Oxford Journal of Legal Studies, 73-102.

[266] J R Franks and K G Nyborg, 'Control Rights, Debts Structure and the Loss of Private Benefits: The Case of UK Insolvency Code' (1996) 9 Review of Financial Studies, 1165-1210.

English insolvency law has since moved away from the 'contractualism' approach to a 'neutral management' orientation. This has been achieved through the use of the administration procedure enabling the appointment of an outside manager to take charge of an insolvent company's affairs in the form of the administrator or a liquidator. Although the administration regime has created a three-way entry route into administration, one out of the two out of court entry routes allows a secured creditor the choice and power of appointing an administrator.[267] A creditor holding a qualified floating charge (QFC) in respect of a company's property is, under certain prescribed conditions, able to make an out-of-court appointment of an administrator of a company.[268] Thus, it can be argued that the system is still somehow biased toward the prioritisation of the creditors' interests.

The administration procedure is reliant on 'moratorium.' Like the CBT in which the 'automatic stay' is a key feature, the appointment of an administrator imposes a 'moratorium' on the enforcement of individual claims.'[269] The significance of the 'stay' lies in the fact that it wards off any depredation attempts on the insolvent estate by potentially 'rebellious' or non-complying creditors. The protection of the debtor's estate is ultimately for the benefit of the secured creditors given that insolvency reorganisation transfers interests in the insolvent's assets, rather than the assets themselves, to right holders in the company.[270] This is another way in which the English insolvency system aligns with the CBT.

Because the system tilts towards the creditors, it also promotes creditors' wealth maximisation just like the CBT advocates. English insolvency law appears to adopt the same position or principle with the CBT that pre-insolvency entitlements are to be respected. Both the proponents and exponents of the CBT hold the view that insolvency exists primarily for the benefit of the creditors. The UK Insolvency Act 1986 seems to uphold this position especially when viewed against the background of what the purpose of administration was meant to be and what, ultimately, it usually is.[271] In administration proceedings, one of the most likely outcomes is the sale of the company's business.[272]

[267] IA 1986, Schd. B 1 paras. 14 & 22.
[268] IA 1986, ss 14 & 15
[269] Goode, (n 15) 60.
[270] Adler and Weiss (n 251).
[271] See Insolvency Act 1986 Schedule B1, paragraph 3 (1)
[272] Sandra Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 (2) MLR 247 274.

While 'rescuing' the company as a going concern is the primary objective of administration,[273] rarely is rescue, in the sense of a rehabilitation which enables the company to overcome its difficulties and be restored to financial 'good health' with the survival of the company as an entity intact and no changes in ownership and management, achieved.[274] Corporate rescue is not the necessary outcome of the administration proceedings. Administration may result in the preservation of the value of a company heading for failure in order to achieve a better outcome than would otherwise be possible if it went into an immediate winding-up.[275] It may only be possible to sell the assets of the company on a piecemeal basis through administration. The administration proceedings can also be used for 'the preservation of the company's business, comprising its means of economic production, to be sold as a going concern'.[276] Often, such a sale is pre-agreed in principle with the eventual buyer even before the insolvency proceedings commenced, under what is termed a pre-packaged sale.[277]

In the UK, it is an incontestable fact that when a company is formally insolvent, the shareholders' interests are usually supplanted by the creditors' interests. In *Brady v Brady*,[278] (a case decided in the context of directors' duties in insolvency), the court held that 'where the company is insolvent, or even doubtfully solvent, the interests of the company are in reality the interests of existing creditors alone'.

This position, which has been reaffirmed by the English courts in several decisions, has also given credence to, and even enhanced, the secured creditors' primacy both in theory and practice under the UK insolvency system.[279] The

[273] Insolvency Act 1986, Schd. B1, para 3 (1).
[274] Rebecca Parry, *Corporate Rescue,* (Sweet & Maxwell, London 2008) 2.
[275] IA 1986 Schd.B1, para. 3 (1) (b).
[276] IA 1986 Schd.B1, para. 3 (1) (b). See also, Frisby (n 272); Parry (n 274).
[277] Sandra Frisby, 'The Pre-Pack Progression: Latest Empirical Findings' (2008) Insolvency Intelligence 154; Frisby, 'The Second Chance Culture and Beyond: Some Observations on the Pre-Pack Contribution'' (2009) Law and Financial Markets Review 242; Frisby, 'A Preliminary Analysis of Pre-packaged Administration' (2007) Report to the Association of Business Recovery Professionals http://www.r3.org.uk/media/documents/publications/press/preliminary_analysis_of_pre-packed_administrations.pdf accessed 17 March 2012; Vanessa Finch, 'Pre-packaged Administrations: Bargains in the Shadow of Insolvency or Shadowy Bargains?' [2006] JBL 568; P Walton, Pre-Packaged Administrations: Trick or Treat? (2006) 19 Insolvency Intelligence 113; J Moulton, 'The Uncomfortable Edge of Property – Pre-Packs or Just Stitch-Ups?' (2005) Recovery, 2; A Bloom and S Harris, 'Pre-Packaged Administrations – What should be Done Given the Current Disquiet?' (2006) 19 Insolvency Intelligence 122; Bo Xie, 'Protecting the Interests of General Unsecured Creditors in Pre-Packs: The Implication and Implementation of SIP 16' (2010) 31 Company Lawyer 189-195.
[278] [1987] 3 BCC 535, 552 (Nourse LJ).
[279] This principle which was established in the earlier Commonwealth case of *Kinsella v Russell Kinsella Pty Ltd* [1986] 4 NSWLR, was given recognition in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC

proprietary rights of secured creditors against the assets of the company entitle them to be regarded as the company when the latter is formally insolvent.[280]

However, there are other circumstances in which the directors' duties to the shareholders might be required to shift to the creditors. These, according to case law, include where the company is approaching, nearing, on the verge of, or on the borderline of insolvency,[281] doubtfully solvent[282] or subject to a risk of insolvency.[283] It is also true that the system functions in a way that in a winding-up proceeding, only a very limited measure of statutory support is available to employees. In administration, the interests of the employees are very low down the priority list of most administrators.

However, as noted above, English insolvency law is no longer solely based on contractualism, neither is it totally liquidation biased, even though in most proceedings, liquidation is still one of the possible outcomes. The reorganisation of the affairs of the insolvent is currently one strong possibility during corporate distress. But this comes with a price. While reorganisation functions to gather all the claimants in one forum so as to make a collective decision regarding the future of the debtor and its assets, it also overrides, alters and redistributes the pre-insolvency rights and entitlements of the individual claimants.[284]

The change in approach to corporate insolvency in the UK has also brought about a marked change in attitude in the way employees, as one of the stakeholders in corporate insolvency, are treated. It could be argued that the strengthening of 'rescue-oriented' law by the Enterprise Act (EA) 2002 was to ensure that employee-related liabilities did not frustrate business rescues to the detriment of the employees themselves.[285] Although under the EA 2002 the employees

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250, 252-53. In subsequent English cases, the courts have adopted this approach. See e.g. *Re Pantone 485 Ltd* [2002] 1 BCLC 266, 69; *Gwyer v London Wharf (Limehouse) Ltd* [2003] BCC 885, 74; *Re MDA Investment Management Ltd* [2004] EWHC 42 Ch.; *Re Cityspan Ltd* [2008] BCC 60.

[280] *Lonrho v Shell Petroleum Ltd* (1980) 1 WLR 627, 634 (Lord Diplock); *West Mercia Safetywear Ltd v Dood* [1988] BCLC 250, 252-3.

[281] See e.g. *The Liquidator of Wendy Fair (Heritage) Ltd v Hobday* [2006] EWHC 5803, 66; *Gwyer v London Wharf (Limehouse) Ltd* [2003] BCC 885, 74; *Gillespie, Airdrie North Limited* [2010] CSOH 132, 22.

[282] *Gwyer v London Wharf (Limehouse) Ltd* [2003] BCC 885, 74

[283] *Kinsella v Russell Kinsella Pty Ltd* [1986] 4 NSWLR; *Winkworth v Edward Baron Development Ltd* [1986] 1 WLR 1512.

[284] Warren (n 61) 776.

[285] Paragraph 99 of Schedule 1B to the Enterprise Act 2002 makes it very clear that only certain specified elements of employee claims should be afforded super-priority status. An administrator is allowed a 14-day period to decide whether to adopt the contracts of employees. No liabilities under

retained the status of preferential creditors for their arrears of pay and for holiday pay claims in insolvency situations, an argument may be made that Parliament understood that there would be cases in which the aggregate claims of employees who are retained by an administrator would be very substantial.

Had such liabilities continued to receive super-priority status (as was decided in the *Paramount Airways* case[286] which was to right previous wrongs against the employees[287]), there is a tendency that administrators would be unwilling to retain employees after appointment, unless they were satisfied that the available assets are sufficient to meet employee claims as well as all other costs and expenses (including the administrator's), and that this would still enable a better return to creditors than would be possible in liquidation. This would have resulted in administrators having to err on the side of caution by retaining very few employees, or in some cases even dismissing the entire workforce and closing businesses. The consequence would be that the chances of the business being rescued as a going concern would be limited or even completely lost. Such an outcome would be contrary to the rescue culture which the Insolvency Act 1986 and subsequent amending legislation[288] were intended to promote. It would also

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these contracts which arose during this 14-day period would be granted super-priority status. Case law have demonstrated that **even** after contracts of employment were adopted by an administrator, any claims with respect to liabilities under them would be granted super-priority status only if they related to wages or salary with respect to services rendered wholly or partly after adoption. See generally *Re Allders Department Stores (in administration)* [2005] ICR 867; *Re Huddersfield Fine Worsteds Ltd, Re Ferrotech Ltd and Re Granville Technology Group Ltd* [2005] EWCA Civ 1072. However, in *Delaney v Staples* [1992] 1 AC 687, the Court of Appeal accepted that, in certain very limited circumstances, payments in lieu of notice could be made under a contract of employment and would be granted super-priority status. However, such circumstances were limited to instances of 'garden leave', where the departing employee was paid for his notice period in full, but not required to attend work. In practice, these will very rarely be encountered in administration situations.

[286] [1994] 2 All ER 513.

[287] See e.g. *Re Specialised Mouldings Ltd* (unreported) 13 February 1987. In that case, the court approved a form of letter to be sent to employees by receivers declaring that they were not adopting contracts of employment or assuming any personal liability by virtue of allowing those contracts to continue. It became common practice of both receivers and administrators to rely on the decision to keep employees, use their services and dismiss them just before transferring the business. In the context of receivership, the vulnerability of employees whose contracts of employment continued during the life of the receivership was brought to the fore in the Court of Appeal's decision in *Nicoll v Cutts* [1985] BCLC 322. Although it had been the practice of receivers to pay for services rendered, however, here a contract of employment had not been terminated, and the receiver had not paid, despite having used the employee's services to a limited extent.

[288] See e.g. Insolvency Act 1994 which restricted the consequence of adoption to 'qualifying liabilities', which are basically liabilities to pay wages, salaries and contributions to occupational pension schemes incurred both while the administrator or administrative receiver is in office, and in respect of services rendered after adoption.

not be helpful to the employees themselves as they would lose their jobs should the business be closed down.

Granted, in administration proceedings, the administrator once appointed is legally the agent of the company,[289] and must perform his functions in the interests of the company's creditors as a whole,[290] the administrator must however pursue the paramount statutory objective of rescuing the company as a going concern where reasonably practicable.[291] Even though in practice business rescue is more common in comparison to company rescue, the point is that the shift in focus from liquidation to going concern rescues of insolvent businesses is, arguably, an indication that there is a change in priority of both interests and objectives in English insolvency law.[292] While the sale of a business as a going concern is not directly aimed at benefiting the employees (the sale is to enable the creditors capture full going concern value for the business), a presumption could be made that the practice of going concern sales is advantageous for the employees as it guarantees continuity of employment, at least, for some workers.[293]

The point here is that although under the Schedule B1 paragraph 3 overriding duty of the administrator, the creditors' interests appears to take precedence over those of other stakeholders, and the preservation of the whole or a substantial part of the company intact, is intended to incentivise administration for the company's directors,[294] it could also be argued (despite there being no direct statutory evidence to this) that rescuing the company as a going concern, or at least, rescuing its business (which is a more common outcome of administration proceedings in the UK), may be intended to indirectly benefit other team members of the company - especially the employees.[295]

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[289] IA 1986 Schd. B1 para 69. For an explanation of an agency created by agreement to which the agent is not a party to it, see *Gaskel v Gosling* [1896] 1 QB 669 at 692-693 (Rigby L J).

[290] IA 1986 Schd BI, para 3 (2).

[291] IA 1986 Schd. B1, para.3 (1) (a).

[292] Paul Davies, 'Employee Claims in Insolvency: Corporate Rescues and Preferential Claims,' (1994) 23 IL.J 141-151.

[293] This appears to be the global perspective on going concern business rescues. See 'UNCITRAL Legislative Guide on Insolvency Law' (2005) 287-8 <http://www.uncitral.org> accessed 20 June 2009.

[294] HL Deb., 29 July 2002, Cols 764-767.

[295] The International Monetary Fund (IMF), in its *Orderly and Effective Insolvency Procedures; Key Issues* (1999) Handbook, demanded that the protection of the employees of financially troubled enterprises should be taken into account by states when designing insolvency laws as much the weight given to economic efficiency.

From a judicial perspective, the English courts have long supported business rescues that are aimed at saving jobs for the employees. In fact, even before the wind of change in insolvency orientation in the UK came, the English courts had long been receptive to the notion that saving an insolvent business has the potential for preserving jobs for the employees.[296] In *Re Welfab Engineering Ltd,*[297] (a case which concerned the scope of the directors' duties to creditors, and when these duties might clash with wider issues such as the duties directors owe to the society in general in the context of insolvency) the English court rejected the liquidator's claim that by turning down a higher offer made by one of the prospective purchasers in preference for a lower offer made by another, *Welfab's* directors violated their fiduciary duty to the company's creditors.

The court took the view that under the circumstances, the directors' rejection of the higher offer was justified because it was not guaranteed to lead to the survival of *Welfab's* business as a going concern. This was a ground breaking decision which has implications for insolvency law in the UK in general and for employment protection in particular. It was a statement by the court that in spite of the predominant rule being creditors' wealth maximisation in insolvency reorganisations, employment protection for the company's employees should be given equal consideration just as maximising value for the creditors is.

Similarly, in *DKLL Solicitors v HM Revenue & Customs*[298] where HMRC as majority creditor, opposed the sale of DKLL through a pre-packaged sale, and sought to wind it up instead, the submission that the court ought not to have made an administration order where it was known that the majority creditor opposed the sale was rejected and the winding-up petition was blocked by the court. The presiding judge said in that case that he was influenced against granting the application by reason of the opposition of HMRC. However, the judge was more heavily influenced by the fact that the proposed administrators' intended sale through the pre-pack strategy appeared to be the only way of saving the jobs of DKLL's employees.

The courts' positions in the above two cases, arguably, aligns with the developing law on stakeholders' interests in insolvency law. Under section 172 of Companies

[296] See Samuel E Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory' (2011) 32 Company Lawyer 99, 105-106.
[297] [1990] BCC 600 Ch D.
[298] [2007] EWHC 2067 (Ch); [2007] BCC 908.

Act 2006, the directors of a UK company have a duty to act in a way they consider would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard, *inter alia,* to the interests of the company's employees.[299]

Another principal way in which the hitherto creditor-driven English insolvency legal system has undergone significant change is to be found in the duty placed on the administrator in relation to the employees of the insolvent company. In administration proceedings, the administrator is statutorily obliged to inform and consult with the designated representatives of the employees when he or she is contemplating a sale of the business. As the transferor of the business, this duty requires the administrator to intimate to the employees that a transfer will take place, tell them (technically via their representatives) approximately when the transfer is expected to take place, the reason for the transfer, the legal and economic implications of the transfer for those that will potentially be affected by it and the measures that will be taken to ameliorate the impact of the business transfer on affected employees.[300]

However, it must be stressed that though these duties arise in insolvency in general, and particularly during transfers of insolvent businesses; they do not originate from insolvency law. Rather, these are duties emanating from a different body of law: employment law through the TUPE Regulations. Moreover, these employment law rules in themselves are not native to the UK. TUPE owes its origin to an EU social policy initiative aimed at safeguarding the rights of the employees during business transfers. This is a typical example of how employment law and insolvency law interact in corporate insolvency. Here employment law obliges the office holder appointed under insolvency law to take into account the interests of employees in insolvency situations involving the transfer of the business.

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[299] Companies Act 2006, s. 172 (1 (b).

[300] TUPE 2006, Regulation 13. According to case law, it seems that there is no duty to provide accurate information, but just information that the transferor thinks to be true. See *Royal Mail Group v Communication Workers Group* [2009] EWCA Civ. 1045. While the decision in that case may provide an excuse for employers who could argue similar facts and raise a defence that they genuinely did not believe that TUPE applied in order to defend claims that they are in breach of the informing and consulting obligations, the case also raises many difficult questions about when a belief that TUPE did or did not apply can be said to be genuine. Note however, that the rule on information and consultation only apply pre-transfer and does not apply post transfer. See e.g. *Ucatt v Amicus and others; Amicus and another v City Building (Glasgow) LLP and others,* EAT/0007/08 & EAT/0014/08.

2.10 Conclusion

The theories that have been considered above show that there is no agreement on what the purpose of insolvency law is, or should be. While some theorists favour an exclusive creditor protection role for insolvency law, others subscribe to the inclusive perspective which requires it to consider a wider set of interests. This division also goes to show that insolvency policies cannot be the same everywhere and that depending on which ideological camp policymakers in a particular jurisdiction belong to insolvency policy of that jurisdiction would be either pro-debtor or pro-creditor. The choice will also reflect the normative value judgment and determine how the interests of the various stakeholders in the insolvent company will be treated in a given jurisdiction. While all the theorists are agreed that the employees should be protected in corporate insolvency, they however differ on how this should be done.

Applying the theories to the English insolvency system, it is evident that the system is a halfway house between the contract model which allows companies to contract *ex ante* over the allocation of control rights in the event of default[301] and an insolvency law model which mandatorily imposes particular collective procedures on insolvent companies.[302] However, even with the changes made to the law by the Enterprise Act 2002, which was intended to facilitate a system favourably disposed to company rescues, the 'contract bankruptcy'[303] model which puts secured creditors in vantage position to 'control'[304] insolvency proceedings continues to loom large.[305]

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[301] There is the view that mandatory imposition of particular collective insolvency procedures on insolvent companies is undesirable. Rather, companies should be free to contract how control rights will be allocated based on anticipated changes in its financial situation. See R. Rasmussen, 'Debtor Choice: A Menu Approach to Corporate Bankruptcy' (1992) 71 *Texas Law Review* 51; A Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 Yale Law Journal 1807.

[302] J Armour, A Hsu & A Walters, ` Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) ECFR 148, 153.

[303] ibid.

[304] Ian Fletcher, 'UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – The Insolvency Act 2000, The White Paper 2001, and the Enterprise Act 2002' (2004) 5 European Business Organization Law Review, 119-151.

[305] Even though with the implementation of the relevant part of EA 2002, insolvency process has shifted its focal concern –away from debt collection and towards the management of insolvency risks and rescues of financially troubled businesses, the 'spectre' of debt enforcement continues to hunt insolvency proceedings. To a limited degree, administrative receiverships still remain a procedure of limited use for floating charge holders. A floating charge holder may still appoint an administrative

Insolvency law theories support employee protection in various degrees and ways. There are statutory protections in the insolvency laws of various countries protecting certain employees' rights, but there are divergences of opinions how employees should be protected in transfers. UK employees enjoy continuity of employment under the same terms of employment when the insolvent business that employed them is transferred to a third party purchaser, but as indicated above this protection is foreign. That is to say, it comes from an extraneous source. It is from a different body of law which has been imposed on the structure of insolvency law. Thus, the law, taken as a whole, conforms to TPT but it is the application of EU employment law to transfers of insolvent undertakings which supplies the employees a focus and accommodates the employees' interest.

In the next chapter, the focus of analysis will be on the origin of the regime that protects employees' during transfers of insolvent undertakings in the UK.

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receiver in the exceptional situations listed under sections 72H -72H of the Insolvency Act 1986. In essence, even the reformed administration procedure is not spared from the control of secured creditors either by virtue of their ability to either request the appointment of, or appoint an administrator as of right. See Insolvency Act 1986, Schd. B1 paras 12 (1) (c) & 14.

CHAPTER THREE

EUROPE AND SOCIAL POLICY: GENESIS OF EMPLOYMENT PROTECTION LEGISLATION

3.1 Introduction

The focus of this thesis is on the tension between business rescue and employment protection in corporate insolvency. Given the problem posed by employment protection to the 'rescue culture' in the United Kingdom (UK), the origin of employee protection legislation during business transfers in the UK deserves to be explored. The source of the tension is not internal, it is external. It is traceable to the European Union (EU)[1] and its legal order. The EU's social policy[2] has impacted significantly on the Member States. EU social policy legislation has permeated legal spheres which hitherto used to be the exclusive preserve and jurisdiction of the Member States. For example, European law on the protection of employees' rights in business transfers has supplanted the domestic legislation of the Member States that govern the rights of the employees in business transfer situations.

Today, it is almost impossible to determine UK national employment law solely by its domestic developments without reference to EU labour law. While EU law has intruded into the UK domestic employment sphere, it has equally brought with it several problems. This is evident in the way European labour legislation has changed the way the common law regulated transfers of undertakings in the UK and tended to shift the balance in favour of the employees. The EU-derived law on transfers of undertakings (discussed in chapter 4) may be regarded as the

[1] The European Union as it is known today is the result of the change in nomenclatures and the transformations that the original European Economic Community (EEC) founded in 1957 have undergone. The three foundation Treaties/Communities of the EEC were merged in 1967 to create the European Communities (EC). In 1993, the European *Communities* was renamed the European *Community* by the Maastricht Treaty on European Union (TEU). However, for convenience, the name European Union (EU) will be used in this chapter with references to the EEC and EC as appropriate.

[2] The terminology 'social policy' as used in this chapter and the entire thesis simply refers to labour law which include a whole raft of measures relating, but not limited to, the protection of workers' rights in transfers of undertakings situations, health and safety at work, equal treatment in employment and redundancy.

genesis of the tension between employee protection and business rescue during transfers of insolvent undertakings in the UK.

One reason why this has been possible is because the UK is, first and foremost, a member of the EU. However, the second and perhaps, most important reason relates to the legal doctrine of supremacy of EU law. This means that EU labour law, for example, takes precedence over the domestic labour laws of the Member States.[3] The creation of a new legal order of EU law coupled with its supremacy and system of qualified majority voting (QMV)[4] means that EU institutions may create rules affecting employment and industrial relations in Member States whether or not they approve of them.[5]

Thus, through the doctrine of supremacy, the Europeanisation of employment and industrial relations has been fostered by ensuring that EU law applies in those areas that fall within its sphere of competence.[6] For example, the EU has introduced a protective legal framework for European citizens. It has minimum requirements in the labour law field in relation to the rights of workers and work organisation. EU legal developments in the labour law field are responsible for the legislation that mandatorily transfers the employees' contracts of employment where there is a change in the ownership of the business that employs them following a legal transfer or sale to a third party purchaser.[7] This was never the case when the common law regulated business transfers in the UK. All

[3] The supremacy of EU law was established in the landmark ECJ decision in Case 6/64 *Flaminio Costa v ENEL* [1964] ECR 585. See also Case C-271/91 *Marshall v Southampton and South West Area Health Authority (No. 2*), [1993] ECR I-4367 which reaffirmed the doctrine of supremacy of EU law.

[4] Currently, QMV which is required for the adoption of many internal market measures such as employment policies, among others, operates as a system of weighted votes. It is based loosely on Member States' population size. This means that the larger the Member State, the more votes it holds. The weighting system on votes is laid out in Article 3 (3, Protocol No. 36 (which is annexed to the TEU and TFEU). For an act to be adopted using QMV, at least 255 votes must be cast in favour and a majority of Member States has to vote in favour in respect of a Commission's proposal and two-thirds otherwise. QMV will be replaced with the 'double majority' principle (based on number of Member States and population from 1st November 2014. See John Fairhurst, *Law of the European Union* (8th edn., Pearson Education Ltd, Essex 2010) 130-131.

[5] The supremacy of EU law over national law is confirmed by Article 288 TFEU [ex Art.249EC/ Art.189 EEC]. This article makes it explicitly clear that EU laws have an obligatory value and so 'cannot judicially be contradicted by an internal law, whatever it might be...'

[6] See e.g. the ECJ's decision in Case 43/75 *G Defrenne v Sabena*, (1976) ECR 455.

[7] See Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

employment relationships were deemed terminated upon the transfer of a business.[8]

This chapter traces the origin of employment protection legislation as it relates to transfers of insolvent undertakings in the United Kingdom, which is a key example of the influence of EU law on UK labour law. It is not proposed here to attempt a comprehensive and chronological history of the European integration project. Rather, the purpose of the chapter is to provide a brief but general account of the origin of EU social policy. Granted, there has been significant expansion of the social agenda *vis-a-vis* European integration in the last four decades,[9] this chapter is however mainly concerned with tracing the several attempts made by the EU to tackle employment issues in the early 1970's. The focus here is on the process of European economic integration and particularly on tracing the genesis of EU social policy as it relates specifically to employee protection in situations of employer insolvencies.

It is intended to explore briefly the milestones in the European integration project up to the time when the ground breaking Social Action Programme (SAP) was adopted in 1974. The chapter will then go on to examine briefly social policy directives that were the offshoot of the SAP. It argues that the SAP was instrumental to the eventual enactment in 1977 of the European-wide regime on the safeguarding of employees' rights in the event of business transfers resulting in a change in ownership of the business: the Acquired Rights Directive (ARD).[10] The ARD is the parent law of the UK's equivalent: the Transfer of Undertakings (Protection of Employment) Regulations (TUPE).[11]

The specific aim of this chapter therefore, is to explore how the law regulating transfers of undertakings (which, in the context of insolvency, is the main source of the tension existing between business rescue and employment protection in the UK) became legislated on at the European level. The chapter will explore the difficulties faced by the then European Economic Community (EEC) in crafting

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[8] The common law rule on business transfers enunciated in the seminal House of Lords decision in *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014 (HL).

[9] See e.g. L Hantrais, *Social Policy in the European Union* (2nd edn., Palgrave Macmillan Press, Basinstoke 2000); Robert Geyer, *Exploring European Social Policy* (Polity Press, Cambridge 2000). Robert Geyer, *Exploring European Social Policy* (OUP, Oxford 2000); Robert Geyer, 'The state of European Union Social Policy' (2000) 21 (3) Policy Studies 245–261.

[10] The ARD is considered in detail in the next chapter (Ch. 4).

[11] TUPE is analysed in chapter 5.

social policy legislation even when it finally felt the need to do so. It will be argued that social policy took a back seat in the EU scheme of things due to several factors. The purely economic beginning of the EU, the ideological mindset of the founding fathers, the differences in the legal traditions or origins of the Member States, the differing approaches or responses to social issues and the lack of a sound Treaty base for crafting legislation on social policy were factors that impeded the EU from legislating and accounted for the low legislative output in the area of social policy.

It is also intended to use this chapter to show that, though legislation on social policy was eventually adopted following the rise in unemployment in Europe, these laws had an underlying economic rationale for their adoption: they were intended to address the social issues that were deemed capable of directly impeding the operation, or reducing the benefits that could be derived from the common market. That social policy was enacted to eliminate obstacles to the functioning of the Common Market goes to further underscore the dominance of the economic over social considerations in the EU in the early years. The discussion of European integration and social policy legislation sets the stage for the discussion of the ARD that follows in chapter 4.

3.2 The 'European construction'[12]: milestones

The purpose of this section is to provide a brief historical analysis on the EU from infancy to the present day. Although 1952 is officially credited as the year when the European 'construction' began, it is the event of March 25, 1957 in Rome that may be considered as the most important milestone in the history and annals of European integration. It was on that day that six sovereign western countries[13] signed the agreement that culminated in the establishment of the then European Economic Community (EEC). Since that time, the then EEC has undergone transformations in its size, composition, name, as well as in the areas and matters upon which it can legislate.[14]

[12] This term is used in the context of this research to refer to the conception and institutionalisation of the EEC and the common market leading to the present day EU.

[13] These countries were France, Germany, Italy, Belgium, Netherlands and Luxemburg.

[14] Currently, the EU comprises 27 member states from the six original member countries in 1957. These countries are made up of civil and common law countries in comparison to the original six who

3.3 European integration without a 'social face'

The European Economic Community (EEC), as its name indicated, was meant to be a purely economic community. This is evidenced by the non-interventionist, market-oriented legal nature of the 1957 Rome Treaty which created the then EEC. The Treaty elaborated a fairly strict separation between the economic and social spheres.[15] Based on this separation, and on the continuous consolidation of an economic union, every other provision (including social provisions) of the Treaty was subordinate to economic provisions.[16] Thus, as far as the European construction project was concerned, not only was 'social policy' a late comer in the scheme of things, but it played second fiddle to policies designed to achieve economic goals.[17] It took almost twenty years for the EU to finally put in place a social policy programme (see section 3.10.1 below)

The point here is not that social policy was completely absent within the EU framework.[18] Rather, the argument is that even though the EU has always had a social dimension from inception, its primary rationale, in the initial phases, was economic integration among the Member States. The rationale for pursuing economic goals was to create an effective and undistorted functioning internal market. In that context, social policy played a very minimal role.[19] In fact, social policy was regarded as the 'Cinderella'[20] of European integration - a term used derogatively in indicating the low status and the lack of regard in which social

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were all civil law countries. From EEC, it is known today as the European Union (see fn. no. 1 above) and the union now legislates on social policy matters in comparison to its pursuit of mainly economic policies in early integration phases.

[15] Franck Lecomte, 'Embedding Employment Rights in Europe' (2011) 17 Col. J of Eur. L. 1.

[16] Carlos A Ball, 'The Making of a Transnational Capitalist Society: The Court of Justice, Social Policy and Individual Rights under the European Community's Legal Order' (1996) 37 Harvard Int'l L .J. 307, 309; Stefano Giubboni, *Social Rights and Market Freedom in the European Constitution: A Labour Law Perspective* (CUP, Cambridge, 2006) 7.

[17] Paul L Davies, 'The Emergence of European Labour Law' in William McCarthy (ed.) *Legal Intervention in Industrial Relations: Gains and Losses* (Blackwell Publishers, Oxford 1992) 318; P Watson, 'Social Policy after Maastricht' (1993) Common Market Law Review 30, 481-513; Sandra Fredman, 'Europe with a Social Face: Equality and Social Rights in the European Union' (2001) 22 ILJ 1467-80.

[18] Davies (n 17) above.

[19] N Nevra Esenturk, 'EU Social Policy: Progressive Development in Legal and Governance Aspects' <http://www.social-policy.org.uk/lincoln/Esenturk.pdf> accessed 17 May 2012.

[20] Davies (n 17); Monica Threlfall, 'The European Union and Social Policy: An Innovative Approach to Regional Integration? (2006) <http://www.cris.unu.edu/fileadmin/workingpapers/20060620144201.O-2006-14.pdf> accessed 11 May 2012; Michael Shanks, 'The Social Policy of the European Communities' (1977) 14 CMLR 373.

policy was held in the entire European integration project.[21] The dominance of economic over social provisions in the foundation Treaties, and the preponderance of the former over the latter in the common market policy considerations however, was to such an extent that even the agreement by Member States on the necessity to promote improvement in the living and working conditions of workers was to result from the functioning of the common market[22] and not through any direct legislative interventions.[23] Economic ideals effectively trumped social ideals to the extent that social rights only warranted protection if they were necessary for the enhancement of an economic goal.[24]

3.4 Arguments contra social policy legislation

The impetus behind the relegating of social policy to the background was two-fold. First, it was based on the notion that the 'amalgamation' of the various economies into a single European market would automatically lead to gradual harmonisation of social policy throughout the EU thus removing any need for the Union to have a social policy of its own.[25] Put differently, it was conjectured that progress in the social arena would be an automatic 'by-product' of economic integration[26] and as such intervention at the EU level would not be necessary.[27] Thus, in striking contrast to how matters in the economic sphere were dealt with by the EU, social matters, particularly matters relating to employment law were to be left to the jurisdiction of Member States.[28]

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[21] Threlfall (n 19).

[22] On the characteristics of a common market, see John Tilotson & Nigel Foster, *Text, Cases and Materials on European Union Law* (4th edn., Cavendish Publishing, London) 37.

[23] See e.g. Article 117 EEC.

[24] Fredman (n 17).

[25] R Nielsen & E Szyszczak, *The Social Dimension of the European Community,* (2nd edn., Viborg, 1993) 17; P Craig and G De Burca, *EU Law* (2nd edn., OUP, Oxford, 1998) 5. The relegating of social policy to the background, or more accurately, making social considerations subservient to economic considerations appears to be the norm even today. This has prompted one commentator to articulate that: 'Social policy issues are addressed at EU level almost entirely through measures consistent with policies designed to advance the market and that where social policy measures exist they are largely passive and represent some kind of spill over effect.' See Mary Daly, 'EU Social Policy after Lisbon' (2006) 44 (3) JCMS 461, 464.

[26] Peter Hoeller and Marie-Odile Louppe, 'The EC's International Market: Implementation and Economic Effects' (1994) 23 OECD Economic Studies 55, 417. See also Jo Shaw, Jo Hunt & Chloe Wallace, *Economic and Social Law of the European Union,* (Palgrave McMillan, Hampshire, 2007), 394.

[27] Fredman (n 17) 1467.

[28] J Kenner, *EU Employment Law: From Rome to Amsterdam and Beyond* (Hart Publishing, Oxford, 2003) 12.

Perhaps the above philosophy was borne out of the notion that policies that are so closely linked with the 'social contract'[29] between governments and citizens are better decided nationally.[30] Perhaps, the reasoning was due to the difficulty envisaged in getting a consensus on social policy issues due to the unique composition of the EU. The EU comprises both civil law and common law countries. These countries have different labour market models existing in parallel in the EU. These various national models, which are the result of long and complex historical processes,[31] include the corporatist[32] model in old continental Europe and the UK's Anglo-Saxon 'at will' labour law model.[33] There are also the Scandinavian arrangement of voluntary collective agreement and the diverse set of flexible models of the newly acceded Member States in the early 1970s.[34]

Because Member States have different labour market models with different levels of social protection, it was (and still is) very difficult to achieve consensus and therefore effectively legislate on social matters centrally at the European level.[35] It was thought that any attempts to regulate such a diverse set of labour markets,

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[29] The 'social contract' is the view that the moral and/or political obligations of persons are dependent upon a contract or agreement among them to form the society in which they live. See C Friend, 'Social Contract Theory' (2004) Internet Encyclopaedia of Philosophy <http://www.iep.utm.edu/soc-cont/> accessed 20 June 2012.

[30] See Open Europe, 'Repatriation of EU Social Policy: The Right Focus for a Conservative Government' (2009) <http://www.openeurope.org.uk/Content/Documents/PDFs/eusocialpolicy.pdf> accessed 11 March 2012.

[31] Roger Blanpain, *European Labour Law,* (11th edn., Kluwer Law International, The Netherlands 2008) 797.

[32] Corporatism is a type of organized or coordinated capitalism where power to make important economic policies in a state are transferred from the parliament and government to semi-private organizations yet subordinate to the state. These are based on economic function or industrial sector and include a strong representation of labour interests. See F Pryor, 'Corporatism as an Economic System: A Review Essay' (1988) 12 Journal of Comparative Economics 317–344. See also Alan Siaroff, 'Corporatism in 24 Industrial Democracies: Meaning and Measurement' (1999) 36 European Journal of Political Research 175-205.

[33] Before the enactment of the ARD, which has been implemented in the UK by TUPE, there was no obligation from the employer towards the welfare of the employee in Britain's labour market. This created a perverse corporate, economic, and social environment. The 'at will' employment law doctrine created a culture of trigger-happy executive leadership that seeks to get rid of hundreds even thousands of employees at the slightest hint of weakness in corporate profits. Corporate restructuring or downsizing was often the first port-of-call rather than the last resort for companies to cut costs and increase profitability in times of financial distress.

[34] Simon Deakin & Beth A Ahlering, 'Labour Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?' (2005). Uni. of Cambridge Centre for Business Research Working Paper No. 312; ECGI - Law Working Paper No. 72/2006 <http://ssrn.com/abstract=898184> accessed 2 December 2011.

[35] See Thijmen Koopmans, 'The Birth of the European Law at the Crossroads of Legal Traditions' (1991) 39 (3) American Journal of Comparative Law 493-507. This situation has persisted today and is accountable for the innovative approaches that have been adopted by the EU to make legislation in the labour and employment sphere discussed in section 3.9 below.

without circumspection, would have amounted to inviting trouble. This is because while all the Member States share similar values and pursue the same objective *vis-a-vis* the combining of economic performance and competiveness with social justice, they however differ markedly in terms of the instruments and approaches used in the attainment of these goals.[36]

Second, and most importantly, given that those contracting Member States who wished to liberate the labour market stood for the free circulation of labour, it was of utmost importance that the drafters of the Rome Treaty divorced free movement provisions from the other social provisions. Accordingly, the provisions on free movement of labour within the EU were included together with free movement provisions of goods, services and capital.[37] This approach was perhaps intended to re-emphasise the economic as opposed to the social nature of the EU.[38] This approach prevented, from the outset, the provision of a sound legal base for initiating policy in the employment law sphere and it has continued to limit the EU's power to initiate policy in that field.[39]

However, it is noteworthy that the EU's non-intrusion into the labour law arena stance was not an oversight. Rather, it was an informed decision based on the opinions of policy and integration experts. The exclusion of policy on labour law was based on a report of the group of experts charged with investigating the social aspects of European economic co-operation. This report was commissioned by the International Labour Organisation (ILO).[40] The experts had concluded in their 1956 report that differences in levels of social protection offered to citizens by Member States did not create competitive disadvantages of an alarming proportion which deserved EU-level intervention. Accordingly, to harmonise

[36] Craig and De Burca (n 25).
[37] Davies (n 17) 320.
[38] However, the free movement provisions have been extended by subsequent judicial and legislative interventions to include social and tax advantages. See e.g. Council Directive 64/221/EEC of 25 February 1964 on the co-ordination of special measures concerning the movement and residence of foreign nationals which are justified on grounds of public policy, public security or public health. See also Directive 2004/38/EC of the European Parliament and of the Council on the right of citizens and of their family members to move and reside freely within the territory of the Member States.
[39] Craig & De Burca (n 25).
[40] See Le Comite Intergouvernemental crée par la Conférence de Messine, *Rapports des chefs de délégation aux Ministres des Affaires Étrangères,* Brussels 1956 (Expert Reports) 104-5, 107.

measures or policies in the area of labour and employment law was, in their view, unnecessary.[41]

The above reasons perhaps explain why the EU, in its formative years, was mainly focused on developing the framework necessary to establishing a Common Market that would enable the achievement of what is characterised in EU literature as the four freedoms:[42] free movement of goods, persons, capital, and the freedom to provide services, considered as necessary ingredients for economic integration.[43] The idea that Europe would be fully integrated through the Common Market and without any properly defined social policy was so overwhelming that not even the potential danger posed by 'social dumping'[44] to the Member States, and to the overall integration project, could have forced a change of opinion on the founding fathers in a hurry. [45]

3.5 The notion of social dumping

'Social dumping' is a generic term used to describe a situation of reduced social protection.[46] For example, in international trade, this will apply to the practice in which the export of goods from country 'A' with weak enforced labour standards allows the exporter from that country to gain an unfair advantage over an exporter from country 'B' because his costs of production are lower than those of his competitor in country B with higher enforced labour standards.[47] The reason often cited for this inequality is differences in direct and indirect costs of labour.[48] Countries with reduced labour standards invariably have lower wage rates and low costs of production. This often encourages the relocation of facilities by

[41] ibid.
[42] Hoeller and Louppe (n 26) 91.
[43] Shaw *et al* (n 26) 394.
[44] See discussion below.
[45] Manfred Weiss, 'Fundamental Social Rights for the European Union' (1997) 18 ILJ 417, 418
[46] Jacobien W Rutgers, 'An Optional Instrument and Social Dumping' (2006) Centre for the Study of European Contract Law Working Paper Series No. 2006/03 <http://ssrn.com/abstract=969293> accessed 24 November 2009.
[47] See e.g. B Amoroso, 'A Danish Perspective: The Impact of the Internal Market on the Labour Unions and the Welfare State' (1990) 11 Comparative Labour Law Journal, 483, 491.
[48] Roger Blanpain, '1992 and Beyond: The Impact of the European Community on the Labour Law Systems of the Member Countries' (1990) 11 Comparative Labour Law Journal 403, 409.

companies from countries with high labour wages to countries where wage rates and other social costs are significantly lower.[49]

Thus, as it relates to the EU, low labour costs in some Member States could encourage relocation of companies from another with higher formal legal protection to those with lower or non-existent labour standards creating an imbalance in competition with adverse consequences on the functioning of the Common Market. The founding fathers of the EU also failed to take into account what consequences the free movement of persons could have on the functioning of the Common Market.[50] Free movement of persons in the context of the EU meant that migrants from countries within the territorial scope of the Rome Treaty had the right to live and work in any of the Member States. They were also to be treated in the same way as the national workers of the host country *vis-à-vis* working conditions, social and tax advantages.[51]

3.6 Lack of treaty base for social policy

One of the primary roles of the EU is to oversee economic co-operation between Member States. Consequently, the EU plays a very important and big role in how business is conducted throughout Europe.[52] To fulfil this role, the Union needs a sound legal base to enact legislation not only in the economic but also in the social arena. This is why the absence of a legal base in the foundation Treaty for enacting social policy raised concerns.

However, it is important to note that the Treaty that created the original EEC did not completely lose sight of the importance of having a social policy. In fact it did acknowledge social policy. The 1957 Rome Treaty did actually express the need to promote close collaboration between Member States in the social field. The areas particularly mentioned therein included matters of employment and labour legislation and on the improvement in working conditions. It also contained a

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[49] See Marc H Klein, 'The Single European Act and Social Dumping: A New Appeal for Multinational Collective Bargaining' (1991) University of Pennsylvania Journal of Int'l Bus. Law <http://www.law.upenn.edu/journals/jil/.../Klein12U.Pa.J.Int'lBus.L.411(1991).pdf> accessed 24 March 2009.

[50] Shaw *et al* (n 26) 394; Weiss (n 45) 417.

[51] See Directive 2004/38/EC of the European Parliament and of the Council on the right of citizens and of their family members to move and reside freely within the territory of the Member States.

[52] J McCormick, *Understanding the European Union: A Concise Introduction* (3rd edn., Palgrave McMillan, New York 2005).

number of other implicit but limited social provisions. These provisions extended to concerns beyond those that were necessary for the creation of the common market.

In other words, the Rome Treaty had binding provisions that are aimed at establishing freedom of movement of workers (Article 48-49), freedom of establishment (Article 52 -58), equal pay for men and women (Article 119), rights to social security of migrant workers (Article 51). It also touched on the need to put in place laws relating to trade unions, collective bargaining between employers and workers as well as those offering protection against occupational accidents and diseases (Article 136-140) and to the creation of the European Social Fund (Article 125).

Although all of the above issues touched on by the Treaty had social dimensions, they were still not enough reason to vest the EU with power to legislate on social policy. As a union of several independent states,[53] the EU could not also abrogate to itself the power to do so. The lack of a treaty base upon which to enact social policy meant that the EU lacked the necessary competence to instigate policies in the social field.[54] The absence of any affirmative provision in the Treaty for the protection of the social rights of the citizens of the EU meant that the Member States continued to be individually responsible for social policy in their respective states.[55]

The lack of competence to legislate on labour and employment matters at the EU level left the employees at the mercies of their respective national governments. This meant that there was no parallel protection for employees in identical or facing similar employment-related issues in the Member States.[56]

For example, where there was a business reorganisation in two Member States, depending on the labour law provisions of each of the two Member States, an employee in one of the states was likely to have more social protection than the other.[57] It seems that the only time there was justification for enacting legislation to protect the rights of the citizens was if it aided the removal of obstacles to the functioning of the Common Market. That is, if the legislation aided the

[53] There are currently 27 Member States in the EU.
[54] Nielsen & Szyszczak (n 25) 17.
[55] Bob Hepple, 'The Crisis in EEC Labour Law' (1987) 16 ILJ 77.
[56] See discussion on the Acquired Rights Directive in chapter 4.
[57] See further section 4.2 of chapter 4.

advancement of the EU's economic goals generally.[58] It is not surprising therefore that the ARD (as we will see in chapter 4) was adopted on the basis that if the labour laws of Member States were not harmonised, differences in their employment standards would distort the functioning of the Common Market.[59]

The lack of Treaty base to enact social policy legislation meant that the European polity struggled to strike a balance between the economic and the social spheres.[60] This 'economic versus social paradigm'[61] has progressively led to a normative conundrum of the post-EU employee protection legislation era.[62] The problem concerns whether the market should be liberalised to allow free competition between the enterprises or whether a level playing field on a much wider basis including, for example, equivalent protection for workers potentially impacted by corporate restructurings across the EU is required instead?[63]

Put differently, the point here is that, as with the goods market, the key concern over the protective dimension of EU labour and employment legislation is whether 'market integration would need to be accompanied by more widespread standardisation of labour standards.'[64] If so, how would the standardisation of labour laws 'interact with the need for greater labour market flexibility which is essential for reaping gains from corporate restructuring?'[65] It is submitted that a good balance between the economic and the social objectives was (and is still) needed to strengthen integration. Stimulating economic growth through closer European integration requires the support of EU social policy that would ensure

[58] Davies (17) 325.
[59] See preamble to the 1977 ARD.
[60] See Miguel Poiares Maduro, 'Europe Social-Self: The 'Sickness unto Death,' in Jo Shaw (ed) *Social Law and Policy in an Evolving European Union,* (Hart Publishing, Oxford, 2000) 325.
[61] Catherine Bernard, 'British Jobs for British Workers': The Lindsey Oil Refinery Dispute and the Future of Local Labour Clauses in an Integrated EU Market (2009), 38 ILJ 245, 277; Phil Syrpis & Tonia Novitz, 'Economic and Social Rights in Conflict: Political and Judicial Approaches to their Reconciliation, (2008) 33 Eur. L. Rev. 411.
[62] Ian H Eliasoph, 'A Switch in Time for the European Community? Lochner Discourse and the Recalibration of Economic and Social Rights in Europe,' (2008) 14 Col. J Eur. L. 467, 494; Claire Kilpatrick, 'Laval's Regulatory Conundrum: Collective Standard-Setting and the Court's New Approach to Posted Workers' (2009) 34 Eur. L. Rev. 844.
[63] Elspeth Attwool, 'Constitutional Implications of EU Employment Policy' (ND) <http://denning.law.ox.ac.uk/iecl/pdfs/working1attwool.pdf> accessed 8 August 2010.
[64] Hoeller and Louppe (n 26) 67.
[65] ibid.

that employment law assists the integration process, and that the benefits of economic growth are evenly spread throughout the EU.[66]

To focus solely on the economic aspects of integration to the exclusion of social goals tends to discount the notion, *a la* Alain Supiot, that 'no legal relationship exists that does not have both an economic and a social dimension.'[67] In fact, European economic and social rights are not mutually exclusive. Rather, they are interpenetrated. For example, it is obvious that any piece of legislation dealing with labour (social), jointly regulates, supports and restrains the power of management (economic) or the power of labour.[68] This is evident in the ARD which, though a social policy legislation, severely limits management powers (economic) over labour. In a similar vein, the protection of the employees' terms of employment from unilateral alteration by the relevant employer during transfers of insolvent businesses as a social right has an economic connotation: remuneration.

It is equally demonstrable that economic rights have a social dimension. Granted, the provisions dealing with the free movement of persons mainly concern a limited number of persons (workers),[69] a comparative and historical legal analysis has demonstrated however, that the free movement of persons is first and foremost a social right. It is a social right in the sense that workers that cannot circulate may well face difficulties in earning a sufficient living.[70] Based on this analysis, it is imperative that economic integration go hand in hand with social protections.

As the EU expanded, it was faced with complex problems in the employment law front in the forms of discriminations, redundancies associated with restructurings and business transfers resulting in changes in employers, all of which impacted on employees' job security. Accordingly, cracks began to emerge in the long held philosophy that market factors would achieve an optimum social system. The

[66] Stephen Hardy and Nick Adnett, `Entrepreneurial Freedom versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam (1999) 9 Journal of European Social Policy, 127, 128.

[67] Alain Supiot, 'Critique du Droit du Travail,' (1st edn Presses Universitaires Du France, 2002) XXIII. Supiot's French version translated by the author himself in to the above quotation reads:' Il n'est pas de lien de droit qui n'ait à la fois une dimension économique et une dimension sociale.'

[68] Otto Kahn-Freund, *Labour and the Law,* (2nd edn., Stevens and Sons Ltd, London, 1977) 4

[69] Ian Ward, *A Critical Introduction to European Law*, (3rd edn CUP, London 2009) 143.

[70] See Simon Deakin and Frank Wilkinson, *The Law of the Labour Market: Industrialization, Employment and Legal Evolution*, (OUP, Oxford 2005) 110-200.

emergence of these social problems called for actions to be taken fast. But how did the EU address these problems? This is the focus of the next section.

3.7 The genesis of EU social policy

European integration has progressed since 1957 when the EEC Treaty was concluded. Similarly, progress has been made in social policy legislation, through convergence of trends and policies, the approximation of national laws and the harmonisation of various practices. These have in turn facilitated the creation of a series of single social areas within the EU.[71] EU social policy in the context of legislation geared towards addressing employment issues gained prominence during the first phase of the Union's enlargement in 1973 with the accession of new member countries. This was the period when the common law countries became members of the union.[72] The accession of the common law countries to the EU was significant for two reasons. The composition of the EU was changed. It comprised two distinct legal families or traditions: civil and common law families. The accession marked, arguably, the beginning of tensions and disagreements, at the European level governance, between the two legal families regarding the best way to handle employment oriented social protection issues and other issues having a social dimension.[73] In the area of social protection, for example, the way employment relationships are regulated in each member country is different. While some Member States were tolerant of, for example, trade unions, others were not. Some states were already used to legislative and government involvement in employment relationships, others were used to contract as the main instrument in employment relationships.

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[71] Threlfall (20).

[72] Britain became full member of the EU in 1973. This was after two previous applications to join had been vetoed by Charles de Gaulle (the then French president) in 1963 and 1967 respectively. Popular opinion has it that he doubted Britain's political will. However, it is understood that de Gaulle's real fear was that the English language would become the common language of the community. See BBC ON THIS DAY <http://news.bbc.co.uk/onthisday/hi/dates/stories/june/6/newsid_2499000/2499297.stm> accessed 05 April 2012. The other non-common law state that also joined the EEC in 1973 was Denmark. Greece joined in 1981. Spain and Portugal became members in 1986 while Austria, Finland and Sweden respectively joined in 1995.

[73] One example is the UK's opposition to the Commission's proposal for a special social chapter to be included in the new Maastricht Treaty. This forced the terms of what would have been the social chapter to be relegated to a Protocol on Social Policy. See John T Addison, 'In the Beginning, There was Social Policy: Developments in Social Policy in the European Union from 1972 through 2008' (2009) The Rimini Centre for Economic Analysis <http://www.rcfea.org/pr2009/pr01_09.pdf> accessed 28 March 2011.

3.8 Triggers for social policy legislation

The enlargement[74] of the EU was done with a view to achieving the eventual economic integration of Europe into a single market.[75] Economic integration has negative and positive implications for Member States. From the positive perspective, economic advantage is a major stimulant for migration—both for individuals seeking economic 'greener pastures' and for the States in terms of attracting workers to fill labour shortages and skills gaps.[76] However, as workers moved freely to and from countries, there were several social issues that arose.

Granted, the free movement of persons in the context of European integration was understood as a necessary pre-condition for the effective functioning of the common market,[77] but this does have negative implications for social policy in the Member States.[78] The literature on integration-migration trends points to the fact that free movement often results in Member States with stronger economies having to cope with the influx of economic migrants.[79] This was no different in the

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[74] Enlargement is one of EU's very useful and powerful tools. According to the European Neighbourhood Policy (ENP) website:

> The pull of the EU has helped to transform Central and Eastern Europe into modern, well-functioning democracies. More recently it has inspired far-reaching reforms in the candidate and potential candidate countries. All European citizens benefit from having neighbours that are stable democracies and prosperous market economies. Enlargement is a carefully managed process which helps the transformation of the countries involved, extending peace, stability, prosperity, democracy, human rights and the rule of law across Europe.

See The official website of the ENP: <http://ec.europa.eu/world/enp/index_en.htm> accessed 10 March 2012.

[75] Mark Jeffery, 'European Labour Laws Relating to Business Restructuring' (2004) 24 (4) Comp. Labour Law & Policy Journal 669, 670 <http://ssrn.com/abstract=655487> accessed 29 October 2009; Hoeller & Louppe (n 26).

[76] See e.g. House of Lords' European Union Committee Report on 'Economic Migration to the EU' (2005) 14th Report of Session 2005-06, Published by the Stationary Office Limited, London <http://www.publications.parliament.uk/pa/ld200506/ldselect/ldeucom/58/58.pdf> Accessed 01/09/2011.

[77] 'The underlying premise is that movement of persons for economic activity is not only necessary in the interests of EU market integration but positively beneficial to growth and innovation in the EU'. House of Lords European Union Committee's Report on 'Economic Migration to the EU' (2005) 14th Report of Session 2005-06, Published by The Stationary Office Limited, London. <http://www.publications.parliament.uk/pa/ld200506/ldselect/ldeucom/58/58.pdf> accessed 01 August 2011

[78] Weiss (n 45) 417.

[79] See e.g. Christina Boswell, 'Migration in Europe' (2005) A paper prepared for the Policy Analysis and Research Programme of the Global Commission on International Migration <http://www.iom.int/jahia/webdav/site/myjahiasite/shared/shared/mainsite/policy_and_research/gcim/rs/RS4.pdf> accessed 21 May 2012; Kristin Archick, 'European Union Enlargement' (2012)

context of the European integration. Free movement had a peculiar trend: job seekers migrated from the newly acceded and economically 'unsound' Member States to the older and economically 'stable' ones.[80]

The influx of job seekers adversely affected the economies of the host countries. It led to a rise in unemployment in the old Member States.[81] Unemployment was not the only social problem facing the EU. Admittedly, the notion of free movement of workers within the EU was premised on the principle of non-discrimination, that is, migrant workers are to be admitted in their host countries for employment or self-employment on equal terms and conditions as the home workers[82] but this was certainly not the case with migrant workers. There were a number of employment-associated discriminations to contend with. This, in relation to migrant workers was due, perhaps, to too many workers chasing very few jobs in the host countries. Preferences for home country workers were banal as were wage discriminations. Home and migrant workers did not receive equal pay for equal work done from most employers.[83]

Economic integration did, as predicted,[84] trigger a number of business restructurings in the Member States. These in turn led to the occurrence of large scale redundancies in those circumstances. The problem was that in a redundancy situation for example, the absence of a harmonised set of rules meant that different provisions were applied to workers in comparable situations in different Member States. This, more often than not, produced different results in

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Congressional Research Service 7-5700 prepared for Members and Committees of Congress <http://www.fas.org/sgp/crs/row/RS21344.pdf> accessed 2 April 2012.

[80] It should be pointed out that each Member State's need in respect of migrant workers varies. While the UK, for example, may prefer highly skilled migrants, Spain, with its large agricultural sector would welcome unskilled migrants. See e.g. the Secretary of State for the Home Department's Report on 'Controlling our Borders: Making Migration Work for Britain-Five Year Strategy for Asylum and Immigration' (Feb. 2005) Home Office, Published by The Stationary Office. <http://www.archive2.official-documents.co.uk/document/cm64/6472/6472.htm> accessed 01 July 2011.

[81] Elspeth Guild & Sergio Carrera, 'Labour Migration and Unemployment: What can We Learn from EU Rules on Free Movement of Workers?' (2012) CEPS Paper on Liberty and Security in Europe No. 46 <http://www.ceps.eu/ceps/download/6624> accessed 19 March 2012.

[82] See e.g. House of Lords' European Union Committee Report on 'Economic Migration to the EU' (2005) 14th Report of Session 2005-06, Published by The Stationary Office Limited, London <http://www.publications.parliament.uk/pa/ld200506/ldselect/ldeucom/58/58.pdf> accessed 01 August 2011.

[83] See United Nations Human Rights Office of the High Commissioner: Rights of Migrant Domestic Workers In Europe <http://www.europe.ohchr.org/Documents/Publications/Study_Domestic_Migrant_webversion.pdf> accessed 19 April 2012.

[84] See Commission's Explanatory memorandum: Proposal for a Council Directive, COM (94) 300 final.

terms of the way affected workers were treated by the extant national laws of their respective countries.

All of the above issues served as a 'wake-up call' for the EU to re-assess its stance on not having legislation on social policy. There was a sudden consciousness that economic integration without legislative intervention was not capable of harmonising the national employment laws of the Member States. Thus, it was time for the misplaced reliance on the market to harmonise the discrete employment laws of the Member States to give way to a more proactive approach in that regard.[85] What was needed was social policy legislation that would address the social consequences of business restructuring[86] by taking into account the individual rights of the workers in such situations.[87] However, to move in the direction of social policy legislation, the EU would need to navigate obstacles in its way. Below is a summary of some of the factors that impeded the EU from progressing quickly on the social policy front.

3.9 Towards an EU-wide employment policy: crossing the first sets of hurdles

Under the regime of the foundation Treaties, European labour and employment law could hardly be spoken of.[88] While social integration is hampered currently by the eagerness of national governments to retain control over welfare provision and social expenditure budgets,[89] there were different factors that accounted for the low legislative output in the social policy field in the developmental phase of the EU.

The first major reason why the EU was not legislatively very active in the social field was that it lacked a sound legal base of competence on which to enact social

[85] Catherine Barnard, *EC Employment Law*, (2nd edn., OUP, Oxford 2000), 445.
[86] ibid.
[87] Jeffery (n 75).
[88] Catherine Barnard, 'Social Policy Revisited in the Light of the Constitutional Debate', in Catherine Barnard (ed) *The Fundamentals of EU Law Revisited: Assessing The Impact of The Constitutional Debate* (OUP, Oxford 2007) 109.
[89] G De Burca, (2005) *EU Law and the Welfare State: in search of solidarity* (OUP, Oxford 2005); Monica Threlfall, 'Social Integration in the European Union: Towards a Single Social Area? (2002)' in M Farrell, S Fella & M Newman (eds.) *European Unity in Diversity - Challenges for the Twenty-first Century* (Sage, London 2002) 135-157.

policy.[90] The Rome Treaty did not provide the necessary base of competence[91] upon which social policy could be legislated. This Treaty defect hampered legislation on employment matters.

The second obstacle pertained to the composition of the EU. By the time the EU was finally ready to introduce measures on employee protection the union had already undergone its first phase of enlargement resulting in the Union being comprised of countries with two legal traditions or families: common law and civil law countries.[92] Legal theory posits that countries with different legal origins or traditions use different institutional mechanisms for social control of business.[93] Common law countries rely more on markets and contracts whereas their civil law counterparts tend to rely on regulation (government intervention).

The third problem is directly linked to the second. The two legal families are ideologically divided. Thus, there was always a tension between the interventionists and the non-interventionists stances of the civil and common law countries regarding the involvement of the EU in the employment matters of the Member States. Opinions were often divided amongst the Member States also over the desirability of new forms of labour-market regulations and the means that will be acceptable to all parties for accomplishing them. Some Member States (notably the United Kingdom),[94] vigorously resisted any attempts to transfer policy making powers in social policy and particularly, in employment law

[90] Sebastian Krebber, 'Status and Potential of the Regulation of Labour and Employment Law at the European Level,' (2009) 30 Comparative Labour Law and Policy Journal 875, 879.

[91] It must be mentioned that Article 117 of the Rome Treaty recognised the need to promote improved working condition and living standards for workers so as to make their harmonisation possible. However, the difficulty posed by not having a solid legal base and for switching between Articles to push through employment law legislation at EU level would later provide ground for the UK government to mount an (albeit unsuccessful) action for the annulment of the Directive on Working Time (Council Directive 93/104 OJL 307/93) under Article 173 EC (now 230 TEC) on ground that the use of Article 118a EC (now 138 TEC) was an inappropriate legal base. See Case C-84/94 *UK v Council* [1996] 3 CMLR 761.

[92] The first phase of enlargement took place in 1973 whereas adoption of measures aimed at employee protection did not come until the adoption of the 1974 SAP which was a direct resulted of the 1972 Paris conference of Heads of States or Governments of EC Member States which advocated the taking of positive steps in the social policy sphere.

[93] See Juan C Botero *et al*, 'The Regulation of Labour' (2004) <http://www.doingbusiness.org/~/media/fpdkm/doing%20business/documents/methodology/supporting-papers/db-methodology-regulation-of-labor.pdf> accessed 19 May 2012.

[94] One example of the UK's opposition is when it opposed the Commission's proposition of a special social chapter to the new Maastricht Treaty. This forced the terms of what would have been the social chapter to be relegated to a Protocol on Social Policy. See John T Addison, 'In the Beginning, There was Social Policy: Developments in Social Policy in the European Union from 1972 through 2008' (2009) The Rimini Centre for Economic Analysis <http://www.rcfea.org/pr2009/pr01_09.pdf> accessed 28 March 2011.

domain to the EU.[95] Employment matters were perceived then (and continue to be so perceived now), as the exclusive preserve of the Member States[96] therefore control of such 'a politically sensitive area public policy' should not be surrendered. [97] Moreover, the resistance against granting open-ended employment legislation making powers to the EU was also a way of the member countries protecting their sovereignties.[98]

The fourth obstacle was the applicable voting rule in the social policy domain. Proposals on social policy issues could not easily be passed in the Council of the European Union because of the unanimity voting system. When unanimity was required for a particular legislation, it was always difficult to press ahead with proposals on employment matters since any one state could veto any of them. The implication of the unanimity rule for employment legislation was that where a consensus could not be reached by all the Member States on the issue proposed pre-voting, it was doomed to fail. The Treaty of European Union (TEU) extended the qualified majority voting (QMV) system to employment legislation.[99] Although QMV gives countries with demographic advantage the power to sway decisions, it ensures that no majority is gained on employment matters without the support of at least a proportion of smaller Member States.

The EU has also developed new flexible techniques and approaches in the employment field. The difficulty experienced in securing agreements on employment policies has led to the experimentation of more flexible approaches such as the open method of coordination (OMC)[100] and subsidiarity[101] to push

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[95] See also Martin Rhodes, 'Employment Policy: Between Efficacy and Experimentation' in Helen Wallace, Mark Pollack and Alistair Young (eds) '*Policy-Making in the European Union'* (5th edn., OUP, Oxford 2005), 279; Jeff Kenner, *EU Employment Law: From Rome to Amsterdam and Beyond'* (Hart Publishing, Oxford 2003) 12.

[96] There is evidence in the Treaty of Rome to support this assertion. Only 12 out of the 248 Articles (Articles 117-128) of the Rome Treaty had a social dimension. Moreover, the list of matters relating to the social sphere in Article 118, and the limited role given to the European Commission in Title III, Part Three of the Rome Treaty is indicative of the fact that, save for very few matters, social policy domain was originally considered to be *ultra vires* the competence/scope of EU institutions. See Andrew Moravcsik, 'Negotiating the single market act: National interests and Conventional Statecraft in the European Community' (1991) 45 (1) International Organization 19-56. See further G Majone, 'Europes "Democratic Deficit": The Question of Standard' (1998) 4 (10 European Law Journal, 5, 13.

[97] Majone (n 96).

[98] Moravcsik (n 96) 19-56.

[99] See the Agreement set out in Protocol No 14, which was annexed to the TEU.

[100] The OMC has been described as a 'soft' law approach to EU social policy as opposed to the 'hard' law approach of Council Directives as a means of delivering social policy agendas. See Nick Adnett & Stephen Hardy, *The European Social Model – Modernisation or Evolution* (Edward Edgar, Cheltenham UK 2005) 15. 'Soft law' may be defined as non-legally enforceable instruments that can assist in the

through employment policies. In other words, in relation to employment legislation, there is a shift at the European level from 'hard law' to 'soft law'. This is intended to yield, what has been termed 'flexicurity,' [102] in employment relations. Therefore there is now less likelihood of states having to adopt policies against their will.

3.10 Responding to challenges in the social policy arena

It has been noted in the preceding sections that when the EU was set up in 1957, there was little or no 'social Europe' worthy of discussion.[103] The six founding Member States already had in place some fairly sophisticated labour law and social security systems, and were content with their respective and extant welfare state models. However, as a reaction to concerns on social issues in Member States in general, a summit of the Member States' Heads of Government was held in Paris in 1972. The purpose of the summit was to find ways of addressing issues of social dimensions. The Paris summit was unanimous in urging the EU to take positive steps in addressing social policy issues. The Paris summit was instrumental to the eventual adoption of the Council Resolution on the Social Action Programme (SAP) discussed below.[104]

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construction and application of EU law. They may be referred to by the ECJ when construing or applying EU law. Examples of 'soft law' are recommendations and opinions. See F Snyder, 'The Effectiveness of European Community Law: Institutions, Process, Tools and Techniques'. (1999) 56 (19) MLR 32; B Eberlein & D Kerwer, 'New Governance in the European Union: A Theoretical Perspective' (2004) 42 (1) JCMS 121-124 <http://eucenter.wisc.edu/OMC/Papers/eberleinKerwer.pdf> accessed 12 December 2011.

[101] Simon Deakin, 'Reflective Governance and European Company Law' (2007) CBR Univ. of Cambridge Working Paper (No. 346) <http://www.cbr.cam.ac.uk/pdf/wp346.pdf< accessed 2 July 2012.

[102] Flexicurity is an integrated method for combining simultaneously flexibility and security in the labour market. It is a strategy that endeavors to reconcile labour market flexibility with employment security. That is, it attempts to marry the employers' need for a flexible workforce with workers' need for job security. See e.g. Tom Wilthagen, 'Flexicurity: A New Paradigm for Labour Market Policy Reform? (1998) Social Science Research Center Berlin Discussion Paper No. FS I 98-202 <http://ssrn.com/abstract=1133924> accessed 21 April 2010. See also S Sciarra, 'Is Flexicurity a European Policy?' (2008) URGE Workin Paper 4/2008 <http://www.urge.it/files/papers/2_wpurge4_2008.pdf> accessed 12 January 2012.

[103] Barnard (n 92) 109; Nicola Countouris and Mark Freedland, 'Reviving the "Social Europe" Myth – from Ring of Gyges to European Prometheus' (2012) <http://www.ucl.ac.uk/europeaninstitute/comment_analysis/commentary/socialeurope> accessed 25 May 2012

[104] 1974 (OJ/74/C/13/1.

3.10.1 The social action programme

The failure of the market to go in the predicted direction of 'spontaneous harmonisation' and accelerate the raising of the standard of living in the EU[105] provided the impetus for legislation in the social field.[106] Legislative activity on the social policy front started in earnest in 1974 following the Council of Ministers resolution on the SAP.[107] The SAP was the precursor to EU social policy. It marked the gradual shift in focus from an 'economic' Europe to a 'social Europe.'

It is pertinent to note however that the SAP was not, in itself, legislation. Rather, it was a set of proposals or declaration of general principles which provided the foundation for social policy legislation at the EU level.[108] It involved more than 30 measures that were to be executed over a period of three to four years. Each of these measures was to be accomplished subsequently, through the employment of appropriate EU legislative channels or procedures.[109] The SAP had three main objectives. These could be summarised as: the attainment of full and better employment in the EU, the improvement of living and working conditions for all EU workers, and fostering of the involvement of management and labour in the economic and social decisions in businesses with the EU.[110]

The resolution by the European Council for the EU to adopt social policy legislation was a major policy shift considering the Union's original pursuit of purely economic goals via market integration.[111] The Council's resolution represented, up to that point, the most comprehensive attempt by any of the European institutions to identify its task in the area of social policy.[112] The sudden change in policy direction not only represented, one may argue, an unequivocal indication that the governments of the Member States saw intervention by the EU in social policy issues as necessary, but it showed also their realisation that social policy ought to have been, and in fact should continue to be, an integral part of

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[105] The 'Spaak Report' noted 'the spontaneous tendency to harmonisation of social systems and of the level of wages […] will be favoured by the progressive creation of a common market'. See discussion this above in the section entitled 'arguments contra social policy.'
[106] Countouris & Freedland (n 104).
[107] 1974 (OJ/74/C/13/1.
[108] Addison (n 73); Davies (n 17) 324; Hepple (n 55) 79.
[109] Davies (n 17) 324.
[110] Eurofound: 'Social Action Programme' <http://www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/socialactionprogramme.htm> accessed 11 May 2012.
[111] Franck Lecomte, 'Embedding Employment Rights in Europe' (2011) 17 Col. J of Eur. L. 2.
[112] Jeffery (n 75) 670.

the overall European integration project which should never have been overlooked in the first place.[113] Perhaps it was also a tacit rejection of the founding fathers' philosophy regarding social policy even though the change itself was couched in terms of pursuit of closer economic and monetary co-operation by Michael Shanks, who was the Director-General for Social Affairs at that time.

If the EU's change in attitude regarding social policy legislation was surprising, the *modus operandi* it adopted for achieving it left many in utter consternation. In expressing its 'political will'[114] to legislate in the social policy arena, the EU resorted to the 'general "gap-filling" provisions of the Treaty' [115] in Articles 100 and 235 (now 115 and 296 TFEU) of the Treaty of Rome. The consternation in using either of these Articles as bases for social policy was that, neither of them had any specific link to social policy *per se*.[116] Article 100 Treaty of Rome empowered the EU to legislate against distortion of competition. Under Article 100, the Council of Ministers can, acting unanimously on a proposal from the Commission:

> Issue directives for the approximation of such provisions laid down by law, regulation or administrative action in Member States as directly affect the establishment or functioning of the Common Market.

On its part, Article 235 merely established a reserve competence for the EU to rely on where specific powers granted it did not suffice or where the Treaty had not provided the necessary powers for the realisation of any of the EU's objectives. This Article also required unanimity. The implication of the unanimity requirement for EU measures was that even a disagreement by one member country would block the decision. The problem with the unanimous voting requirement was that it could produce an inconclusive end to a decision with the consequence that progress on EU measures such as legislation on labour and employment matters was very slow. The situation was not helped either by the UK led opposition which questioned the EU's competence to enact legislation on employment matters.[117]

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[113] Gerda Falkner, *EU Social Policy in the 1990s: Towards a Corporatist Policy Community,* (Routledge, New York, 1998) 57.
[114] Krebber (n 90).
[115] Davies (n 17) 329.
[116] John Gennard, 'Labour Government: Change in Employment law' (1997) 20 (1) Employment Relations 12- 25; Weiss (n 45) 418; Jeffery (n 75) 670.
[117] Hepple (n 55) 129.

If both of these Articles were not the correct legal bases for EU measures and both required unanimous voting for legislation to succeed, this then begs the question how was the legal problem of using Article 100 navigated by the Council? As Davies articulates, the political consensus over the need for a Social Action Programme in the seventies made the requirement of unanimity inconsequential.[118] In this period, Member States had no choice but to co-operate in the social field. They could no longer afford to be indifferent to the shift from an 'economic Europe' to a 'social Europe' that was taking place. Thus, they unanimously approved actions aimed at combating the adverse effects of the Common Market on employment and industrial relations.

Despite the above shortcomings, the resolution to adopt legislation on social policy represented the most comprehensive attempt by any of the European institutions to identify its task in the area of social policy.[119] The conclusion that may be drawn here is that even though prior to 1974 the Council had no base of competence, it was determined to adopt measures in social policy sphere.[120] This was due, perhaps, to how important it perceived this to be to the functioning of the Common Market in particular and to the protection of the rights of European workers generally. The SAP clearly demonstrates the increased commitment of the EU to social integration in that the programme contained wide-ranging social protection measures (see the objectives of the 1974 SAP listed above).

3.10.2 EU social policy: from resolution to substantive law

As noted above, the 1974 SAP proposed a mandate for more proactive measures to be taken in the social policy field. That proposal led to the adoption by the EU of a range of labour law measures. In 1975, the equal pay Directive[121] was adopted. The Equal Pay Directive (EPD) sought to ensure that all workers received equal pay for the same work, or work to which equal value is attributed. It also sought to eradicate remuneration discrimination on grounds of gender.[122]

[118] Davies (n 17) 329.
[119] Jeffery (n 75) 670.
[120] Krebber (n 90) 885.
[121] Council Directive 75/115/EEC of 10 February 1975 on the approximation of the laws of the Member States relating to the application of the principle of equal pay for men and women
[122] Articles 1 & 2 of Council Directive 75/115/EEC of 10 February 1975 on the approximation of the laws of the Member States relating to the application of the principle of equal pay for men and women

The EPD was followed in 1976 by the Equal Treatment Directive.[123] This was aimed at putting into effect the principle of equal treatment for men and women in all working relationships including access to employment, promotion and dismissal irrespective of whether the person was home or migrant worker.[124]

Three further directives, targeted at employment protection and working conditions of the employees in businesses seeking to restructure,[125] were also adopted as a result of the 1974 SAP mandate. These directives which were milestones in European social policy are the Redundancy Directive,[126] the insolvency Directive,[127] and the Acquired Rights Directive (ARD).[128] The ARD (which is the focus of this thesis in general and the subject of discussion in the next chapter), is aimed at protecting the employees' rights when there is a going concern transfer of the business or undertaking they work for to a third party purchaser. The ARD is perceived as being the root of the difficulty faced by rescuers of insolvent businesses in the UK.[129]

Perusals of the last three directives reveal one thing in common. They all require measures aimed at protecting the employees in different situations to be put in

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[123] Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions. An amending Equal Treatment Directive (Council Directive 2002/73/EC) came into effect in 2002 to bring the original Directive up to date. The amendments required were brought into effect in the UK from 1st October 2005 by the Employment Equality (Sex Discrimination) Regulations 2005, (SI 2005/2467) - just four days before the 5th October deadline set by the EC was due to expire.

[124] The equal pay provisions was held directly applicable by the court (doctrine of direct effect) hence capable of being enforced by a complainant in his/her domestic courts against both public and private employers, whether or not that person's home legislature has legislated on the issue. For judicial authority on this, see *Defrenne v Sabena* (no.2) [1976] ECR 455.

[125] Bob Hepple, 'New Approaches to International Labour Regulation' (1997) 26 ILJ (vol.4) 353-66.

[126] Council Directive 75/129/EEC of 17 February 1975 on the approximation of the laws of the Member States relating to collective redundancies as amended by Council Directive 92/56 of 24 June 1992, and consolidated by Council Directive 98/59/EC.

[127] Council Directive 80/987/E EC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer as amended by Council Directive 2002/74/EC.

[128] Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses as amended by Council Directive 98/50 EC, and consolidated by Council Directive 2001/23/EC.

[129] TUPE 2006 implements the provisions of the ARD into UK law. TUPE'S application to insolvent transfers has been identified as the main factor inhibiting business rescues in the UK. See J Armour, A Hsu & A Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' [2008)] 5 (2) ECFR 148 -171; Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Rescue and "one Unholy Mess"' [2000] 3 CFILR 249.

place.[130] Thus, these directives were meant to address, in different ways, the anticipated social consequences that were to accompany restructuring of enterprises in the Member States during, and especially in the years after the completion of the European economic integration.[131] Granted, the institution of these measures may place some sort of burden on employers of labour, the function of these directives, as noted by one commentator,[132] is not to impede or deter employers from restructuring their businesses. Rather, they are meant to provide the procedural framework for employers to follow when the need to restructure businesses arise even though they have sometimes indirectly obstructed business rescues.[133] The expectation is that applying these directives to restructuring would facilitate the emergence of more competitive and efficient businesses in the Member States.[134]

3.11 Conclusion

The EU has been described as 'a law intensive organisation.'[135] However, the legislative output on social policy was very slow in comparison to economic related legislation during the developmental years of the EU. The core framework of the EU in its early construction phase was the creation of a Common Market. This entailed the gradual eradication of obstacles to trade, free movement rights for workers and the prevention of anti-competitive practices so as to attain eventually, full economic integration of Europe. Social policy played a very limited and subdued role in the 'European construction' process. It was mainly geared towards mobile workers and creating gender equality in pay and social rights. The peripheral role played by social policy reflected the political conflicts that existed between the different legal families that comprise the EU.[136] These conflicts were a major limiting factor in the evolution of the social dimension of

[130] In relation to the ARD, see discussion on *'modus operandi'* in section 4.6 of chapter 4.
[131] Jeffery (n 75)
[132] ibid.
[133] ibid.
[134] Barnard (n 85) 445
[135] See E C Page and D G Dimitrakopoulos, 'The dynamics of EU growth: A cross-time analysis' (1997) 9 (3) Journal of Theoretical Politics 365-87; D G Dimitrakopoulos, 'The Transposition of EU Law: "Post-Decisional Politics" and Institutional Autonomy' (2001) 7 (4) European Law Journal 442.
[136] Moravcsik (n 96).

Europe.[137] However, the EU's involvement in the social affairs of the Member States has grown since its inception in 1957.[138] The Union has moved from being an economic community with a focus on the realisation of economic goals to taking a proactive role in tackling social problems in Europe. It has become an 'influential force in the shaping of social policy regulation within the Member States.'[139] In the employment space, the EU has intervened in the labour markets of the Member States with a view to promoting greater job security for European workers.[140] Among the employment problems the EU has had to grapple with in the member countries is the protection of the rights of the employees' during business transfers. The Union has been responsible for the harmonisation of the national employment policies of the member countries regarding the protection given to the employees' acquired rights in business transfers. This, it has done through the adoption of the ARD in 1977. With the ARD (discussed in chapter 4), certain employee rights have become statutorily defined in common law countries such as Britain, rather than being defined according to what the judges think they should be.

The genesis of the EU's employment protection legislation during transfers of insolvent businesses is traceable to the adoption of the ARD. It was through the mandatory implementation of the ARD in the UK, by the TUPE Regulations in 1981, that the EU became a key player in the protection given to the employees impacted by transfers of undertakings in the UK. Thus, from a 'purely' economic beginning, the EU's role in the social policy arena has grown making it, from a global perspective, a 'model of social protection'[141] for workers particularly in transfer situations involving insolvent businesses in Member States.

The next chapter will consider the ARD in detail.

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[137] F Scharpf, 'The European Social Model: Coping with the Challenges of Diversity' (2002) Journal of Common Market Studies 40; M Dawson, 'The ambiguity of social Europe in the open method of coordination' (2009) European Law Review 34.

[138] See e.g. G Falkner, *EU Social Policy in the 1990s: towards a corporatist policy community* (Routledge, London 1998); R Geyer (n 9); Hantrais (n 9).

[139] Jochen Clasen, 'Comparative Social Policy and the European Union' (2006) <http://www.institute-of-governance.org/__data/assets/pdf_file/0011/9020/SPtext2007.pdf> accessed 20 April 2012.

[140] R Blank & R Freeman, 'Evaluating the Connection between Social Protection and Economic Flexibility' in R Blank (ed) *Social Protection versus Econmic Flexibility: Is there a Trade-off?* (University of Chicago Press, Chicago, IL 1994).

[141] Ralf Ragowski and Edit Kajtar, 'The European Social Model and Coordination of Social Policy: An overview of policies, competences and new challenges at the EU level' Paper delivered at the TLM.NET Conference, Quality in Labour Market Transitions: A European Challenge, Amsterdam 25-26 November 2004.

CHAPTER FOUR

THE ACQUIRED RIGHTS DIRECTIVE

4.1 Introduction

This chapter will set in context the legal regime of the European law-derived Acquired Rights Directive[1] (ARD) which is the precursor of the regime governing business transfers in the UK as outlined in chapter 3. The ARD represents one of the many legislative responses by the EU to social issues affecting EU workers.[2] It was enacted in anticipation of the challenges that European economic integration was expected to pose to workers' job security in the Member States.[3]

After the discrete markets of the EU Member States were 'amalgamated' into a Common Market,[4] there were concerns that incidences of business restructuring would be on the increase in Member States of the EU.[5] The main fear was that, if business restructuring occurred on the scale that was anticipated, differences in the employment laws of the Member States in relation to the protection afforded to employees in business reorganisations resulting in a change in the ownership of businesses in those states would have a direct effect on the functioning of the Common Market. The EU moved to 'nip in the bud' any potential threats to the smooth functioning of the Common Market by approximating the discrete employment laws of the Member States in this area. It follows that though the ARD's aim is to protect the rights of employees in business transfer situations its

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[1] Council Directive 77/187/EEC as amended by Council Directive 2001/23/EC.

[2] There are other responses to other social issues such as the Equal Treatment (social security) Directive (79/7/EEC); the Equal Pay Directive (75/117/EEC); Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies and the insolvency Directive (Council Directive 80/987 as amended by Council Directive 2002/74), which requires Member States to establish 'guarantee institutions' to cater for outstanding and unsatisfied employees' claims when their employer becomes insolvent.

[3] There were other measures designed to protect the rights of employees in businesses generally which have been discussed under the section: 'From Council Resolution to Directives' in chapter 3 of this thesis.

[4] The term 'Common Market' is used here to refer to a Custom Union featuring provisions to achieve the free movement of persons, services, and capital through economic integration. See Catherine Barnard, *The substantive law of the EU: The Four Freedoms* (3rd edn., OUP, Oxford 2010) 8-9.

[5] Jo Hunt, 'Success at Last? The Amendment of the Acquired Rights Directive' (1999) European Law Review 215-230.

adoption was for the economic benefit of the EU as a whole in the first instance.[6] The point here is that it was the desire to protect the economic gains of the Common Market, by avoiding distortions to competition that led to the law which protects employees' rights when business transfers take place: the ARD. The ARD was intended to help create a level playing field for fair competition between firms in Member States through legislative harmonisation.

The ARD fulfils the very important role of protecting employees in the event of a change of employer following a transfer of undertaking. It also specifies the rights and obligations of employers affected by the transfer. However, its application to insolvent business transfers is deemed problematic. For example, whilst the ARD's default rule on compulsory transfers of employment contracts following a business transfer may be good for the employees in terms of job security; this on the other hand may impinge on going concern rescues of insolvent businesses with dire consequences for employees. [7] The ARD, as implemented by TUPE in the UK, may be regarded as the genesis of the existing tension between the rescue of insolvent businesses and employment protection in corporate insolvency.

This purpose of this chapter is to analyse the ARD and its implications for EU employees. In order to fully appreciate the difference made to the employment

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[6] Paul Davies, 'The Emergence of European Labour Law' (1992) in W McCarthy (edn) *Legal Intervention in Industrial Relations: Gains and Losses* (Blackwell Publishers, Oxford 1992) 331-332. In explaining the necessity for its introduction, the preamble to the 1977 ARD stated that:

> Economic trends are bringing in their wake, at both national and Community level, changes in the structure of undertakings, through transfers of undertakings, businesses or parts of businesses to other employers as a result of legal transfers or mergers.
> It is necessary to provide for the protection of employees in the event of a change of employer, in particular, to ensure that their rights are safeguarded.
> Differences still remain in the Member States as regards the extent of the protection of employees in this respect and these differences should be reduced. These differences can have a direct effect on the functioning of the common market it is therefore necessary to promote the approximation of laws in this field.

[7] The ARD tends to vest employees with rights akin to property rights in undertakings given that their 'existing or acquired rights arising from employment automatically bind third parties...such as the purchaser of the undertaking.' See John Armour & Simond Deakin, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No 204 <http://www.cbr.cam.ac.uk/pdf/wp204.pdf> accessed 09 January 2011. This may not augur well for the rescue of insolvent businesses as prospective buyers could be deterred by potential liabilities.

relationship in the context of business transfer, it is intended to first put in perspective what the legal position of EU workers was before the adoption of the ARD in 1977 and how the ARD has changed that position. Thereafter, the reasons why the ARD was adopted will be explored. The chapter will then move on to discuss the objectives of the regime, its scope and the *modus operandi* adopted by the regime towards achieving those objectives.

The application of the ARD in the context of insolvency will be considered. The aim is to ascertain whether ultimately, the change effected by the regime is beneficial to the employees or whether, as contended, 'a measure ostensibly designed to improve security of employment' has achieved 'precisely the opposite effect.'[8] It is intended also to consider the possible range of effects of the ARD regime on the UK's national employment law space and especially its effect on the rescues of insolvent businesses.

4.2 EU workers before the adoption of the acquired rights directive

Prior to the adoption of the ARD in 1977, European Member States' laws on transfers of insolvent undertakings was divided, as were the protections offered to affected employees in EU Member States.[9] There were different approaches taken by EU Member States regarding the determination of the 'fate' of employees when the business employing them became insolvent and was transferred to a third party purchaser on a going concern basis. The treatment of employees' concerns varied according to the jurisdiction where the business or undertaking transferred was located.[10] This was because each Member State had its own unique way of protecting the rights of employees in transfer situations.

The EU is made up of both civil and common law (essentially the UK and Ireland) countries. These countries have very different legal traditions on employment matters. In relation to transfer of undertakings, whilst some member countries already had laws similar in effects to those canvassed by the ARD, others did not. For example, in a civil law country such as France, from as far back as 1928, there

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[8] H Collins, 'Dismissals on Transfer of a Business' (1986) 15 ILJ, 244, 255.
[9] Marlene Frank, `The Rights of Employees in the Event of the Employer's Insolvency: A Comparative Approach to the Rights of Employees during Restructuring in the United States and Europe' (2005) 1 New Zealand Postgraduate Law E-Journal 7.
[10] ibid.

have been laws requiring the mandatory transfer of employment contracts from the seller to the buyer whenever there was a transfer of an undertaking on a going concern basis.[11] The justifications for having this type of law are that continuity of employment facilitates the transfer of skills that will be deployed to the usage of the assets of the undertaking transferred[12] and that the transfer of employees' contracts of employment ensures that workers are retained in employment, as against dismissing and putting them back on the job market. From this perspective, continuity of employment achieves both social as well as economic objectives.

In common law countries, employment relationships are mostly contract based.[13] In Britain, for example, before the advent of legislation on the protection of the rights of workers during transfer of undertakings, the traditional view was that the employment relationship was a personal one based on personal agreement between the employer and the employee. The personal nature of the relationship is attributed to the provision of personal service by the employee to his employer.[14] The notion of personal service, as an essential element of a contract of employment, significantly influenced the views of common law countries' judges on change in employer when there was a business transfer. The transfer of a business from one employer to another was determinative of the employment relationship between the employee and the employer.[15] The practice of terminating all employment contracts upon the occurrence of a business transfer

[11] See Code du Travail Article L122-12 of 1928 (currently codified in Articles 1224-1 and 1224-2 of the French Labour Code of June 28, 1983. It is important to note however that in France, the law does not expressly use the words 'business transfer'. It refers to the modification of the 'legal situation' of the employer. French case-law has, however, identified this type of modification by reference to the business transfer. See further Lovells, 'Business Transfer Across Europe' (2010) <http://www.hoganlovells.com/files/Publication/fd44d5e5-bc19-42b2-a40d-7f33e91db78f/Presentation/PublicationAttachment/639d7e9c-4959-4d0f-8505-808388a6bf00/CN_Business_Transfers_Across_Europe_June_2010.pdf > accessed 20 March 2012.

[12] Robert Upex and Michael Ryley, *TUPE: Law and Practice* (Jordan Publishing Limited, 2006) 4.

[13] S Deakin & W Njoya, 'The Legal Framework of Employment Relations' (2007) Centre for Business Research, University of Cambridge Working Paper No. 349 <http://www.cbr.cam.ac.uk/pdf/WP349.pdf> accessed 29 April 2012. Professor Janet Dine has described contract as an instrument of capitalism. J Dine, 'Post-Concession Company Models in Potential European Company Law' (2010) paper presented at the 'Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis' conference (University of Leeds Centre for Business Law and Practice, September 20, 2010) <http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/dine-post-concession-company-models.pdf> accessed 12 March 2012.

[14] *Ready Mixed Concrete (South East) v Minister of Pensions and National Insurance*, [1968] 2 QB 497; *Express & Echo Publications v Tanton* [1999] ICR 409.

[15] *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014. See further discussion on this in chapter 5

rather than having them transfer automatically to the transferee was justified on the principle that contracts of employment are personal contracts and so cannot be transferred without the consent of the employee.[16]

What is evident in the above analysis is that in a situation where there was a going concern transfer of an insolvent business in two EU Member States, employees in country 'A' (France in our example) would have the advantage of continuity of employment by virtue of the existing French law which made it possible for contracts of employment to transfer automatically upon a transfer from the transferor to the transferee. On the other hand, employees in country 'B' (Britain in our example) would be dismissed in a similar situation, due to the operation of a different legal (common law) rule on transfer which did not support automatic transfer of employment contracts following a business transfer. However, since 1977 the dichotomy between continuity and termination of the employees' contracts of employment when there is a change in the ownership of a business that employs them following a business transfer has been eliminated. EU workers currently enjoy automatic transfers of employment contracts alongside other 'parallel' protections in business transfers in the Member States. This is due mainly to the harmonisation of the discrete employment laws of the Member States on transfer of undertakings made possible by the adoption of the first generation ARD in that year.

The ARD may have enhanced the rights of the employees in transfers, but it also had some effects on businesses in the Member States as discussed at section 4.7 below. Also, its adoption is said to have signaled the gradual but continuous involvement of the EU in the social affairs of the Member States.[17] The ARD is, arguably, the genesis of the existing tension between employee protection and business rescue in UK corporate insolvency setting. In tipping the balance in favour of the employees in transfers, and given that the automatic transfer

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[16] A classic example of the application of rule is found in the House of Lords' decision in *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014, where Lord Atkins stated:

> My Lords, I confess it appears to be astonishing that apart from overriding questions of public welfare, power should be given to a court or to anyone else to transfer a man without his knowledge and possibly against his will from the service of one person to the service of another.

[17] Andrew L DaSilver, 'Directive 77/187: The EEC's Attempt to Protect Employees upon the Sale or Transfer of Businesses' (1998) 11 B. C. Int'l & Comp. L. Rev. 147. See also Dubois, 'European Social Law', in M Ellis & P Storm (eds) *Business Law In Europe: Legal, Tax and Labour Aspects of Business Operations in the Ten European Community Countries and Switzerland* (Kluwer Law & Taxation Publishers, The Netherlands, 1982) 59.

principle applies to both solvent and insolvent transfers, there is inevitably a tension between employment protection (championed by the ARD) and the rescue culture (championed by UK insolvency law) in the UK. This is basically a conflict between the employment rights of the employees and the rescue of insolvent but viable businesses in the UK.[18]

In relation to insolvent businesses, the regime is perceived as having adverse effects on the going concern rescues of those businesses. This is because with the intervention of the ARD, not only do workers who are employed in a UK business (immediately before the transfer[19]) transfer or move across to the transferee, they do so on the same terms and conditions of employment they enjoyed with the previous employer. Viewed from a social lens, the ARD can easily be justified on grounds of offering a measure of social protection of the type canvassed by Traditionalists [20] for workers during transfers of insolvent businesses or undertakings when their jobs are most likely to be at risk.[21] However, from a purely business standpoint, and especially from the perspective of the rescue and continuity of insolvent businesses, this European law engendered practice could cause more harm than good, even for the employees themselves.[22] There is the view that legislation such as the ARD which aims to provide a measure of job security increases costs to transferees.[23] A law such as the ARD operates as a disincentive to prospective buyers of insolvent undertakings. It restricts their entry into the market potentially resulting ultimately in job losses for the

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[18] Richard Parr & Nicola Bennett, 'The Rescue Culture Versus Collective Employment Rights' (2005) 18 (10) Insolvency Intelligence 156-157.

[19] The meaning given to this phrase by the courts is discussed in chapter 6.

[20] See generally Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 Uni. Chi. L. Rev. 775; Donald G Korobkin, 'Employee Interests in Bankruptcy' (1996) 4 Am. Bankr. Inst. L. Rev. 5; Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (YUP, New Haven 1997); Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; L M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741, 769.

[21] M A Rothstein *et al*, *Employment Law* (West, St. Paul, 1994) 589; Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee Claims' in Paul J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, Hampshire 2008); M Gronow, 'Insolvent corporate groups and their employees: The case for further reform' (2004) Legal Studies Research Paper No.130, Melbourne Law School <http://ssrn.com/abstract=81424> accessed 27 January 2011.

[22] Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Insolvency and One "Unholy Mess"' (2000) 3 CFILR 249-271; John Armour & Simon Deakin, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No 204 <http://www.cbr.cam.ac.uk/pdf/wp204.pdf> accessed 09 January 2011.

[23] Adrian Walters, 'The Impact of Employee Liabilities on the Administrator's Decision to Continue Trading' (2005) 26 (11) Company Lawyer 321.

employees if the cost of the transfer deters the purchase.[24] It follows that it is absolutely important to balance the statutory protection of the employees of an insolvent business against the 'statutory pursuit of the rescue culture'.[25] In the next section, the introduction of the ARD will be considered.

4.3 The Acquired Rights Directive

In 1977 the Council of the European Community (EC) unanimously adopted Council Directive 77/187/EEC on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses.[26] Because the Acquired Rights Directive (ARD) contemplated a situation where differences in the level of employee protection would remain across the Member States, it was not intended to establish a uniform regime on employee protection. Rather, the ARD sets a floor, not a ceiling, and permits Member States to confer greater protection on employees as they see fit.[27] The 1977 ARD was first amended in 1998 by Council Directive 98/50/EC, and then in 2001 by Council Directive 2001/23/EC.[28] The 2001 ARD codifies both the 1977 and 1988 legislation on business transfer.

It will be argued in this thesis that it was the need to balance employee protection with rescues of insolvent businesses that provided the impetus for revising the ARD. [29] There was a perception that the application of the regime to transfers in the context of insolvency impacted negatively on the rescues[30] of insolvent businesses in the Member States.[31] As discussed in this thesis, the ARD has been

[24] Wanjiru Njoya, 'The Interface between Redundancy and TUPE Transfers' (2003) 32 (2) ILJ 123, 127.
[25] Walters (n 23).
[26] Hereafter the Acquired Rights Directive or ARD for convenience.
[27] See Article 8, ARD 2001. This article states: 'This Directive shall not affect the right of Member States to apply or introduce laws, regulations or administrative provisions which are more favourable to employees or to promote or permit collective agreements or agreements between social partners more favourable to employees'.
[28] The 2001 ARD is the current European law on transfer of undertakings. Thus, reference to the ARD in this chapter is reference to the 2001 law except where reference to the 1977 directive is specifically made to that regime.
[29] Regarding the changes that have been made to aid business rescues, see chapter 7 of thesis.
[30] For a discussion on the problems the ARD posed rescues, see the section on 'Perceived problems with the Original ARD' below.
[31] Recital 7 of the 2001 ARD states that the amendment made to the original regime was '...in the light of the impact of the [ARD on the] internal market, the legislative tendencies of the Member States with regard to the rescue of undertakings in economic difficulties... 'See also Oliver Brettle, 'The EU Acquired Rights Directive and its Impact on Business Transfers' (2008) 37 Benefits and Compensation International 4-7.

the principal source of the existing tension between the business rescue and employee protection policies of the UK regarding the transfer of insolvent undertakings.

4.4 Why the ARD was adopted: facts and conjectures

There are conflicting views on the main motivation for the adoption of the ARD. One view opines that it was purely economic and Common Market protection motivated. The other view, which is supported by the preamble to the 2001 ARD[32], posits a social and employee protection-motivated reason for its adoption. However, the legislative history of the ARD seems to reveal that there were both social and economic reasons that underpinned the Council of Ministers' decision to adopt the first ARD in 1977. These reasons are considered briefly below.

4.4.1 To protect the common market

There is the notion that the adoption of the ARD was motivated by a desire to protect the Common Market.[33] There were concerns that if economic trends in Europe were to bring changes in the structure of undertakings through transfers of undertakings, businesses or parts of businesses to other employers as a result of legal transfers or mergers of the scale and frequency that was anticipated, it would lead to large scale redundancies and unemployment[34] that could have a direct effect on the functioning of the Common Market. This fear was borne out of the differences that existed in the protection given to employees in the Member States in transfer situations. It was feared that these differences could push labour standards to low levels and distort competition between firms in the Common Market.[35]

[32] According to its preamble, the ARD was adopted to 'provide for the protection of employees in the event of a change of employer, in particular, to ensure that their rights are safeguarded'.
[33] Michael Shanks, 'The Social Policy of the European Communities' (1977) 14 CMLR 373; Davies (n 6). See also P Watson, 'Social Policy after Maastricht' (1993) Common Market Law Review 30, 481-513.
[34] Peter Hoeller and Marie-Odile Louppe, 'The EC's Internal Market: Implementation and Economic Effects' (1994) 23 OECD Economic Studies 55.
[35] S Hardy and N Adnett `Entrepreneurial Freedom versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam (1999) 9 Journal of European Social Policy 130.

To avoid that happening, the EU thought it necessary to harmonise the discrete employment laws of the Member States.[36] This has provided the basis for the argument that the main reason for the adoption of the ARD was to protect the functioning of the Common Market. The contention is that employee protection as a social goal was subordinate to the economic objective of preventing distortion to the functioning of the Common Market in the adoption of the ARD.[37]

There are a couple of reasons that could support the veracity of the above view. First, the directives adopted in the period 1975-1986, that is, the period between the adoption of the Social Action Programme (SAP)[38] and the Single European Act (SEA), were, as articulated, mainly measures directed at 'limiting the social impacts of the economic crisis and of the industrial transformations that took place in Europe'.[39] Second, as far as the EC Treaties were concerned, a common market presupposed an undistorted competition. Besides, Article 100 of the Rome Treaty which provided the legal basis for the ARD required any measures proposed to be justified on the basis of removing obstacles which could directly affect the establishment or functioning of the Common Market. Therefore, the ARD, like any other social policy measures enacted on the basis of that article was expected to genuinely have as its object the improvement of conditions for 'the establishment and functioning of the Common Market.'[40] This requirement, it has been argued, was intended to strengthen 'the economic basis for social measures and to prevent the express articulation of social policy as an end in itself.'[41]

[36] The preamble to the 1977 ARD gives credence to this view. It states, *inter alia* that 'these differences can have a direct effect on the functioning of the common market... Whereas it is therefore necessary to promote the approximation of laws in this field while maintaining the improvement described in Article 117 of the [Rome] Treaty. Article 117 concerns the agreement by the Member States on 'the need to promote improved working conditions and an improved standard of living for workers'.
[37] B Bercusson, *European Labour Law* (Butterworth, London 1996) 234.
[38] See full discussion on this in chapter 3.
[39] J Kenner, *EU Employment Law: From Rome to Amsterdam and Beyond* (Hart Publishing, Oxford 2003); Olivier De Schutter, 'The Balance Between Economic and Social Objectives in the European Treaties' (2006) 5 Revue française des affaires socials <http://www.cairn.info/revue-francaise-des-affaires-sociales-2006-5-page-119.htm> accessed 30 April 2012.
[40] On this see Article 115 TFEU (ex Art 95 EC/ ex Art. 100 1957 Rome Treaty). The Lisbon Treaty also defines the Internal Market as an area without distortions of competition under Protocol No. 27 (On the Internal Market and Competition).
[41] Davies (n 6) 329.

4.4.2 To protect employees during business transfers

To claim that the ARD was adopted primarily to ensure an undistorted Common Market would be both erroneous and fallacious given that the ARD regime itself is all about the safeguarding of the rights of the employees during a business transfer resulting in a change in employer.[42] The European economic integration process discussed in chapter 3 was expected to trigger a lot of business restructuring activities in the EU.[43] The absence, both at the national and EU levels, of any legislation offering a robust protection for the rights of employees in business transfer situations was disturbing to the European Commission.[44]

The closest to a prospect of statutory protection that workers affected by a business transfer had in the pre-ARD era was in the form of the Draft Third Mergers Directive (DTMC)[45] and the Draft International Mergers Convention (DIMC) respectively. These two regimes, however, had several limitations *vis-à-vis* employee protection.

Both incidentally touched upon the position of the workers. They lacked express provisions on protection of the workers' rights. Both focused solely on asset mergers where the assets and liabilities of the acquired company were transferred to the purchasing company and the company acquired was then dissolved without liquidation. This type of 'asset merger' whilst banal in the original six founding members of the then EEC, is found in only in a small proportion in the UK[46] and so the draft directives would have done little to bolster the protection of UK employees.

The draft directives were also confined to mergers occurring in either one, or two Member States, where the companies merging were located. These directives were further limited by the fact that they were, in comparison to the ARD (see 4.6

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[42] See preamble to the 1977 ARD.

[43] Bob Hepple, 'Workers' Rights in Mergers and Takeovers: The EEC Proposals' (1976) 5 ILJ, 197, 198.

[44] See e.g. Mary Ann S Bartlett, 'Employees' Rights in Mergers and Takeovers-EEC Proposals and the American Approach,' (1976) 25 ICLQ 621. See also similar sentiments expressed by the Commission in the Proposal for a Council Directive, on the Harmonisation of the Legislation of Member States on the Retention of the Rights and Advantages of Employees- In the Case of Mergers, Takeovers and Amalgamations, May 31, 1974, J O C E., No.-G104/I, Sept. 13, 1974 (Preamble).

[45] This Directive which had as its purpose the regulating of mergers between public limited liability companies from the same Member State was later adopted as 'Third Council Directive 78/855/EC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies.

[46] Bob Hepple, 'Community Measures for the Protection of Workers against Dismissal' (1977)14 CMLR 489, 493.

on *modus operandi* below), conceived as tools of company law applicable only to one form of economic organisation: the limited company. The implications were that where an economic entity other than a limited company was acquired and, in a mode other than a merger, the employees in those entities were not protected.

The limited nature of the draft directives in relation to employee protection in business transfers and the social injustice caused by the application of different provisions to employees impacted, in comparative terms, by business transfers in the Member States called for a European-wide legislative solution. Thus, it was thought necessary to adopt special legal rules to cope with the social impact that business transfers within the EU were expected to bring.[47] One way of realising this goal was to offer a legislative response that was capable, not just of mitigating the immediate challenges that business transfers were expected to have for the workers, but to offer a lasting solution in the form of harmonised rules that can be applied in the management or resolution of any collective discontents that might arise, during and after, a legal business transfer involving a change in ownership in the Member States.[48] The consensus was to promote laws that would keep workers in their jobs over those that would put them back on the labour markets.[49] This is the type of law championed by the ARD.[50] Therefore, it was borne out of genuine concerns for employee protection during transfers of undertakings or businesses that the ARD was adopted in 1977.[51]

Based on the above analyses, a conclusion may be reached that, although there was an underlying economic goal of protecting the Common Market, the reason for the adoption of the ARD in 1977, however, was primarily to safeguard the rights of employees in business transfers situations involving changes in

[47] C Ohly, 'What Have We Learned about the Economic Effect of EC Integration?' (1993) 103 Economic Papers; J M Burniaux & J Waelbroeck, 'Effects of Firm Closures on Employment: is the Single European Market a Real Shock of the Third Kind? (1993) mimeo.
[48] D Marsden, 'The ''Social Dimension'' as a Basis for the Single Market', in J T Addison & W S Siebert (eds) *Labour Markets in Europe: Issues of Harmonization and Regulation* (London, Dryden Press 1997).
[49] Upex & Ryley (62); R Upex, R Benny & S Hardy, *Labour Law* (2nd edn., OUP, Oxford 2006) 4. This approach, it is submitted, may not have been unconnected to the civil law tradition of some of the Member States, especially, the French, which has had a law dating back to 1928, providing for transfer of employees' contracts of employment/ continuity of employment when there is a transfer of an undertaking.
[50] Hardy & Adnett (n 32); Mark Jeffery, 'European Union Developments: European Labour Laws Relating to Business Restructuring' (2003) 24 Comp. Labour Law & Policy Journal 670.
[51] See explanatory statement of Council proposal for a Directive on the harmonisation of the Member States relating to redundancies. COM (72) Brussels November 8, 1972.

ownerships of the businesses or undertakings that employ them in Member States.[52]

4.5 Legal base of the ARD

It was noted in chapter 3[53] that social policy played second fiddle to policies aimed at the attainment of economic goals.[54] However, attitude towards social policy legislation at the European level started to change from 1974 following the adoption of the resolution on the Social Action Programme (SAP) by the Council in that year.[55] In spite of the obstacle posed to employment legislation by the defect in the Rome Treaty, the European Council was determined to make legislative progress in the employment law field.[56] The non-provision of a sound legal base for employment legislation by the 1957 Rome Treaty was navigated by using one of the Treaty's provisions in Article 100. This article empowered the EU to take action concerning the approximation of national provisions directly affecting the Common Market.[57] Article 100 therefore provided the EU with the legal base for the adoption of the ARD.[58]

4.6 The ARD: modus operandi

It was noted above (see the discussion of why the ARD was adopted at section 4.4 above) that although there were within the EEC some measures that were put in place to protect employees, these measures were limited in scope and effect.

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[52] This view is buttressed by the 3rd recital of Council Directive 2001/23/EC. See also Sebastian Krebber 'Status and Potential of the Regulation of Labour and Employment Law at the European Level,' (2009) 30 Comparative Labour Law and Policy Journal 875, 882.

[53] See the section on 'The 1974 Social Action Programme' in chapter 3.

[54] Sandra Fredman, 'Europe With a Social Face: Equality and Social Rights in the European Union' (2001) 22 ILJ 1467; Jo Shaw, Jo Hunt & Chloe Wallace, *Economic and Social Law of the European Union,* (Palgrave McMillan, Hampshire, 2007), 394; A Sapir, 'Regional Integration in Europe' (1992) 102, The Economic Journal.

[55] Hoeller and Marie-Odile Louppe, (n 34) 417.

[56] Manfred Weiss, 'Fundamental Social Rights for the European Union' (1997) 18 ILJ 417, 418.

[57] It seems that in spite of there being no direct treaty base, that even Article 235 of the Rome Treaty (which concerned the right of the Council to take actions to achieve the objectives of the Community where the Treaty has made no provision for such) could have suffice for adoption of the ARD. It is important to note also that Council Directive 75/129 1975 O.J. (L. 48) 29 (EC), on the approximation of the laws of the Member States relating to collective redundancies was also based upon this Article.

[58] It is pertinent to note that the EU institutions empowered to propose social policy measures are usually given some degree of flexibility in relation to the mode of instrument to be used. However, some Treaty articles actually dictate the type of instrument to be used. Article 100 (now Art. 115 TFEU) chose directive as the mode of instrument for approximation of the laws of the Member States relating to transfers of undertakings, businesses or part thereof.

They were restricted to a particular type of limited companies and were confined to either one or two Member States meaning that the protections they offered to the employees were also circumscribed. This then begs the questions: how different is the ARD from these previous measures? Has the ARD succeeded where these other measures failed? How effective is the ARD in terms of protecting the employees' rights in transfers?

Far from being conceived as a tool of company law applicable to one form of economic organisation only (i.e. the limited company as was the case with the earlier measures discussed above), the ARD embraces the concept of the enterprise or undertaking. This means that, unlike previous attempts that were made to protect employees, its application is not restricted to limited liability companies and mergers, and the ARD goes further than mergers. It applies to various kinds of transfers.[59] These include transfers where individual businesses, places of production, subsidiary businesses, organised work units or undertakings are transferred from one legal person to another in a manner that enables the latter to replace the former in its capacity as the new employer.[60] The implication is that the social protection that it offers to employees, rather than being limited to a particular form of business (limited company) and one type of transfer (merger), covers a wide spectrum of business transfers[61] so long as the transfer in question triggers a change in the identity of the employer.[62]

Another characteristic of the ARD that differentiates it from the previous measures is that, the ARD is an EU-wide regime on business transfer. Unlike the measures above, it is not confined to one or two Member States. This is evidenced by its territorial coverage. [63]

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[59] W Green, *Encyclopaedia of Employment Law,* (Sweet & Maxwell, 2007) Vol. 1, 4A-102.

[60] Hepple, (n 43), 205.

[61] See Article 1, ARD 1977. The Directive, however, specifically excludes transfers of sea-going vessels (Art. 1(3)) and transfer effected through majority share transfer ownership of a business.

[62] Dubois, 'European Social Law' in (M Ellis & P Storm eds.) *Business Law in Europe: Legal, Tax and Labour Aspects of Business Operations in the Ten European Community Countries and Switzerland* (Springer, 1982); A L DaSilver, 'Directive 77/187: The EEC's Attempt to Protect Employees upon the Sale or Transfer of Businesses' (1998) 11 B. C. Int'l & Comp. L Rev. 147.

[63] According to Article 1 (2) the ARD applies 'where and insofar as the undertaking, business or part of the undertaking or business to be transferred is situated within the territorial scope of the [EC] Treaty' or a member country of the European Economic Area (Norway, Iceland and Liechtenstein). It is worthy of note that though not all member states of the EEA are members of the EU, the EEA however, includes all Member States of the EU and the EFTA states which, after the accession of Sweden, Finland and Austria to membership of the EU in 1995, now include Norway, Iceland and

Based on the difference it has made to the status of EU workers in transfers as discussed at section 4.2 above, and its impacts on business transfers,[64] the effectiveness of the ARD *vis-à-vis* the protection of employees' rights is not in doubt. The regime is concerned with the protection of substantive individual rights of the employees during a relevant business transfer.[65] This, it has done, through three main layers of protection.

The first layer of protection is the establishment of the right to continued employment for the employees.[66] Upon the occurrence **of** a relevant transfer, the ARD operates to transfer all existing or acquired rights of the workers from the transferor to the transferee. Since it is national laws of the Member States and not the ARD that define what rights the employees have,[67] the inference is that whatever the substantive scope of those rights was prior to the transfer, they should be no less under the new employer.[68] That is, the 'employees should retain a nationally defined pre-transfer level of protection.[69] The aim, ultimately, is to maintain the legal position in which employees impacted by a business transfer would have been, had the change in the ownership of the business not occurred.[70] That way, the ARD mitigates the effects of the business transfer on the employees and bolsters protection of employees' rights in all Member States.

The second layer of protection is the granting to the employees of conditional guarantee against dismissal.[71] The rule against dismissal extends to constructive dismissal. For example, if, by reason of the business transfer, the contract of employment is terminated because there is a substantial change in working

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Liechtenstein. See John McMullen, 'International Outsourcing and Transnational Transfers of Undertakings-A UK Perspective' (2005) 26 *Company Lawyer* (10) 296, 298.

[64] Brettle (n 31); Hepple (n 46); Bob Hepple & Angela Byre, 'EEC Labour Law in the United Kingdom - A New Approach' (1989) 18 ILJ 129.

[65] Bob Hepple, 'Community Measures for the Protection of Workers against Dismissal' (1977) 14 CMLR 489.

[66] ARD 2001, Art. 3 (1).

[67] See Case C-105/84 *Mikkelsen v A/S Danmols Inventar* [1986] CMLR 316 ECJ. See also *Adams and others v Lancashire County Council and another* [1997] IRLR 436, CA; *Rask and Christensen v ISS Kantinenservice A/S* [1993] I.R.L.R. 133, ECJ; *Havering College of Further & Higher Education v Ralton* [2001] IRLR 738, EAT.

[68] Paul Davies, 'Acquired Rights, Creditors' Rights, Freedom of Contracts and Industrial Democracy' (1989) Yearbook of European Law 21.

[69] Bob Hepple, 'Report for the Commission of the European Communities Directorate-General: Employment, Industrial Relations and Social Affairs - Main Shortcomings and Proposals for Revision of Council Directive77/187/EC'. (1990)

[70] C Bourn & P Thorpe, 'Preservation, Variation and Harmonisation of Terms and Conditions', in Bourn (ed) *The Transfer of Undertakings in the Public Sector* (Ashgate, London 1999) 161.

[71] ARD 2001 Art. 4.

conditions to the detriment of the employee, the employer is regarded as responsible for that termination. This protection is not, however, absolute. It is subject to certain exceptions. Member States may exclude from the rule employees who are not covered by national protection against dismissal. Also, the employer retains the right to dismiss the employee for 'economic, technical or organisational reasons entailing changes in the workforce'.[72] This provision, it is submitted, is intended to provide employers with a legally sanctioned excuse with which to use and make changes to their corporate structures whenever the need arises. It is intended to allow a balance to be struck between employee protections on the one hand and the preservation of distressed businesses on the other. Thus, where an insolvent but economically viable business could be rescued by dismissing some staff, the rule against dismissal should not stand in the way of such rescue.

The third approach used by the ARD to protect employees is the mandatory duty it imposes on the employers to inform and consult their representatives when a transfer of an undertaking is envisaged.[73] The employees are to be furnished (technically through their representatives) with the date, or proposed date of the transfer, the reason for the transfer, the legal, economic and social implications of the transfer for the employees and of any measures envisaged in relation to the workers. This provision is aimed at ensuring that the employees' interests are taken into account by relevant employers when they have made plans for restructuring businesses.[74] This duty fulfills, it is submitted, one of the key objectives of the 1994 SAP namely the involvement of workers and management in the life of businesses in Member States (discussed in chapter 3).

The ARD is a public policy. It is not possible to derogate from its provisions with impunity.[75] The protection it offers to the employees cannot, for example, be waived even with consent of the employee. Equally, the employer cannot, either

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[72] Art. 4 (1), ARD 2001.
[73] Art. 7 ARD 2001.
[74] In *Akavan Erityisalojen Keskusliitto AEK ry v Fujitsu Siemens Computers Oy* [2009] IRLR 944 the ECJ made it explicitly clear that an employer is required to commence the consultation procedure only when either a strategic or commercial decision forcing him or her to contemplate the restructuring of the business had been taken, but not before.
[75] See e.g. *Katsiskas- Joined Cases 132, 138 and 139/91 Katsikas, Skreb and Schroll* [1992] ECR 1-6577. In the earlier case of *Daddy's Dance Hall Case 324/86* [1986] ECR 739, the ECJ stated at para.14 that the provisions of the Directive and in particular of Art. 3(10) are mandatory.

by agreement with the employee,[76] or otherwise, postpone its effects once a business transfer has occurred. [77] An employee is, however entitled to refuse the transfer of his or her contract to the new employer as demonstrated by case law.[78] However, the legal effect of refusal to transfer is a matter for the national law each Member State to determine. In the UK, for example, refusal to transfer has the legal effect of termination of the employment contract. The employee will not be treated as having been dismissed and therefore would not be entitled to any redundancy payments or other compensations for the loss of his or her job. The exception to this rule is if refusal to transfer was as a result of a detrimental or negative change in the employee's working condition. Where that is the case, the employee will be treated as dismissed as opposed to a resignation.[79]

In sum, the need to offer robust protection for workers' rights, involve them in the decision making of an insolvent business and especially the right to refuse to be transferred to the workforce of the transferee, may have been borne out of the global recognition that workers are no longer simply an economic factor to be considered in the cost of production.[80] It is recognition that the employees have become a working partner in a triangle collectively made up of shareholders, workers and management. This triangle, as articulated by Bartlett, [81] 'represents the enterprise,'- which traditionally protected the interests of shareholders and creditors, has now been embraced, given legislative recognition and, used by the ARD to protect the rights of workers in transfers. This approach, it is submitted, is consistent with the Traditionalists' employee protection ambitions generally and especially, that of team production theory. For team production theory, all those who make valuable contribution to the business or enterprise in its solvent state

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[76] See Joined Cases 144 and 145/87 Berg.

[77] Article 3 (1) ARD 2001; See also Case C -362/83 *D'Urso v Ecole Marelli Elettromeccanica Generale SpA* [1992] IRLR 136; Case C -305/94 *Rotsart de Hertaing v J Benoidt SA and IGC Housing Service* [1997] IRLR 127 (ECJ); *Celtic Ltd v Astley* **[2006]** IRLR 635.

[78] See *Katsikas v Konstantinidis and Skreb* [1993] IRLR 179.

[79] See *University of Oxford v (1) Humphreys and (2) Associated Examining Board* [2000] IRLR 183 CA. The recent and perhaps the most controversial refusal to transfer following a TUPE transfer is the situation at Rangers Football Club at the moment in Scotland where as many as ten players have refused to transfer their contracts to a Newco. See Andy Hunter, 'Rangers Newco to begin Pre-Season Training with Only Three Players' Guardian News Wednesday 27 June 2012 <http://www.guardian.co.uk/football/2012/jun/27/rangers-training-three-newco-players> accessed 4 July 2012.

[80] See P O'Higgins, 'Labour is not a Commodity – an Irish Contribution to International labour Law' (1997) 26 ILJ 225.

[81] Bartlett (n 44) 625.

are working partners and therefore deserve to have their respective interests taken into account when the business is insolvent.[82]

4.7 Intrusion of European legal developments into national employment law space: the range of possible effects of the ARD

The ARD is not an employment law of national emanation. It is 'foreign' in the sense that it originates from the EU. Given the intent of the regime and the different traditions of the Member States regarding transfers of undertakings, it is very unlikely that the ARD would not have had a major impact on business transfers in Member States. The ARD imposes obligations on employers. The precise scope of the obligations varies from country to country. It has had differing effects on the labour and employment laws of the Member States. The adoption of the ARD has led to the legislation of certain employment rights and relationships in some Member States which hitherto were never legislated for.

Whilst it has strengthened the generally weak level of protection employees used to have in going concern business transfers in most Member States, it has also impacted on employers' abilities to restructure freely and on business rescues in these states. Using the UK as an example, the implementation of the ARD effectively overturned the common law rule on business transfers. The implication of implementing the ARD is the adoption of the practice of automatic-transfer of contracts of employment. This practice, hitherto non-existent in UK business transfer legal history, has now put the UK among the jurisdictions of the world adopting the 'automatic-transfer'[83] of employment contracts approach in business transfers.[84]

Whilst the ARD-induced automatic-transfer of employees and novation of contracts rule may be a good legal development for the employees, the practice

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[82] See discussions on theories generally and, on team production theory in particular in chapter 2.

[83] The term 'automatic-jurisdiction' is used here to denote those jurisdictions in the world where employees automatically transfer from the transferor to the transferee when there is a business transfer. There are automatic transfer principle and countries outside the EU as well. These may be found in countries such as Korea where it applies to certain types of transactions, and in Singapore for certain types of employees. South Africa is another example of a jurisdiction outside the EU with compulsory transfer of employees from transferor to transferee. See C A Spink & U Krudewagen, 'From Acquired Rights to Reverse TUPE: Employment Law Issues in Global Outsourcing Transactions' (2009) 9 Chicago-Kent Journal of International and Comparative law 1-54.

[84] ibid. 17.

could on the other hand impact negatively on the rescue of insolvent businesses. A major reason why this could be problematic for business rescues in Member States is because termination of employment contracts has now become far more onerous than what obtains in the 'termination-and-re-hire' or the 'at-will' jurisdictions of the world such as the US and the Asia Pacific.[85]

The transfer of employees in a termination and re-hire jurisdiction in a business transfer situation requires an act by the transferor employer terminating existing employment, followed by an act by the transferee employer offering new employment.[86] By contrast, termination of employment contracts in the UK and other Member States now involves the observation by the employers of several transfer related legal rules of EU emanation. The employer cannot dismiss workers to enhance the sale of the business. The transferee cannot cherry-pick employers he wishes to retain. Both the transferor and transferee cannot collude to dismiss employees before a transfer without incurring liability. Dismissing employees pre-transfer could result in employees having claims against both transferor and transferee for unfair dismissals.

A business transfer imposes information and consultation duties on EU employers. The employers are statutorily obliged to notify and consult[87] with the employees before a business transfer. While in countries such as the UK and France, there is no minimum period for the consultation to last, and the employees are informed through their representatives in the UK, in Germany on the contrary, all individual employees must be informed in writing about the proposed transfer before the transfer actually takes place. In the context of insolvent business transfers, the requirement that the transferee take on all the employees on their existing terms and conditions imposes additional costs on rescue. These are costs that a prospective purchaser might regard as outweighing the advantages derivable

[85] Examples of countries within this jurisdiction include countries such as Argentina, Canada, Hong Kong and Japan to South Korea, Taiwan and the United States of America.
[86] While this is generally a very straightforward process involving issuance of a termination notice by the outgoing employer, and a new employment agreement or offer letter by the new employer, it is not without its pitfalls.
[87] See Article 7, ARD 2001.

from purchasing such businesses and which might lead them to abandon the purchase.[88]

Also, even after the purchase, the transferee could still inherit previously unanticipated employees-related liabilities. Therefore purchasers of business often want to factor in these costs when buying a business. Where an agreement cannot be reached between the buyer and the seller, the deal would collapse exposing the employees to job losses.

Lastly, the protective disposition of the ARD towards the employees could be a catalyst for prospective buyers of insolvent businesses to structure the transaction in a way so as to avoid its application. They could structure the deal in a way that ensures the purchased entity does not 'retain its identity' since the ARD only applies where the undertaking or business transferred retains its identity post-transfer. It follows that if the business is broken up and is absorbed by the transferee's existing business, rather than kept or treated as a separate and ring-fenced part of his or her business (such that it does not maintain its identity), the ARD will not apply. This artificiality will be unhelpful for going concern rescues and ultimately for the employees who will lose their jobs.

4.8 Conclusion

The ARD has brought with it several changes in the way EU member countries conduct business transfers and protect employees' rights during transfers. For a country such as the UK where the employment relationship in business transfer situations was fundamentally a personal relationship based on contract between the employee and the employer, the intrusion of the ARD into domestic transfers with its prescriptive approach to employee protection has caused serious distortions in the employee-employer relationship. In the UK, for example, a

[88] This was, in the context of UK' equivalent legislation, clearly the view of the Society of Practitioners of Insolvency when in their evidence to the House of Lords Committee investigating changes to the ARD stated that:

> It has been well known since the *Litster* case in 1989 that the transfer of undertakings legislation is an impediment to the rescue of businesses in the context of formal insolvency and therefore has the opposite from its intended effect of preserving employment and employees' rights. Insolvency Practitioners can cite numerous examples of cases where the prospect of taking over accrued liabilities under employment contracts has either deterred prospective purchasers of insolvent businesses from dealing altogether, or has caused them to discount the price they are prepared to pay. See Select Committee on the European Communities session 1995-96 5th Report.

business transfer is no longer regulated by domestic law in this regard. The common law practice of terminating all extant contracts upon the occurrence of a business transfers is now extinct. Rather, contracts of employment of employees who transfer to the transferee's workforce in a business transfer survive the transfer intact.

The changes that were forced on the UK's employment relations by the ARD in relation to business transfers have tended to portray it in a bad light. These have led to the ARD being described as a radical law.[89] It gives employees protection beyond those previously provided for them by national laws of several of the Member States. For the employees, the ARD is an invaluable law, but to sellers and buyers of businesses, especially insolvent businesses, the regime is nothing other than an impediment. Its application to transfers of insolvent businesses is a disservice to the rescue culture.

The next chapter will consider business transfers in the UK from the common law era to 1981 when TUPE began to regulate transfers of undertakings.

[89] Davies, (n 68).

CHAPTER FIVE

TRANSFER OF UNDERTAKINGS IN THE UNITED KINGDOM: FROM COMMON LAW TO THE TRANSFER REGULATIONS' ERA

5.1 Introduction

The effect of United Kingdom's membership of the European Union (EU) is evident from the previous chapter on the Acquired Rights Directive. EU laws in different spheres have intruded upon the UK's domestic legal arena. This is a truism especially in the context of employment law where the intervention of EU's business transfer regime has completely and radically altered the common law rule regarding the rights the employees and employers have when an insolvent business is transferred on a going concern basis. Without the intervention of the EU's business transfer directive, the common law would still govern transfers of undertakings in the UK today.

When ownership of a business is transferred from one person to another (legal or natural), the change in employer usually have consequences for the employees of the business transferred. The employees have several rights in the business the work for which deserve to be protected especially where the business becomes insolvent and is sold to a purchaser as a going concern. However, matters concerning the protection of employees' rights when ownership of a business is transferred are not very easy to deal with. The transfer of an insolvent business in particular raises several fundamental issues. The key issue is usually whether the affected employee should have the right to continue working for the new employer. If so, should the contractual and all other employment rights which he enjoyed with the transferor employer be transferred to the new employer? Should the employee's rights be respected by the transferee? These are very difficult questions which do not yield to any easy answers.

The difficulty anyone attempting to address the above issues would face stems from the fact that the employee's interests do not always align with those of the transferee when a business is transferred. The employee and the transferee may want different things. The transferee, for example, may not be interested in retaining the services of the employee because the latter may be excess to his requirement. Where the employee is willing to work for the new employer, he or she could insist on doing so on the same terms and conditions as obtained with the transferor whereas the transferee may not be willing to take on the employee on the terms he or she enjoyed with the transferor. Conversely, the employee may not be willing to work for the new employer at all or be transferred to the transferee without his consent. However, the employee's freedom to choose who to work for and the employer's right to cherry-pick who to retain when there is a business transfer are considerably curtailed in the UK.[1] This is due primarily to the effect of the business transfer regime operational in the UK (the Transfer of Undertakings (Protection of Employment) Regulations (hereafter the Transfer Regulations or TUPE),[2] on transfers. TUPE transfers all subsisting employment contracts from the transferor to the transferee, irrespective of the parties' wishes, upon a 'relevant'[3] business transfer.

The purpose of this chapter is to provide a general overview of TUPE. The aim is to explore how transfers of undertakings were conducted under the common law before the coming into force of the European-induced statutory regime of TUPE and the effect this has had on especially insolvent business transfers in the UK. This chapter will consider the common law rule on business transfers with the aim of comparing the rights of the employees in transfers under the common law and under TUPE. The scope of the TUPE Regulations, the notion of 'relevant transfer' in relation to a TUPE transfer will be considered. This will then set the stage for analysing the Transfer Regulations in the context of insolvency in the next chapter.

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[1]It is pertinent to pointed out, however, that the employee's right to choose who to work for is not affected that much. The employee reserves the right not to **be** transferred to the services of the transferee by informing the transferor or transferee of his or her objection to be transferred. See TUPE 2006, Reg. 4 (7). However, objection to transfer effectively terminates the employee's contract of employment and the employee 'shall not be treated, for any purpose, as having been dismissed by the transferor'. See TUPE 2006, Reg. 4 (8). In a similar vein there is no obligation on the part of the transferee to take on all of the transferor's employees, or any automatic assumption that they were so taken on. However, a transferee who does not take on the employees is liable, under TUPE, to compensate them for the loss of their employment. See *British Fuels Ltd v Baxendale* [1999] 2 AC 52. See further W Njoya, 'The Interface between Redundancy and TUPE Transfers' (2003) 32 (2) ILJ 132.

[2] Reference to 'Transfer Regulations' is reference to the TUPE 2006. However, where reference to the original TUPE regime is made, TUPE 1981 or the 1981 Transfer Regulations will be used.

[3] The concept of 'relevant transfer' is considered below.

5.2 Transfer of undertakings: the common law[4] era

Currently, the rights of the employees in business transfers are statutorily regulated in the UK due to the operation of the TUPE Regulations (see below). However, prior to the emergence of TUPE, and even before the Employment Rights Act 1963 (which was the first statutory provision in respect of the rights of employees in the employment relationship), the rights of UK employees in business transfers was determined exclusively by the common law.[5]

Under the common law, employment involves two key elements: a contract and a relationship. 'The contract of employment is the legal frame by which one person's labour is put, on agreed terms, at the disposal and under the authority of another.'[6] The employment relationship, on the other hand, is a legal notion used globally to refer to the relationship which exists between a person who works (often referred to as the employee) and the person (legal or natural and often referred to as the employer) for whom the former is working under certain conditions in return for remuneration.[7] Evidently, the employment relationship

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[4] The term 'Common law' can be used to mean three different things. It could be used in reference to a legal system, case law developed by judges and it can be used to refer to equity. The 'common law' is used in this context to refer to the legal tradition which evolved in England from the 11th Century onwards. This legal tradition is the basis of private law not only for England (as its country of origin), but also for Wales and Ireland. It is also the legal tradition followed by most states of the United States of America (except for Louisiana), most part of Canada (except from Quebec) and by several other countries in Africa and Asia that received the common law tradition as former colonies of the defunct British **Empire.** William Tetley, 'Mixed Jurisdictions: Common Law v Civil Law (Codified and Uncodified) (2000) 60 La L Rev. 677-738 <http://www.mcgill.ca/files/maritimelaw/mixedjur.pdf> accessed 1 May 2012

[5] The common law in this context refers to law developed by judges through decisions of courts and similar tribunals, as opposed to law imposed by legislatures or other government officials through statutes or executive action. *Osborn's Concise Law Dictionary,* L Rutherford and S Bone (eds.) (8th edn, Sweet and Maxwell, London 1993). Judges develop the common law by applying their common sense and knowledge of legal precedent to the facts of each individual case that is brought before them. Following past decisions (*stare decisis*) on similar cases is very valuable to common law. The strength of the similarity among the cases and evaluating a new case on the basis of the reasoning applied to past cases with similar facts gives credence to the eventual decision reached on a new case. In *Re Hallett* (1880) 13 Ch. D 712, Sir George Jessel, MR noted that: 'the only use of authorities or decided cases is the establishment of some principle which the judge can follow out in deciding the case before him.'

[6] André Rouast, 'Quelques Réflexions sur L'originalité Sociologique du Contrat de Travail' Mélanges offerts à Jean Brèthe de la Gressaye (Bordeaux, 1969) 663.

[7] Tony Honore, 'The Quest for Security: Employees, Tenants, Wives' in the *Hamlyn Lectures* (34th series, Stevens & Sons Ltd, London 1982) 1. See also ILO: 'The Employment Relationship' (2006) Report V (1) of International Labour Conference, 96th Session, 3. In the context of the ARD and TUPE (discussed below), see *Botzen v Rotterdamsche Droogbok Maatschappij BV* [1985] ECR 519 in which the ECJ applied the 'assignment test' to define the employment relationship thus:

> An employment relationship is essentially characterised by the link existing between the employee and the part of the undertaking or business to

under the common law is purely contractual. It is predicated on the notion of personal service[8] in that it involves day-to-day contact.

The common law was very straightforward regarding what the 'fate' of the employee was when there was a business transfer resulting in a change of employer. A business transfer automatically put paid to all contracts of employment. The origin of this common law rule on transfer dates back to 1940, and specifically, to the House of Lords' decision in the seminal case of *Nokes v Doncaster Amalgamated Collieries Ltd.*[9] In that case, the respondents argued that consequent upon the court order transferring the business of the of Hickleton Main Co Ltd (HMCL), under section 154(1) of the Companies Act 1929, to Doncaster Amalgamated Collieries Ltd (DACL), Nokes' contract of employment with his previous employers, HMCL, *ipso facto* was transferred to them, irrespective of Nokes' consent. Thus, by absenting himself from work, Nokes was in breach of contract. Both the Chancery Court and the Court of Appeal held Nokes liable to pay damages to the new employer under section 4 of the Employers and Workman Act 1875. Nokes refused to pay, contending that there was no contract between himself and HMCL.

Reversing the CA's decision, the House of Lords (HL) agreed with Nokes holding that his contract of employment did not transfer. The HL took the view that to hold otherwise would have produced a result in total contrast to the common law rule which provides that the services of an employee who is under a contract of employment cannot be transferred from one employer to another without the consent of the employee. It noted that:

> which he is assigned to carry out his duties. In order to decide whether the rights and obligations under an employment relationship are transferred it is therefore sufficient to establish to which part of the undertaking or business the employee was assigned.

[8] See e.g. *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497, 515; *Express & Echo Publications v Tanton* [1999] ICR 409, 699-700.

[9] [1940] AC 1014. See also other authorities on this point e.g. *Stevens v Beenning* [1855] 24 LJ Ch. 153; *Griffith v Tower Publishing Co Ltd* [1897] 1 Ch. 21. In *Denham v Midland Employers' Mutual Assurance Ltd* [1955] 2 QB 437, Lord Denning noted that:

> No contract of service can be transferred from one employer to another without the servant's consent: and this consent is not to be raised by operation of law but only by the real consent in fact of the man, express or implied.

> [A] free citizen, in the exercise of his freedom, is entitled to choose the employer whom he promises to serve, so that the right to his services cannot be transferred from the employer to another without his assent. [10]

According to the HL, 'the right to choose for himself whom to serve' is 'ingrained in the personal status of a citizen' under the common law. The citizen's right to choose 'constituted the main difference between a servant and a serf.'[11] *Nokes* became the high-water mark in transfers of undertakings law that a contract of employment was a personal right arising from the employment relationship and so could not legally be assigned without the consent of the employee. *Nokes* may have served its purpose namely: freedom to choose one's employer, but this was a negative right that prejudiced the interests of the employees collectively as far as job security was concerned. A business transfer, under the *Nokes* rule, had the inevitable consequence of terminating all contracts of employment since the transferee was under no obligation to continue the employees' contracts post-transfer. Also, the transferee had a corresponding right to 'cherry-pick' [12] employees he or she wishes to retain following a business transfer.[13]

In an economy or countries where jobs are difficult to come by and, where keeping the job a worker already has is of paramount importance, *Nokes* would not be good law. The principle inherent in the decision would be inimical to the employees' interest job wise. This is because the *Nokes* decision, rather than operate to ensure that the employees already in employment keep their jobs (which, given the volatile labour market conditions is, arguably, what the employees themselves would prefer,[14] and which in the context of an insolvent business transfer, would be the best outcome for them) *Nokes* would operate to put them back on the job market each time there was a business transfer

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[10] [1940] AC 1014 (Viscount Simon LC) 1020.

[11] [1940] AC 1014 (Lord Atkin) 1026.

[12] See Sandra Frisby, 'TUPE or not TUPE? Employee protection, corporate rescue and "one unholy mess"' (2000) CFILR 249 - 271.

[13] It appears that from a theoretical view point, the common law rule on business transfer would have pleased scholars of the Proceduralists orientation and the creditors' bargain theorists, especially regarding insolvent business transfers. *Nokes* eliminated any obstacles to dismissals making the insolvent business command a higher sale price for the benefit of the creditors. On the other hand, the decision would not have been popular with the Traditionalist if it was still the law today. On theories of insolvency law, see chapter 2.

[14] D T Mortensen and C A Pissarides, 'Job Creation and Job Destruction in the Theory of Unemployment' (1994) 61 (3) Review of Economic Studies 397–415; M Merz 1995. 'Search in the Labor Market and the Real Business Cycle' (1995) 36 (2) Journal of Monetary Economics 269–300; Alejandro Cunat and Marc J Melitz, 'Volatility, Labour Market Flexibility, and the Pattern of Comparative Advantage' (2007) <http://ssrn.com/abstract=1136036> accessed 4 May 2012.

involving an insolvent transferor. If the common law still governed business transfers in the UK today, another implication of the decision for the employees would be that the employees who would be lucky to be retained by the transferee, would not be able to have their years of service with their previous employer transferred to the new employment. Continuity of employment[15] would be broken as employees would have had to begin working for the new employer on a clean slate. They would be deemed as employed by the transferee on the day they commenced working for the new employer.

5.3 Transfer of undertakings: Statutory provisions before 1981

Before 1981, when the first TUPE Regulations were enacted, statutory employee protection laws had gradually begun to evolve in the UK.[16] The significance of the statutory body of rights granted to employees by protective employment legislation is that they constitute an autonomous layer of employment law which is distinct from the contractual framework of employment relationship fostered by the common law.[17] There is the view, however, that although most laws relating to job security derive from statute, that statutory rights 'derive their normative and conceptual coherence from the common law.'[18] What this implies is that statutory rights cannot be fully understood if the conceptual premise from which they derive their normative content is not identified.[19]

[15] The importance of continuity of employment in UK law lies in the fact that an employee must complete a minimum period of 'continuous employment' to be eligible for certain rights in any employment relationship. The importance of continuity of employment is underscored by the fact that the length of continuous employment is an important factor in the assessment of any compensation which may be due to the employee if the employee is unfairly dismissed. The courts take the view that if the work (whether full or part time) carried out by the worker involves short engagements with gaps in between during which no 'mutuality of obligation' exists between the employer and the employee, there will be no continuity of employment. see *Carmichael & anor v National Power Plc* [1999] ICR 1226, HL. However, it seems that continuity will be preserved if the gap between the two employments is related to the machinery of the transfer. *Macer v Abafast Ltd* [1990] IRLR 477, HL.

[16] Robert Upex & Michael Ryley, *TUPE: Law and Practice* (Bristol, Jordan Publishing Limited, 2006) 2.

[17] Steven Anderman,`The interpretation of protective employment statutes and contracts of employment' (2000) 29 ILJ 223-43.

[18] Mark Freedland, *The Personal Employment Contract* (OUP, Oxford 2006) 10-11.

[19] It seems that the type of statutory rights conferred on the employees and, or the protection employees enjoy during transfers of undertakings in the UK, do not derive from contract at all. These rights, as will be seen when TUPE is considered below, arguably, go beyond contract. See Fox, *Beyond Contract: Work, Power and Trust Relations* (Faber, London 1974). The current law protecting

5.3.1 The Contracts of Employment Act 1963

The first statutory provision regulating an employee's continuity of service post-transfers of undertakings was Schedule 1 to the Contracts of Employment Act of 1963 (CEA).[20] The CEA 1963 was a novel approach to employee protection.[21] It made provisions for new laws to protect workers' rights and vested in them legal rights which they never had before. The 1963 Act obliged employers to give their employees, in writing, the terms and conditions of their contracts of employment prior to them commencing work.[22] It also required both parties to give each other fixed notices before terminating the employment relationship.[23] In spite of the fact that the protections the 1963 Act provided for the employees were limited,[24] this Act was still widely acclaimed as 'the first modern employment protection statute' in the UK.[25]

5.3.2 The Contracts of Employment Act 1972

Schedule 1 to CEA 1963 made provisions for ascertaining the length of an employee's period of employment and for determining whether that period of employment had been continuous. When the CEA 1963 was replaced with CEA 1972, Schedule 1 to CEA 1963 became paragraph 9 of schedule 1 to the CEA 1972. Paragraph 9 (2) provided that:

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employees during transfers of undertakings has its origin in a foreign as opposed to a domestic source: the 1977 ARD.

[20] Paragraph 10 (2) CEA 1963.

[21] Cyril Grunfeld, 'Contracts of Employment Act, 1963' (1964) 27 MLR, 70; P O'Higgins, 'The Contracts of Employment Act, 1963', (1964) 22 The Cambridge Law Journal 220-225.

[22] Under this Act, it was a criminal offence, punishable by fine, for the employer to refuse to give the requisite written statement. But this was repealed by the Labour government in 1965.

[23] The employee was to give the employer not less than a week's notice and the employer had to give (if the employee had worked for him for five or more years) four weeks' notice to the employee. The CEA 1963 s. 1

[24] The CEA 1963 'deliberately' excluded certain categories of workers from its protection. For example, for its protection to avail an employee, the Act required a weekly threshold of 21 hours work. According to the then Parliamentary Secretary for the Ministry of Labour (William Whitelaw MP), the imposition of this condition was deliberate. It was premised on a policy that was intended to exclude 'people with spare-time occupations and those who [did] weekend jobs.' It was also intended to remove from the scope of protection, or exclude cases where the employment relationship was not of substantial importance to the parties concerned. Those envisaged, somewhat insensitively, included shift workers who were nearly all women with domestic responsibilities. See Hansard, HC Deb, 1 May 1963 vol 676, col 1154. That threshold was carried into the Redundancy Payments Act 1965 and the Industrial Relations Act 1971. However, for notice and terms of employment, the threshold was gradually lowered until it was finally abolished after it was held to be incompatible with the Equal Treatment Directive, 76/207/EEC, by the House of Lords in the case of *R v Secretary of State for Employment, ex parte Equal Opportunities Commission* [1994] IRLR 176.

[25] Simon Deakin and G Morris, *Labour law* (4th edn., Hart Publishing, Oxford 2005) 194.

> If a trade or business or an undertaking ... is transferred from one person to another, the period of employment of an employee in the trade or business or undertaking at the time shall count as a period of employment with the transfer, and the transfer shall not break the continuity of the period of employment.

This section was often interpreted to determine issues on continuity of employment where there had been a business transfer and the employee continued his or her work as normal with the new employer.[26]

5.3.3 The Redundancy Payments Act 1965

Two years after the CEA was enacted, it was followed by the Redundancy Payments Act of 1965 (RPA). The RPA carried forward the employment conditions that were put in place by the CEA 1963. The RPA provided that the computation of the period of an employee's period of continuous employment must take into account his or her employment with a previous employer.[27] This provision was subsequently re-enacted in Schedule 1 to the Contracts of Employment Act 1972 (see above. Thereafter, it was consolidated into Schedule 13, paragraph 17 (2) to the Employment Protection (Consolidation) Act 1978 (EP (C) A). The RPA was subsequently consolidated into the EP(C) A 1978 which became Part VI of that Act.[28] This provision has now been consolidated by the Employment Rights Act 1996 discussed below.

5.3.4 The Employment Rights Act 1996

The provisions of Part VI of the Employment Protection (Consolidation) Act 1978 are consolidated as Part XI of the Employment Rights Act 1996 (ERA). The provisions of Schedule 13, paragraph 17 (2) to EP(C) A are now found in Section 218 (2) of the ERA. This is the section of the home grown law that allows, in the special case of employment by a number of different employers, an employee's service periods with those previous employers to be carried over to a new employment where the business or undertaking employing him or her is transferred from one employer to another in which the employee in question is

[26] See e.g. *Young v Daniel Thwaites & Co Ltd* [1977] ICR 877.
[27] See s. 8 of the RPA 1965
[28] See ss. 81-120.

part of the transfer.[29] This then raises the question as to whether there is possible overlap between section 218 and TUPE on continuity of employment. This is further explored below.

5.4 Overlap between section 218 of ERA and TUPE

Whilst the cornerstone of the Transfer Regulations (discussed below) is the automatic transfer of the employees' contracts of employment from the transferor to the transferee,[30] no express mention of continuity of employment is made in them. TUPE may be silent on continuity, but there is no doubt whatsoever that once the employee's contract transfers to the transferee, the employee's service years in previous employments is carried over to the new employment. Continuity of service is not broken. In a similar vein, section 218 of ERA 1996 also preserves continuity of employment where there is a change in ownership of a business.

The existence of two separate pieces of legislations preserving continuity of employment may be problematic in circumstances where continuity of employment is litigated given that the Transfer Regulations have not been repealed, altered or amended Section 218 ERA in any way. Difficulties may arise regarding which of these two laws should apply in a dispute. The contention might be whether the Transfer Regulations or section 218 of ERA 1996 is the applicable law. It appears that in an unfair dismissal scenario in which continuity of employment is at issue, the Transfer Regulations may not provide the best channel for a claimant to establish continuity of employment. To succeed, rather than rely on the provisions of TUPE, the claimant might have recourse to section 218 of ERA.[31]

This is not to say that TUPE is ineffective in this regard. In fact regulation 4 goes further than section 218 in that a relevant transfer has the effect of automatically transferring the employees' contracts of employment to the transferee. The point

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[29] Section 218 (2) (a) & (b) provide: If a trade or business, or an undertaking (whether or not established by or under an Act), is transferred from one person to another –

> (a) the period of employment of an employee in the trade or business or undertaking at the time of the transfer counts as a period of employment with the transferee, and
> (b) the transfer does not break the continuity of the period of employment.

[30] See TUPE 2006, Reg. 4.

[31] On the problem and uncertainty surrounding this point, see the recent case of *Oakland v Wellswood (Yorkshire) Ltd* [2009] IRLR 250. This case is discussed in detail in chapter 7 of this thesis.

however, is simply that section 218 ERA may be best suited for determining continuity of employment in TUPE and non-TUPE transfer situations.

5.5 The transfer regulations: heralding a new era in business transfers

Under the common law, the employment relationship was strictly contractual. This meant that unless the employment contract expressively granted employment protection rights to the employee, he or she remained, at common law, unprotected when a business was transferred from one employer to another.[32] The common law no longer determines what rights employees have during transfers of undertakings in the UK.[33] Currently, the rights of the employees during a business transfer are statutorily regulated (see TUPE Regulations below).

Statutory regulation of employees' rights in business transfers is a relatively new phase in UK business transfer law space. It is a phase made possible by the emergence of more positive legal and extra-legal institutional structures for the protection of the employees' rights during transfers of undertakings. In other words, this new phase has led to the enforcement of mandatory and some non-derogable employment standards in the UK. It is fair to say therefore that, in the context of UK business transfers, the protections employees enjoy currently were externally induced. They are primarily of European labour law emanation. They are as a result of the government's fulfilment of its obligation to implement an EU directive (the ARD)[34] in the UK.

This new approach to employee protection during transfers of undertakings is problematic in the UK. It does not conform to the traditional common law rule on transfers *vis-a-vis* the rights of parties. Contrary to the prevailing norm where the employer had unfettered discretion to restructure his business, the new legal

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[32] Wanjiru Njoya, *Property in Work: The Employment Relationship in the Anglo-American Firm* (Ashgate Publishing Ltd, 2000) 55.

[33] There were cases which, prior to the first Transfer Regulations in 1981, recognised the inherent weakness of the common law and the injustice that it visited on employees during business transfers. See e.g. *Woodhouse v Peter Brotherhood Ltd* [1972] ICR 186 CA*; Melon v Hector Powe Ltd* [1981] ICR 43 HL. In *Woodhouse*, however, one important factor in a going concern transfer – goodwill - was missing. See *HA Rencoule (Joineries and Shopfitters) Ltd v Hunt* (1967) 2 ITR 475; *Kenmir Ltd v Frizzell* [1968] 1 All ER 414.

[34] Employment protection legislation is part of the EU's effort to enact legislation on social policy for the Community. The origin of employment protection laws as a social policy instrument is discussed in chapter 3.

order limits (without completely destroying however) that prerogative. It is, arguably, a phase which operates to tip the balance in favour of suppliers of labour (employees) as against those who engage the services of labour (employers) during transfers of, especially, insolvent businesses in the UK.[35] This has resulted in a conflict between the rights of the employees and those of the employers in business reorganisations in the context of insolvency. It has also created a tension between saving insolvent businesses and protecting the rights of employees during going concern transfers of insolvent undertakings in the UK.

TUPE is the herald of this new wave in employee protection during transfers of undertakings (solvent or insolvent) occurring in the UK. As far as the protection of rights in business transfer scenarios is concerned, TUPE swings the pendulum towards the employees. Below, we consider briefly, the origin of TUPE.

5.6 TUPE and transfer of undertakings: overview on its origin

When the ARD was adopted in 1977, all Member States without laws compliant with the directive had an obligation to transpose the ARD into their domestic laws within a two-year time period.[36] The UK did not have such a law in place and so the government had to enact implementing legislation to bring the ARD into effect. It was through the UK fulfilling its EU obligation of implementing the ARD

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[35]Arguably, legislation seeking to protect the interests of the employees and vest in them rights they hitherto did not have in business transfers is a form of 'social engineering.' It involves the re-ordering of existing social arrangement *vis-a-vis* business transfers. Law, according to Roscoe Pound, is a tool for social engineering. Law is concerned with the ordering of human relations. See Roscoe Pound, *Jurisprudence* (West Publishing Co., St. Paul, Minn 1959) 27-68. However, in choosing between social arrangements, it is important not to lose sight of the fact that while a change in the existing order (here the common law employer's freedom to restructure his business and terminate all contracts of employment where that is necessary to save the business) will tilt the balance in favour of the employees (i.e. the transfer of their employment contracts/continuity of employment on the same terms and conditions to the transferee). It could, under certain circumstances (e.g. insolvency), be disadvantageous to the wellbeing of legal persons and ultimately of the employees themselves. It is therefore pertinent to always take into account the overall cost involved in making a change to an existing social arrangement (R Coase, 'The Problem of Social Cost' (1960) 3 (1) J L Econ. 44) which in context of this thesis is the movement away from the old common law system on transfers to the new statute-based governance in business transfers. After all, the proper end of legislation is to make political and economic conditions such that one party while seeking its own good, will not inflict suffering upon others (See John Dewey, *Ethics* (Forgotten Books, 2010) 296). The point here is that efforts must be made to ensure that the new employment rights that legislation will give to the employees during transfers of insolvent businesses, in particular, does not deter the purchase and hence rescues of such businesses resulting, ultimately, in job losses for the employees whom the law was meant to protect in the first place.

[36] ARD 1977, Article 8 (1).

that TUPE became part of UK employment law. TUPE is a statutory instrument,[37] adopted under the European Communities Act (ECA) of 1972 for the purpose of giving effect to an EU directive.

TUPE began life with problems. The Conservative Government, to whom the task of adopting the Regulations fell, was very reluctant to bring them into force.[38] TUPE was perceived as an employment protection law with potentially detrimental effects on employment prospects for UK workers.[39] Perhaps this concern was the reason why the Conservative Government of the day procrastinated in implementing the ARD. Perhaps the delay in giving effect to the ARD, and the lackadaisical manner in which it was eventually done[40] was purely political[41] in the sense that the government did not want to be seen as giving teeth

[37] Statutory Instruments are a form of legislation that allows provisions of an Act of Parliament to be subsequently brought into force, amended or altered by a primary legislation (if the Act contains a Henry VIII clause permitting it) without Parliament having to pass a new Act. See E.g. first Report of the House of Lords Select Committee on the Scrutiny of Delegated Powers of 1992-93 [HL 57 1992-93, para 10]. The clause derived its name from the Statute of Proclamations 1539, which gave King Henry VIII power to legislate by proclamation. Statutory Instruments are also referred to variously as secondary, delegated or subordinate legislation. Statutory instruments (SI) come in a variety of forms. Regulation is an example of SI. Statutory Instruments are a part of the law of England in the same way Acts of Parliament are. Acts of Parliaments are supreme and may overturn the common law. See e.g. *Burmah Oil Company Ltd v Lord Advocate* [1965] AC 75.

[38] See opinion of Mr Michael Meacher in the House of Commons debates: Hansard HC Deb. 06 February 1996 vol 271 cols 197-238 (see especially pt. 22). The Conservative Government of the day perceived the ARD as a social policy which required a trade-off between economic and social rights. They had always been of the view that the ARD would preserve pockets of inefficiency and induce distortionary compliance behavior in the UK economy. Nick Adnett, 'The Acquired Rights Directive and Compulsory Competitive Tendering in the UK: An Economic Perspective' (1998) Eur. J. of Law & Econs. 69, 70.

[39] R Lewis and B Simpson, *Striking A Balance? Employment Law after The 1980 Act,* (Martin Robertson & Co Ltd, Oxford 1981) 23.

[40] It is on record that when the draft Transfer Regulations were introduced on the floor of the House of Commons for adoption, the government spokesman at the time (David Waddington, MP, who was the Under Secretary for Employment), said that he was recommending them with 'a remarkable lack of enthusiasm' because according to him, the Government was implementing '...what may be thought a nonsensical bargain—or perhaps a good bargain—struck by the previous Government'. See Hansard, HC Deb. Vol. 14 col. 680.

[41] It is noteworthy that although the ARD was adopted during the British Presidency of the then EEC, it was adopted by a Labour Government. The problem was that it was left to a Conservative Government to implement. This was rather unfortunate given that the Conservative Government of the day did not subscribe to the idea of legislating on employment matters and was very unwilling to surrender control in that regard to the EU. For criticisms of the Government's attitude to the ARD, see the view of Harold Walker, MP, who described the legislation that finally made it to the HC for adoption as a 'butchered version' that 'suffered from political prejudice- and the interests of the Government's friends in the city-to the detriment of the spirit and intention, and indeed, the words of the EEC directive which gave birth to those regulations' Hansard, HC Deb. 7 December 1981 vol. 14, col. 685. See also the view expressed by Lord Wedderburn in the House of Lords, Hansard, HL Deb. 10 December 1981, vol 425, col. 1490.

to the type of employment policy it has always derided.[42] TUPE was adopted in the UK belatedly and, only after the EU Commission pursued infraction proceedings against the UK because it failed to honour the dateline for implementing the ARD.[43] With this kind of attitude, it is hardly difficult to appreciate why the first generation Transfer Regulations was controversial and its application to transfers in the UK very problematic. This was especially true of the 1981 Regulations in the context of insolvent business transfers discussed in chapter 6. Below we consider the purpose and effects of TUPE.

5.6.1 Purpose and Effects of TUPE

The Transfer Regulations were enacted in the UK to give effect to the ARD on the safeguarding of the employees' rights during business transfers. Like the parent law, TUPE is essentially 'social legislation'[44] for offering greater protection to employees impacted by business transfers where there is a change of employer.[45] The essence of the policy underlying the TUPE Regulations is contained in Regulation 4 which provides for the automatic transfer of contracts of employment to the transferee except where an employee objects[46] to the transfer. The aim is to ensure, as far as possible, that the contracts of employment of the affected employees continue unchanged with the transferee. Put differently, the

[42] The Conservative Government in power then had a deep suspicion of the value of regulating the labour market. This suspicion was rife whether or not the particular regulation derived from legislation directly regulating employment relationships or from collectively established norms between employers and the trade unions. Simon Deakin, 'Transcending the Flexibility Debate? Deregulation and Employment in Britain 1979-1997' (1999) ESRC Centre for Business Research, University of Cambridge Working Paper No. 13. <http://www.cbr.cam.ac.uk/pdf/wp132.pdf> accessed 11 November 2011; Catherine Barnard and Simon Deakin, 'In Search of Coherence: Social Policy, the Single Market and Fundamental Rights' (2000) 32 Industrial Relations Journal 331-345. Collective bargaining which denotes the negotiation of pay and other conditions of employment between an employer (or a group of employers) and a trade union acting for its members is a key focus in industrial relations. P Edwards, 'The Employment Relationship and the Field of Industrial Relations' <http://www.blackwellpublishing.com/content/BPL_Images/Content_store/Sample_chapter/9780631222576/Edwards_C01.pdf> accessed 26 December 2011.

[43] C Brewster and P Teague, *European Community Social Policy and its Impact on the UK* (Institute of Personnel Management, London 1989) 120-21; W Derbyshire, S Hardy and S Maffey, *TUPE: Law and Practice: An Overview of the New TUPE Regulations 2006* (Spiramus Press Ltd, London 2006) .

[44] Frisby (n 12).

[45] Smit has articulated that in relation to the parent law (ARD) 'this essentially social objective was added by the court, rather than by the Commission, and [that] the objective at the start certainly was to prevent unfair advantages existing between member states'. See Nicola Smit, 'Automatic Transfer of Employment Contracts and the Power to Object' (2003) Journal of South African Law 465, 467.

[46] The courts have held in several cases that the transfer of contracts and other rights from the transferor to the transferee is automatic whether the transferee consents to it, or opposes this consequence. See generally *Rotsart de Hertaling v J Benoidt SA* [1997] IRLA; *Celtic v Astley* [2005] IRLA 649; *Newns v British Airways Plc* [1992] IRLR 525 CA.

contracts are to have effect after the transfer as if originally made between the transferred employees and the transferee. The policy behind this provision is to prevent the workers affected by the transfer from being placed in a less favourable position solely as a result of the transfer.[47]

Whilst the automatic transfer of contracts where there are transfers is done in the interests of the employees, does this practice not offer to the law a principle which detracts from the notion, which Lord Atkins in *Nokes v Doncaster Amalgamated Collieries Ltd*[48] said was fundamental to UK employment law? [49] That is, the principle that the services of an employee should not be transferred from one employer to another without the consent of the employee, because that is what distinguishes the employee from the serf. Commenting on the automatic and 'compulsory' TUPE transfer rule, Collins has articulated that the Regulations produce the ultimate commodification of labour because with TUPE the employees become intangible assets, to be sold along with 'lock, stock and barrel' at the transferor's discretion.[50]

The automatic transfer of contract is of course not the only effect of TUPE. There are several other effects. From the transferee's perspective, the effect of TUPE is that where TUPE applies to a transfer, liability for anything done by the transferor before the transfer passes to the transferee. [51] This is because the transferee mandatorily steps into the shoes of the transferor inheriting virtually all of the latter's rights, powers, duties and liabilities[52] in respect of the transferor's employees employed in the undertaking or business 'immediately before'[53] the transfer.

The obverse of the automatic transfer of contract rule is that, upon the happening of a relevant TUPE transfer (and subject to the employee's right to object to transfer under regulation 4 (7) not being activated), the transferor rids himself of the employees as well as the obligations incurred under their contracts of employment by transferring them to the transferee without the consent of the

[47] The ECJ has emphasised this point in relation to the parent law (ARD) in several caes. See e.g. Case C-362/89 *D'Urso v Ercole Marelli Elettromeccanica Generale SpA* [1992] ECR I-4105 (para 9).
[48] [1940] AC 1014 HL.
[49] See Lord Wedderburn in House of Lords' debates on TUPE. See Hansard, HL Deb 10 December 1981 vol 425 col 1490.
[50] Hugh Collins, 'Dismissals on Transfer of a Business' (1986) 15 (1) ILJ 244, 247.
[51] TUPE 2006, Reg. 4 (2).
[52] The liabilities that will transfer in the context of a TUPE transfer are discussed in chapter 6.
[53] The meaning of these words is considered below.

employees concerned.[54] The implication is that where the transferee refuses to take the workforce on, the transferor would be absolved from making redundancy payments since the employee's previous right to claim against him is no longer applicable. It is the transferee that will be responsible for any redundancy payments to be made. Evidently, TUPE imposes enormous costs on business rescues if the transferee becomes subject to these types of liabilities.

A TUPE transfer also imposes information and consultation duties on the employer.[55] Long before a relevant transfer, the employer is obliged to consult[56] with the employees' representatives and inform them of the proposed transfer, date or proposed date of the transfer, the legal, economic and social implications of the transfer for any affected employees, the measures he envisages to take in connection with the transfer. Also, if an employee is dismissed, before or after a business transfer, the relevant employer may be liable for unfair dismissal if the sole or principal reason for the employee's dismissal is the transfer itself or 'a reason connected with the transfer that is not an economic, technical or organisational (ETO) reasons entailing changes in the workforce.[57]

The flip side to the dismissal conundrum is that TUPE allows an employee to be dismissed for ETO reasons which entail changes in the workforce. There is the view that the reason why TUPE allows dismissals for ETO reasons which entail changes in the workforce is because since the Regulations derived from the then EEC directive – the 1977 ARD, they were 'shot through with the competitive assumptions of the European Economic Community'.[58]

In sum, these are some of the provisions of TUPE that have been very problematic when the regime is applied in the context of insolvency.[59] These provisions have created a tension between business rescue and employment in going concern rescues of insolvent businesses in the UK.

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[54] See e.g. *Newns v British Airways Plc* [1992] IRLR 525 CA; *Gabriel v Peninsula Business Services & Anor* [2012] UKEAT 0190 11 2302.

[55] See generally TUPE 2006, Regs. 13 - 15.

[56] Case law has established that the requirement to consult with employees under TUPE applies whether or not the transfer actually takes place. See e.g. *Banking Insurance and Finance Union v Barclays Bank Plc* [1988] 3 CMLR 587; *South Durham HA v UNISON* [1995] ICR 495.

[57] TUPE 2006, Reg. 7.

[58] Lord McCarthy, Hansard, HL Deb 10 December 1981 vol 425 cc 1482-501.

[59] This argument is developed further in chapter 6 of this thesis.

5.6.2 Scope of TUPE Regulations

The Transfer Regulations apply to a range of business transfer situations where there is a transfer of control of an 'economic entity.' [60] These include the sale of part,[61] or of the whole of the business (solvent or insolvent)[62] executed through a binding agreement between the parties. TUPE also applies to transfers of subsidy[63] and franchise.[64] Transfers by gifts[65]and by lease[66] are caught by them. The transfer of licences[67] and transfers between subsidiaries[68] are not exempt. The transfer of services,[69] transfer by succession, transfer by operation of law[70] or by a court order creating a transfer all constitute 'relevant transfers'[71] and come within the scope of the 2006 Transfer Regulations.

Not all types of transfers are covered by the Transfer Regulations. For any type of transfer not covered, the consequence is that the protection of the Regulations will not avail the employees affected by such a transfer. The re-organisation of public administrative authorities or the transfer of administrative functions between public administrative authorities is not, by virtue of Regulation 3(5) of TUPE 2006, a relevant transfer.

TUPE does not apply to transfers by way of share sales. This is because transfer by way of share sale does not constitute a 'relevant transfer.' The consensus at the time TUPE was enacted was that it should be confined to the traditional business takeover method[72] in which the business is transferred from employer (often corporate) to another. The reference to a 'transfer to another person'[73] imposes the main limitation that TUPE has never applied to a business transferred by way of share capital takeover. There is, technically, no business transfer from one

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[60] TUPE 2006, reg. 3 (1) (a).
[61] See *GD Ault (Isle of Wight) Ltd v Gregory* (1986) KIR 590, 2ITR, 30, Div Ct. See also *Secretary of State for Employment v Spence* [1986] 3All ER 616.
[62] There is no distinction between a solvent and insolvent business in the TUPE Regulations. See TUPE 2006, Reg. 3.
[63] See *Dr Sophie Redmond Stichting v Bartol* (C-29/91) [1992] IRLR 366.
[64] *Merckx & another v Ford Motor Co. Belgium SA* (C-171, 172/94) [1996] IRLR 467, ECJ.
[65] *Brooks v The Grays Co-operative Society Ltd* [1967] ITR 345.
[66] *Berg & Busschers v Besselsen* (C-144, 145/87) [1989] IRLR 447, [1990] ICR 396, ECJ.
[67] *CWW Logistics v Ronald & Digital Equipment (Scotland) Ltd* (EAT, 22 April 2002).
[68] See *Allen v Amalgamated Construction Co. Ltd* [2000] IRLR 119, ECJ.
[69] *Kenny v South Manchester College* [1993] IRLR 265.
[70] *Charlton v Charlton Thermosystems (Romsey) Ltd* [1995] IRLR 79, [1995] ICR 56.
[71] The concept of 'relevant transfer' is addressed below.
[72] John McMullen, 'Atypical Transfers, Atypical Workers and Atypical Employment Structures – A Case for Greater Transparency in Employment Issues'(1996) 25 (4) ILJ 286-307.
[73] TUPE 2006, Reg. 3 (1) (a).

person *to another* in a share takeover since the legal identity or personality of the corporate employer does not change.[74] TUPE will not apply to transfer by way of share purchases even if such a tactic is adopted deliberately to avoid the effects of the Regulations.[75]

5.6.2.1 Exclusion of share transfer: Possible effects on employees

Although the legal identity of the corporate employer does not change merely on account of a change in the identity of the principal shareholder(s) in a share transfer, it cannot be said with certainty that the result of a change in *control* may not, in some way, be 'ruinous' for the employees in the same way a business transfer carried out by other means could be in the absence of TUPE.[76]

A transfer by share takeover could have several consequences for the employees. The fact that the employees' contracts of employment continue in a takeover by share acquisition does not constitute complete protection from adverse consequences. It seems also that if an employee is dismissed in the course of a transfer by share takeover, such a dismissal is not likely to engage the protection against unfair dismissal rule under Regulation 7 in comparison to a dismissal made in relevant TUPE transfers which would be automatically unfair. In effect, the employees' job security could be jeopardised as the Kraft-Cadbury takeover by share acquisition, for example, has shown. When the US food firm (Kraft P) was taking over the UK chocolate firm (Cadbury), Kraft promised to keep open Cadbury's Somerdale chocolate factory near Bristol. Soon after the deal was done, Kraft reneged on its promise and shut the factory that employed 400 staff.

Even in circumstances where the company taken over continues to trade, should the new controlling shareholder decide to implement strategies for redundancies or business reorganisation, job security could still be at risk. There is no legal requirement, for example, that such policies must be discussed with Union representatives prior to the share transfer as would be the case in a typical business transfer which TUPE applies. Thus, the employees affected would have

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[74] *Henry v London General Transport Services Ltd* EAT/960/97

[75] *See e.g. Brooks v Borough Care Services* [1998] IRLR 636 (EAT).

[76] See e.g. M R Freedland, *The Contract of Employment* (Oxford, Clarendon Press, 1976) 341; P L Davies, *The Regulation of Takeovers and Mergers,* (London, 1976) Chapter VIII. See also Bob Hepple, 'Workers' Rights in Mergers and Takeovers: The EEC Proposals' (1976) 5 ILJ 197, 201; R W Painter and A E M Holmes, *Cases and Materials on Employment Law,* (8th edn, OUP, Oxford 2010) 590.

been deprived of the information and consultation rights that TUPE gives employees in transfers.

The controlling shareholder may also want to introduce, for example, new policies and ideas for change. He or she may change (without consultation) the non-contractual work situation of the workers. Opportunities for voluntary overtime and other fringe benefits, for example, may be reduced as a result of a decision to transfer work to other plants. The employees may be compelled by economic pressures to accept these changes even though these are not advantageous to them. Also, the need to integrate the employees of the acquired company into the existing workforce of the controlling shareholder could adversely affect prospects of promotion for the employees.

5.7 TUPE and the notion of 'relevant transfer'

One of the accusations that were often levelled against the old TUPE Regulations was that there was a high degree of uncertainty surrounding when a transfer took place.[77] It appears that is a generic problem in the sense that it is not confined to the Transfer Regulations. It is one problem that has plagued the parent law (ARD) as well.[78] Arguably, a significant number of often conflicting cases which the 1981 Transfer Regulations generated had to do with whether or not a transfer had actually occurred.[79]

However, no inference should be drawn that the problem has abated under the 2006 Transfer Regulations because it has not. The revised Transfer Regulations

[77] M Dulovic, 'A Sense of Deja-Vu: Remedies in Employment Claims', cited by K Williams & N Johnson, 'Transferring Employment between the Public and Private Sectors in the United Kingdom: Acquired Rights and Revising TUPE' (2007) <http://shura.shu.ac.uk/707/1/fulltext.pdf> accessed 01 February 2009.

[78] The difficulty encountered in determining when there is a 'relevant transfer' under the ARD has arisen mainly in relation to service provision transfers. This is hardly surprising given that the ARD was conceived mainly to regulate mergers and acquisitions. The outsourcing industry and support services companies were not as active in the mid-1970s as they are today. See R Upex & M Ryley, *TUPE: Law and Practice* (Bristol, Jordan Publishing Limited, 2006) 46. Service provision changes which constitute the second type of relevant TUPE-transfer are outside the purview of this thesis. However, this is dealt with under Reg. 3 (1) (b) of TUPE 2006. See further Giuseppe Sigillo Massara, 'Transfer of Undertakings: Insolvency Proceedings in the United Kingdom and in Italy and the European Court of Justice Case Law' in *Compliance with Labour Legislation: Efficacy and Efficiency* (2010) Labour Administration and Inspection Programme, ILO Working Document (No 6) 74.

[79] Oliver Hyms, *Employment Aspects of Business Reorganisations* (OUP, Oxford 2006); Upex & Ryley (n 77) above; John McMullen, 'An analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' (2006) 35 ILJ 113-139.

have not done much in terms of defining what a relevant transfer of an undertaking is. The definition of a 'transfer' offered by TUPE 2006 simply reflects the meaning of a 'transfer' contained in the 2001 ARD.[80] This definition is copied out from the spectrum of decisions made by the European court on the subject matter (see discussion on the ARD in chapter 4).

The difficulty with the notion of 'relevant transfer' relates to ascertaining whether there has, in fact, been a transfer of an undertaking or not.[81] According to Regulation 3, TUPE applies to the:

> …transfer of an undertaking, business or part of an undertaking or business situated immediately before the transfer in the United Kingdom to another person where there is a transfer of an economic entity which retains its identity…[82]

From the above statement, it appears that for a business transfer to be deemed a 'relevant transfer' under the TUPE Regulations, four key conditions would have to be satisfied. The first major condition is that the entity transferred must have been 'situated immediately before the transfer' in the UK.[83] The second condition is that the business or undertaking the subject of transfer must have been transferred from one person to another in any of the legally acceptable modes of transfer listed above (see scope of TUPE in secion 5.6.2).

The third subsidiary rule is that there must be an identifiable 'economic entity'[84] meaning 'an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is 'central or ancillary'[85] to its function.[86] The fourth condition is that not only must the economic entity in

[80] See Article 1 (1) (a) ARD 2001.
[81] It could be argued, on the other hand, that in relation to the acquisition of a business, there is hardly any difficulty in deciding if the Transfer Regulations apply. Those who buy businesses seek to acquire an economic entity. In other words, economic entity is, arguably the only thing with value within the target which any buyer seeks to acquire. See Upex & Ryley (n 6) 46. What constitutes an 'economic entity' was first defined by the ECJ in *Spijkers v Gebroeders Benedik Abattoir CV* [1986] 2 CMLR 296.
[82] TUPE 2006, Reg. 3 (1) (a)
[83] Regulation 3(1) a) TUPE 2006.
[84] See *Whitewater Leisure Management Ltd v Barnes and ors* [2000] IRLR 456, EAT.
[85] TUPE 2006, Reg. 3 (2).
[86] According to the jurisprudence of the European court, an organised grouping of wage-earners who are specifically and permanently assigned to a common task may in the absence of other factors of production, amount to an economic entity. See e.g. *Francisco Hernández Vidal SA v Gómez Pérez and others* [1999] IRLR 132 ECJ*; Sánchez Hidalgo and others v Asociación de Servicios Aser and Cooperativa Minerva* [1999] IRLR 136 ECJ.

question be capable of being transferred to 'another person,'[87] it must retain its identity post-transfer.[88] What this simply means is that after an economic entity has been transferred from one 'person' to another, its operation must be continued or resumed with the same or similar activities as was the case prior to the transfer.[89] This condition carries also the implication that assets sale is not a relevant transfer under TUPE because it does not satisfy the 'economic entity' test. It remains the case that the question regarding whether 'economic entity' exists in assets sales is a question of facts for the tribunal to decide. The difficulty however, is that since 'appeals from an Employment Tribunal to the Employment Appeal Tribunal lie only on questions of law, and not on questions of fact, decisions in this area are, in theory, difficult to challenge'.[90]

5.8 Conclusion

Before 1981, if a business was sold as a going concern in the UK all contracts of employment terminated. Today, business sales no longer have this effect due to TUPE. If TUPE applies to the sale employees' contracts of employment automatically transfer to the purchaser. From the employees' perspective therefore, TUPE is certainly not a bad law. TUPE is not a home grown law. It has its origin in the European ARD. It follows that how TUPE is applied to business transfers in the UK is heavily influenced by European law. It is almost impossible to consider any point relating to TUPE in the UK without reference, at least, to one ECJ decision. Courts in the UK have adopted widely purposive (as opposed to literal) construction of TUPE's provisions in order to achieve the effect intended by the parent law – the ARD.

The House of Lords has often construed the Regulations purposively and, in accordance with ECJ's decisions upon corresponding provisions of the Directive,

[87] *Whitewater Leisure Management Ltd v Barnes and ors* [2000] IRLR 456, EAT.
[88] *Spijkers v Gebroeders Benedik Abattoir CV* [1996] 2 CMLR 296. See also *Mathieson, Cheyne v United News Shops Ltd* EAT 554/94.
[89] ibid. See also *Allen and others v Amalgamated Construction Co Ltd* [2000] IRLR 119 ECJ. As far as UK case-law is concerned, the main guidance on the retention of identity post-transfer was laid down by the EAT in the case of *Cheesman and ors v R Brewer Contractors Ltd* [2001] IRLR 144, EAT in which the tribunal states, *inter alia,* that : 'As to whether there is an undertaking, there need to be found a stable economic entity whose activity is not limited to performing one specific works contract, an organised grouping of persons and assets enabling (or facilitating) the exercise of an economic activity which pursues a specific objective...'
[90] *Transfer of Undertakings: Employment Law Handbook* (Incomes Data Services, London 2011) 11.

which Parliament intended TUPE to effectuate.[91] It follows that a concept, such as 'relevant transfer' as it is understood today is nothing but a 'judicially constructed fiction' resulting from the creativity of the courts and employment tribunals and the desire to give TUPE the purposive construction required so that the rights of the employees in transfers can be maximally protected.

Granted, the more types of transfer scenarios that are brought within the meaning of TUPE 'transfer' as a result of the 'judicial engineering',[92] the better this is for the employees. This, in theoretical terms, will be seen by the employee protection acolytes (see discussion of the Traditionalists and their employee protection in business transfers standpoint in chapter 2) as a very important way of providing protection to the rights of employees in different transfer modes. This school of thought would argue that employees' rights in transfer situations would not be effectively protected save for this type of inventiveness by the courts. There is the view however that the rights which were intended for the employees by the ARD have been snatched away 'like some bicycle thief snatching purses in the night'[93] by TUPE due to the purposive interpretation approach adopted by the courts. The point here is that the protective disposition towards the employees, especially in relation to insolvent transfers (discussed in the next chapter), may not be in the best interests of the employees themselves. It may deter potential buyers of such businesses. To that end, TUPE impacts negatively on the rescue culture.

The discussion in the next chapter will centre on TUPE and its application to insolvency.

[91] See e.g. *Pickstone v Freemans plc* [1989] AC 66; *Litster v Forth Dry Dock & Engineering Co Ltd* [1990] 1 AC 546.

[92] 'Judicial engineering' is used here to imply the interpretation of statutory provisions to give it its intended effect even if doing so would involve departing from the strict and literal application of the words which the legislature used. In effect, this is a way of using the judicial system as a tool for 'social engineering' in business transfer scenarios. The term 'social engineering' was coined by Roscoe Pound. See Roscoe Pound, *Jurisprudence* Vol. III (The Law Book Exchange Ltd, 2000). Pound used this term to mean finding a balance between the competing interests in society. What calls for social engineering in business transfers is the conflict of interests of employees and employers. TUPE is a social legislation that is meant to promote social justice for employees during business transfers (on the notion that TUPE is a social legislation, see Sandra Frisby (n 12) above). But whether judicial engineering actually promotes social justice better than strict legal interpretation is a moot point.

[93] Lord Wedderburn, Hansard, HL Deb 10 December 1981 vol. 425 col. 1490.

CHAPTER SIX

THE TRANSFER REGULATIONS: APPLICATION AND EFFECTS ON INSOLVENT BUSINESSES IN THE UNITED KINGDOM

6.1 Introduction

The Transfer Regulations discussed in chapter 5 have been central to the conflict between business rescue and employment protection.[1] Granted, in the context of a business transfer, the employees are usually one of the most affected groups in the business[2] in terms of job security. The employees deserve protection especially when their corporate employer becomes insolvent and is sold to a third purchaser so that the new owner does not walk over their rights. TUPE is social legislation enacted to remedy the hardship the common law visited on the employees in business transfer situations. From that perspective, TUPE may be seen as legislative intervention by the state to give some measure of social protection to the constituency (employees) often identified in the literature on corporate insolvency as the most vulnerable.[3]

The problem with legislation (such as TUPE) is that, although it is often enacted to take care of perceived or real problems, legislation could end up creating problems of their own; some of which could be far worse than the ones they were originally intended to solve. Professor Dicey has unequivocally said of legislation that:

> The beneficial effects of state intervention, especially in the form of legislation, are direct, immediate, and so to speak, visible, whilst its evil

[1] Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Rescue and "One Unholy Mess"' [2000] CFIL 249-271; Richard Parr & Nicola Bennett, 'The Recue Culture v Collective Employment Rights' (2005) Insolvency Intelligence 156- 157; David Pollard, 'TUPE and Insolvency: Part 2' (2006) Insolvency Intelligence 102- 108; Jeremy Goldring & Grant Spooner, 'New TUPE Regulations – Impact on Distressed Business Dispositions', (2006) 26 IL &P.

[2] Leslie Braginsky, 'How Changes in Employer Identity Affect Employment Continuity: Comparison of the United States and the United Kingdom' (1995) 16 Comparative Labour Law and Policy Journal 231.

[3] Donald Korobkin, 'Employee Interests in Bankruptcy' (1996) 4 Am. Bankr. Inst. L Rev.; Karen Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U L Q 1031; Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, CT: YUP, 1997); Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee claims' (2008) in P J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, 2008); Vanessa Finch & Sarah Worthington, `The *Pari Passu* Principle and Ranking Restitutionary Rights' in F Rose (ed.) *Restitution and Insolvency* (Mansfield Press, London 2000).

> effects are gradual, indirect and lie out of sight... Hence the majority of mankind must almost of necessity look with undue favour upon governmental intervention...[4]

Professor Dicey's observation holds true in respect of the Transfer Regulations. TUPE has, undeniably, been very effective in safeguarding the rights of employees in business transfer situations, but it has equally impacted negatively on transfers of insolvent business. Some of these negative impacts were either discounted or not contemplated at the time TUPE was enacted.[5] In protecting the employees, the regime has tended to create more problems in the process than it has solved. TUPE protects not just the employees' jobs but also their terms and condition of employment. The employees' contracts with the previous employer are compulsorily transferred to the transferee in the event of a relevant transfer irrespective of the wish of the transferee.[6] There is the perception that TUPE 'over-deters' purchases of insolvent businesses and so undermines the prospect of successful going concern rescues of such businesses in the UK.[7]

To save a financially distressed business by way of a going concern sale, it might sometimes be expedient to scale down the workforce in order to achieve that goal but TUPE makes the use of this strategy very difficult to apply.[8] TUPE's principle

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[4] Albert V Dicey, *Law and Public Opinion in England in the 19th Century,* Richard Vande Wetering (ed) (New Liberty Fund Book, Indianapolis, 2008) 257-58.

[5] Frisby, (n 1).

[6] TUPE 2006, Regs. 4 & 5. See also *Parkwood Leisure Ltd v Alemo-Herron & Ors* [2011] UKSC 26. The meaning of the words 'shall have effect after the transfer as if originally made between the person so employed and the transferee' was explored by Lord Bingham in *North Wales Training and Enterprise Council Ltd v Astley & Ors* [2006] UKHL 29 ('The Celtec case') where he noted that:

> The benign intent of the legislation is not in question. But its effect is, inevitably, to introduce a fictional element into this tripartite relationship, since (where the legislative conditions are satisfied) the employee is treated as having been employed by the new employer all along when in fact such is not the case.

[7] Simon Deakin & John Armour, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) University of Cambridge Working Paper No. 249; John McMullen, 'An analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' [2006] ILJ 113; H Collins, 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144; Wanjiru Njoya, 'The Interface Between Redundancy and TUPE Transfers' (2003) 32 (2) ILJ 123-128; John Armour, Audrey Hsu and Adrian Walters, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings: A Report Prepared for the Insolvency Service' (2006) <http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96...rep...> accessed 18 March 2012; David Burdette, 'Formalities for the Transfer of Insolvent Business: Obligatory Transfer of Employees in South Africa and the United Kingdom' (2007) 3 INSOL International Technical Services Issue.

[8] Frisby (n 1).

of compulsory transfer of employment relationships[9] and the significant liabilities associated with unfair or wrongful dismissals makes downsizing to rescue insolvent businesses difficult. Dismissals can no longer be made, before or after a business transfer, without an economic, technical or organisational (ETO) justification.[10] With TUPE in the picture, it is almost impossible to sell any insolvent businesses, or part of a business (including in a pre-pack), without certain liabilities transferring to the transferee. The problem is that where an insolvent business cannot be sold this could have dire consequences, not just for the continuous existence of the business, but for the employees employed by the business. In the absence of a buyer, the business would be liquidated and given that liquidation is terminal, it inevitably, results in job losses for the employees. In such circumstances, TUPE would be otiose as it would have worked against the very employees it was intended to protect. In other words, employee protection and business rescue do not to go hand in hand.

The purpose of this chapter is to analyse the interplay between employee protection and business rescue policies during going concern transfers of insolvent businesses. The discussion will focus on the negative effects that applying TUPE to insolvency have on rescues of insolvent businesses in the UK. It is intended to critically examine the purposive approach of interpretation that UK courts have been constrained to adopt in relation to TUPE and the negative effects this has had on the rescue culture. This chapter argues that while the purposive interpretation required for construing TUPE may have enhanced the protection of employees' rights in insolvent business transfers, it is has not been helpful to the pursuit of business rescues.

Cases generated by TUPE as a result of its application to insolvency will be analysed and used to demonstrate the ambivalence and the differing effects of the regime on the employees and on the rescue culture in the UK. It will be illustrated that the negative impact TUPE has on the rescues of insolvent businesses is due

[9] TUPE 2006, Reg.4(2).

[10] Giuseppe S Massara, 'Transfer of Undertakings: Insolvency Proceedings in the United Kingdom and in Italy and the European Court of Justice Case Law' (2010) in *Compliance with Labour Legislation: Its Efficacy and Efficiency,* ILO Working Paper <http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---lab_admin/documents/publication/wcms_140685.pdf> accessed 18 March 2012; M Sargeant, 'Transferring Liabilit for Employee claims' (2000) JBL 188- 192; A Kastrinou, N Shah & O Gough, 'Corporate Rescue in the UK and Effect of the TUPE' (2011) 32 (5) Company Lawyer 131; Frisby (n 1); Goldring (n 1).

mainly to the strict conditions TUPE imposes on transferors and transferees alike and the rights it gives to employees during insolvent business transfers.

6.2 TUPE and transfers in the context of insolvency

Under the 1981 TUPE Regulations, it was very problematic determining the scope of the regime. It was not very clear whether or not TUPE applied to transfers effected in the context of insolvency. This was because TUPE 1981 did not contain any special provisions to cater for transfers of insolvent undertakings. This was because the 1981 Regulations failed to expressly include or exclude transfers where the business, the subject of insolvency proceedings (liquidation, administration or receivership) was transferred. The *lacuna* or defect in the 1981 Regulations could be attributed to the parent law- the 1977 ARD (see chapter 4) which failed also to state expressly whether or not a business or undertaking transferred in the context of insolvency was covered.[11]

The absence of any express provisions on TUPE's application or otherwise to transfers in the context of insolvency meant that the responsibility for establishing the precise scope of the regime fell to the courts. To do so, however, the English courts had to look to the European Court of Justice (ECJ) for guidance. TUPE was enacted to implement the ARD. The ECJ is a referral (not appellate) court on all matters of EU law including those arising from the ARD which TUPE implemented.

It follows that the UK courts and employment tribunals, like the courts of all other Member States, are obliged to follow the interpretations of the ARD and decisions handed down by the ECJ[12] in relation to it.[13]

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[11] For analysis on the ARD, see chapter 4.

[12] Under S. 3(1) of the European Communities Act 1972 and in relation to matters of EU law, decisions of the ECJ are binding on all courts up to, and including the Supreme Court of UK. Section 3(1) provides:

> For the purpose of all legal proceedings any question as to the meaning or effect of any of the Treaties, or as to the validity, meaning or effect of any EU instrument, shall be treated as a question of law (and, if not referred to the European Court, be for determination as such in accordance with the principles laid down by and any relevant decision of the European Court).

[13] The problem with this is that the ECJ is not consistent in the way it makes decisions. Often, decisions made by the ECJ conflict with its previous decisions on the same issue. What is more frustrating, perhaps, is the fact the ECJ seldom gives explanations on why it holds a contrary view from its previous view. The court rarely explains whether a particular decision it has made is meant to be of general importance. A good example of this problem is the case of *Boor v Ministere De La*

Regarding whether TUPE 1981 applied or not to transfers of undertakings in the context of insolvency, the guidance that the UK courts got from the ECJ in relation to the parent law (the ARD) on the issue was not very helpful. The available ECJ case-law (see below) which could have provided judicial authority on the matter was tentative. It did not categorically state whether the ARD applied or not to all transfers effected in the context of insolvency. In the leading case of *Abels v Administrative Board of the Bedrijfsvereniging voor de Metaal-Industrie en de Electrotechnische Industrie*[14] the ECJ was asked to decide whether the scope of the ARD extended to a situation in which the transferor of an undertaking who had been adjudged insolvent and was granted a judicial leave to suspend payment of its debts under the Netherlands' equivalent legislation to TUPE.

In its response, the ECJ did not completely rule out the possibility of the ARD applying in such situations. The court said that the ARD did not impose an obligation on the Member States to extend the rules laid down therein to transfers of undertakings, businesses or part of businesses taking place in the context of insolvency proceedings which have been instituted with a view to the liquidation of the transferor's assets and which the proceedings in question is under the supervision of a competent judicial authority. In other words, the ECJ said in paragraph 24 of the *Abels* decision[15] that it was possible for a Member State to apply the principle of the ARD wholly, or in part, to such a business transfer on the basis of their national law alone. It seems the ECJ's response was guided by the perception that applying the ARD to insolvent enterprises might deter potential rescuers and ultimately impact on employees' job security.[16]

The ECJ effectively left the decision on whether or not to apply TUPE to transfers out of insolvency to the courts. The *Abels'* decision did not shed light on whether the ARD, and by extension TUPE, apply to transfers of insolvent undertakings. The decision caused confusions for UK judges and insolvency practitioners alike and

Fonction Publique [2005] IRLR 61 ECJ which was contrary to well established principles on changes to employees' terms and conditions of employment. The ECJ in that case said that it is sometimes legitimate for a transferee employer to vary terms and conditions following, and in connection with a transfer. But no explanation was given of why this case should constitute an exception. The unpredictability of the ECJ regarding the interpretation of the provisions of the ARD is, partly to blame, why TUPE (especially the first generation TUPE Regulations) has generated the mass of case law that it has in the UK. Malcolm Sargeant, 'New Transfer Regulations' (2002) 31 (1) ILJ 35-54

[14] Case C-135/83 [1985] ECR 469.

[15] *Abels* is discussed in details below.

[16] Malcolm Sargeant, 'Business Transfers and Corporate Insolvencies –the Effect of TUPE' (1998) 14 (1) IL & P 8, 11.

led to the view that TUPE *prima facie* applied if the transferor was insolvent and, irrespective of the type of insolvency proceedings that were opened in relation to it, but that the ARD did not necessarily require it to. The confusion may have been due, in part, to the Government's position on the matter. It seems that the UK Government had 'decided' from the outset that if the protections contained in the ARD, (as implemented by TUPE 1981) were to apply to transfers at all, they should do so regardless of whether the transferor was solvent or insolvent.

There were a couple of provisions in the 1981 TUPE Regulations, for example, that pointed to that intent. For example, Regulation 3 (2) which stated that the Regulations apply 'whether the transfer [was] effected by a sale or by some other disposition or by operation of law' gave no indication that transfers by insolvent transferors were not caught by TUPE. In fact, the choice of words Regulation 3 was couched, if anything, gave rise to the notion that TUPE 1981 applied to transfers in all types of insolvency situations including liquidation. For this reason, TUPE was regarded as having a more favourable disposition towards UK employees than did the ARD upon which it is based (see below).

The old Regulation 4 of TUPE 1981(concerning the 'hive-down' mechanism)[17] was also indicative of the Government's intention to apply the Transfer Regulations to insolvent businesses. Regulation 4 did not expressly apply TUPE, but it could be argued that it did so by implication. Regulation 4 provided that where a receiver, an administrator, or a liquidator in a creditors' voluntary winding up hived down the business of the company to a wholly-owned subsidiary before selling the shares or business of the subsidiary to a buyer, the latter transaction alone was to be considered a transfer for the purpose of TUPE.[18]

The reference to insolvency procedures in the old Regulation 4, so the analysis goes, implied that TUPE was intended to apply to insolvent transfers, 'and because such an extension would be more favourable to employees, that was

[17] The purpose of 'hiving down' was well articulated in *Pambakian v Brentford Nylons Ltd* [1978] ICR 665.

[18] See e.g. Gerard McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Edward Edgar Publishing, 2008) 230, Sargeant (n 9); Wynn Derbyshire & Stephen Hardy, *TUPE: Law and Practice* (2nd edn., Spiramus Press, London 2009); McMullen (n 7) John McMullen, 'TUPE Transfers: Changing Conditions of Employment' (2006) <http://www.info4security.com/story.asp?storycode=3081454> accessed 19 August 2011.

permissible under the then Article 7[19](now Article 8)[20] of the ARD.[21] Ironically, while the purpose of the 'hiving-down' provision under Regulation 4 was meant to strengthen the position of insolvent transferors in selling insolvent undertakings, it was not favourable, to say the least, to the interests of the employees whom TUPE was meant to protect.[22] The 'hiving-down' of a business served to defeat the ARD's purpose of enabling existing employees to move across to the transferee with their contracts of employment.[23]

It afforded parties the opportunity to structure transfer transactions in a way that ensured that liability for all employee-related matters remained with the insolvent transferor. It was not surprising that this 'anti-avoidance' technique, designed to evade the protective regime of TUPE was challenged in *Litster and others v Forth Dry Dock and Engineering Ltd.*[24]

The House of Lords held in that case that the automatic transfer provisions applied not only to those employed 'immediately before the transfer'[25] but also to those

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[19] Robin Henry, 'Application of the Proposed TUPE Regulations to Insolvency Proceedings' (2005) Company Law Newsletter.

[20] Article 8 of the ARD 2001 states: ' This Directive shall not affect the right of Member States to apply or introduce laws, regulations or administrative provisions which are more favourable to employees or to promote or permit collective agreements or agreements between social partners more favourable to employees.'

[21] There is doubt, however, whether the 1981 Regulations could validly have introduced provisions more favourable to the employees within the meaning of Article 7 of the 1977 ARD. This is because the 1981 TUPE Regulations were passed as a Statutory Instrument using the special procedure rule of section 2 (2) of the European Communities Act (ECA) 1972 (which deals with transposition of EU directives), rather than by a formal Act of Parliament. The question is whether legislation enacted under section 2(2) ECA 1972 must be directed specifically to the exact implementation of the European obligation, or whether it may go further than the obligation without being *ultra vires* its statutory limit. This issue came to a head in the Scottish case of *Addison v Denholm Ship Management (UK) Ltd,* [1997] ICR 770 where the issue before the EAT was whether regulations made under section 2(2) of ECA 1972 applied to the crew of a floating hotel /ship in the North Sea. The employers of the crew had contended that TUPE 1981 did not intend to confer employment protection upon the crew but that if, on their proper construction, the TUPE Regulations did purport to do so, they would be *ultra vires* since this was not an EU obligation. The EAT was of the view that the words 'related to' in section 2(2)(b) of ECA 1972 (which counsel for the crew sought to rely on) could not be used to enable a minister to widen, by regulation, the main thrust or effect of the Directive it is seeking to implement. The EAT drew from Lord Mackay of Clashfern LC in *Hayward v Cammell Laird Shipbuilders Ltd (No. 2)* [1988] ICR 464, 473 where it observed that as a matter of general law in relation to primary and subordinate legislation, 'if the Directive [ARD] is to be regarded as a parent law, the child [TUPE] cannot be larger, wider, or have greater implications than its parent allows.' Thus, by implication, if the effect of TUPE is to 'confer a lesser exclusion, and less wider benefit, to workers otherwise excluded by the Directive' the former has to be considered *ultra vires* the enabling power.

[22] Henry (n 19).

[23] For the purpose of the ARD and discussion on the ARD generally, see chapter 4.

[24] [1989] ICR 341 (HL).

[25] The meaning of the words 'immediately before the transfer' is considered below.

who could show that they would have been so employed had they not been unfairly dismissed for a reason connected with the transfer.[26] The *Litster* decision made illegal the kind of 'cavalier' treatment the employees were often subjected to during transfers of insolvent undertakings which the Court of Appeal (CA) had indirectly encouraged in its decision in *Secretary of State for Employment v Spence.*[27] The commercial usefulness of 'hiving-down' was effectively halted by the court in *Re Maxwell Fleet and Facilities Management Ltd (in Administration).*[28]

Prior to *Litster* and *Maxwell* respectively, the CA had held in *Spence,* that contracts of employment of employees who were dismissed roughly 4 hours before a business transfer took place, did not transfer to the transferee.[29] This interpretation drew lots of criticisms. It tended to render compliance with TUPE's obligations 'voluntary'[30] and provided strong economic incentives for the transferee to collude with the transferor to effect such dismissals so as to avoid or limit costs payable as compensation for unfair dismissal and redundancy.[31] It is possible that by inserting the 'hiving-down' principle into the original Transfer Regulations, the Government must have anticipated that TUPE would constitute a major impediment to going concern transfers of insolvent businesses.

6.3 The Transfer Regulations and insolvent businesses: conflict between the 'rescue culture'[32] and employee protection

In the event of a business transfer, the employee, his contract of employment and all rights and liabilities arising in connection with his employment contract, automatically transfer to the transferee. The employee's consent is not

[26] In accordance with the old Regulation 8 of the 1981 TUPE Regulations (now Regulation 7(1)).
[27] [1986] ICR 651 (CA). This case is discussed in detail below.
[28] [2000] IRLR 368.
[29] This pattern of interpretation continued in subsequent cases even after *Litster.* Some of these cases are discussed the section on 'transfer-connected' dismissals below.
[30] Paul Davies, 'Amendments to the Acquired Rights Directive' (1988) 17 ILJ 249, 250.
[31] H Collins, 'Transfer of Undertakings and Insolvency' (1986) 15 ILJ 144, 150.
[32] The term 'rescue culture' as used here denotes the legal and institutional responses to financial distress that is aimed, first and foremost, at saving a company experiencing cash-flow difficulty, and where that proves impossible, save the company's business as a going concern, rather than simply shutting it down and distributing proceeds to creditors at the earliest sign of corporate ill-health. See also definition of terms in chapter 1.

necessary[33] and the transfer is effective whether or not the employee was aware of the transfer and the identity of the transferee before the transfer.[34]

In practice, applying TUPE to insolvency has created a tension between business rescue and employee protection. TUPE has been criticized for bringing confusion in business transfers in the context of insolvency to 'new heights'.[35] The problems TUPE pose to business rescues has made the Regulations to be described as an inadequate response to the UK's obligation to comply with the ARD.[36] Applying TUPE to insolvent transfers is perceived as impeding the rescues of such businesses. The evidence of the Society of Practitioners of Insolvency to the House of Lords corroborates this assertion. The Society stated that:

> It has been well known since the *Litster*[37] case in 1989 that the transfer of undertakings legislation is an impediment to the rescue of businesses in the context of formal insolvency and therefore has the opposite from its intended effect of preserving employment and employees' rights. Insolvency Practitioners can cite numerous examples of cases where the prospect of taking over accrued liabilities under employment contracts has either deterred prospective purchasers of insolvent businesses from dealing altogether, or has caused them to discount the price which they are prepared to pay.[38]

From the above, it is obvious that the perception amongst many is that there is a problem with applying TUPE to insolvency situations. Viewed from the employee protection perspective, the Transfer Regulations have proved very effective. They have enabled the courts to look behind the legal structures of companies in order

[33] *Berg v Besselsen* (Joined Cases 144 and 145/87) [1988] ECR 2559.

[34] TUPE is conflict prone. For example, in *Photostatic Copiers (Southern) Ltd v Okuda and Japan Office Equipment Ltd (in liquidation)* [1995] IRLR 11, the ET was of the view that Reg. 4 does not take effect until and unless an affected employee is given notice of the fact of the transfer and the transferee's identity without which the employee will not be able to exercise his or her right to object to the transfer. The *Okuda* decision has been criticised as not reflecting the correct position of the law. If it was correct it would be alarming because it would allow employers to short-change the employees. Transferor employers could deny employees their rights on a transfer simply by not telling them about the transfer. Morrison J in the later case of *Secretary of State for Trade and Industry v Cook* [1997] IRLR 150 (EAT) said the decision should not be followed. For the correct position on this point, see the ECJ's decision in *Rotsart de Hertaing v J Benoidt SA and IGC Housing Service* [1997] IRLR 127.

[35] See comments by Lord Hunt of Wirral in the House of Lords Debates of May 3, 2006 <http://www.theyworkforyou.com/lords/?id=2006-05-03b.533.2> accessed 12 September 2008. See also S Bewick, 'TUPE 2006- A Missed Opportunity' (2006) 3 International Corporate Rescue 228.

[36] John McMullen, *Business Transfers and Employee Rights* (4th edn., Butterworths Law 1998). See also, Dennis Boyd, 'Corporate Rescue and Employees' Rights' (1997) 48 N. Ir Legal Quarterly 297 – 306.

[37] This case is discussed in detail below.

[38] Select Committee on the European Communities session 1995-96 5th report.

to protect the rights of the employees, especially in insolvent business transfer situations.[39] From the time they were first introduced in 1981 and, as far as the protection of the employees' rights during business transfers is concerned, TUPE has proved to be a good and very effective law.

TUPE offers greater prospects of continuity of employment when the situation of an insolvent business is less than terminal and where a going concern sale of the business can be effected[40] in comparison to the common law rule on transfers. The common law was, in comparative terms, 'hostile' to the interests of the employees in transfer situations. As discussed in chapter 4, a business transfer, solvent or insolvent, under the common law put paid to all employment relationships and terminated contracts of employment. TUPE operates in a completely opposite way. The transfer of a business automatically transfers all extant contracts of employment to the transferee. The underlying philosophy of the regime seems to be that restructuring which prevents employees from maintaining and, or 'benefitting from their legal rights' [41] should not be permitted.[42]

However, TUPE'S application to insolvency situations has imposed costs on rescue. The risk of unknown liabilities, from activities carried out by the transferor, passing to the transferee is particularly high given the financial state of the insolvent transferor. The mandatory transfer of liabilities to the transferee is a major disincentive to prospective purchasers of insolvent undertakings. These have in turn affected the number of insolvent but viable businesses that could have been rescued and the number of jobs that could have been saved had TUPE not prevented the going concern sales of those businesses.[43] It is in these types of scenarios that the role of TUPE in preserving employment rights becomes questionable.[44]

Applying TUPE to insolvent transfers has therefore created a tension between business rescue on the one hand and employee protection on the other. The

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[39] Gill Sage, *TUPE: A Practical Guide,* (The Law Society, London 2002) 1.
[40] Frisby (n 3) 253.
[41] Kastrinou, Shah & Gough (n 16) 137.
[42] This echoes the views of the Traditionalists and in particular, those of LoPucki, the progenitor of the team production theory of bankruptcy reorganization. See Chapter 2 of thesis.
[43] Robert Upex & M Ryley, *TUPE: Law and Practice* (Jordan Publishing Limited, Bristol 2006) 103; Frisby (n 1) 252-255.
[44] Collins (n 31) 147 – 158; Paul Davies, 'Employee Claims in Insolvency: Corporate Rescues and Preferential Claims' (1994) 23 ILJ 141.

employer's prerogatives, for example, to dismiss employees and sell a business that is insolvent in order to save it (and potentially some jobs), clash with TUPE's aim to protect the employees against such dismissals. Dismissals can no longer be made by the transferor in connection with an insolvent business transfer without an economic, technical or organisational justification for dismissing the employees.[45]

The point is not that the transferor cannot dismiss employees, what is problematic however is the fact that liabilities for the dismissals automatically transfers to the transferee. Also, the need to take on all the employees of the transferor does not make the insolvent business an attractive purchase target. TUPE increases the cost of the rescue process to the transferee.[46] A prospective buyer may become reluctant to see the deal through first by potential employee-related liabilities and second if required, regardless of its own requirements, to take on what, in his estimation, is an overstaffed insolvent business.[47] This is because 'cherry-picking' amongst employees, which was legitimate and easy to achieve when the common law regulated business transfers, is difficult and much more complex with TUPE transfers[48] (see below). All of the above issues tend to militate against the 'policy of the law seeking to facilitate corporate rescue'.[49]

As discussed in chapter 7, changes have been made to the current Transfer Regulations to make it easier to sell insolvent businesses, but unfortunately even with these changes the conflict between the rescue objective of insolvency law and the employment protection goal of employment law has not been eliminated

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[45] Regulation 7 of TUPE 2006 (Dismissal of employee because of relevant transfer) reflects the language of the ARD by providing that: 'Where either before or after a relevant transfer, any employee of the transferor or transferee is dismissed, that employee shall be treated for the purposes of Part X of the 1996 Act (unfair dismissal) as unfairly dismissed if the sole or principal reason for his dismissal is (a) the transfer itself; or(b) a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce.' See also *Wheeler v Patel* [1987] ICR 631; *Willis v McLaughlin & Harvey plc* [1998] EuRL 22. See also the recent CA decision on *Spaceright Europe Ltd v Baillvoine* [2011] EWCA Civ 1565 in which the court held that the claimant's dismissal was not for an ETO reason. The dismissal was for transfer-connected reason and was automatically unfair. See further chapter 5.

[46] John Armour and Simon Deakin, 'The Rover Case (2): Bargaining in the Shadow of TUPE' (2000) 29 (4) ILJ 395 – 402.

[47] David Pollard, 'TUPE and Insolvency: Part 2' (2006) Insolvency Intelligence 102, 104; Sargeant (n 10).

[48] Frisby (n 1) 251.

[49] Armour & Deakin (n 9); Frisby (n 1); Collins (n 31).

completely.[50] There are several factors that have made the application of the 2006 Transfer Regulations to insolvent transfers cumbersome one of which is the notion of 'relevant insolvency proceedings' discussed below.

6.4 The concept of 'relevant insolvency proceedings'

According to Regulation 8, TUPE applies to transfers in the context of insolvency 'if at the time of the transfer the transferor is subject to relevant insolvency proceedings.' The question then is: what are 'relevant insolvency proceedings'? This is defined under Regulation 8 (6) as:

> ...insolvency proceedings which have been opened in relation to the transferor not with a view to the liquidation of the assets of the transferor and which are under the supervision of an insolvency practitioner.[51]

It has been unclear from the above definition what proceedings in the UK are 'bankruptcy or analogous insolvency proceedings' and in particular whether administration could come within this definition. While the above definition is convenient for the Government because it avoids the need to list out the different kinds of insolvency procedures to which TUPE applies, **it** carries with it the uncertainty contained in the ECJ case law test in *D'Urso*[52] because it will be difficult sometimes to ascertain whether or not TUPE applies to a transfer.[53]

Broadly speaking insolvency situations in the UK can be divided into liquidation and alternatives to liquidation. There are three types of liquidation namely: compulsory liquidation, members' voluntary liquidation and creditors' voluntary liquidation. Likewise, there are three main alternatives to liquidation namely: company voluntary arrangement, administrative receivership and administration. These are considered below.

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[50] See the section on 'application of the Transfer Regulations to insolvency: Effects on insolvent business' below.

[51] The Government decided, it seems, to take the easy way out by 'copying out' the provisions of Article 5 (1) of the 2001 ARD.

[52] See discussion below.

[53] McMullen (n 7). See also the view of Lord Hunt of Wirral, House of Lords debate 25th Report from the Merits Committee, Hansard, 3 May 2006 col. 534 <http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060503/text/60503-25.htm> accessed 25 November 2011. There is further discussion on this point in chapter 7.

6.4.1 Company voluntary arrangement

The company voluntary arrangement (CVA) procedure was introduced in 1986.[54] It owes its origin to the Cork Committee who felt the need to make it possible for a company, like an individual, to be able to enter into a binding arrangement with its creditors[55] by a simple procedure in order to organise its debts. In a CVA, a proposal has to be submitted by the director, a liquidator or an administrator (if the company is in liquidation or in administration proceedings respectively) to a nominee, whose role is to act initially as nominee while the CVA is being proposed.

If the proposal is acceptable to the nominee, he or she will first file a copy of the proposal with the court, and then call a meeting of the shareholders and creditors. If the proposal is approved[56] during the meeting, it will bind each person (except secured creditors)[57] who had notice of the meetings and was entitled to vote.[58] Once the CVA has been implemented, the nominee becomes the supervisor.[59] At that point he or she becomes an officer of the court and is subject to the court's control.[60] Clearly, the TUPE Regulations will apply to CVA since this procedure does not have the characteristics of liquidation proceedings. The objective of a CVA is to facilitate the continuation of the business as a going concern.

6.4.2 Administrative receivership

An administrative receivership is:

> a receiver or manager of wholly (or substantially the whole) of a company's property appointed by or on behalf of the holders of

[54] The CVA procedure is set in Part 1 of the IA 1986 and Part 1 OF THE Insolvency Rules 1986.

[55] The courts have characterised the relationship between parties to a CVA as essentially contractual. See *Re TBL Realisations plc, Oakley-Smith v Greenberg* [2004] BCC 81; *Whitehead v Household Mortgage Corp* [2003] 1 All ER 319.

[56] The proposal needs to be approved by 75% of creditors voting in person or by proxy by reference to the value of their claims.

[57] IA 1986 s. 4 (3).

[58] IA 1986 s. 5 (2) (b). See also *Wesley v Brelec Installations Ltd* [2002] 2 BCLC 576, 579g. It binds every person who was entitled to vote at the meeting whether such a person was present at the meeting or not, and if present, whether or not he or she voted in favour of the arrangement. The requirement to bind persons who did not receive notice of the meeting was added by IA 2000, s. 2 and Sch. 2. On why this is so see e.g. *Johnson v Davies* [1999] Ch 117, 129H-130A (it creates a statutory hypothesis that a person who had notice of the meeting and, was entitled to vote at it, is a party to an arrangement to which he has given his consent (Chadwick LJ).

[59] See IA 1986, part 1, paras 1(2) & 7 (2)(b).

[60] As an officer of the court he has an obligation to act honourably. He or she is subject to the rule in *Re Condon, Ex parte James* (1874) LR 9 Ch App 609).

> any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities.[61]

Administrative receivership is purely contractual and offers a means for the realisation and enforcement of security. The receiver receives income and takes charge of the management of the company. An administrative receiver, typically, seeks to sell part or all of the business of an insolvent company as a going concern to a transferee. Assets transfer as elements of a going concern in the context of administrative receivership proceedings should not be confused with the transfer of assets as separate assets in liquidation. In *D'Urso v Ercole Marelli Elettromeccanica Generale SpA (in special administration) and others*[62] and *Spijkers v Gebroaders Benedik Abattoir* respectively,[63] the Advocate General pointed out that the transfer of assets as 'a going concern' is not the same thing as the transfer of assets as 'separate assets' in the course of liquidation. The former enables the business of the company to be maintained as far as possible while the latter does not.

Given the fact that whether a particular insolvency procedure is covered by TUPE depends on the purpose of the procedure concerned and, taking into account the views of the ECJ in the above cases, administrative receivership would, clearly, be characterised as insolvency proceedings opened 'not with a view to the liquidation of the assets of the transferor.' This means that the TUPE Regulations, which must be construed in accordance with the ARD, will apply to any eventual transfer. Thus in relation to the discussion on 'relevant insolvency proceedings,' administrative receivership will come under the ambit of TUPE since it does not have the characteristics of liquidation proceedings.

6.4.3 Administration

The administration procedure introduced in 1986 is one of the most commonly used forms of insolvency procedure. It is designed to help in the rescue of companies. Its inherent moratorium is a useful mechanism for freezing the enforcement of security by creditors or for barring creditors from presenting

[61] IA 1986, s. 29 (2). On the advantages and disadvantages of the institution of administrative receivership, see 'situating UK insolvency system within extant theories' in chapter 2.
[62] [1991] ECR 1-4321.
[63] [1986] CMLR 296

petition for the winding-up of the company. This 'buys' the company time to negotiate with its creditors to see if the business can be saved without winding-up the company.

Ordinarily, administration would come under the definition of 'relevant insolvency proceedings,' as the administration procedure is similar to the concept of '*surseance van betaling*' (suspension of payments) under Netherlands law, which the ECJ, in *Abels,* held did not exempt a transfer from the ARD as such proceedings may allow the continuation of business. However, to reach such a conclusion would be hasty given the different objectives of administration.

The provisions of the Insolvency Act 1986 governing administration place a duty on the administrator to pursue the objective of the administration proceedings according to a strictly prioritised order.[64] The Act directs the administrator of a company to perform his functions with the objective of 'rescuing the company as a going concern.'[65] This objective is aimed at the survival of the company intact. It is only if the administrator thinks that it is not reasonably practicable to achieve this primal objective of administration that he or she is entitled to step down to the second objective[66] of 'achieving a better result for the company's creditors as a whole than would be likely if the company were wound up.'[67] The administrator should pursue this objective only if he or she thinks it would achieve a better result for the company's creditors as a whole.[68] This objective may be achieved via the sale or transfer of the business of the company as a going concern to third party purchaser. It is only where the administrator thinks that either the first or second objectives are not reasonably practicable that he or she is at liberty to pursue the third objective[69] of 'realising property in order to make a distribution to one or more secured or preferential creditors.[70]

In light of the above, it appears that any administration having as its purpose the continuation or survival of the business (that is for a purpose within the meaning of Schedule B1 paragraphs 3 (1) (a) & (b) of Insolvency Act 1986), will be deemed

[64] IA 1986 Schd.B1 para. 3(1).
[65] IA 1986 Schd.B1 para. 3(1) (a).
[66] IA 1986 Schd.B1 para. 3(3) (a).
[67] IA 1986 Schd.B1 para. 3(1) (b).
[68] IA 1986 Schd.B1 para. 3 (3) (b).
[69] IA 1986 Schd. B1 para. 3 (4) (a).
[70] IA 1986 Schd. B1 para. 3 (1) (c). Further, the administrator can only pursue this duty in a way that does not unnecessarily harm the interests of the company's creditors as whole. IA 1986 Schd. B1 para 3 (4) (b).

'relevant insolvency proceedings' and therefore within the scope of the Transfer Regulations.[71] As a corollary, an administration for the sole purpose of the more advantageous realisation of the company's assets than would be effected on a winding-up may not come within the scope of the Transfer Regulations. It follows that if the administrator selects the third objective of administration at the outset of the administration, this may not qualify as 'relevant insolvency proceedings.'

6.4.4 Liquidation

Liquidation involves the termination of the existence of a company. This may take place whether the company in question is solvent or insolvent. The liquidation procedure can be a stand-alone procedure or it can be used following a receivership, CVA or administration. Liquidation may either be voluntary or by court order. A voluntary liquidation may be either a members' voluntary winding-up or a creditors' voluntary winding-up. Under the former, control of the winding-up proceedings and the right to appoint a liquidator, remains with the shareholders. Under the latter, members cede control to the creditors. The creditors will also acquire the right to override appointment of a liquidator by the members. The liquidator's main duty is to take over the powers of the Directors of the company, oversee the management of the business, realise the assets of the business,[72] and use the proceeds to pay the debts of the business in the order prescribed by the Insolvency legislation.

6.4.4.1 Is liquidation a 'relevant insolvency proceeding?'

According to the ECJ's jurisprudence in *Abels*, the ARD does not impose obligation on Member States to extend the rules laid down therein to transfers taking place in the context of insolvency proceedings which are instituted with a view to the liquidation of the transferor's assets. This is without prejudice to the national legislator's right to decide otherwise. The ECJ took the view that if it was

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[71]In fact, in the recent case of *OTG Ltd v Barke and other* [2011] IRLR 272, the EAT held that the purpose of administration proceedings under the Insolvency Act 1986 is to rescue the business as a going concern, not to liquidate its assets. Accordingly, employees of a business in administration will transfer under the TUPE Regulations when the business is sold by the administrator to a transferee.

[72] Note however that while the liquidator is responsible for taking custody of the company's assets, the assets in question do not automatically vest in him. This is the difference between the liquidator and a trustee in bankruptcy, in which the bankrupt's estate vests immediately on appointment without the need for any conveyance, assignment or transfer. See Insolvency Act 1986, s. 306 (1). But in a compulsory liquidation, the liquidator can apply to the court for a vesting order. See Insolvency Act 1986, s. 145 (1). See Roy Goode, *Principles of Corporate Insolvency Law,* (Sweet and Maxwell, London 2005) 120.

intended for the ARD to apply to liquidation this would have been expressly stated by its drafters.

It seems that it may be possible for TUPE to apply to liquidation in the UK but this will depend, however, on the type of liquidation procedure and the conduct of the liquidator concerned. To recap, 'relevant insolvency proceedings' is defined by Regulation 8(6) as proceedings opened 'not with a view to the liquidation of the assets of the transferor.' It follows that in any insolvency proceedings, the most important consideration is the purpose of the proceedings (that is, whether they are aimed at the liquidation of the company's assets or not), rather than their outcome.[73] Thus, to ascertain whether any of the liquidation proceedings would be covered, the various types of liquidation procedures would have to be analysed.

6.4.4.2 Members' Voluntary Liquidation (MVL)

The MVL is a solvent winding up of a company and is therefore not a relevant insolvency proceeding under Regulation 8(6). Thus Regulations 4 and 7 will apply to protect employees in MVL. Regulation 8 is not applicable in this respect.

6.4.4.3 Creditors' Voluntary Liquidation (CVL)

In circumstances where a liquidator transfers a business in a CVL procedure, Regulations 4 and 7 will not apply, pursuant to Regulation 8 (7). The CVL proceeding is usually under the supervision of an insolvency practitioner. The transfer of a business by a liquidator in a CVL would, in the absence of express agreement substituting the transferee as the employer, terminate the employees' contracts of employment. Affected employees would then be entitled to claim against the state, (that is, through the National Insurance Fund) payments in relation to arrears of wages and redundancy payments etc.

6.4.4.4 Compulsory Liquidation

Where a company is wound up compulsorily by the court on grounds of being unable to pay its debts,[74] Regulations 4 and 7 will not apply to transfer the employees' contracts automatically to the transferee. The reason is because once

[73] *D'Urso & ors v Ercole Marelli Ellectromeccanica Generale SpA & ors* Case C-362/89 [1991] ECR 1-4105.
[74] IA 1986 ss 122 & 123.

a winding-up order is granted by the court, all existing contracts of employment are deemed automatically terminated. Contracts of employment may not however terminate where the liquidator elects to carry on trading the business with the consent of the court and where the employees continue to be employed by the business. The liquidator and the employees could agree that there is no termination of employment contracts. The same effect would be produced in a situation where a winding-up proceeding is converted into administration.

In sum, the application of the Transfer Regulations to transfers in the context of insolvency may be seen as an attempt by the UK government to provide greater domestic law protection to UK employees that potentially would be impacted by transfers of insolvent undertakings. If that is the case, it could be argued that this reasoning aligns with the aim of those who were instrumental to the adoption of the ARD. The ARD was one of the social policy measures designed to protect the rights of EU workers in the context of business transfers as discussed in chapter 4.

Whether the implementation of the ARD by TUPE 1981 to cover insolvent business transfers, that has been carried over by TUPE 2006, was deliberately done to achieve the 'extended' effect of granting enhanced protection to UK employees is a moot point.[75] One thing is certain: the enhanced protection the Transfer Regulations have given to the employees during business transfers would be acclaimed by the Traditionalists generally and by the progenitor of the team production theory of bankruptcy discussed in chapter 2. On the contrary, the Proceduralists and the creditors' bargain theorists would consider the extended protection an impediment to the creditors' ability to easily dispose of an insolvent business through the liquidation procedure (see discussion on theories in chapter 2).

Having analysed the various insolvency proceedings, it is important also to know when a business may become subject to 'relevant insolvency proceedings' since any action taken prior to that moment may have consequences for the transferee in terms of liability.

[75] David Pollard, 'Insolvent Companies and TUPE' (1996) 25 ILJ 194.

6.5 When is a business subject to relevant insolvency proceedings?

The fact that a business is insolvent does not mean that it is automatically subject to 'relevant insolvency proceedings'. A condition of the TUPE 2006 insolvency provisions applying to a transfer is that at the time the transfer occurs, 'relevant insolvency proceedings' must apply and those proceedings must be under the supervision of an insolvency practitioner.[76]

In *Secretary of State for Trade and Industry v Slater* & ors,[77] the directors of CFG Site Services Limited (CFG Ltd) appreciated that the company was insolvent and on 25 July 2006 made a decision to put it into voluntary liquidation. [78]On the same day the decision to liquidate the company was made (25 July 2006), the directors appointed a firm of accountants (Deliottes) to assist the company in preparing for its eventual winding up.

The next day (26 July 2006), the accountants attended the company's premises and CFG Ltd's entire workforce (including Mr Slater) was given notice of redundancy by Mr Ramsbottom - a staff of Deliottes. On 27 July 2006, CFG Ltd's business was transferred to a new company - CFG Site Services Nationwide Limited (CFG Nationwide – a company formed by some ex-Directors of CFG Ltd) as a going concern. CFG Nationwide then re-employed the staff (including Mr Slater). The sale of the business took place before the members and creditors' meetings (the statutory two stage-procedures required) were held. CFG Ltd was not, however, formally put into voluntary liquidation until after these two meetings took place on 16 August 2006.

The employees (including Mr Slater) wanted arrears of pay. They claimed that, following the transfer, the new employer (CFG Nationwide) owed them back pay. CFG Nationwide argued that it had not acquired any liabilities given that at the time CFG Ltd's business was transferred to it, insolvency proceedings had

[76] See TUPE 2006, regs. 8 (1) & 8 (6).
[77] [2007] IRLR 928 (Elias P).
[78]The process in question was a creditors' voluntary winding up which first required a members' meeting to be called so as to agree on a winding up and then to be followed by a meeting of the creditors to confirm the members' proposal. By virtue of section 98 of the IA 1986, the creditors' meeting is required to be called within 14 days of the members' meeting. Once these formalities have been completed, then a liquidator can be appointed.

already started therefore it was exempt from liabilities under Regulation 8 of TUPE 2006.

The Employment Tribunal (ET) held that under Regulation 7 of TUPE 2006, 'at the time of the transfer' the transferor (CFG Ltd) was subject to 'insolvency proceedings'. For that reason, the ET held that Regulation 4 of TUPE 2006 was excluded and that the Secretary of State for Trade and Industry (SS) was liable for debts under section 182 OF ERA 1996. The SS appealed arguing that though there were insolvency proceedings, they did not exist 'at the time of the relevant transfer'.

The EAT was ask to determine whether 'relevant insolvency proceedings' had been commenced by the directors at the time the decision was made by them to wind up the company, or whether they were commenced following the formal appointment of a liquidator. The EAT was of the view that the liquidation of the company started as a consequence of the creditors' voluntary liquidation which, in turn, commenced either as a result of the resolution of the members, or as a result of the creditors' meeting. However, the liquidation proper did not occur until after liquidators were appointed and the business was transferred. Thus, there were no insolvency proceedings in place when the business was transferred. The EAT stated that even if there were insolvency proceedings, they were not under the supervision of an insolvency practitioner (as required by TUPE Regulations 8 (6) and (7)) since Mr Ramsbottom could not be properly described as an insolvency practitioner until the day he was appointed liquidator.

The consequence of this decision was that the Secretary of State was not liable for the debts, that is, liable to make payments to transferred employees out of the insolvency fund, by virtue of Regulation 8. These liabilities, rather than remained with the insolvent company, where technically, they would have been the responsibility of the Secretary of State, transferred to the transferee. The core or significance of this decision, (as this relates to the notion of 'relevance insolvency proceedings') is that, where a business is insolvent, until formal insolvency proceedings have been instituted or opened in relation to it, such a business is not subject to 'relevant insolvency proceedings.' It also means that in all cases of transfers, the appointment of the supervisor (IP) must precede the business transfer itself before a TUPE-transfer could be deemed to have taken place.

In the section below, it is intended to explore how the Transfer Regulations function in practice and to evaluate whether the protection they give to employees interfere with insolvency proceedings and impair the rescue of financially distressed businesses as claimed.[79] The aim is to conduct an 'audit' of the consequences of a TUPE-business transfer for the parties.

6.6 Application of the Transfer Regulations to insolvency: effects on insolvent businesses

The Transfer Regulations have a dual character. This dual character or goal is in conflict with each other.[80] From the transferor's perspective they are targeted at facilitating the transfer of insolvent undertakings. From the employee's perspective, TUPE's goal is **to** mitigate the effects of business transfers on them. TUPE uses a number of mechanisms for safeguarding the rights of employees in the business when there is a change of employer. Whilst these mechanisms have been very effective in the context of protecting the rights of employees, they have indirectly impinged on the transferor's ability to sell insolvent businesses. Strict compliance with TUPE's provisions in transfers involving insolvent businesses could prove disastrous to their rescues. However, relaxing the provisions of TUPE could expose the employees to job insecurity. Employees could be susceptible to mass dismissals in transfer situations as a result of the transferee's unwillingness to take on all of the transferor's employees.[81] This scenario typifies the tension between employee protection and business rescue in insolvency. In order to fully appreciate how the employee protective regime of TUPE has potentially undermined the rescue culture, it is important to examine the operation of TUPE in the context of insolvency.

[79] John Armour and Simon Deakin, 'Insolvency and Employment Protection: The Mixed Effects of the Acquired Rights Directive' (2003) 22 International Review of Law and Economics 443–463; Parr & Bennett (n 1); Samuel E Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policies through the Lens of Theories' (2011), 32 (4) Company Lawyer 99 -113; Armour and Deakin (n 9); Kastrinou, Shah & Gough (n 16); Davies (n 27); Collins (n 31).

[80] This claim is buttressed by the fact some while some provisions of TUPE 2006 (e.g. reg. 4) is targeted at the protection of the employees' rights in a business transfer, others (e.g. regs. 8 & 9) are directed at facilitating free enterprise and business sales which threatens the employees' job security. See also Guidance issued by the Department for Business, Innovation & Skills at <http://www.berr.gov.uk/files/file20761.pdf>

[81] Kastrinou, Shah & Gough (n 16) 131.

6.6.1 Transfer of employment contracts

Regulation 4 (ex reg. 5) is central to the operation of the TUPE. It is a typical employee protection measure that prevents or alleviates the consequences of workforce reductions in employer insolvency and business transfers. Regulation 4(1) states:

> A relevant transfer shall not operate so as to terminate the contract of employment of any person employed by the transferor and assigned to the organised grouping of resources or employees that is subject to the relevant transfer, which would otherwise be terminated by the transfer, but any such contract shall have effect after the transfer as if originally made between the person so employed and the transferee.

Regulation 4 (2) provides (subject to certain exceptions) that:

> ...on the completion of a relevant transfer- (a) all the transferor's rights, powers, duties and liabilities under or in connection with any such contracts shall be transferred by virtue of this regulation to the transferee...[82]

Deconstructing Regulation 4, it quickly becomes apparent that its provision, (which are the equivalent of Article 3 of the ARD),[83] have several effects. One of the effects is that there is a statutory 'novation' of the contract of employment.[84] Novation (meaning the substitution of a third party for one of the original parties to a contract without the need for a tripartite agreement)[85] is not new to general contractual principles. [86] In its traditional form, novation of contract usually requires the consent of all parties concerned and not by statutory intervention as is the case with TUPE.[87] There is usually an agreement by which a contract between parties A and B is discharged, and a new contract made between parties

[82] Note: the general position set out in Reg. 4 (1) is subject to two qualifications. Regulation 4(7) provides that Regulations 4 (1) and (2) will not take effect if the employees inform the transferor or the transferee that they object to becoming employed by the transferee. In such circumstances, a relevant transfer shall operate to terminate the employee's contract of employment with the transferor but he or she will not be treated, for any purpose, as having been dismissed by the transferor. TUPE 2006, Reg. 4 (8).
[83] See chapter 5.
[84] *Secretary of State for Employment v Spence and ors* [1996] ICR 651, CA (Balcombe LJ).
[85] Look Chan Ho, 'Novation, Variation and Rescission – A Question of Intention? (2008) <http://www.insolvencylawforum.co.uk/index.php?option=com_content&view=article&id=407:novation-variation-and-rescission-a-question-of-intention&catid=8:opinion-posts&Itemid=20> accessed 12 April 2012.
[86] See *Chitty on Contracts* Hugh Beale (ed.) (29th edn, Sweet & Maxwell, London 2004)1201.
[87] *Transfer of Undertakings: Employment Law Handbook* (Incomes Data Services, London 2011) 83.

A and C (with C being the new party that replaces party B).[88] The effect of Regulation 4 is not, technically, to assign or transfer the contract *per se.* Rather, it extinguishes the original contract and replaces it with a new one.[89]

Because Regulation 4 operates to transfer both the benefit and burden of the contract from the transferor to the transferee, novation is required. This is because it is an established rule of English law that an assignment[90] of a contract can only transfer the benefit of that contract (for example the right to receive payment or profits or the benefit of goods or services) to a third party[91] and not the burden[92] (i.e. contractual liability or obligations, for example, to perform certain services, deliver certain goods under the contract). This means that the burden of the contract remains with the assignor. To transfer both the benefit and burden of a contract usually requires novation. This, technically, is what TUPE does in transfers.

6.6.2 Transfer of contracts: benefits for employees

In relation to the employees, and viewed against what their position during business transfers was under the common law, Regulation 4 (1) is a 'game changer' given the benefits it bestows on them. The transfer of a business 'contemporaneously' transfers all contracts of employment to the transferee.[93] In effect, all employees employed in the business 'immediately before the

[88] See e.g. *Davies and ors v Jones and anor* [2009] EWCA Civ 1164.

[89] *Habibsons Bank Ltd v Standard Chartered Bank (Hong Kong) Ltd* [2010] EWCA Civ 1335.

[90] An assignment is a transfer, recognised by law, of the rights held by one person to another. An assignment in itself does not operate to create a contract between the assignee and the non-assigning party nor does it make the assignee a party to the original contract. In other words, assignment differs from novation because in the former, the parties to the contract do not change. It is also not possible to assign the burden of a contract, that is, the obligations.

[91] The only exception is if the contract contains a restriction on assignment or is a personal contract. See e.g. *Don King Productions Inc. v Frank Warren* [1999] 2 All ER 218, where the contracts in question were personal contracts (i.e. between Frank Warren and the boxers he managed) and therefore not capable of assignment.

[92] *Tolhurst v Associated Portland Cement Manufacturers (1900) Ltd* [1902] 2 KB 660. *Collins MR stated at 668:*

> It is, I think, quite clear that neither at law nor in equity could the burden of a contract be shifted off the shoulders of a contractor on to those of another without the consent of the contractee. A debtor cannot relieve himself of his liability to his creditor by assigning the burden of the obligation to somebody else; this can only be brought about by the consent of all three, and involves the release of the original debtor.

[93] Frisby (n 1).

transfer'[94] become, by default, employees of the transferee.[95] Moreover, these employees transfer with the same terms and conditions of employment they had with the transferor.[96]

In *North Wales Training and Enterprise Council Ltd v Astley & others*[97] the House of Lords noted a key effect of Regulation 4. Lord Bingham of Cornhill observed that Regulation 4 introduces a 'fictional element into the tripartite relationship' (i.e. the relationship between the transferor, the potential transferee and the employee in a TUPE business transfer), given that upon the satisfaction of the prescribed legislative conditions, the employee transferred is treated as having been employed by the transferee all along when in fact such is not the case.[98]

Seen from the above perspective, it is safe to conclude that the purpose of Regulation 4 (1), as articulated by Balcombe LJ,[99] is to override the common law contractual position. The common law rule on transfers was hostile to the interest of the employees in terms of job security. A business transfer terminated all contracts of employment.[100] It is this disadvantage that TUPE is intended to obviate. Granted, TUPE was not enacted purposefully to abolish the common law rule on business transfers (since it was enacted primarily to implement an EU Directive), the fact remains, however, that that is one of the effects of Regulation 4. Not only does TUPE supersede the common law rule on transfers, but it has abolished it completely.

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[94] This phrase is defined below. Once an employee's contract of employment is transferred, the affected employee is barred from bringing claims against the transferor in respect of them. TUPE 2006, Reg. 10 (3). Conversely, the transferor will also not be able to assert any of the rights transferred to the new employer against his or her former employees. *Allan v Stirling DC* [1995] ICR 1082).

[95] Frisby (n 1).

[96] Note however that Regulation 4 (1) only transfers contracts of employment and enables them to have effect after the transfer as if originally made between the employees and the transferee. Regulation 4 does not give the employee a contractual benefit to which he or she was not entitled under his or her original contract with the transferor. See e.g. *Jackson v Computershare Investor Services plc* [2007] EWCA Civ 1065 (CA).

[97] [2006] UKHL 29.

[98] According to Lord Bingham of Cornhill: 'In legal parlance, a matter is only deemed to be the case when it is not, or may not, in fact be so, or would not or might not be thought to be so if not deemed to be so. The complexity of this case, I think, derives from the fiction which underlies it'. *North Wales Training and Enterprise Council Ltd v Astley & others* [2006] UKHL 29 (para. 2)

[99] *Secretary of State for Employment v Spence and others* [1986] ICR 651, CA (Balcombe LJ). Note however, that for Regulation 4 to apply however, employees for this purpose are those who have been employed by the out-going employer *immediately before* the transfer took place otherwise Regulation 4 will not apply. The significance of this requirement and its effect on the employee protection generally is further discussed below.

[100] For how employees fared during transfers under the common law, see chapter 5.

It has been noted elsewhere in this thesis[101] that in an era where jobs are not easy to come by, this is the kind of outcome employees would welcome when the business that employs them becomes insolvent and is transferred as a going concern. It is also an outcome, from a theoretical viewpoint, that would please the Traditionalists but to the displeasure of their Proceduralists counterparts discussed in chapter 2. The benign intent of the Transfer Regulations notwithstanding, Regulation 4 has serious implications for the rescue culture. This is considered below.

6.7 Transfer of contracts: possible consequences for business rescue

There are a number of concerns raised by the provisions of Regulation 4. Regulation 4 is an anathema for the employers and the antithesis to business rescue. Very often, an attempt is made to rescue a business in financial difficulty by selling part or all of it to a third party purchaser on a going concern basis. In such circumstances, the transferor's ability to reduce the size of the workforce may be crucial where the sale of an insolvent undertaking is contemplated. Such a strategy is one of the easiest ways of attracting potential buyers to the business. However, selling a business (solvent or insolvent) on a going concern basis brings TUPE into play. Regulation 4 (1) of TUPE 2006 makes it difficult for the transferor to easily achieve that result without attracting liabilities.[102]

From the transferees' perspective, it seems that buying an insolvent business would be worth the trouble if staff surplus to requirements could be easily shed and without liability. Regulation 4 makes this very unlikely. Regulation 4 could hamper the purchase of an insolvent business with dire consequences for the employees as well. It is submitted that if the business to be transferred is already over-staffed (and if this was the reason for its insolvency), a rule which requires the buyer to buy the insolvent business, and to take on all of the transferor's ex-workers, does not offer the necessary incentive needed to buy such businesses.

It is doubtful whether a prospective purchaser would want to purchase any business that is over-burdened with staff without being able, (subsequently and

[101] See particularly the analysis on *Nokes* in chapter 5.

[102] An example of this type of scenario can be found in the 2011 Court of Appeal case of *Spaceright Europe Ltd v Baillavoine and anor* [2011] EWCA Civ 1565

without much expenses), to dismiss employees surplus to his or her need.[103] This type of rule could force prospective rescuers to abandon purchases of insolvent businesses. Even where **a** buyer agrees to buy the business, he or she is likely to demand a discount for it. In a situation where a deal cannot be mutually agreed between the parties, the transferor's (insolvency practitioner) other option may be to sell the business on a break-up basis. This effectively means closing down the business and making all staff redundant.

With such an outcome, not many, if any, will deny the fact that the well-intentioned pursuit of employee protection has inadvertently resulted in the legal demise of the business with consequential job losses for the employees. From this perspective therefore TUPE would be self-defeating. The picture painted above further reveals the tension between the employee protection goal of TUPE and the pursuit of the rescue of insolvent but viable businesses in the UK.

6.7.1 Transfer of rights and liabilities

Another major effect of Regulation 4 is that a relevant transfer operates to transfer all of the transferor's rights, powers, duties and liabilities in connection with the employees' contracts of employment to the purchaser by virtue of the transfer.[104] In effect, the incoming employer (transferee) steps into the shoes of the transferor and assumes responsibility in relation to those rights and obligations.[105] The transferee shoulders the entire burden[106] and cannot pick and choose from

[103] *Transfer of Undertakings: Employment Law Handbook* (Incomes Data Services, London 2011) 253.
[104] Reg. 4(2)(a) TUPE 2006.
[105] Note however, that Reg. 4, to be precise Reg. 4 (2) (a) must be construed in light of Article 3 (1) of the ARD which states that rights and obligations that can transfer are those '... existing on the date of a transfer...' See also *Secretary of State for Employment v Spence and others* [1986] ICR 651 (Balcombe LJ).
[106] In relation to TUPE and the UK, this may be seen as a matter of choice. The ARD attempted to mitigate this hardship on transferees. Article 3 provides that Member States may provide that after a transfer, the transferor and transferee are jointly and severally liable with regards to the obligations which arose before the date of a transfer, but which based on an employment contract or relationship that was in force on the date the transfer actually took place. While the joint-liability option has been taken up and enacted in many Member States such as Portugal, Finland, Sweden and the Netherlands, the UK has not. In practice, however, the joint-liability approach gives the Member States the option of distributing employment-related liabilities arising in business transfers between the buyer and the seller. See O´Leary Siofra, *Employment Law at the European Court of Justice Judicial Structures, Policies and Processes*. (Hart Publishing Oxford, Portland Oregon 2002).

them.[107] Case law has demonstrated that the transfer of rights and obligations is automatic.[108]

Rights and liabilities transfer on the same day the business is transferred[109] and so cannot be put forward to a future date at the instance or will of either the transferor or the transferee.[110] The transfer is mandatory[111] therefore the parties' consents are unnecessary.

6.7.2 What transfers?

The question then is what rights and liabilities actually transfer to the purchaser. The Transfer Regulations do not elaborate on this, but there are a few cases that have provided guidance on the liabilities which the transferee could inherit.

However, given the obligation of the UK courts and tribunals to construe the Regulations (which is an EU-derived law) purposively,[112] so as to bring them into conformity with the protective intent of the ARD, it is to be expected that Regulation 4(2) would be given a broad construction by them whenever possible.[113] This intent has already been demonstrated by the courts in several cases relating to Regulation 4.[114] The English courts have made it very clear that the aim of the Transfer Regulations is neither to create new rights, nor augment existing rights for employees.[115] Regulation 4(2) is aimed at safeguarding the employees' rights as they existed at the time the transfer took place.

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[107] See *Stirling District Council v Allan* [1995] ICR 1082.

[108] Case C-362/89 *D'Urso v Ercole Marelli Ellectromeccanica General SPA* [1991] ECR 1-4105 (para 20).

[109] It is pertinent to note that the ECJ in *Celtec Ltd v Astley and others* [2005] IRLR 647, made it expressly clear that a business transfer takes place on an objectively identified specific date. The court held in that case that Article 3(1) of the 1977 ARD must be construed as meaning that the 'date of a transfer' is the date on which the employer's responsibility for carrying on the business of the entity transferred shifts from the transferor to the transferee. That date is a particular point in time, which cannot be postponed to another date at the will of either the transferor or transferee.

[110] Case C-305/94 *Rotsart de Hertaing v J Benoidt SA* (in liquidation) *and anor* [1996] ECR I-5927 (para 18); Case C-362/89 *D'Urso and Others* [1991] ECR I-4105, (para 20)*; Whent v T Cartledge Ltd* [1997] IRLR 153.

[111] *Foreningen af Arbejdsledere i Danmark v Daddy's Dance Hall A/S* (Case 324/86) [1988] ECR 739, para 14

[112] See e.g. Case 14/83 *Sabine Colson and anor v Land Nordrhein-Westfalen* [1984] E.C.R. 1891*;* Case C-106/89, *Marleasing v La Comercial Internacional de Alimentacion* [1990] ECR I-4135.

[113] Upex & Ryley (n 43)92.

[114] See *Garland v British Rail Engineering Ltd.* [1983] 2 A.C. 751; *Litster v. Forth Dry Dock & Engineering Co. Ltd. and Anor* [1990] 1 A.C. 546.

[115] *Computershare Investor Services plc v Jackson* [2008] ICR 341, CA; *Werhof v Freeway Traffic Systems GmbH &Co KG* [2006] IRLR 400, ECJ.

There are judicial authorities confirming that both *contractual* and *non-contractual* rights and liabilities that pre-date[116] the transfer of the business could pass to the transferee under Regulation 4(2).[117] In *Secretary of State for Employment v Spence and others*[118] (a case which arose under the old Regulation 5 (2) of TUPE 1981, now 4 (2)), the CA indicated that obligations other than contractual, could also transfer following a relevant transfer. In that case the CA noted that the words 'or' in Regulation 4(2) (b) (ex 5 (2)) of TUPE clearly have the effect of transferring obligations other than those which are contractual. This means that non-contractual obligations arising, for example, in tort are capable of transferring too.

6.7.3 Contractual rights and liabilities

In respect of contractual rights and liabilities, case law indicates that in addition to terms and conditions of employment, any arrears of wages and holiday pay owed the employees and all collective agreements subsisting on the date of the transfer will be inherited by the transferee.[119] Also, the employer compulsory liability insurance (where that is in place),[120] rights in relation to share option schemes[121] and the contractual right to enhanced severance schemes[122] all transfer to the purchaser following a relevant business transfer. In *Morris Angels and Sons Ltd v Hollande*[123] the CA held that the right to enforce a restrictive covenant against a departed employee (i.e. post-termination restraints) is also capable of transferring to the transferee.

6.7.4 Non-contractual rights and liabilities

In order that employees impacted by transfers are not short-changed, Regulation 5 (2) of the 1981 TUPE Regulations was given very wide interpretation by the courts to include non-contractual rights and any potential claims which had arisen

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[116] However, contingent liabilities that are subsequent to a business transfer are capable of transferring to the transferee. See *Martin & ors v South Bank University* [2004] ICR 1234, ECJ.

[117] For ECJ case law, see Case 135/83 *Abels v Bedrijfsvereniging voor de Metallindustrie en de Electrotechnische Industrie* [1985] ECR 469; *Arie Botzen and others v Rotterdamsche Droogdok Maatschappij BV* (Case 186/83) [1985] ECR 519, para 16.

[118] [1986] ICR 651. The insurance must be is in place otherwise the court's decision in *Bernadone* will be of no value.

[119] In *Whent v T Cartledge Ltd* [1997] IRLR 153, Hicks J held that there was no reason why a collective agreement which is constantly updated could not bind an employer.

[120] *Bernadone v Pall Mall Services* [2001] ICR 197.

[121] *Unicorn Consultancy Services Ltd v Westbrook* [2000] IRLR 80.

[122] *Jefferies v Powerhouse Retail Ltd* [1996] UKEAT 1328.

[123] [1993] ICR 71.

prior to the transfer due to acts or omissions by the transferor. Regulation 4 (2) of the 2006 Regulations is no different.

Following a business transfer, the transferee may be liable for the tortious act of the transferor provided the act in question was committed against an employee who was employed in the undertaking transferred.[124] Thus, the transferor's liability in respect of negligence or breach of statutory duty committed prior to the transfer of the undertaking taking place passes to the buyer.[125] In *BSG Property Services v Tuck & ors,*[126] both the transferor and transferee mistakenly thought that the transfer of a service was not covered by the Transfer Regulations. Based on that notion, the transferor issued a notice of termination of contracts of employment to the employees. The court held that, for the reason given by the transferor, the dismissal was unfair. Accordingly, the notice was deemed to have been a notice given to the employees by the transferee for the same reason. Therefore liability for the unfair dismissal was held to have transferred to the transferee.

The employee's right to continuity of employmentalso transfers to the purchaser. In *Green-Wheeler v Onyx (UK) Ltd,*[127] the EAT relied on the speech that Lord Lyle gave in the House of Lords when the Transfer Regulations were passing through Parliament[128] to find that the legislature had intended to include continuity of employment in the rights and liabilities that transferred under the Regulations.

6.7.5 Contingent and unknown liabilities

A major concern for prospective buyers of insolvent businesses is liabilities to which the buyer could become subject, but which were non-existent or unknown at the time of the purchase. This is very common in injury cases and in cases involving diseases that may manifest years after the transfer. A typical example would be asbestos-related disease cases. The problem with long-tail disease litigations is that in most cases, the employment would have ceased many years before the sickness manifests. In spite of that, it is possible for an employee to

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[124] See *Bernadone v Pall Mall Services* [2001] ICR 197 (Peter Gibson LJ).
[125] See *Wilson & ors v West Cumbria Health Care NHS Trust* (Unreported 3/8/1994).
[126] [1996] IRLR 134 EAT.
[127] EAT/925/92. See also *Euro-Die (UK) Ltd v Skidmore* EAT 1158/98.
[128] See Hansard, 10/12/1981, paras. 1482-1500.

commence action for personal injury years after the business has been transferred to a third party purchaser.[129]

In *Martin v Lancashire County Council*[130] (a public sector case), the claimant commenced his personal injury action in 1995, even though the business in connection to which the injury arose was transferred in 1993. While it was not established that the transferee in that case was unaware of the potential liabilities, the case represents one instance where a transferee could potentially become subject to unknown liabilities following a business transfer.

Bernadone v Pall Mall Services Group[131] is another injury case that arose under the old Transfer Regulations. This case had to do with transfer of liability in tort for personal injury sustained by an employee. In that case, an employee had an accident at work and suffered injury. Several years after the business was transferred, the employee brought proceedings against the transferor employer for negligence and breach of duty under section 2 of the Occupiers Liability Act 1957. In that case, the court was asked to address two issues one of which was whether liabilities in tort were liabilities 'under' or 'in connection with' the contract of employment. The court approved the decision in *Taylor v Serviceteam and LB of Waltham Forest*[132] where it was held that the duty of care arose out of the contract of employment.

The second question arose in connection to a claim brought after the business had been transferred. The question was: who was the correct defendant to be sued? That is, who, if the claimant became successful, should be responsible for the payment of the damages? Should it be the transferor, who was the claimant's employer at the time of the accident, or should it be the transferee, to whom the employee's contract of employment has been transferred? The court took the view that because the Transfer Regulations were introduced to give effect to the protective intent of the ARD, a purposive interpretation of the Regulations was

[129] The UK's Statute of Limitations, which was introduced in 1980, is strict about when claims for compensation can be made. There is a three year window for claims. It is only in very exceptional circumstances that the time limit can be extended. For example, when a disease is contracted which takes time for the symptoms to be displayed, the UK's Statute of Limitations is applied differently. In such a case it is not the date of injury which marks the start of the three year claim window, but the 'Date of Knowledge' or 'Date of Discovery' of the disease. See Limitations Act 1980.
[130] (1998) PIQR P201.
[131] [2000] IRLR 487 (CA).
[132] [1998] PIQR 201 City Ct (Mr Recorder Pawlak Q. C.).

required.[133] The court came to the conclusion that since the transferee was liable for the acts and omissions of the transferor under Regulation 4 (ex reg. 5) of TUPE, the former was thus not exempted from liability for personal injury claims of the employee transferred to his workforce.[134]

The CA went on to note, however, that where the transferor has in place an employer's liability insurance policy (as required under the Employer's Liability (Compulsory) Insurance Act 1969), the employer's right to indemnity under the policy also transfers to the transferee.[135] This meant that the transferee should be able to call on that cover to meet any personal injury liabilities incurred while the business or undertaking was still in the hands of the transferor but which has now transferred to him or her as the new employer following the business transfer.

The effect of this decision is that where a relevant TUPE transfer of an undertaking takes place, the transferor's liability in tort to an employee will transfer to the transferee notwithstanding that the tort was committed prior to the business transfer. *Bernadone* exemplifies how a transferee who was never in the picture at the time when an employee sustained an injury could become subject to liabilities. This case is also judicial authority that non-contractual liabilities are capable of transferring to a transferee even where there was no contractual relationship in existence between the parties (as in the instant case between the insurance company and the transferee). Depending on the industry in which the business operates, if buyers take into account these types of scenarios happening before buying a business, this could have serious consequences for business rescues.

In *DJM International Ltd v Nicholas,*[136] a non-contractual liability in respect of an employee's right to claim for sex discrimination[137] against the transferor was held to have transferred following a business transfer. Mrs Nicholas was employed by D J Mouldings Ltd from October 1967 until July 1992 (when she claimed that she was forced to retire). In July 1992, she was re-employed on a part-time basis by D J Mouldings. In September of the same year there was a transfer of an undertaking

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[133] See *Marleasing SA v LA Commercial Internacional de Alimentacion SA* [1999] 1 CMLR 205.

[134] *Bernadone v Pall Mall* [2000] IRLR 487 (CA) (Blofeld J).

[135] The court took the view that it would be unjust to allow for the insurance company, having accepted the risk, and having taken the premium, to walk away from its obligation under the circumstances.

[136] [1996] IRLR 76.

[137] *DJM International Ltd v Nicholas* [1996] ICR 214. See also *Tsangacos v Amalgamated Chemicals Ltd* [1997] ICR 154.

from D J Mouldings to DJM International Ltd. Mrs Nicholas then worked for DJM International until she was made redundant in February 1993, after which she complained of unlawful sex discrimination to an industrial tribunal.

The tribunal found that any liability in respect of the act of sex discrimination complained of by Mrs Nicholas (which according to her, forced her retirement in July 1992), transferred from DJ Mouldings in September 1992 to DJM International the transfer of the business from the former to the latter. In the tribunal's view, the act complained of, need not have arisen out of Mrs Nicholas's contract of employment existing at the date of the transfer from DJ Mouldings to DJM International: it could have arisen under her earlier contract of employment with DJ Mouldings which had ceased to exist before the date the business was transferred.

On appeal to the EAT, the EAT rejected DJM International's argument that it was not liable, because it failed to take into account the width of the wording in what was then Regulation 5(2) (b) of TUPE 1981.[138] The provisions of Regulation 5(2) (b) applied, not only to things done before the transfer in respect of the contract in issue, but also to anything done in respect of a person employed in the business or undertaking prior to its transfer. Accordingly, anything done in respect of such a person or tort committed against the individual would be taken to have been done by the transferee. According to the EAT, the issue was not whether what was done was in respect of a particular contract, but whether it was in respect of a particular person who was employed in the undertaking transferred. It followed that since there was an employment relationship between Mrs Nicholas and DJ Mouldings on the date its business was transferred to DJM International, liabilities in respect of the act committed against her (sex discrimination) also transferred under the old Regulation 5 (2) (b) of TUPE 1981. The appeal was dismissed.

The cases analysed above demonstrate the problems that the Transfer Regulations could pose to the rescue of insolvent businesses. The courts have

[138] The wording of Reg. 5(2) (b) reflected the reference in Article 3(1) of the 1977 ARD to 'an employment relationship existing on the date of a transfer.' This, arguably, had a more extended meaning than 'obligations arising from a contract of employment'. What this means is that reference to anything done in respect of a person employed in an undertaking in Reg. 5(2)(b) had to be read in the light of, and consistently with, the reference to 'an employment relationship' in Article 3(1). This should also be construed as referring to obligations other than those which arose out of the particular contract of employment. In other words, Reg. 5(2) (b) was not limited to those obligations which arose out of the particular contract in existence at the date of the transfer.

construed the TUPE Regulations in a way that makes liabilities dependent upon the existence of an employment relationship between the employee and the transferor on the date of the transfer. The effect is that whatever happened to the employee during his or her time with the transferor will be deemed to have happened during the employee's employment with the transferee. These types of unforeseen and unbudgeted costs can impact on going concern rescues. The wider the types of liabilities the more risky and potentially expensive a business purchase will be. Ultimately, the employees are the ones whose interests may be prejudiced if the weight of employee-related obligations prevents a going concern sale of the insolvent business from being achieved.[139]

6.8 Transfer-connected dismissals

The rescue insolvent but viable businesses in the UK are also hampered by the rule on dismissal. The scheme of employee protection envisaged by the Transfer Regulations' is re-enforced by the provision of Regulation 7 (ex reg.8). Regulation 7 (1) (which implements the provisions of Article 4 (1) of the ARD) makes certain transfer-related dismissals automatically unfair.[140] By virtue of Regulation 7 (1), if an employee is dismissed before or after a relevant transfer and, the sole or principal reason for the dismissal is the transfer itself or a reason 'connected with *the* transfer'[141] that is not for 'an economic, technical or organisational (ETO) reason entailing changes in the workforce'[142] the dismissal will be automatically unfair. [143]

Apparently, Regulation 7 (1) is intended to reinforce extant statutory protection against unfair dismissals available for employees in the general unfair dismissal

[139] Simon Deakin and G S Morris, *Labour Law,* 4th ed. (Harts Publishing, Oxford 2005) 216-235. See also evidence presented by the Society of Practitioners of Insolvency to the Select Committee on the European Communities that investigated the feasibility of the ARD, Session 1995-96, 5th Report (HMSO, 1996) 66.

[140] *Kerry Foods Ltd v Creber* [2000] ICR 556.

[141] It is important to point out that the old Reg. 8(2) did not contain the words 'reason connected with the transfer' now found in Reg. 7(2) of TUPE 2006. The lack of clarity in that respect was very controversial. The difference between the old Regulations 8(1) and (2) was contested at the CA in *Warner v Adnet Ltd* [1998] ICR 1056 where it was argued on behalf of the employee that Regulations 8 (1) and (2) were mutually exclusive, and that if the tribunal concluded that the dismissal of the employee was for a reason that fell within Reg. 8(1), it was precluded from considering the case under Reg. 8(2).

[142] TUPE 2006, Reg. 7(2) & (3).

[143] The CA has reaffirmed this position in *Spaceright Europe Ltd v Baillavoine and anor* [2011] EWCA Civ 1565.

law contained in ERA 1996.[144] The primary aim is to prevent the use of transfers by a relevant employer as a pretext for dismissing employees and then re-hiring them under new contracts on (presumably) wholly revised and inferior terms.

The flip side to Regulation 7 (1) is that a dismissal for an ETO reason may be potentially (but not automatically) fair.[145] The burden of proof, however, is on the dismissed employee to show that his or her dismissal was carried out because of the transfer or for a reason connected with it. For the employer, it seems that redundancy[146] or 'some other substantial reason' within section 98(1) (b) of ERA 1996 would provide valid ETO justifications for dismissals.

Regulation 7 (1) is however problematic because of the uncertainty surrounding the meaning of the word *'the'* (as used in the phrase 'connected with 'the' transfer). The meaning has been elusive for more than 16 years now since the first tribunal decision on this issue was handed down in 1994.[147] Does it mean that a pre-transfer *dismissal must be connected* only *to a 'contemplated' transfer* or is it that a *dismissal can be connected to any transfer that eventually occurs*, notwithstanding that the exact transfer in itself was not contemplated at the time of the dismissal.

UK judges are not agreed on the exact meaning of the words. On a straight forward reading, it would appear that 'the transfer' means that the dismissal must be for a reason connected with a transfer contemplated at the time of the dismissal. This reading has found support in some decided cases. But so too has the opposite reading been given judicial blessing in other decided cases (see discussion below on timing of dismissals). Most of the decided cases on 'transfer-connected dismissals' were based on the old Transfer Regulations, but the TUPE Regulations 2006 has retained the same wording and offers no more clarity. It seems that for the ETO defence to avail an employer, the timing of the dismissal

[144] See in particular Part X of ERA 1996.

[145] In *Meade and Baxandale v British Fuels Ltd* [1998] ICR 387, the CA held that a dismissal which falls under what is now Reg. 7(1) (formerly Reg. 8(1)) had to be construed in light of Article 4 (1) of the ARD and that, if construed in that manner, a dismissal covered by it terms would be void and ineffective rather than merely automatically unfair.

[146] In *Gorictree Ltd v Jenkinson* [1985] ICR 51, for example, the EAT said that an 'economic reason' for dismissal would include redundancy. But it does not include a broad economic reason such as dismissal effected for the purpose of obtaining an enhanced price for the business or a desire to achieve a sale. See *Wheeler v Patel* [1987] ICR 631. In *Whitehouse v Charles A Blatchford & Sons Ltd* [2000] ICR 542, the CA said that a transfer could be the occasion for the reduction in workforce without necessarily being the cause or reason for the reduction.

[147] See *Ibex Trading Co Ltd v Walton & ors* [1994] ICR 907, EAT discussed below.

and the interpretation adopted by courts in relation to Regulation 7 will be crucial factors.

6.8.1 Dismissals and transfer of liabilities: timing of dismissals

The problem with TUPE and dismissals is that it is very difficult to judge with absolute certainty how early or late dismissals can be carried out prior to the actual business transfer without these being deemed transfer-connected by the courts due to conflicting authorities on this issue since 1994.[148] The courts have moved the goalposts several times on this issue therefore there is no specific authority that can be relied upon regarding a definite time span. One problem for buyers of insolvent businesses is that a dismissal in advance of sale may still be regarded as transfer-connected.

The difficulty with timing dismissals in advance of sales is reflected in the number of cases TUPE has generated over the years and the differing outcomes of these cases. These differences may be attributed to the different interpretational approaches adopted by different English judges on the matter. While some judges adopt a broad interpretation to questions of 'pre-transfer' and 'transfer-connected' dismissals, others adopt a narrow approach which seems to support the proposition that a specific transfer must be in contemplation at the time of dismissal in order to establish the necessary nexus. There is uncertainty also regarding post-transfer dismissals effected in the context of TUPE transfers.

Below are some cases on pre-transfer dismissals and the narrow interpretation adopted by the courts on them.

6.8.2 Pre-transfer dismissals: narrow interpretation approach

There are, as noted earlier, conflicting authorities on whether or not a dismissal in the face of a putative business transfer is connected with the transfer and therefore automatically unfair in the absence of an ETO reason. Instances abound where the courts and tribunals have appeared ready to sacrifice employee protection on the altar of business rescue. Some decisions appear contrived by

[148] The reading that was approved by the court in *Ibex Trading v Walton* in 1994 was completely opposite to the one supported in *Harrison Bowden v Bowden* (both cases are discussed in detail below) also in the same year by a differently constituted EAT. See case analysis below. Though these cases were decided under the old regulations, the 2006 Transfer Regulations retained the same wording and offer no more clarity.

judges to promote rescues of insolvent undertakings. However, the courts have said that every case is determined based on its own facts. This is capable of producing different results even in situations where the facts of two cases may be similar. Nevertheless, by adopting a narrow interpretational approach to the words 'transfer-connected dismissals', it seems courts are determined to save insolvent but viable businesses in spite of TUPE.[149]

One of the earliest cases on transfer-connected dismissal was *Ibex Trading v Walton and ors.*[150] This case provides judicial authority for the proposition that a specific transfer must be in contemplation at the time of a dismissal in order to establish the necessary 'connection' between a dismissal and the eventual transfer of the undertaking (the narrow interpretation approach). In *Ibex,* the claimants were employed by ITC Ltd when in August 1991 administrators were appointed to run the affairs of the company. The administrators decided to relieve the company of its debts by selling its business. To achieve that aim, they sought to reduce the size of the workforce and lower the wages of those who remained. On 16 October of 1991, 40 of the 94 staff employed by ITC were given notices of dismissal for reason of redundancy. The actual dismissals took effect on 4th of November of the same year. Nine days later the administrators received an offer for the business, and the sale was completed in February of the following year. Walton and six of his ex-colleagues brought unfair dismissal claims against the transferor and the transferee.

The Employment Tribunal (ET) and the EAT were not convinced that the dismissals carried out were connected with the subsequent transfer of the business. The EAT held that while it could be said that the employees were dismissed for a reason connected with 'a' possible transfer, they had not been dismissed for a reason connected with the transfer that eventuated. It opined that at the time the dismissals occurred the transfer of ITC's business was a *'mere twinkle in the eye and might well have never occurred.'* Clearly here the court gave business rescue the edge over employment protection.

[149] It is important to mention that most of the cases that will be reviewed below in relation to transfer-connected dismissals happened under the old Regulation 8 of TUPE 1981. Also, although not all of the dismissals in the cases discussed below took place in the context of insolvency, the same principle applies to dismissals made in the context of insolvent business transfers.
[150] [1994] ICR 907, EAT.

In *Dynamex Friction Ltd & anor v Amicus & anor*[151] the Court of Appeal (CA) had to consider whether the dismissal of the employees, (claimed to have been necessitated by an 'economic' reason rather than for a transfer-related reason, as held by the ET), was justified. The facts of the case are that Mr Smith was the sole Director of Friction Dynamics Limited (FDL). Following an application by him, joint administrators were appointed. The administrators immediately dismissed the entire workforce because there was no money to meet their wage bills. FDL's production line and customers were subsequently taken over by Dynamex Friction Limited (DFL). DFL also took on 60 of FDL's former employees. DFL had been set up by an ex-Friction employee with support from Mr Smith who later acquired a controlling shareholding. Parts and machinery of FDL were sold to Ferotec Realty Limited (FRL) (controlled by Mr Smith himself) that owned the premises from which FDL operated its business.

Claims were brought by the employees dismissed by FDL's administrators. The contentious issue was whether the pre-transfer dismissal was stage-managed by the administrators in order to create an avenue for the eventual transferee to avoid taking the employees on and evade liability under TUPE. The ET found that there was no collusion between the administrator and Mr Smith meaning that the employees were dismissed for an economic reason. Liability for the employees' claims therefore fell to the state and not to the transferee.

The EAT disagreed. However, on further appeal to the Court of Appeal (CA), the CA upheld the ET"s decision. It held that when an ET is determining the reason for a dismissal, what counts is the thought process of the decision maker. Here, the decision maker (who was the administrator) dismissed the employees because there was no money to pay wages. As far as the CA was concerned, the reason for the dismissal was not the prospective transfer. Rather, the reason was purely an economic one based solely on the company's poor cash-flow situation. Here again, it seems that the need to save the business must have influenced the CA's decision. The conflict between business rescue and employee protection was once again decided in favour of business rescue by construing the words 'transfer-connected dismissals' under Regulation 7 narrowly.

Notwithstanding the unfavourable outcome of the *Dynamex* decision for the employees, the case is, without a doubt, confirmation that the motive or thought

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[151] [2008] ECWA Civ 381.

process of those who actually take the decision to dismiss will be crucial in establishing whether or not a particular dismissal is transfer connected. Granted, in the instant case, the transferee was not held liable. This does not, however, detract from the fact that the transferee may be liable for dismissals made before the business was transferred even though at the time of the dismissals he or she was not in the picture.

6.8.3 Pre-transfer dismissals: broad interpretation approach

It seems that in relation to TUPE, and especially on matters of dismissals in connection with business transfers, the employees find favour with the courts any time they cast their net wide. That is to say, the employees' right not to be unfairly dismissed during transfers is most protected when courts adopt a broad interpretation approach in relation to Regulation 7.

In *Harrison Bowden Ltd v Bowden,*[152] the company (NGS) experienced serious financial difficulties and went into receivership in January of 1991. NGS's business was run by G on behalf of the receivers. On the 29th of January 1991, G placed an advertisement in the Financial Times for the sale of NGS's business. The following day HB Ltd responded to the advert and showed interest in buying the business. On 31st January 1991 majority of NGS's employees (including the claimant) were dismissed by G for reason of redundancy while the sale was completed 8 days later. Bowden brought a claim for unfair dismissal.

The ET held that the dismissals that were made were transfer-connected because they were aimed at facilitating a proposed transfer. The transferee (HB Ltd) appealed against the decision, arguing that Regulation 7 can only have effect where there is an actual or where a prospective buyer had been identified by the transferor (here the receiver) at the time dismissals are effected. The EAT rejected the transferee's argument. It held that the dismissals were for a reason connected with the transfer, and so automatically unfair, despite the fact that at the time of the dismissals no actual or prospective buyer had been identified.

In reaching its decision, the EAT adopted the ECJ's approach in *Bork,*[153] in which the latter noted that it was necessary to look back in time and take into account the objective circumstances in which a dismissal occurred if a subsequent transfer

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[152] [1994] ICR 186, EAT.
[153] See *P Bork International A/S v Foreningen af Arbejdslederen i Danmark* [1989] IRLR 41.

took place. The EAT's decision must have been made on policy grounds. It must have feared that to take any action to the contrary could set a bad precedence and potentially open a loophole in the Transfer Regulations to be exploited by transferees and transferors alike to the disadvantage of the employees during transfers of undertakings. Although the *Bowden* decision is capable of affecting decisions to purchase insolvent businesses, it can be argued that the EAT's interpretation of Regulation 7 was a purposive one intended to give effect to the protective intent of TUPE. With this approach, the tension between employee protection and business rescue in insolvent business transfer, was decided, it seems, in favour of the former.

In *CAB Automotive Ltd v Blake & anor,*[154] after RDS Automotive Interiors Ltd went into administration, only those employees who were deemed necessary to fulfill existing contracts were retained by the administrator. All other employees were dismissed on grounds of redundancy. Subsequently, RDS's assets were transferred to CAB Automotive Ltd. The dismissed employees brought claims for unfair dismissal against RDS and CAB Automotive Ltd. The EAT held that the administrator's intention in dismissing the employees was to ensure that the business would be attractive to buyers. Therefore, the dismissals were connected with the transfer. The EAT was of the view that the protection provided to employees against dismissals in a TUPE business transfer apply even in circumstances where potential buyers are merely interested in buying the business but at the time of the dismissal no firm agreement had been reached on the sale of the business. This approach favours the employees. It restricts transferors' ability to dismiss employees and dispose of the business. It aligns with the Traditionalists ideals on employee protection (see chapter 2).

Coutinho v Vision Information Services (UK) Ltd and another[155] concerned Vision Information Services (VIS) which entered in 2003 into negotiations to sell its business to Deluxe Media Services (DMS). At the time, Coutinho was the highest earning employee at VIS and was made redundant in March 2004. VIS's business was subsequently sold to DMS in July 2004. Coutinho brought a claim for unfair dismissal and race discrimination. He argued that his dismissal was for a reason related to the transfer. The tribunal found that there had been a relevant transfer

[154] [2007] UKEAT/0298/07

[155] EAT/0469/07, 31.10.07, (unreported). See also *Vision Information Services (UK) Ltd v Coutinho* EAT/0466/06, 20 August 2007 (unreported).

from VIS to DMS and that Coutinho was dismissed in order to facilitate the sale of the business. The dismissal was therefore for a reason connected with the transfer which the ETO defence could not avail the transferor. Consequently, DMS was liable for damages for unfair dismissal and race discrimination. This is clearly another case in which employee protection is privileged over business rescue.

In the 2011 case of *Spaceright Europe Ltd v Baillavoine and anor,*[156] the CA upheld the decisions of both the ET and the EAT that the dismissal of the Claimant (Mr Baillavoine) was for a reason connected with the transfer therefore automatically unfair. The claimant (Mr Baillavoine) was employed as Chief Executive Officer of Ultralon Holdings Limited ('Ultralon'), a company that manufactured office equipment. In May 2008, the company went into administration and the same day, Mr Baillavoine's employment was terminated. A month later, the business and assets of Ultralon were sold as a going concern to *Spaceright Europe Limited* ('Spaceright'). Mr Baillavoine claimed that the eventual transfer was a 'relevant transfer' under the TUPE Regulations 2006 hence his dismissal was automatically unfair because it was connected with 'the' transfer.

Both the ET and the EAT took the view that the reason for the claimant's dismissal was related to the sale of the business and therefore the dismissal was unfair. On further appeal to the Court of Appeal (CA), the key issue brought before the court centred on the meaning of the phrase : *'a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce'* in Regulation 7(1) (b). Was the phrase to be construed as requiring a specific transfer to be in contemplation at the time of dismissal? Or was it to be interpreted more widely so that a dismissal would be deemed connected with a transfer even though no actual prospective transferee had been identified at the time the dismissal was effected? (See earlier articulation on this point above).

The CA did not accept the Administrator's evidence of the reason behind the dismissal. It adopted the second and broad interpretation holding that Mr. Baillavoine's dismissal was necessitated mainly by a desire on the transferor's part to attract the purchaser. What the CA's decision simply means is that there need not be a specific intent to sell in order for a dismissal to be deemed connected with the eventual transfer. This decision encapsulates and reinforces

[156] [2011] EWCA Civ 1565.

previous case law[157] by confirming that employees dismissed before a business sale can argue that their dismissals were connected with an eventual transfer. Thus, affected employees may not need to show that a specific transferee had been identified at the time of dismissal.[158]

In relation to pre-transfer dismissals, and as it stands, *Spaceright* is the latest authority. Whether this will be the last we will hear on this point is hard to tell. The decision is further demonstration of the different types of TUPE liabilities to which a purchaser of an insolvent business could be exposed. This will exacerbate the problem by putting further pressure on the amount prospective purchasers of such businesses would be willing to pay for them. Granted, the broad interpretation tends to favour workers and aligns with the Traditionalists, such an approach, it is submitted, could be detrimental to the rescue culture. It could 'over deter' purchases which is a major concern of the Proceduralists.[159]

While it makes sense for courts to hold that where a transfer is contemplated (rather than a specific sale), dismissals around that time should be deemed effected to facilitate the sale and should therefore be automatically unfair, there is a real danger of a presumption that administrators are never dismissing employees for business conduct. To hold such a view, it is submitted, is not only unfair to insolvent transferors, but could be harmful to insolvent business rescues since there are genuine underlying economic reasons for dismissals in some cases. In any case, this problem reflects the inherent tension between rescues oriented insolvency law and employment protection legislation in transfers.[160]

Whilst it is desirable to have a legal authority to which reference could be made in future on this point, it cannot be stated with absolute certainty that this will be the last we will hear of this issue. This is a truism as each case will be decided based on its unique facts.

[157] See particularly the EAT's decision in *Morris v John Grose Group Ltd* [1998] IRLR 499 and *Harrison Bowden Ltd v Bowden* [1994] ICR 186.
[158] Charles Wynn-Evans, 'Transfer-related dismissals – the latest case law' (2008) ELJ 7.
[159] See chapter 2 on theories.
[160] It seems that by the time the CA made its earlier decision in the *Dynamex* case, courts and tribunals may have had an ideological shift from employee protection to facilitating going concern rescues of insolvent undertakings. However, such a conclusion would be hasty or premature given that there is no consistent pattern on how courts construe the provision of the Transfer Regulations on dismissals that could be pointed to since 1994. Confusion looms.

What is evident in the two approaches (i.e. the broad and narrow interpretations) adopted by the courts in the construction of TUPE's provision *vis-à-vis* pre-transfer dismissals is that, the narrow approach tended to prioritise business rescue over employment protection. This approach ensured that employees-related liabilities did not deter the purchases and rescues of insolvent but viable undertakings. On the other hand, the application of the broad interpretation approach favoured the employees. It was employment protection friendly because it ensured that the employees of insolvent businesses were not unfairly dismissed during transfers.

6.9 Post-transfer dismissal case law

Regulation 7(1) is not limited to pre-transfer dismissals. It covers post-transfer dismissals as well. It states:

> Where either before or *after*[161] a relevant transfer, any employee of the transferor or transferee is dismissed, that employee shall be treated for the purposes of Part X of the 1996 Act (unfair dismissal) as unfairly dismissed if the sole or principal reason for his dismissal is—(a) the transfer itself; or (b) a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce.

The transferee, like the transferor (in the context of pre-transfer dismissals) could be liable for unfair dismissals effected long after the business had been transferred. The difficulty faced by transferees, like their transferors counterparts, is that there is no specific authority on a time limit in which a post-transfer dismissal may or may no longer be deemed transfer-connected. This is because in spite of when the dismissal was done, it may still be possible for it to be linked to the transfer that took place. This however will depend on the circumstances that led to the dismissal. The onus is however on the employee. If the affected employee can establish that his or her dismissal was due to the eventual transfer, or for a reason connected with it, the dismissal would amount to a breach of Regulation 7(1) of TUPE 2006.

In *Taylor v Connex South Eastern Ltd,*[162] Taylor (T) refused to accept changes to his terms and conditions which were introduced (for purposes of harmonisation) two

161 Emphasis mine.
162 EAT 1243/99

years after his employment transferred under TUPE from British Rail to CSE. For refusing to accept those terms, T was dismissed and he brought an unfair dismissal claim. T's argument that he was dismissed for a reason connected with a relevant transfer, contrary to TUPE, was accepted by the ET. The ET noted that there is no specific time after a business has been transferred that a dismissal that was effected and which was transfer-connected will cease to be so deemed. In other words, what the ET was saying is that the passage of time may break the chain of causation, but the mere passage of time without anything happening will not suffice. The important consideration is not the elapse of time; rather it is what has occurred in that time to break the link between subsequent changes to the employment contract and the transfer that took place.[163]

On appeal, the EAT overturned the ET's decision based on the reason it found for T. However, turning to the facts, the EAT found that T's dismissal was transfer-connected because it was one of the important terms of his contract that transferred under TUPE that was the subject of CSE's attempt to change T's contract.

In *London Metropolitan University v Sackur and ors*[164] (a public sector case) a similar conclusion was reached by the EAT. The case concerned the merger of two universities to form London Metropolitan University (LMU). Post-merger, the new university (LMU) tried to harmonise terms and conditions of employment. After negotiations broke down, the employers imposed the new terms. Staff subsequently claimed unfair dismissal. The Employment Tribunal held that employees dismissed two years post-transfer, in order to effect harmonisation changes, had been dismissed for a reason connected with the original transfer.

At the EAT, the question turned on whether the employer's actions could be justified on the basis of an ETO reason entailing changes in the workforce.[165] The EAT was of the view that for the ETO defence to apply there had to have been a reduction in the number of employees employed or a change in the job functions

[163] See also the case of *Sackur* below.
[164] EAT 0286/06
[165] There is no definition of 'workforce' in either the Transfer Regulations or the ARD- from which it derives. However, case law has established that the word 'workforce' covers more than just employees. It encompasses all individuals working within the organisation, whether as employees, franchisees or individuals working under some other arrangements. See e.g. *Hardy and others v Meter U Ltd,* ET/1700982/10 to ET/1700986/10. Regarding what the phrase 'entailing changes in the workforce' means, see *Delabole Slate Limited v Berriman* [1985] IRLR 308, CA (Lord Browne-Wilkinson) .

of the entire workforce.[166] As there was no reduction in the workforce in this case but simply a desire on the part of the employer to change the terms and conditions on which existing employees continued to work, the EAT held that the ETO defence did not avail the university meaning that the employees were unfairly dismissed.[167]

The main difficulty envisaged with the EAT's decision is that the provisions in the revised 2006 TUPE Regulations, which appear to allow employers to change employment terms where there is an ETO reason, may also be otiose if the employer cannot, at the same time, establish a workforce reduction.[168] This case is, once again,[169] illustrative of the difficulty transferees may face where they seek to change employees' terms of employment to bring them into line with the rest of the workforce post business transfers.[170] Granted, the further away a given transfer is from a dismissal, the less likely it is that it will be deemed connected to it, but this will always be a matter of fact and degree for the ET. What will always be of paramount considerations is whether there is a link between the eventual transfer and the dismissal; and whether that connection was the main reason between the dismissal and the transfer. However, not every dismissal will be held transfer-connected and hence in breach of Regulation 7 as each case is decided on its own facts.

In sum, the benign intention of Regulation 7 is not in doubt. It protects workers against unfair dismissals in transfer situations. However, Regulation 7's (over) protective disposition could adversely harm the very employees it was meant to protect as it threatens their job security. When a business is insolvent, its survival may depend on the transferor's ability to sell it as a going concern. In most cases, ability to sell an insolvent business is dependent on whether the terms of sale are

[166] *Delabole Slate Ltd v Berriman* [1985] IRLR 305 CA. The Court of Appeal in that case upheld the EAT's decision that a dismissal which occurred as a consequence of a change in terms of employment following the transfer of an undertaking was not a dismissal for 'an economic, technical or organisational reason entailing changes in the workforce', and so was automatically unfair under reg. 8(1) of TUPE 1981.

[167] See also *Vallance v Maes Corporation Ltd* ET Case No. 1101491/09

[168] John McMullen, 'Much Lies in Store for TUPE Laws in 2007' (2007) http://www.personneltoday.com/articles/2007/01/09/38777/much-lies-in-store-for-tupe-laws-in-2007.html accessed 30 March 2012.

[169] See *Delabole Slate Ltd* (n 123) above.

[170] It is pertinent to note however that a dismissal which is automatically unfair by virtue of reg. 7(1) of the Transfer of Undertakings Regulations can become effective if it is 'accepted' by the employees transferred. This was the view taken by the EAT in the case of *Cornwall County Care Ltd v Brightman and others* [1998] IRLR 228 EAT.

favourable to the prospective buyer. Sometimes, as a pre-purchase condition, a prospective buyer may request the transferor to downsize the workforce.[171]

However, as the various cases analysed above demonstrate, it is difficult to achieve that result without the courts treating the dismissals as carried out with the aim of facilitating the eventual transfer.[172] Whether the transferor can successfully argue that the dismissals were necessary for the survival of the business, and that they were not effected merely to satisfy the transferee's pre-purchase condition, is difficult to say. This is a burden[173] that is very difficult to discharge.[174] Case-law has demonstrated that arguments by transferors that pre-transfer dismissals are not transfer-motivated do not always prove successful. The situation is further compounded by the facts that there is no specific authority on when it might be considered safe to dismiss employees before or after a business transfer and because of the requirement to construe the provisions of TUPE purposively to achieve its employee protection purpose.[175] These issues, it is submitted, do not augur well for the rescue culture. For potential transferees, the fear of potential liabilities would be the beginning of wisdom not to buy such insolvent businesses. Ultimately, the closure of the business would be most felt by the employees who would lose their jobs.[176]

[171] For example, in *Longden v Ferrari* [1994] BCC 250, a prospective transferee gave the receivers a list of workers to retain. The receivers then dismissed the remaining employees at the instance of the would-be transferee. However, in spite of the available evidence that there was collusion between the eventual transferee and the receivers, the EAT refused to set aside the Industrial Tribunal's finding of fact that the dismissals were eventuated by financial constraints and pressure from the appointor, rather than because the receivers had received a request or instruction from the prospective purchaser.
[172] Frisby (n 1) 257.
[173] Regarding claims on transfer-connected dismissals, the burden of showing that the dismissal was necessitated by a reason other than the transfer itself and which makes it fall within Regulation 7(2) shifts to the transferor. See the House of Lord's view on this in *Litster v Forth Dry Dock Engineering Co Ltd* [1989] ICR 341, 353-54 (Lord Templeman). See also *Gateway Hotels Ltd v Stewart* [1989] IRLR 287.
[174] This burden can only be successfully discharged if the transferor can demonstrate that the dismissals were objectively necessary and were not effected just to facilitate the sale that eventuated. See *Willis v McLaughlin and Harvey Plc,* [1996] NI 427 (Kerr J) at 444.
[175] See Section 3(1) of the European Communities Act 1972. See also *Marleasing SA v LA Commercial Internacional de Alimentacion SA* [1999] 1 CMLR 205.
[176] Collins (n 31); Frisby (n 1); Massara (n 10); Anneli Loubser, 'The Interaction Between Corporate Rescue and Labour Legislation; Lessons to be Drawn from the South African Experience' (2005) 14 Int'l Insol. Rev. 57-69; Parr & Benett (n 1); Sargeant (n 16); McMullen (n 7); Burdette (n 7); Etukakpan (n 77).

6.10 Transfer Regulations: interpretations and effects of other provisions on business rescue and employment protection

The 2006 revised Transfer Regulations now contain special provisions to aid transfers of insolvent undertakings.[177] Prior to these measures, transferors of insolvent businesses had to carefully navigate TUPE's provisions in order to avoid liabilities during transfers. Successful utilisation of these mechanisms depended, however, on how the courts interpreted them where they were legally contested. Whereas some of the provisions of the original TUPE Regulations have been retained in the 2006 regime, the 'hiving-down' provision of the old regulation 4 (see discussion above) considered a major way of rescuing insolvent businesses has not. This is because even though the mechanism was rescue friendly, it was detrimental to the employees' interests in business transfer situations. It defeated TUPE's purpose of protecting the employees' rights during business transfers.[178]

Below we consider the interpretations the courts have given to some words and concepts and their effects on business rescue and employment protection.

6.10.1 The 'employee' in the context of TUPE

According to Regulation 4(3) of TUPE 2006 an employee is:

> … a person employed by the transferor and assigned to the organised grouping of resources or employees that is subject to a relevant transfer, is a reference to a person so employed immediately before the transfer, or who would have been so employed if he had not been dismissed in the circumstances described in regulation 7(1)...

This seems to suggest that both the transferor and the transferee of an insolvent business may be able to avoid liabilities where the employee could be dismissed in advance before the transfer because he or she would no longer be considered an 'employee' under the terms of Regulation 4(3). The view then was that if the IP made dismissals as close to the point of transfer as possible, no employee would be *employed immediately before the transfer*. This would then ensure that no employee transferred and the transferee could avoid inheriting employee-related liabilities.

[177] These provisions are contained in Regulations 8 & 9 of TUPE 2006 discussed in chapter 7.

[178] See the courts' views on this in *Litster v Forth Dry Dock Engineering Co Ltd* [1989] ICR 341 and *Re Maxwell Fleet and Facilities Management Ltd (in Administration)* [2000] IRLR 368 discussed above.

Dismissing employees very close to the period of the actual business transfer was a shrewdly contrived stratagem to ensure that the IP could secure the services of the employees for as long as possible and use them to continue the business to the very moment before the business was transferred.[179] Usually, if there is any prospect of rescuing the company's business in administration proceedings, for example, the IP must be able to sustain the essential activities of the business for a period while an assessment is made to determine whether a rescue is feasible. This allows time for negotiations to be commenced with potential buyers of the business as a going concern.[180] In relation to TUPE 1981, the success or failure of this practice depended however, on how the courts interpreted the old Regulation 5(3) (now 4 (3)).[181] That is, whether the regulation was given a literal or purposive, wide or narrow construction as discussed above in relation to the other provisions.

A literal and narrow interpretation aided rescues of insolvent businesses whereas a purposive and wide orientation tended to work in favour of employment protection. In any case, each case was decided based on facts unique to it. The courts will take into account factors such as whether a temporary period between dismissal and the transfer of the business could quash any argument that an employee was *not* employed in the business or undertaking when the transfer took place. The result of each case depended on how the courts construed the words: '*a person employed immediately before the transfer'.*

6.10.2 Judicial construction of the words 'immediately before the transfer'

As far as the interpretation of the phrase 'a person employed immediately before the transfer' under Regulation 4 (3) of TUPE 2006 is concerned, there was confusion regarding its real meaning and intent. Under the original TUPE, while some judges appeared uncomfortable with the employer's ability to circumvent TUPE simply by terminating employment slightly before the transfer, others tended to condone it perhaps to promote business rescues.

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[179] Frisby (n 1) 254.

[180] This practice which has come under scrutiny by the courts in recent times may have personal liability consequences for the office-holder in relation to 'adoption of contracts' of employment of the employees retained for that purpose. See e.g. *Powdrill v Watson* [1995] 2 AC 394: an employment contract is 'adopted' if the administrator causes the company to continue the employment relationship beyond the 14 days' grace period after his or her appointment. See also Section 19 and 44 of IA 1986.

[181] Frisby (n 1) 255; Massara (n 10); McMullen (n 7).

Judges who tended to support employee protection tried to prevent late dismissals with impunity and to the disadvantage of the employees, by focusing on the meaning of the words 'immediately before the transfer' in early cases and gave them purposive and broad interpretations. It was held in several cases that the words 'immediately before' did not mean a precise instance of time but could mean a *period of time before* the transfer.[182]

In *Kestongate v Miller*,[183] for example, contracts for the sale of R Ltd (R) to Kestongate Ltd (K) were exchanged on 20 August 1984. Four days later the employee was told that she would be dismissed on 31 August. On 14 September the sale of R's business to K was completed. The employee complained to an industrial tribunal (now employment tribunal)[184] claiming compensation for unfair dismissal from K Ltd by reason of Regulation 5 of the Transfer of Undertakings (Protection of Employment) Regulations 1981, on the ground that she had been employed 'immediately before the transfer' within the meaning of the old Regulation 5(3) of TUPE 1981 (now Reg. 4(3) under TUPE 2006). The tribunal held that the Regulations applied.

The flexible and broad and purposive interpretation approach that was adopted by the tribunal in that case, apart from not striking a chord of popularity with transferors and transferees alike, created legal uncertainty. It was not also helpful to the rescue culture. It inhibited the transfer and hence rescues of insolvent businesses. It was not surprising that other judges (who were pro-business rescues?) took the view that intervals of perhaps a day or even a weekend between dismissal and transfer could be ignored.

Secretary of State for Employment v Spence[185] typified this alternative perspective. In that case the employer went into receivership in November 1983. On Monday 28 November, the receiver dismissed the entire workforce of the company three hours before selling the undertaking on a going concern basis to the buyer on the same day. The transferee then re-engaged all dismissed employees the following morning under fresh contracts of employment. The employees claimed

[182] See e.g. *Apex Leisure Hire v Barratt* [1984] 3 All ER 795; *Kestongate v Miller* [1986] ICR 672).
[183] [1986] ICR 672).
[184] Industrial Tribunals were created in the UK by the Industrial Training Act 1964. Under the Employment Rights (Dispute Resolution) Act 1998, the name Industrial Tribunals was changed to Employment Tribunals from 1 August 1998. The change in nomenclature does not affect their function as Employment Tribunals perform the same function as did the Industrial Tribunals.
[185] [1986] ICR 651 (CA).

redundancy payments from the transferor. As the transferor was insolvent, a claim for reimbursement was made to the Secretary of State who refused to pay on grounds that liabilities transferred to the transferee as the employees dismissed were employed in the business *immediately before the transfer*. Both the industrial tribunal and the EAT found in favour of the employees and held that the transferor was liable which meant that the Secretary of State had to reimburse.

However, on further appeal by the Secretary of State to the CA, the latter favoured a narrow interpretation of Regulation 5 and construed the words '*employed immediately before the transfer'* to mean employed *up to the very point the business is transferred.* The CA took the view that as the employees were dismissed moments before the transfer of the undertaking took place, there was nothing on which Regulation 5 of TUPE 1981 could bite. Regulation 5(1) did not therefore apply, as it related only to an employment contract subsisting at the very time the transfer occurred.[186] What the CA was implying was that unless there is a subsisting employment relationship at the very moment a transfer is effected, the protection TUPE offers to the employees against unfair dismissal would not avail them.

For a while, *Spence* was regarded as the judicial authority on the notion that contracts of employment of employees dismissed prior to a transfer, however close to it, do not transfer to the transferee. The decision was rescue friendly but had some limitations. It allowed IP's to utilise the services of the employees and keep the business going up to the point when they were ready to sell the business before dismissing them.[187] It promoted business rescues by eliminating the possibility of buyers being potentially liable for dismissals. Sales arrangements were made in a way that ensured that liabilities for pre-transfer dismissals

[186] The ramification of this decision was that earlier decisions of the EAT such as *Apex Leisure Hire v Barratt* [1984] IRLR 224, which adopted a contrary interpretation of the 1981 regulations, were wrongly decided.

[187] See how the courts reacted to this practice, however, in *Powdrill v Watson* [1995] 2 AC 394 (HL) in the context of of adoption of contracts of employment. The decision may be regarded as a conscious and vigorous attempt by the courts to protect the employees against this sort of practices in insolvency. It **was** to discourage receivers and administrators from retaining the employees and obtaining value-enhancing services from them without providing them with any corresponding job security in return. 'In other words, the decision served to put office-holders on notice that adopting employees' contracts of employment and enjoying the benefits of those contracts by utilising their services to keep the business going and then rejecting the burdens accompanying those contracts by dismissing affected employees just before a sale will not be condoned'. See Etukakpan (n 79) 106.

remained with the insolvent transferor, technically with the Secretary of State, and paid out of the National Insurance Fund (NIF).[188]

Granted, the approach in *Spence* aided rescues of insolvent businesses, but it also had its down side. The CA's interpretation of the phrase 'immediately before the transfer' was too restrictive and had the effect of curbing the full range of protections to which UK employees are entitled under the ARD.[189] While dismissals just before transfers provided the incentive to buy insolvent businesses, some prospective purchasers took the practice to the extreme. As part of the pre-purchase agreements, not only did they request the transferor to repudiate some contracts of employment and dismiss the employees that may be 'surplus' to their requirements, but some prospective purchasers often requested the dismissal of the entire workforce. This afforded them the opportunity to 'cherry-pick' those they wanted to retain, free and clear of accrued rights[190] (such as continuity of service, redundancy payments etc.). *Spence,* arguably, was a return to *status quo.* It took employees back to the *Nokes* era (see discussion in chapter 5) and to the very injustice TUPE was meant to remedy.

6.11 Litster v forth dry dock: game changer

The legality of the extreme practice perpetuated by *Spence* was put to the test in the landmark House of Lords case of *Litster v Forth Dry Dock and Engineering Company Ltd.*[191] To summarize, *Litster* concerned a dispute where an insolvent company (*Forth Dry Dock and Engineering Ltd*) was put into administrative receivership and the receiver dismissed 12 workers including Litster an hour before the sale of the insolvent company's undertaking took place. The reason for the dismissals was so that there would be no staff to transfer to the new entity and liabilities would not transfer to the buyer. Forty-eight hours later, some of the dismissed employees were re-hired by the transferee on less attractive terms and conditions. The dismissed employees contested their dismissals and brought claims for unfair dismissal against the company. The company argued that those

[188] V Finch, *Corporate Insolvency law: Perspectives and Principles* (2nd edn., Cambridge University Press, 2009) ; J McMullen (n 7); Oliver Hyams, *Employment Aspects of Business Reorganisations*, (OUP, Oxford 2006); Frisby (n 1) 256.
[189] Amie Jasmine Ahanchian, 'Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision' (2002) 2 The Journal of International and Comparative Law*,* 29*,* 49.
[190] See e.g. *Harrison Bowden Ltd v Bowden* [1994] ICR 186.
[191] [1989] 1 All ER 1134, [1989] IRLR 161.

dismissed could not be said to be employed immediately before the transfer. The Court of Session held, following *Spence,* that none of the employees were employed 'immediately before' the transfer. The employees appealed.

The House of Lords was asked to consider whether the time between the dismissals and the transfer there could have been contracts of employment in existence so as to enable liabilities for unfair dismissals to pass to the transferee under Regulation 5 (3) of TUPE 1981. Their Lordships were of the view that it was incumbent on Member States' courts to construe national legislation (TUPE) in conformity with the spirit of the ARD.[192] In Lord Oliver's view, the remedies provided in the case of an insolvent transferor would be 'largely illusory unless they can be exerted against the transferee.'[193] Therefore TUPE must be construed teleologically to give effect to the ARD. To achieve that aim, Article 4 of the ARD require a purposive construction of the phrase *'immediately before the transfer'* as used in the TUPE Regulations.

The House of Lords made the point that the construction of the words to a person employed in an undertaking in Regulation 4(3) of TUPE as meaning a person so employed *immediately before the transfer* should not be allowed to derogate from the requirements of the ARD. The HL noted that the automatic transfer provision under Regulation 4 (3) not only applies to workers employed *immediately* before a transfer, but that the rule apply also to employees who are able to show that they would have been so employed had they not been unfairly dismissed for a reason connected with the transfer in accordance with Regulation 7(1) TUPE 2006).[194] For these reasons, the HL held that the reason for the dismissals was the transfer of the business. It appears that what their Lordships did in *Litster* was add

[192] Member States have an obligation arising from an EU Directive to achieve the result envisaged by the Directive. They also have a duty under Article 5 of the Rome Treaty to take all appropriate measures, whether general or particular, to ensure the fulfilment of that obligation. That obligation is binding on all the authorities of Member States including, for matters within their jurisdiction, the courts. It follows that, in applying national law, whether the provisions in question were adopted before or after the Directive, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the Directive in order to achieve the result pursued by it. The aim is to ensure that the way national courts interpret a Directive comply with the third paragraph of Article 189 of the Rome Treaty. See *Marleasing SA v La Comercial Internacional de Alimentacion SA* (1990) C- 106/89.

[193] [1989] IRLR 161, 172.

[194] In fact, the change in approach following the *Litster* decision was such that in the case of *G4S Justice Services (UK) Ltd v Anstey and others* [2006] IRLR 588 EAT, the EAT was able to hold that even employees dismissed for gross misconduct prior to a TUPE transfer, but whose appeals were subsequently upheld, were employed 'immediately before' the transfer, to the effect that their employment transferred to the transferee.

a qualification to Regulation 4(3) to enable an interpretation that is in consonant not only with the terms of the ARD, but also with the jurisprudence of the ECJ developed in relation to the ARD in *P Bork International A/S v Foreningen af Arbejdslederen i Danmark.*[195] In that case, the ECJ had stated that whenever within the framework of contractual relations, there is a change in the natural or legal person responsible for running the undertaking, and that person enters into contractual obligations as employer with the employees, then the ARD will apply.

Litster represented a strong philosophical commitment to upholding and developing EU-derived employment rights. It reflected the English courts' intent to construe implementing legislation purposively to accord with the spirit and letter of EU directives.[196] Perhaps the HL used *Litster* to warn stakeholders in insolvent transfers that it may be prepared to recharacterise certain transactions by pushing at the boundaries of the statutory language as a way of limiting the scope for novel attempts to structure transactions with a view to avoiding the effects of TUPE. The decision represented the first step towards harmonising TUPE with the ARD.

6.11.1 Effects of Litster on business rescue and employment protection

The decision in *Litster* had both positive and negative effects. The judicial creativity in *Litster* trod upon new grounds. It altered the operation of the Transfer Regulations.[197] Besides re-writing the plain words of the Transfer Regulations so as to facilitate an interpretation consistent with European law, the judgment also had wider legal consequences. The HL in that case put relevant employers on notice that, even in circumstances where termination of a contract of employment may be accepted by an employee, Regulation 4(3) still bites where an employee,

[195] [1989] IRLR 41. The question put to the ECJ in *Bork* centred on whether the ARD applied in a situation in which the owner of a building, installations and machinery that were used to operate a factory took over its main elements after the termination of the lease and some interruption in the operations of the undertaking and ultimately transferred them to a third party (transferee) who shortly afterwards returned the undertaking to trading without recruiting new staff. *Bork* was a unique case because the transferee, rather than employing new staff, re-engaged about half of the transferor's workforce that was retained by the lessee without reaching any new agreement with the latter or with the transferor.

[196] See e.g. *Von Colson and Kamann v Land Nordrhein-Westfalen*Case 14/83 [1984] ECR 1891 para 28.

[197] P Wallington and R Lee, 'Transfer of Undertakings: EEC law and judicial creativity' [1989] JBL 513-518, 516.

dismissed by reason of a business transfer, is later re-engaged by the transferee.[198]

The questions provoked by *Litster* therefore are: (1) should dismissals which have already been made be regarded as never having taken place, or (2) should it be accepted that there had indeed been a dismissal, but because they were automatically unfair the employees' contracts are therefore statutorily novated? The consensus seems to be that the second interpretation should prevail. The dismissals are to be treated as ineffective and the employment statutorily continued since there is no concept of 'nullified dismissal' in English law as obtains in the employment laws of some other Member States.[199]

From the employees' perspective, *Litster* was a game-changer. The decision gave back to the employees the protection intended for them by the ARD threatened by the practice encouraged by the *Spence* decision. For some, *Litster* conferred 'super-priority' status on the employees of insolvent undertakings.[200]

Litster may have succeeded in restoring the protection envisioned by the ARD for the employees, but it was not in any way helpful in terms of promoting the 'rescue culture' in the UK. This is because inability to downsize the workforce (albeit in *Litster* the timing was too close to the transfer) increases the cost of the rescue process. The prospect of inheriting liabilities could mean that a prospective buyer would either ask for a price discount or abandon the purchase deal altogether. A 'no deal' situation for an insolvent transferor invariably means that the IP would have to break the business up and sell it piece meal. This option 'while leaving shareholders and creditors comparatively unscathed' would impact negatively on the employees in terms of job security. For the employees, the best outcome would have been the emergence of a buyer who would continue the business as a going concern and preserve as many jobs as practicable.[201] It is in this type of

[198] It would appear that from the decision of the HL, the interval between the two contracts is irrelevant. What matters is that the contracts of employment of employees dismissed and re-engaged would be deemed as never terminated in the first place. This is an improvement on the literal interpretation of reg. 5 that was adopted by the CA in *Secretary of State for employment v Spence* [1986] ICR 651 which was that the employee must be employed 'up to the point of the transfer' to be protected by TUPE.
[199] F R Younsen, *Employment Law and Business Transfers,*(1989) 107.
[200] John Armour and Simon Deakin, 'The Rover Case (2) - Bargaining in the Shadow of TUPE' (2000) 29 ILJ 395, 396.
[201] ibid.

situation that the role of the Transfer Regulations in safeguarding employment rights is often called into question.[202]

In sum, it is important to note that *Litster* did not outlaw dismissals. It only discouraged the practice instituted by the CA's decision in *Spence. Lister* merely requires that dismissals in business transfer situations, especially in those involving insolvent undertakings, should be made fairly, lawfully and reasonably.[203] Through *Litster,* the HL demonstrated a fidelity to the protective purposes of TUPE. *Litster* may be regarded as a warning from the courts that it will not condone the use of transparent devices such as the 'hiving-down' mechanism to deprive employees of the protection intended for them by the ARD and TUPE during transfers.

The hiving-down route having been severely restricted by the courts, it seems that an employer's ability to successfully dismiss employees without incurring liability for unfair dismissals would be dependent on how effective the relevant employer can make use of the economic technical or organisational (ETO) defence as an escape route.

6.12 Using the 'ETO' defence as an escape route

Not all dismissals carried out by the employers in connection with business transfers will be automatically unfair. This is made possible by the ETO provision under Regulation 7(2). There is no statutory definition of what an 'economic, technical or organisational reason' is and so employers have been reluctant to use this provision for fear of being challenged in an employment tribunal. However, Regulation 7(2) operates to disapply Regulation 7(1) in certain circumstances by providing that a dismissal connected with a transfer will not be automatically unfair if the reason or principal reason for the dismissal is an ETO reason entailing change in the employer's workforce. In such circumstances, the dismissal would be treated as having been necessitated either by redundancy or by some other substantial reason within the meaning of section 98(1) (b) of ERA 1996.

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202 Collins (31) 147-158.

203 With regard to reasonableness, the test is whether the employer's decision to dismiss fell within the range of reasonable responses available to it. See e.g. (1) *Post Office v Foley* (2) *HSBC Bank PLC v Madden* [2000] ICR 1283, CA.

Regulation 7(2) may be viewed as 'a defence to the automatic unfairness presumption'[204] of Regulation 7(1) if the two paragraphs are read together.[205] Clearly, what the ETO exception has done is provide the relevant employer with an escape route to avoid liabilities for transfer-connected dismissals. The use of this 'leeway' will depend, however, first, on what constitutes an ETO reason and second, on how broadly the courts construe this concept. Frisby has articulated that, 'the broader the view taken of this concept, the less critical becomes the TUPE dilemma'.[206]

It follows that the ETO defence, if expansively construed by the courts, is capable of restoring the pre-Transfer Regulations' advantages of transferring a business free of its employees and all pre-transfer employee related obligations since the employer can dismiss an employee lawfully for an ETO reason.[207] The implication is that in a business transfer scenario, the transferor, for example, can strategically and lawfully dismiss an employee if he or she can show that the dismissals were necessitated by an ETO reason.[208] However, this strategy must be carefully managed because if an employee is wrongfully dismissed, and the dismissal is not for an ETO reason, liability will still pass to the transferee.

The flipside to this argument is that, the narrower the interpretation accorded the ETO defence by the courts, 'the more employees are protected against strategic dismissals.'[209] The inevitable result would be that rescues of insolvent businesses would be very difficult to achieve in the UK.

6.12.1 The 'ETO' provision: broad or narrow construction?

Perhaps compelled by the need to ensure that the employers' prerogative to restructure the operations of their businesses is not completely eroded by TUPE and the ARD, the ETO shield was made available. The strategy may also have been conceived out of the need to foster the policy of giving distressed but

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[204] See Frisby (n 1) 260; MacMullen (n 7).

[205] See *Warner v Adnett* [1998] IRLR 394.

[206] Frisby (n 3) 260.

[207] This was the approach sanctioned by the ECJ in *Jules Dethier Equipement SA v Dassy and another.*[207] The ECJ held in that case that both the transferor and the transferee may lawfully dismiss employees for an ETO reason without incurring liability for unfair dismissal based on Article 4(1) of the ARD.

[208] *Warner v Adnet* [1998] IRLR 394; *Kerry Foods Ltd v Kreber* [2000] IRLR 10.

[209] Frisby (n 1) 260. See also McMullen (n 7); Ahanchian (n 189); Massara (n 10).

economically viable businesses 'a second chance' of survival. The English courts have demonstrated their commitment to supporting this objective.

The broad construction the courts have given to the ETO concept in certain cases ensures that employee-related liabilities do not inhibit transfers and hence rescues of insolvent businesses. The availability of this defence shifts the burden of proof onto the dismissed employee. That is, a dismissed employee seeking to make the relevant employer liable for an unlawful dismissal will have to prove that: (1) he or she was dismissed for a reason connected to the transfer and; (2) that the dismissal was not made for an ETO reason entailing changes in the employer's workforce.[210] This provision has tended to reduce the protection envisaged by the ARD for the employees as it is considered employer-friendly.[211]

Instances abound where dismissals were made by transferors for the obvious reason of facilitating the sales of an insolvent undertaking, but the courts found creative and permissive ways of construing TUPE by holding that they were made for an ETO reason. Perhaps, this type of creative construction of the Regulations was invented by the courts as a way of supporting the rescue culture that was in the air in the early 1980s.[212] The courts may have come to this conclusion on the view that TUPE curtail employers' freedom to reduce the workforce in an insolvent business and make finding solutions to corporate financial difficulties more difficult to achieve.[213] Perhaps the approach taken to interpreting the provision is further reflection of the conflicting lines of reasoning in relation to the interpretation of the provisions of the Transfer Regulations highlighted in some of the cases already discussed above and the few below.

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[210] See e.g. *Michael Peters Ltd v Farnfield*, [1995] IRLR 190. See also *Honeycombe 78 Ltd v Cummins* [2000] UK EAT 4, December 10, 1999, where the tribunal held that liability for pre-transfer dismissal did not pass to the transferee where the administrator had made the dismissal for an economic reason.

[211] Ahanchian (n 189) 49.

[212] The Cork Committee Report in the 1980s did put a great deal of emphasis on reforming the existing insolvency law, but more so on the need for the system to have a mechanism capable of preserving insolvent but economically viable businesses which, in spite of their financial difficulty, could continue to contribute to the economic life of the country. See the various reports by the Cork Committee, *Report of the Review Committee on Insolvency Law and Practice* (1982) Cmnd 8558; *A Review of Company Rescue and Business Reconstruction Mechanisms: Report by the Review Group,* the Insolvency Service (London: HMSO, 1999). The Committee was chaired by Sir Kenneth Cork, and its membership included representatives of the legal and accountancy professions as well as three co-opted members, authorities on insolvency law. The Committee first met in February 1977 and ran for five years.

[213] F Baumann, 'On Unobserved Worker Heterogeneity and Employment Protection' (2010) 29(2) E.JL & E, 155-175.

In *Anderson v Dalkeith Engineering Limited,*[214] for example, the Scottish EAT held that pre-transfer dismissals made at the request of the prospective purchaser of the business were made for an economic reason covered by Regulation 8(2) of TUPE 1981. Dalkeith Engineering Ltd (DEL) went into receivership in 1983. Anderson (A) was made redundant on March 11 of the same year. On 21 March, Precision Machining (PM), having completed the purchase of the business earlier, re-commenced the business and re-engaged some of DEL's ex-employees. The applicant (A) was not among those re-engaged so he brought a claim for redundancy payment against PM.

It was held that Regulation 5 of TUPE 1981 did not apply to transfer A's dismissal claim to PM because he was not employed at the point of the transfer. A then claimed unfair dismissal under Regulation 8 of TUPE 1981 against the company in receivership. The ET dismissed A's claim. It held that there was an ETO reason entailing changes in the workforce[215] which made A's dismissal not automatically unfair under Regulation 7 (old reg. 8 of TUPE 1981). Normally, dismissals on grounds of redundancy would be for ETO reasons,[216] but the employer will need to make sure that the redundancy is fair within other employment legislation provisions.[217]

However, the approach adopted by the ET in *Dalkieth* caused consternation. The ET appeared to have 'shut its eyes' to the fact that the dismissal was made at the instance of the eventual purchaser. It also failed to take into account the fact that the seller's willingness to oblige the prospective buyer's request to dismiss employees was motivated purely by a desire to secure the sale of the business. Not even the fact that there was a contractual stipulation to that effect in the vending agreement could change the outcome of the case. A's dismissal, according to the ET, was necessitated purely by an economic reason. The

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[214] [1985] ICR 66.

[215] Rarely do courts make a distinction between each of the three ETO categories. They often treat them as a single concept. The courts have held the words 'entailing changes in the workforce means a change in the numbers of people employed or a change in employees' particular functions. See *Berriman v Delabole Slate Ltd* [1985] ICR. The ET in that case stated that there is a requirement that the change in the workforce is part of the economic, technical or organisational reason. This means that '...the employers' plan must be to achieve changes in the workforce. It must be an objective of the plan, not just a possible consequence of it.' See also *Whitehouse v Chas A Blatchford & Sons Ltd* [1999] IRLR 492; *London Metropolitan University v Sackur* (EAT/0286/ 06).

[216] *Wheeler v Patel* [1987] IRLR 211; *Willis v McLaughlin & Harvey plc* [1998] EuLR 22.

[217] One of the key requirements is that the selection of workers for purposes of redundancy must be fair and not biased. See e.g.*Stacey v Babcock Power Limited* [1986] IRLR 3; *Howarth Timber (Leeds) Ltd v Biscomb* [1986] IRLR 52.

vendor's compliance with the purchaser's request was not unfair unless there was an additional oblique motive. Under normal circumstances, the ETO reason does not apply, if the reason relied on does not relate to the future conduct of the business as a going concern but is related, for example, to bringing about a sale of the business at an enhanced price.[218]

A possible explanation for the ET's decision in that case would be that UK judges were beginning to embrace the 'rescue culture' philosophy that was in the air round about the time *Dalkieth* was decided. Here, we see the court construing TUPE's provision in a way that ensures that TUPE does not obstruct the rescue and continuation of the insolvent undertaking. This type of judicial creativity ensured that in a situation where the award of compensation for unfair dismissal could have affected the effective functioning of the undertaking post-transfer was avoided.

Similarly, in *Thompson v SCS Consulting Ltd and others*[219] the EAT followed the approach in *Dalkeith* and held that employees dismissed 11 hours before the insolvent business was transferred was for economic reason which made those dismissed surplus to the requirement of the business. The court was of the view that notwithstanding the timing of the dismissals, they were unconnected with the transfer and because there was a genuine ETO (economic) reason, the dismissals were therefore not automatically unfair. [220]

In *Nationwide Building Society v Benn and ors*[221] several employees resigned and brought claims for unfair dismissals following the transfer of the undertaking that employed them from Portman Building Society (PBS) to Nationwide Building Society (NBS) in August 2007. The employees cited a number of fundamental changes to their contract terms and other detriments as reasons for their resignations. These ranged from a diminution in skills and responsibilities of their jobs when they were assimilated into NBS's workforce. They also cited violation of the implied term of mutual trust and confidence in the assimilation process as

[218] *Whitehouse v Chas A Blatchford & Sons Ltd* [2000] ICR 542. Buxton LJ had said in that case that: 'the reason for dismissal must be related to the conduct of the business and a dismissal that is simply related to the sale of the business does not so qualify.'
[219] EAT (3 Sept. 2001).
[220] See also *Dynamex Friction Ltd & anor. v Amicus & ors* [2008] EWCA Civ 381 discussed above. Collins LJ dissenting in the *Dynamex* case favoured a more liberal interpretation of Regulation 8 of TUPE 1981 which, in his opinion, permitted a transferee's motive to be taken into account in such circumstances.
[221] UKEAT/0273/09/JOJ.

well as the application of a substantially less beneficial bonus scheme to them to argue that they had been constructively and unfairly dismissed for reasons related to the transfer under the 2006 Transfer Regulations.

Their argument was premised on the fact that Regulation 7(2) of TUPE 2006 requires an ETO reason to *entail changes in the workforce as a whole* but, given that the changes in NBS's workforce only affected transferred employees, the requirement of Regulation 7(2) of TUPE 2006 was therefore not satisfied. The workers' arguments were rejected by the ET.

On appeal, the EAT held that the employees who resigned in protest at their jobs being downgraded and their bonus entitlements being reduced following the business transfer were constructively dismissed. However, the dismissals were not automatically unfair even if connected to the transfer, as they were made for valid ETO reason entailing changes in the workforce. The EAT went on to opine that the phrase 'entailing changes in workforce' does not imply that an ETO (in this case organisational) reason for dismissal must entail changes in the *entirety of the workforce*.

This type of ingenious interpretation of the ETO provision by UK courts and tribunals, it is submitted, is aimed at ensuring that transfers of insolvent undertakings are not overly hampered by employee-related liabilities. However, it has to be pointed out that for the ETO defence to avail the relevant employer, the scope of the 'economic' limb of Regulation 7(2)) of TUPE 2006 has to be confined to something related to the conduct of the underlying business. It follows that whilst true redundancy would be an ETO reason for dismissals, an outright desire to achieve a sale of a business or to receive an enhanced price for the business may not suffice as ETO defence. [222]

The problem with the ETO route as far as the rescue culture is concerned is that the transferee must first take on all of the transferor's employees before he or she can make some of them redundant. It is submitted, that in addition to the special insolvency measures discussed in chapter 7 which were introduced into TUPE 2006 to aid business rescues, the 'rescue culture' would be further boosted if the law could be changed so that transferors could validly make employees

[222] Pollard (n 47) 103. For cases where this position was upheld, see generally *Ibex Trading v Walton* [1995] IRLR 190; *Wheeler v Patel & J Golding Group of Companies*, [1987] IRLR 211; *Gateway Hotels Ltd v Stewart* [1988] IRLR 287.

redundant using the ETO defence before transferring the undertaking or business to the transferee. This, in addition to avoiding a situation whereby an employee is taken on by a transferee company only to be immediately declared redundant, would also facilitate the process of rescuing a business which is in administration by relieving the transferee of the burden of redundancy costs for those employees they would not, but for TUPE, wish to take on because one of the reasons for the business becoming insolvent was excess workforce.

6.13 Danger of misinterpretation and over-stressing the protective purpose of TUPE

It has already been shown that the way the provisions of the Transfer Regulations are interpreted by courts and tribunals is problematic. Confusion is the name of the game *vis-a-vis* TUPE. In his criticism of the literal approach to statutory interpretation, Lord Reid stated unequivocally that:

> ...to apply the words literally is to defeat the obvious intent of the legislature. To achieve the intent and produce a reasonable result, [the court] must do some violence to the words.[223]

In effect, what his Lordship is implying is simply that a purposive approach is the way forward if the purpose of a given statute is to be achieved. However, the requirement to apply a 'purposive interpretation' to the Transfer Regulations carries with it certain risks. It results, as argued, in

> ... a tension between the need for legal certainty, which is one of the fundamental elements of the rule of law, and the need to give effect to the intention of Parliament, from whatever source that (objectively assessed) intention can be gleaned.[224]

In relation to the TUPE Regulations, there is the risk that judges could over-emphasise or even misinterpret the purpose of the legislation by virtue of their lack of experience in the application of the purposive method of interpretation. This could have detrimental effects on either the rescue culture or on employment protection. Examples of such misinterpretations abound.

[223] *Pepper v Hart* [1993] AC 593.
[224] See *R v SOS for the Environment ex parte Spath Home* (2001) 1 AER 129 HL (Lord Nicholls).

In *Milligan and Another v Securicor Cleaning Limited,*[225] for example, the EAT found that employees who claimed that their dismissals were automatically unfair under the 1981 TUPE Regulations, were not required to fulfil the statutory two years' continuous service normally required to bring an unfair dismissal claim. The EAT opined that the second part of Article 4(1) of the 1977 ARD permitted the exclusion of certain specific categories of employees, but they found nothing in Regulation 8 of TUPE 1981 that had the effect of excluding employees with less than two years' service from that protection. According to the EAT, any such exception would have to be identified specifically.

This decision, it is submitted, is confusing given that normally statutory protection from unfair dismissal only avails employees with two years' of continuous service,[226] save in exceptional circumstances where there is no qualifying period. This exception, for example, applies to dismissals on grounds related to trade union membership or activities and dismissals on grounds of pregnancy or childbirth. Whereas the decision could be regarded as representing an important extension to the rights of employees dismissed in connection with the transfer of an undertaking in circumstances where TUPE applies, it is contestable both on grounds of policy and interpretation.

Both the ARD and TUPE are concerned principally with the safeguarding of employees' rights on a change of employer as opposed to creating new ones but the interpretation given to it by the EAT in the *Milligan* case, arguably, went beyond the safeguarding of the employees' acquired rights in transfer situations, to creating new rights. Usually, employees with less than two years' of continuous employment with the employer are vulnerable to dismissal for a range of unfair reasons without being in a position to seek remedies from an employment tribunal notwithstanding how capricious or unfair the reason for the dismissals would have been. However, under the *Milligan* principle, it would be possible to bring claims.

The problem of misinterpretation was once again evident in *Allan v Stirling DC,*[227] where the Scottish EAT held that the transferor and transferee were jointly and severally liable for any dismissals which were automatically unfair by virtue of

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[225] [1995] IRLR 288, EAT.

[226] Employment Protection (Consolidation) Act 1978, s. 64.

[227] [1994] ICR 34.

TUPE. This decision was in spite of the fact that the option to make the transferor jointly liable in such circumstances (provided by the ARD to the Member States) has not been taken up or implemented by the UK. This decision, it is submitted, was wrong in the light of the discretionary provision of Article 3(1)[228] and, on account of the ECJ's ruling in *Wendelboe.*[229]

On appeal, the EAT's decision was overturned by the Scottish Court of Session.[230] Construing the wordings of the 1981 TUPE Regulations, the Court of Session confirmed that the old Regulation 5(2) clearly did not provide for any continuing liability on the part of the transferor. However, this clearly demonstrates how easy it is to misinterpret the provisions of TUPE. While the purposive interpretation has its advantage, it is laden with uncertainties.[231] These cases further demonstrate the problems judges could face in applying non home grown laws. It also demonstrates that misinterpretation of TUPE resulting in the 'over-protection' of the employees could 'over-deter' purchasers and hinder business rescues.

6.14 Conclusion

TUPE is an important plank of UK's employment law. It regulates the transfer of a business or of an undertaking from one employer (legal or natural) to another. TUPE is a social legislation. With it the employment contract is no longer seen as one involving an exchange of 'labour for money'.[232] Rather, it has become the 'principal distributive mechanism for wealth, status, and social power' which provides the 'necessary context for an individual to attribute meaning to his or her

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[228] To recap, Article 3(1) 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 within the meaning of Article 1(1) shall, by reason of such transfer, be transferred to the transferee.
>
> Member States may provide that, after the date of transfer within the meaning of Article 1(1) and in addition to the transferee, the transferor shall continue to be liable in respect of obligations which arose from a contract of employment or an employment relationship.

[229] Case 19/83 *Wendelboe v LJ Music* [1985] ECR 457.
[230] *Stirling District Council v Allan & ors* [1995] IRLR 301 Ct. Sess.
[231] Peter Wallington, 'TUPE Update' <http://www.11kbw.com/articles/docs/TUPEUPDATE.pdf> *access 25 January 2012*
[232] ibid.

life'.[233] Therefore, it should be safeguarded as much as practicable. This is what the Transfer Regulations aim to achieve.

While TUPE has been effective in enhancing the social rights of the employees, it failed to correspondingly increase entrepreneurial freedom.[234] Its application to insolvency has been particularly problematic. TUPE's protective stance inhibits taking actions, such as reducing the size of the workforce, whenever economic exigencies in relation to an insolvent business demand such action to be taken in order to save the business. There may be an economic argument that to require an employer to pay compensation for dismissals carried out in order to save an insolvent business is tantamount to punishing the employer for trying to save jobs through purchasing and continuing an otherwise liquidation and eventual legal-death destined business.

In other words, TUPE increases the costs of business rescues. These costs are borne solely by the transferee. This is because, rather than spread the burden of transferable liabilities between the transferor and the transferee, the UK chose to cast the full burden of liability on the transferee.[235] This, from a theoretical and Proceduralists standpoint, serves to 'over-deter' going concern sales of insolvent businesses. For the Proceduralists, the Transfer Regulations do nothing other than take into account extraneous interests which impede the sales and realisations of full going concern value of insolvent businesses. Discounted sales of insolvent businesses to account for employees' liabilities deprive the creditors, according to the Proceduralists, of the extra monies that would have been available for distribution to them. At the other end of the spectrum, Traditionalist will appreciate what the Transfer Regulations have done to protect employees' rights in insolvent business transfer situations. For them, TUPE satisfies their yearnings to make the protection of employees' rights in transfers in the context of insolvency a legitimate goal of insolvency law albeit this is done externally by a different body of law.[236]

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[233] ibid.

[234] See S Hardy and N Adnett `Entrepreneurial Freedom versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam (1999) 9 Journal of European Social Policy 130.

[235] In Case 19/83 *Wendelboe v LJ Music* [1985] ECR 457, the ECJ has held that if the Member State does not make the transferor so liable, once a relevant transfer occurs, the transferor is discharged from obligations by reason of the transfer leaving the transferee to shoulder all such obligations.

[236] E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 *Mich. L. Rev.* 336, 354-55; D G Korobkin, 'Employee Interests in Bankruptcy' (1996)4 *American Bankruptcy Inst. L. Rev.* 5; J Sarra, 'Widening the Insolvency Lens: The Treatment of Employee Claims' in P J Omar (edn) *International*

Given the tension generated by TUPE between business rescue and employee protection in insolvency, perhaps what is needed are laws that would demonstrate a commitment to protecting the rights of employees while maintaining corporate employers' abilities to operate their businesses with as limited restrictions as possible. What is desirable are rescue friendly laws as opposed to laws that will accelerate the 'strangulating' of business already in 'financial straits'.

Such a law will require a balance to be struck between social policy legislation aimed at protecting employees' rights during transfers of undertakings and business-friendly laws that will enhance free market principles. Laws that are business friendly will ensure that insolvent but viable businesses are given a second chance to continue trading in order to provide jobs for UK workers. This will require, it seems, ensuring that insolvent transferors, rather than legislation of EU emanation, determine the decisions made in relation to employees of insolvent transferors during transfers of insolvent businesses.

However, such an approach must have mechanisms to ensure also that employees are not left without any protection at all during the process of insolvent business transfers. This thinking might have informed the revisions to the ARD and TUPE respectively. There are a number of changes (see chapter 7) in TUPE 2006 that have been specifically introduced to cater for insolvent business transfers.

In the next chapter, the task will be to explore how the revised Transfer Regulations set out to strike a balance between the social rights of the workers and entrepreneurial freedom of UK corporate employers. The analysis will focus on the so-called rescue provisions of the revised ARD and TUPE 2006. The aim is to examine why these changes were made. It is intended to explore if the new provisions were intended to foster business rescues, whether they have actually succeeded in doing so.

Insolvency Law: Themes and Perspectives, (Ashgate Publishing Ltd, Hampshire 2008); L Lopucki, 'A Team Production Theory of Bankruptcy Reorganisation' (2003) *UCLA School of Law, Law & Econ Research* Paper No. 3-12. <http://ssrn.com/abstract=397801> accessed 26 December 2011.

CHAPTER SEVEN

RESCUES OF INSOLVENT BUSINESSES: NAVIGATING THE OBSTACLES POSED BY THE TRANSFER REGULATIONS

7.1 Introduction

Corporate restructuring is usually aimed at altering the structure of a business or making a change in the business activities of a company.[1] However, where a business is insolvent, its continuous survival may be predicated on the transferor's ability to sell it to a third party purchaser. During the common law era on transfers, insolvent businesses were attractive targets to purchasers because where the purchaser acquired the undertaking of a company, that undertaking did not include obligations in relation to employees' contracts of employment.[2] TUPE has radically altered the previously well-established common law practice whereby an insolvent business could be sold free of the employees and all associated liabilities.[3]

Whilst TUPE has proved to be a very effective legal regime for safeguarding the employees' contractually acquired rights during transfers of insolvent undertakings, it must however, be remembered that 'the cost of exercising a right is always the loss suffered elsewhere in the consequence of the exercise of that right.'[4] This is no different with TUPE. The full exercise by the employees of the rights TUPE gives to them when the business that employs them becomes insolvent and is transferred as a going concern is not unlikely to be detrimental to other stakeholders with economic interests in the insolvent business.

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[1] See G B Stewart and D M Glassman, 'The motives and methods of corporate restructuring' (1988) 1 *Journal of Applied Corporate Finance* 79-88; P A Gibbs, 'Determinants of corporate restructuring: The relative importance of corporate governance, takeover threat, and free cash flow' (1993) 14 *Strategic Management Journal*, 51-68.

[2] Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Rescue and "One Unholy Mess"' [2000] CFIL 249, 250.

[3] At common law a business transfer automatically terminated all contracts of employment. See *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014 HL. In the context of a business transfer or sale effected by a privately appointed receiver, see *Re Foster Clark Ltd's Indenture Trusts* [1966] All ER 43; Griffiths v Secretary of State for Social Services [1973] 3 All ER 1184.

[4] Ronald H Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law and Economics 44.

There is a perception that TUPE's application to insolvency hinders the going concern rescues of insolvent businesses.[5] TUPE tends to vest in the employees certain 'dormant' rights which are triggered only when the business employing them is transferred on a going concern basis to a third party purchaser.[6] The protection TUPE gives to the employees in the context of insolvency increases costs for transferees due to employee-related liabilities. The problem is that when an insolvent business becomes 'pregnant' with employee entitlement obligations, it ceases to be an attractive purchase target.[7] Inability to sell an insolvent business comes with a price for not just the creditors of the business who might not get paid what they are owed, but also for the employees who would inevitably lose their jobs if the business is liquidated.[8]

The 1981 TUPE Regulations were very rigid in the way employees were protected. TUPE tended to privilege employee protection over rescues of insolvent businesses. There were no inbuilt mechanisms in TUPE 1981 to incentivise purchases of insolvent undertakings. Like the 1977 ARD, TUPE did not contain any special provisions to cater for business transfers in the context of insolvency. This was rather surprising given that where a company is insolvent and its underlying business is economically viable, its rescue sometimes depends on the transferor's ability to sell the business to a third party buyer.[9]

However, as a result of there being no special provisions in the original Transfer Regulations to cater for transfers of insolvent undertakings, there was no balance between employee protection and business rescues. There was a real need for an effective balance to be struck between the business rescue and employee protection policies' goals in insolvent business transfer situations.

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[5] McMullen, 'An analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' [2006] ILJ 113; H Collins, 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144; Frisby (n 2); Wanjiru Njoya, 'The Interface between Redundancy and TUPE Transfers' (2003) 32 (2) ILJ 123-128. John Armour, Audrey Hsu and Adrian Walters, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings: A Report Prepared for the Insolvency Service' (2006) <http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96...rep...> accessed 18 March 2012.

[6] John Amour & Simon Deakin, `Insolvency, Employment Protection and Corporate Restructuring: the Effects of TUPE' University of Cambridge CBR Working Paper No. 204 (2001) 10.

[7] Michael Sloan, 'Close but no Cigar: Reform not Rescue' (2008) 20 Australian Insolvency Journal 10; 'Model Agreement to Promote Company Restructuring' (2008) 20 Australian Insolvency Journal.

[8] Roy Goode, *Principles of Corporate Insolvency Law*, (3rd edn Sweet & Maxwell, London 2005) 119-127.

[9] In *Litster v Forth Dry Dock Engineering* (1989) IRLR 161, Lord Keith of Kinkel said insolvencies were 'a situation commonly forming the occasion for a transfer of an undertaking.'

This chapter considers the Transfer Regulations in the context of insolvency. The aim is to explore how rescues of insolvent businesses have been boosted by the special insolvency measures introduced into the revised 2001 ARD and TUPE Regulations 2006 respectively. It will be argued that the measures were necessitated by the desire to strike a balance between business rescue and employee protection during transfers of insolvent businesses. In order to fully appreciate the difference the insolvency measures have made to the rescue culture, this chapter will explore the perceived problems with the original ARD and TUPE regimes and how these affected business rescues. Thereafter, a brief overview of how the 1977 ARD and TUPE 1981 were revised and why they were revised is presented. Then the substantive changes made to these regimes and how these have aided rescues of insolvent businesses is considered. Lastly, the potential difficulty posed by adopting the 'purpose of insolvency' approach developed by case law to determine whether or not TUPE applies to a particular transfer in the context of UK insolvency proceedings so as to determine whether or not the employees are protected is examined.

7.2 Perceived problems with the original ARD

The 1977 ARD was heavily criticised by Member States for its inflexibility in situations where transfers took place as part of an insolvency procedure and other shortcomings. Because of these issues, the first generation ARD was the subject of a plethora of cases before the European Court of Justice (ECJ)[10] and national courts of the Member States due to inherent legal uncertainties and defects as well as problems associated with its transposition to Member State legislation. These cases resulted in a deluge of often conflicting rulings that were handed down by the court. There were concerns among the Member States about the impacts of the ARD on transfers of insolvent businesses. The consensus was that the ARD needed to be revised to address the criticisms levied against it. Before looking at the process of its revision and the substantive changes that were made

[10] Expressing concern about the number of litigations that arose in relation to the various directives in 1992, the Commission noted that of the three directives that were adopted as part of the 1974 SAP to protect employees' rights (*viz* Council Directive 75/129/EEC; Council Directive 77/187/EEC and Council Directive 80/987/EEC discussed in chapter 3), the ARD was by far the one that was problematic because it engendered the most litigations before the ECJ. See Commission Report to the Council 2/6/92- SEC/92/857. At the time the Commission made this observation, a total of 12 judgments had already been handed down. See Professor Rolf Birk, 'The Contracting-out: Report for the Commission of the EC' DG V (1994) 1-46.

to the regime, it is intended to first summarise the perceived defects in the 1977 ARD.

7. 2.1 Drafting defects

A key problem with the original ARD relates to the imprecise way in which it was drafted. This defect was responsible for the legal uncertainty and inconsistency in the ARD. Imprecise drafting of the legislation generated considerable debates on the meanings of certain key terms and concepts. Two of the most debated issues (which could still give rise to future litigations even in the revised version),[11] pertained to the precise meanings of 'transfer' and 'undertakings' in the context of the ARD. Also, there was very little assistance in the text regarding what was an 'economic, technical or organisational' reason for dismissing an employee.[12] Imprecise drafting of the legislation created confusion for stakeholders in insolvency in the Member States since it was difficult to determine whether or not the regime applied to certain transactions. For example, it was difficult to ascertain when to dismiss employees before a business transfer without falling 'foul' of the ARD. In the UK for example, the fear of incurring liabilities deterred buyers from buying insolvent businesses (as discussed in chapter 6).

7.2.2 Interpretation problems

The corollary of the imprecise drafting problem was that the definitions of key terms and the interpretation of the provisions of the ARD were left to the ECJ. The ECJ adopted a purposive interpretation approach to the ARD and in the process widened the scope of the regime to cover modes of transfers that were not envisaged by the original authors of the ARD. The expansion of the scope of the ARD by ECJ case law was a major source of confusion in the Member States regarding the level of social protections their implementing legislations should actually give to their employees.[13]

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[11] See e.g. Vivien Shrubsall, querying whether the new definition of 'transfer' in the amended Directive is capable of resolving the uncertainty surrounding such transfers as the transfer of labour-intensive service contracts, particularly in the context of the contracting-out and competitive tendering for support services. V Shrubsall 'Employment Rights and Business Transfers- Changes to the Acquired Rights Directive' <http://webjcli.ncl.ac.uk/1998/issue5/shrubsall5.html> accessed 06 December 2011.

[12] See chapters 5 and 6.

[13] J M Henderson, 'The Institutional and Normative Significance of the European Union's Acquired Rights Directive' (1996) 29 George Wash Journal of Int'l Law & Economics 803, 827.

For example, it was not very clear whether the ARD was to be interpreted to protect only those employees who, at the time of a business transfer held contracts of employment, or whether employees who would have held contracts of employment at the time of the transfer had they not been unfairly dismissed days or just hours before a business transfer were to be protected too.[14] The drafters of the TUPE Regulations which implemented the ARD into UK law also misconstrued the meaning of certain concepts such as 'undertaking.' Regulation 2(1) of TUPE 1981 stated that an 'undertaking' included 'any trade or business' but did not include 'any undertaking or part of an undertaking which is not in the nature of a commercial venture.'[15]

English judges tended to give judicial blessings to this limited interpretation of 'undertaking'.[16] For example, in *Woodcock and others v Committee for the Time being of the Friends School, Wigton*[17] where a school (initially operated by the Quakers as a registered charity) was sold to a company, the key issue was whether or not this type of transfer was within the scope of TUPE 1981 (the UK equivalent of the ARD). The Industrial Tribunal (IT)[18] held that the school was not 'in the nature of a commercial venture' as it was not a business in which capital was invested with a view to profit. On appeal, both the Employment Appeal Tribunal (EAT) and the Court of Appeal (CA) agreed with the IT that the school was not a business or undertaking 'in the nature of a commercial venture'.[19]

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[14] TUPE 1981 only protected those who were employed 'immediately before' the transfer. However, in *Litster v Forth Dry Dock Engineering Ltd,* the House of Lords having enquired into the purpose of the ARD, interpreted TUPE by reading in additional words to protect workers not only if they were employed 'immediately before' the time of transfer, but also when they would have been so employed if they had not been unfairly dismissed by reason of the transfer.

[15] C-29/91, *Dr Sophie Redmond Stichting,* [1992] I ECR 3189, which concerned the transfer of activities of a foundation financed wholly out of public funds.

[16] It is pertinent to note, however, that English courts and tribunals took this view prior to the ECJ accepting, at least, impliedly, that in the context of social law (see *Dr Sophie Redmond Stichting* case [1992] ECR I-3189) and competition law (see *Hofner v Macrotron GmbH* (Case C-41/90) [1991] ECR I-1979), that a body might be engaged in economic activities and be deemed an 'undertaking' for the purposes of Community law even though it does not operate with a view to profit.

[17] [1987] IRLR 98.

[18] Currently, industrial Tribunals are known as Employment Tribunals. On when the name was changed to employment tribunal, see fn. 184 in chapter 6.

[19] The EAT took a broad view in that case and adopted the first impression test – a test which the CA in its later decision agreed with and also adopted. The EAT held that:

> …. the proper meaning of the words 'in the nature of a commercial venture' is very much a matter of first impression. The majority form the view that undoubtedly the operation conducted by the first respondents was an undertaking in the sense at least of being a trade or business but that the

Woodcock demonstrates the English courts' proclivity to draw a distinction between the facts that before a transfer the 'undertaking' was not operated for profit whereas after the transfer it was so operated. This distinction was in spite of the ARD, which TUPE implemented, making no such distinction.[20]

It was this type of restricted interpretations of the regimes' provisions that the European Commission took issues with. The infraction proceeding brought by the European Commission against the UK in *Commission of the European Communities v UK* [21] was as a result of this type of limited interpretation of the ARD.[22] The European Commission felt that the UK's interpretation of 'undertaking' was too restricted and so short-changed employees of the full protection the ARD intended for them. The Commission was of the opinion that the contentious words: 'in the nature of a commercial venture', must be interpreted as referring to the investment of capital with a view to making profits and accepting the risk of losses that goes with the investment. It follows that although an undertaking not set up specifically with profit-making in mind is unlikely to come within the meaning of a 'commercial venture,' such an undertaking may nevertheless still operate as 'businesses' offering products or services for remuneration which brings it within the ambit of the ARD as held in *Stitcting*.[23]

> operation was excluded from being an undertaking within the meaning of the Regulation because it was not in the nature of a commercial venture. The way that it was organised, conducted (particularly the way its finances were conducted), the fact perhaps above all of its charitable status combined, in the judgment of the majority, to make it an enterprise which could not fairly be described as an undertaking in the nature of a commercial venture.

[20] See e.g. Article 1 of ARD 2001. In fact, ECJ case-law has established that the ARD apply to all undertakings - inclusive of those undertakings not aimed at profit-making. See particularly Case C-29/91, *Dr Sophie Redmond Stichting v Bartol* [1992] ECR 1- 3189.

[21] [1994] ICR 664.

[22] Other complaints against the UK in that case included failure to provide for compulsory designation of employee representatives, the requirement for a transfer of ownership of the undertaking (with reference to two judicial *decisions: Robert Seligman Corp. v Baker* [1983] ICR 770*; Hadden v University of Dundee Students' Association* [1985] IRLR 449, *the Commission* argued that the decided case law in the United Kingdom in matters relating to the surrender of franchises, the termination of a subcontract or other transfer of management functions did require a transfer of ownership in order for the provisions of the 1981 Regulations implementing the 1977 ARD to be applicable). There were also complaints regarding the limited substantive obligations to inform and consult with employees' representatives and the inadequate sanctions provided for violation of these requirements.

[23] Case C-29/91, *Dr Sophie Redmond Stichting v Bartol* [1992] ECR 1- 3189. The UK was not the only guilty party with regards to defective implementation of the ARD. Other Member States such as Belgium and Italy also had infringement proceedings brought against them under Article 169 of the Treaty of Rome of 1957. There were also several requests made by national courts of Member States

7.2.3 Lack of flexibility

A major problem with 1977 ARD was that although it strengthened the rights of EU employees during transfers of undertakings, it failed to correspondingly increase entrepreneurial freedom.[24] The ARD failed to provide greater flexibility for transfers involving businesses experiencing serious economic crises[25] and so failed to reconcile the objective of employment security and that of labour market flexibility.[26] There were no measures to aid the sales of insolvent businesses. It is unimaginable that a labour legislation intended to protect employees potentially impacted by business collapse failed to consider or even contribute to the rescues of such businesses since that would be the best outcome for the employees in terms of job security.[27]

With all these shortcomings, it was apparent that the ARD was not going to have a trouble-free 'life'. It was obvious that the 1977 ARD needed to undergo a major revamping if purchases of insolvent businesses were to be encouraged. The original ARD has been revised twice. The first revision was in 1998 and the second in 2001. Below is a brief overview of how the 1977 ARD was revised.

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to the European Court of Justice (ECJ) for preliminary rulings under Article 177 most of which were in relation to the interpretation of provisions of the 1977 ARD. For instance, *Spijkers v Gebroeders Benedik Abbatoir CV and another,* Case 24/85 (1986) CMLR 296; *Schmidt v Spar und Leihkasse der Fruhern Amter Bordeshol Kiel und Cronshagen,* Case 392/92 (1994) ECR 1-1311; Ledernes Hoversorganisation, acting for *Rygaard v Dansk Aebejdsgiverforening, acting for Stro Molle Akustik A/S,* Case C-48/94 (1995) ECR 2745 were all Article 177 references from the Dutch Supreme Court, the Scleswig-Holstein Regional Court of Germany, the Danish Maritime and Commercial Court to the ECJ. According to a report published in 1994 by Professor Rolf Birk, the number of judicial rulings by the ECJ in relation to the ARD after 17 years of its existence was 458 in total. These were: Belgium, approximately 30 rulings; Germany, approximately 130; France, approximately 260; Luxembourg, approximately 3 and the Netherlands, approximately 35. See Rolf Birk, 'The Contracting-out: Report to the Commission' (1994).

[24] S Hardy and N Adnett, 'Entrepreneurial Freedom Versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam' (1999) 9 European Journal of Industrial Relations, 127.

[25] See opinion of the Commission in the explanatory memorandum on the proposal for the amendment of Council Directive 77/187/EEC.

[26] S Hardy and N Adnett, 'Entrepreneurial Freedom versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam' (1999) 9 European Journal of Industrial Relations, 127.

[27] A Loubser, 'The Interaction between Corporate Rescue and Labour Legislation: Lessons to be Drawn from the South African Experience' (2005) 14 Int'l Insolv. Rev, 57-69; M Armstrong and A Cerfontaine 'The Rhetoric of Inclusion? Corporate Governance in Insolvency Law' (2000) Ins. Law 38.

7.3 Amendments to the ARD: overview of the revision process

Due to the application of the ARD to business transfers in the Member States of the EU, it has been contended that the field of employment rights in business transfers has witnessed more cases being brought before the ECJ than any other topic in EU employment law.[28] By 1994, the ECJ had made over 40 rulings on the ARD and the spate of litigation showed no sign of abating. Conscious of all the controversies generated by the original ARD and, particularly the adverse effects of the regime on rescues of insolvent businesses, the European Commission moved to put things right seventeen years after the ARD was adopted. The Commission tendered proposals for amendments to the 1977 ARD in 1994.

The first set of the Commission's proposals made pursuant to Article 189A (2) of the EC Treaty ran into a great deal of opposition within the European Parliament and amongst trade unions. They were widely discussed, and in part, heavily criticised by the European Parliament (EP).[29] What was initially intended as a straightforward 'housekeeping' measure, became a very politicised battle with a host of restructuring techniques of more recent vintage (e.g. outsourcing, competitive tendering etc.) having been brought within the ambit of the ARD following decisions by the ECJ. The opposition to the draft proposals forced the Commission to withdraw them.

The revised proposals submitted by the Commission took into account the concerns and opinions of several Committees. These included the views of the Economic and Social Committee and the Committee of the Regions adopted in March and April 1995 respectively. They also took on board the amendments made to the original draft proposals by the European Parliament. All these bodies were unanimous in requesting that several technical improvements be made to the wording of the ARD so as to make for legal certainty and consistency.[30] However, given that the final amended scripts were also based on a number of ECJ rulings, clarity was really lacking as we still have to look to case law for

[28] Gavin Barrett, 'Light Acquired on Acquired Rights: Examining Developments in Employment Rights on Transfers of Undertakings' (2005) 42 Common Market Law Review. 1053 – 1105.
[29] OJC 124, 21. 4. 1997. COM (97) 60 final,
[30] COM (97) 60 final of 24. 02. 1997, 94/0203 (CNS).

further explanation.[31] This was rather surprising given that lack of clarity (discussed above) was one the things that triggered the amendment in the first place.

7.3.1 The Principle of subsidiarity[32] and the revised ARD

Due to the conflict between the EU and Member States regarding what role the former has, or should have, in social policy generally and in employment matters specifically discussed in chapter three, the 1977 ARD was revised based on the principle of subsidiarity.[33] Currently, most draft employment directives take cognizance of national legal diversity.[34] This principle underlies everything the EU does today in areas or on matters which it does not have exclusive competence to legislate.[35] Subsidiarity[36] allows for some sort of 'division of labour' on EU legislation between the central (EU) and the national governments

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[31] Adam Wickes, 'The Reformation of TUPE Regulations in 2006 Sought to Reinforce Previous UK Regulations by Implementing the Amended Acquired Rights Directive. Provide a Critique of the Domestic legislation'. <http://www.appartnership.co.uk/files/Critique%20of%20the%20TUPE%202006%20Regulations.pdf> accessed 30 April 2012.

[32] Subsidiarity entered into the political agenda of the EU in the 1990's due to concerns expressed by some Member States that the EU's progressive acquisition of powers (under Article 308 TEC) and exercise of competences was increasingly encroaching on 'policy issues where domestic legislative competence lay with the sub-national rather than national government'. See N Burrows, C Carter & A Scott, 'Subsidiarity and the Draft Treaty' (2004) Sub Rosa Discussion Paper <http://www.regleg.eu/downloads/activities/9.doc> accessed 03 April 2012.

[33] In 1992, prior to the entry into force of the EU Treaty, (Article 3b of which referred explicitly to the principle of subsidiarity), a compulsory procedure was introduced within the Commission whereby all draft proposals to the Council and Parliament were to be reviewed based on the principle of subsidiarity. See 'Report to the European Council on the Application of the Subsidiarity Principle 1994' Com (94) 553 final 25.11.1994. See also comment by the Parliamentary Under-Secretary of State, Department of Employment (Lord Henley) in the House of Lords debates on the amendments of the ARD. HL Deb 22 June 1994 vol 556 cc268-9.

[34] Paul Teague, 'Deliberate Governance and EU Social Policy' in C Pierson & F G Castles (eds.) *The Welfare State Reader* (Polity Press, Cambridge 2006) 275.

[35] Wolf Schafer 'Harmonisation and Centralisation versus Subsidiarity: Which Should Apply Where?' (2006) 41 (5) Intereconomics, Brugel Forum (September / October) 246 -249.

[36] The legal basis for the principle of subsidiarity is Article 5 (3) Treaty of the European Union (TEU).[36] Article 5 (3) states that:

> Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

See further V Harrison, 'Subsidiarity in Article 3b of the EC Treaty—Gobbledegook or Justiciable Principle?' (1996) 45 International and Comparative Law Quarterly 431-439; Van Kersbergen and B Verbeek 'The Politics of Subsidiarity in the European Union' (1994) 32 Journal of Common Market Studies, 215-36.

of Member States at the European level.[37] Subsidiarity in the context of EU law means that in the absence of a clear rationale to support EU level action to uphold the internal market, national governments should rule.[38] Conversely, it also means that the functions handed over to the EU level government are those which Member States, at the various levels of decision making, can no longer discharge satisfactorily.'[39] One of the significant legal functions of subsidiarity is that it imposes a certain onus on the various EU institutions to justify their actions[40] otherwise the action by the directive or regulation may be considered disproportionate. If justification for an action cannot be provided, to avoid the enacting of disproportionate directives or regulation, there is the view that only coordination, recommendations or consultations should be pursued.[41] The principle also requires that whatever action is taken at the European level has to be able to secure greater freedoms for the individuals in the Member States.[42]

In relation to the ARD, revising it based on the principle of subsidiarity demonstrated the Commission's readiness to take into account the opinions of the Member States and those of the social partners when reviewing existing social policy legislations and in the enactments of future ones.[43] It also showed that the EU respects the multiplicity of the economic, social and legal traditions of the Member States[44] and that it is making genuine efforts to balance its social policy legislations (such as the protection of employees' rights in business transfer

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[37] Anna Verges Bausili, 'Rethinking the Methods of Dividing and Exercising Powers in the EU: Reforming Subsidiarity and National Parliaments (2002) Jean Monnet Working Paper 9/02 <http://www.centers.law.nyu.edu/jeanmonnet/archive/papers/02/020901.rtf> accessed 8 May 2012.

[38] L Brittan, *Europe: The Europe We Need* (Hamish Hamilton Ltd, London 1994) 17; Grainne De Burca, 'Re-appraising Subsidiarity's Significance after Amsterdam' (1999) Harvard Jean Monnet Working Paper No. 7

[39] See also 'The Principle of Subsidiarity: Communication of the Commission to the Council and the European Parliament' SEC (92) 1990 Final.

[40] Grainne De Burca, 'Re-appraising Subsidiarity's Significance after Amsterdam' (1999) Harvard Jean Monnet Working Paper No. 7/99 <http://www.jeanmonnetprogram.org/papers/99/990701.html> accessed 11 March 2012.

[41] Jacques Pelkmans, 'Testing for Subsidiarity' (2006) 13 Burges European Economic Policy Briefings <http://www.coleurope.eu/file/content/studyprogrammes/eco/.../BEEP13.pdf> accessed 18 April 2012

[42] Philippe de Schoutheete, *The Case for Europe: Unity, Diversity, and Democracy in the European Union* (Lynne Reinner Publishers Ltd, 2000) 42; D Z Cass, 'The Word that saves Maastricht? The Principle of Subsidiarity and the Division of Powers within the European Community' (1992) 29 CMLR 1107; J Peterson, 'Subsidiarity: A Definition to Suit any Vision?' (1994) 47 Parliamentary Affairs 116-132.

[43] Andrew Beale and Roger Geary, 'Subsidiarity Comes of Age?' (1994) 144 NLJ 12.

[44] Jo Hunt, 'Success at Last? The Amendment to the Acquired Rights Directive,' (1999) 24 (3) European Law Review 215- 230; Teague (n 34).

situations) against the national practices of the individual Member States.[45] The principle was instrumental to the quantity of discretions granted Member States in the 2001 ARD.[46]

Council Directive 98/50/EC which was adopted at the Cardiff Summit in June 1998 officially amended Council Directive 77/187/EEC. It replaced Articles 1-7 of the 1977 ARD with new Articles 1-7b. Member States were given three years to implement the ARD into their respective national laws. The 1998 ARD made **a** substantial advance in the area of insolvency with the introduction of measures to help those businesses that can be rescued. It also made efforts to align European and Member State legislations with ECJ case law. Outside of this, the vast majority of the changes made to the ARD from the 1977 version were word alterations.[47] However, before the three years allowed for the implementation could lapse, further updates were made to the regime in 2001.

7.4 Council Directive 2001/23/EC

Council Directive 2001/23/EC codify Council Directive 77/187/EEC as amended by Council Directive 98/50/EC. The codification concerns a number of formal aspects of the texts of previous legislations only, with no implications for their contents. It does not in any way alter their contents which remains unchanged. To encourage rescues of insolvent businesses, the 2001 ARD has provided two options that may be used to enhance the sales of such businesses. These options are considered below.

7.5 Measures introduced to aid rescues of insolvent businesses

The lack of flexibility in the ARD discussed in section 7.2.4 above and, the adverse effect this had on transfers of insolvent undertakings prejudiced the interests of

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[45] Cass (n 42).

[46] Giuseppe S Massara, 'Transfer of Undertakings: Insolvency Proceedings in the United Kingdom and in Italy and the European Court of Justice Case Law' in 'Compliance with labour legislation: its efficacy and efficiency' ILO Working Paper No. 6 <http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---lab_admin/documents/publication/wcms_140685.pdf> accessed 21 April 2012.

[47] Shrubsall (n 11); Paul Davies, 'European Developments - Amendments to the Acquired Rights Directive' (1998) 27 ILJ 365.

the very employees the regime was meant to protect.[48] The Commission therefore felt that a better articulation of the basic individual rights of the employees was needed. This does not, however, translate into increasing the employees' formal legal rights.[49] In fact, the opposite seems to be the case. It will be shown later in the thesis[50] that in a bid to promote the going concern rescues of insolvent businesses, the amending Directives rather than increasing the employees' formal legal entitlements reduced them instead.[51]

What was not certain at the time the amendments were made was whether in return for a reduction in their legal entitlements, the employees would be guaranteed greater substantive job protection.[52] This, however, is doubtful given that employers continue to have the ETO defence which they could legally use to terminate the employee's contract of employment following a business transfer. The main provisions protecting employees' rights during transfers of undertakings which were perceived as hampering business rescues under the original ARD are found in Articles 3 and 4 of the 2001 ARD.[53]

Although these provisions remain the law and continue to apply to transfers other than those effected in the context of insolvency, some measures to incentivise purchases of insolvent businesses have however been introduced into the framework of the 2001 ARD. Article 5 of the 2001 ARD provides for a two-fold exception to the primary protection afforded to the employees by Article 4 to facilitate going concern sales of insolvent businesses.

[48] Hunt (n 44) 215, 217.

[49] Davies (n 47) 365.

[50] See the section on 'drawbacks of Article 5' below.

[51] Davies (n 47).

[52] Davies (n 47).

[53] Article 3(1) (a) & (b) states: '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'. Article 4(1) provides: 'The transfer of the 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'.
Article 4 (2) states: 'If the contract of employment or the employment relationship is terminated because the transfer involves a substantial change in working conditions to the detriment of the employee, the employer shall be regarded as having been responsible for termination of the contract of employment or of the employment relationship'.

7.5.1 Rescue measure one: capping of transferable liability

The first measure introduced to aid business rescue is contained in Article 5 (2) (a). This provides that:

> ...the transferor's debts[54] arising from any contracts of employment or employment relationships and payable before the transfer or before the opening of the insolvency proceedings shall not be transferred to the transferee, provided that such proceedings give rise, under the law of that Member State, to the protection at least equivalent to that provided for in situations covered by Council Directive 80/987/EEC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer...[55]

The broad effect of Articles 5 (2) (a) is to exclude the application of the ARD to transfers in which the transferor is insolvent and is subject to insolvency proceedings, other than bankruptcy proceedings or any analogous insolvency proceeding, instituted with a view to the liquidation[56] of its assets and which are under the supervision of a competent public authority.[57] In such situations, a Member State is at liberty to provide that the transferor's debts[58] (arrears of payments, damages or other liabilities)[59] arising from the contract of employment or employment relationship and payable before the transfer of the undertaking or due prior to the opening of insolvency proceedings shall not be transferred to the transferee. Instead, those debts are to remain with the insolvent transferor where they will be paid by the Member State's guarantee institution established for that

[54] The use of the word 'debts' in this new Article 5 provision designed to facilitate rescues of insolvent businesses is significant. This is because the word used in Article 3(1) is 'obligations' which is suggestive of the fact that only accrued and liquidated amounts may be excluded from transferring to the purchaser. This, for example, would include arrears of wages and salary or accrued holiday pay. See further Insolvency Act 1986, Schd. B1, para 99 (6). For what does not constitute 'wages' see *Re Huddersfield Fine Worsted Ltd* [2005] 4 All ER 886 and *Re Allders Department Stores Limited* [2005] All ER (D) 231 both of which, though decided on different points of law, defined wages.

[55] Article 5 (2) (a) ARD 2001

[56] In the context of UK insolvency system, these proceedings will include administrative receivership and the administration proceedings discussed in chapter 6. See particularly the section entitled: 'the concept of relevant insolvency proceedings'.

[57] Article 5(1) ARD 2001.

[58] On the definition of debts, see fn 17 in chapter 1.

[59] At law, the word 'liability' is widely defined to cover a liability to pay money or money's worth, any liability under enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution. See Insolvency Rules 1986, r. 13. 12 (3) and r. 1312 (4).

purpose as required by Council Directive 80/987/EEC on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer.[60]

7.5.2. Rescue measure two: modification of the principle of compulsory transfer of contracts of employment on existing terms and conditions

The second measure is found in Article 5 (2) (b). This measure, while less problematic in principle, is much more problematic operationally. This measure which can either be adopted as an alternative to, or in conjunction with, the Article 5 (2) (a) option above provides that:

> ...the transferee, transferor, or person or persons exercising the transferor's functions, on the one hand, and the representatives of the employees on the other hand may agree alterations, insofar as current law or practice permits, to the employees' terms and conditions of employment designed to safeguard employment opportunities by ensuring the survival of the undertaking, business or part of the undertaking or business.

What this means is that Member States are permitted to make provisions in their implementing legislations for downward negotiation of terms and conditions of employees' contracts of employment where the business or undertaking is insolvent and is transferred as a going concern. Under the 1977 ARD, modification to terms and conditions was firmly rejected by the ECJ and by UK national courts.[61] This provision is very helpful to business rescues. It ensures that the employees' rights could be waived in order to rescue an insolvent but viable business where the transfer of such terms would impede the rescue of the business employing them. Although modification to terms is now permissible under the revised 2001 ARD, there are however certain conditions that must be satisfied before variation to terms and conditions can be valid.

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[60] Article 3(1) of Council Directive 80/987/EEC provides: 'Member States shall take the measures necessary to ensure that guarantee institutions guarantee, subject to Article 4, payment of employees' outstanding claims resulting from contracts of employment or employment relationships and relating to pay for the period prior to a given date.'

[61] See e.g. C -324/86 *Foreningen of Arbejdslere I Danmark v Daddy's Dance Hall A/S* [1988] ECR 739; C -209/91 *Rask v ISS Katinenservice A/S* [1993]ECR 1 -5755. For UK case law, see *Wilson v St Helens Borough Council and Meade & Baxendale v British Nuclea Fuels* [1997] IRLR 505 and *Credit Suisse First Boston (Europe Ltd v Litster* [1998] IRLR 700 CA.

7.5.2.1 Conditions for modifying terms of employment

There are important safeguards in the ARD to prevent employers from making changes to terms that would be detrimental to the employee. First, to make valid changes to employees' terms, Article 5 (2) (b) requires a tripartite and consensual agreement involving the transferee, transferor (or any person or persons exercising the transferor's functions), and the representatives of the employees to effect the changes. The second safeguard is that variation to terms and conditions must be subject to what 'current law and practice' in the Member State permits.[62] The implication is that the changes that may be agreed by the parties cannot be inferior to what obtains in the Member State. In effect, employees' representatives are to enter into what may be described as 'concession bargaining' and not to agree to terms that are inimical to the employees' interests.[63]

The third condition is that changes must be targeted specifically at safeguarding employment opportunities for the workforce by ensuring the survival of the undertaking, business or part thereof that is transferred.[64] Lastly, recognising the degree of flexibility that Article 5 (2) (b) gives to employers, the asymmetry in bargaining power between the employer and employees and the possibility of employers misusing insolvency proceedings to alter terms unnecessarily,[65] Article 5(4) requires Member States to take 'appropriate measures' to prevent the use of insolvency proceedings to make changes to terms that may be detrimental to the employees. It is pertinent to note also that the agreement to vary terms is permitted only where the undertaking is already subject to 'relevant insolvency proceedings'.[66]

The above safeguards are put in place to prevent employers from making unilateral changes to the employees' terms of employment. However, what is not immediately clear is whether the agreement to vary terms of employment is to be reached before or after the transfer of the undertaking has occurred. Article 5 (2) (b) merely says that the parties may agree to vary terms but does not state

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[62] Article 5 (2) (b) ARD 2001.

[63] Armour and Deakin have also discussed this issue in the context of the TUPE Regulations. See John Armour and Simon Deakin, 'The Rover Case (2): Bargaining in the Shadow of TUPE' (2000) 29 ILJ, 395-402.

[64] ibid.

[65] Stephen Hardy and Richard W Painter, 'The New Acquired Rights Directive and its Implication for European Employees Relations in the Twenty-first Century' (1996) 6 (4) MaastJECL, 336, 378.

[66] This concept is discussed in detail in chapter 6.

whether this is to be done before or after a transfer. The substance of the agreement is, however, very clear: it is to all intents and purpose aimed at *modifying* the principle of compulsory transfer of the employees' contracts of employment on their existing terms and conditions to transferees. This measure is to help foster the rescues of insolvent but viable businesses in Member States.

7.5.3 Appraisal of the Article 5 'rescue' measures

The relief provided by the Article 5 options is very significant for insolvent transferors and for the rescue culture. In transfers involving insolvent businesses, knowing that the transferor's debts will not pass to the purchaser is a great way of incentivising potential purchasers.[67] However, the introduction of measures to aid business rescue and the flexibility that comes with this has equally raised other issues of grave concern. Below we examine the advantages and disadvantages of the flexibility that Article 5 has introduced to aid transfers of insolvent businesses.

7.5.3.1 Significance of the Article 5 provisions

In the context of an insolvent business, given that the transferor would be insolvent at the time the business is transferred, there are likely to be a backlog of substantial and unmet debts, in such a situation, Article 5 (2) (a) operates to ensure that the transferee is not liable for such pre-transfer liabilities. Rather, this provision ensures that the transferee is contractually liable only for debts arising from future transactions involving the business transferred. This measure ensures that insolvent businesses are attractive purchase targets to prospective buyers by not being unnecessarily encumbered with employee-related liabilities. From the transferor's perspective, once the business has been relieved of its debts, it could easily be sold and, perhaps, for a higher price. The sale would be of benefit both to the company's creditors and at least, some of the employees whose jobs the transferred business will undoubtedly preserve.

From the employee's perspective, it might appear as if the Article 5(2)(a) requirement not to allow pre-transfer debts to transfer to the transferee could

[67] McMullen (n 5); John Armour & Simon Deakin, 'Insolvency, Employment Protection and Corporate Restructuring: the Effects of TUPE', CBR, University of Cambridge CBR Working Paper No. 204 (2002), 2; P Davis, 'European Developments-Amendments to the Acquired Rights Directive' (1998) 27(4) ILJ 367; Shrubsall (n 11); Samuel E Etukakpan, 'Business Rescue and Employment Protection: Analysing Policy through the Lens of Theory' (2011) 32 Company Lawyer 99-113.

deprive them of the opportunity to claim money owed to them, by the transferor, from the transferee (who presumably would be solvent). This seeming problem is effectively taken care of by the additional requirement (in the concluding part of that article) that Member States should give employees equivalent protection that is provided for in situations covered by Council Directive 80/987/EEC. This part is to be construed as implying that those employee claims unmet by the transferor, and which are not capable of being claimed against the transferee, are to be paid out of a guaranteed fund financed by the tax payer as required by the Insolvency Directive of 1980.[68]

On its part, Article 5 (2) (b) is very useful for prospective purchasers of insolvent businesses. This option seems to suggest that certain contracts can, if necessary, be overridden in the overall interest of the insolvent business. The rationale for this may be that legal rules that protect parties from the effect of fundamental corporate change rather than increase the overall value of the businesses that must comply with them tend to have the opposite effect. They reduce their value instead.[69] This option could also benefit transferees in 'a continuing way into the indefinite future'[70] since there is no express provision limiting how many times an employer is permitted to vary contract terms. Thus, it may be possible for the transferee to vary terms whenever the economic situation of the business demands. Also, not only is it possible for the changes that may be agreed by the parties able to produce a package of terms and conditions, which may be completely different but overall as favourable as those that were in place prior to the transfer, but it seems the transferee can effect changes that overall could

[68] What this means in respect of the UK, for example, is that the transferor's debts falling within the scope of those listed in section 184 of ERA 1996 are frozen upon the occurrence of a relevant transfer of an undertaking. The transferee is relieved from their payments. They are to be paid instead, by the Secretary of State- technically by the National Insurance Fund (NIF).This is supposed to be a statutory protection for the employees flowing from the social security system of the Member States. See e.g. I Clarke and H Rajak, '*Mann v Secretary of State for Employment'* (2000) 63 *MLR* 895; H Collins, K Ewing & A McColgan, *'Labour Law Text and Materials* (2nd edn, (Hart Publishing, Oxford, 2005) ch. 10. The advantage of the NIF entitlements for the employees, as articulated by Finch, is that they are guaranteed as opposed to preferred. See V Finch. *Corporate Insolvency Law: Perspectives and Principles* (2nd edn CUP, Cambridge 2009) 757. This means that the employees are certain to be paid up to the statutory limit whether or not the insolvent employer has funds. See e.g. *McMeechan v Scretary of State for Employment* [1997] *ICR* 549, CA; *Everson & Barras v Secretary of State for Trade and Industry and Bell Lines Ltd (in liquidation)* [2000] IRLR 202 (ECJ). For analysis on this, see R Morgan, 'Insolvency and the Rights of Employees' [1989] Legal Action 21; V Finch. *Corporate Insolvency Law: Perspectives and Principles* (2nd edn CUP, Cambridge 2009) 757.

[69] Jonathan R Macey, 'Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes' (1989) Duke Law Journal 173, 180.

[70] Davies (n 47) 568.

produce a package of rights that is less favourable than what obtained before the changes.[71]

The employer's ability to modify the employees' existing terms and conditions of employment is of great significance to UK employers given that the introduction of this measure came at a time when the English courts appeared to be totally averse to all modifications to terms. The English courts were adamant that alterations to terms were not permitted under the ECJ's interpretation of the 1977 ARD. In *Wilson* v *St Helens Borough Council and Meade & Baxendale* v *British Nuclear Fuels,*[72] the Court of Appeal (CA) ruled that upon the happening of a transfer of a business, the employees' terms cannot be varied lawfully for a reason *connected to the transfer*. Variations were not permitted even if the employees consented.[73]

7.5.3.2 Drawbacks of Article 5

The first main criticism that may be leveled against the Article 5 measures is that while they contribute to business rescues, the level of protection they guarantee employees is low. Rather than advance the cause of employment protection which the ARD was enacted to achieve, these measures reduce them. The ARD, for example, allows employers to make downward variations to employees' original terms and conditions of employment. However, it could be argued that this is the employees' way of contributing to the survival of businesses that employs them when they become insolvent. Accepting a reduction to their contractual rights is to reciprocate the provision of continued employment by the transferee.[74]

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[71] However, any alterations must be subject to what current law or practice in the Member State permits as required under Article 5 (2) (b).

[72] [1997] IRLR 505. This case is discussed further below.

[73] The ECJ had in an earlier case taken the same view in *Foreningen v Daddy's Dance Hall* [1988] IRLR 315. Note however that although variation is permitted under the 2001 ARD, case laws have demonstrated that where an employee challenges changes to his or her contract of employment, the courts may declare a variation invalid even though the variation in question was to that employee's advantage. See *Credit Suisse First Boston (Europe) Ltd v Litster* [1998] IRLR 700 CA; *Martin v South Bank University* [2004] IRLR 74 ECJ.

[74] Team Production theory of corporate bankruptcy acknowledges the fact that this type of sacrifice would be necessary in times of insolvency so that some employees can keep their jobs. For more on this, see chapter 2 of this thesis. For an extensive review of the theory, see generally Lynn M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization', UCLA Law School, Law and Econ Research Paper 3-12 (2003), at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=397801> accessed 27 January 2011; M M Blair and L.A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Va. L

The second drawback of Article 5 is that it threatens contractual freedom in the context of business transfers. The practice whereby employees' representatives (and not the employees themselves) have to agree variations to terms is not likely to yield a better result for the employees in transfer situations. This is because whatever agreement is reached collectively is capable of depriving the workers of their real legal entitlements which, but for the collective agreement, they would have been able to assert individually. Granted, the agreement reached by the representatives on behalf of the employees may, overall, be to the benefit of the employees as a group yet, individual employees may be considerably worse off in the end.

The third issue with the Article 5 provision is that it inevitably creates a tension between the acquired rights of the employees and the rights of the creditors of the insolvent entity. Theoretically, the Article 5 (2) derogation of the rights of the employees may be seen as a form of wealth transfer from the employees to the creditors of the insolvent business.[75] For others, the effect of the compulsory transfer of employment relationships rule is that 'the employees are treated more favourably than all other creditors because there is no risk of their claims not being met in full'.[76] Moreover, the depressing effect that employees' liabilities could have on sales of insolvent businesses short-changes the creditors. The argument here is that since a prospective buyer would only be willing to pay a discounted price for the insolvent business to offset whatever monies he or she would pay for employees-related liabilities, this reduces the amount that will be available for distribution to the creditors.[77]

In the next section, we will explore how the Government responded to the changes made to the ARD.

Rev 247; Donald R Korobkin, 'Contractarianism and the normative foundations of bankruptcy law' (1993) 71 Tex. L Rev. 554.

[75] Davies (n 47) 368.

[76] Massara (n 48).

[77] T H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale Law Journal 857, 860; D G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Leg Stud.127, 133.

7.6 Aligning the TUPE Regulations with the revised 2001 ARD

The TUPE Regulations (discussed in chapter 5) have been very effective in protecting the rights of employees in transfer situations. However, the 1981 TUPE Regulations were very problematic and controversial. Their applications to transfers in the UK gave rise to lots of litigation with contradictory decisions and were, therefore, in need of amendments. There were several gray areas in the 1981 Regulations that needed clarification. For example, the meaning of concepts such as 'undertaking' and 'relevant transfer' and the scope of the Regulations (which the Commission in the *Commission v UK* case discussed in section 7.2.2 above felt was too narrow in comparison to the ARD) all of which were left to the courts to interpret needed to be properly defined. [78] The Government deliberately excluded transfers of charitable or not-for-profit undertakings, government departments and local authorities from the scope of the 1981 TUPE Regulations.

The revision also provided an opportunity for concerns expressed by stakeholders about the impact of TUPE on outsourcing to be addressed. There was need to ensure that in addition to providing an appropriate level of employee protection, outsourcing operated within a commercial and legal environment which provided value for money. That is, it was important for outsourcing to operate in a way that can deliver the optimum combination of quality and cost to the clients of the business outsourced. Another issue that needed to be attended to pertained to the question of whether or not to make the transferor and the transferee jointly liable for employees unfairly dismissed prior to a business transfer. Also, the issue concerning workers representation during transfers involving businesses or undertakings where no Trade Unions existed or in situations where Unions existed but were not recognised. This was one of the sticking points in the infraction case brought by the Commission against the UK.[79] One other significant change made to the previous regime is employee right to resign and claim unfair dismissal if substantial and materially detrimental changes to terms and conditions results from the transfer.

[78] McMullen (n 5) 113; K Williams & N Johnson, 'Transfering Employment between the Public and Private Sectors in the United Kingdom: Acquired Rights and Revising TUPE' (2007) <http://shura.shu.ac.uk/707/1/fulltext.pdf> accessed 22 March 2010.
[79] See *Commission v UK* C-382/92) [1994] ECR 1-2435. See also fn 22 above.

However, it was the problems caused by applying TUPE to insolvency that needed to be addressed. TUPE 1981 had no special provision to limit its application or to mitigate the effects of its two principles of automatic transfer of contracts of employment and unfair dismissal contained in the old regulations 5 and 8 on insolvent transferors. These core precepts made it very difficult for employers to either reduce costs by downsizing the workforce, or reduce the level of pay of the employees transferred to their workforce after a business transfer without the possibility of incurring liability. The full application of TUPE to insolvent business transfers without exception was perceived to be detrimental not just to the 'rescue culture' but also to the employees the regime was intended to protect in terms of job security where an insolvent business could not be sold.

It was therefore obvious that TUPE needed to be amended so that some degree of flexibility in relation to insolvent transferors could be introduced. In general terms, a new TUPE was needed so that the changes made to the ARD (discussed in section 7.5 above) in 1998 and 2001 respectively could be incorporated into the regime. There was need for TUPE to be revised so that clearer and more practical regulations with legal certainty could be achieved. It was also important for a revised TUPE Regulations to reflect important developments in case-law across the 25 years during which TUPE 1981was in force.

TUPE 1981 was eventually revised in 2006[80] after a long period of consultations which eventually shaped and brought TUPE 2006 up to date with the ARD. Below, I present a brief summary of the general changes made to TUPE Regulations 1981 as well as analysis on the special measures introduced aid transfers of insolvent businesses.

[80] It is important to note that the 2006 revision was not the first time the Transfer Regulations were amended. In 1993 the 1981 Transfer Regulations were amended by the Trade Union Reform and Employment Rights Act 1993. TUPE 1981 was also amended in 1995 and 1999 by the Collective Redundancies and Transfer of Undertakings (Protection of Employment) (Amendment) Regulations SI 1995/2587 and SI 1999/1925. These amendments were made in order to correctly align the 1981 Regulations with the original ARD following litigation against the UK (see EC Commission v United Kingdom (C-382/92) [1994] ECR 1-2435) at the ECJ where the court upheld the Commission's argument that the UK had failed to fulfil its obligation under Community law. The ECJ ruled that, by not providing an adequate system for the designation of employees' representatives in an undertaking in which the employer refused to recognise a trade union, the UK failed to properly implement the 1977 ARD.

7.6.1 TUPE 2006: substantive changes introduced by the new regime

The changes introduced into the 2006 Transfer Regulations include widening the scope of the TUPE Regulations to cover employees in service provision change situations which the 1981 Regulations did not cover. The Government has taken steps to address, *inter alia,* the confusion created by case law[81] regarding the applicability or otherwise of the Transfer Regulations to service provision changes. Regulation 3 (1) (b) of the 2006 Regulations now provides that TUPE applies to service provision changes.[82] The 2006 Regulations do not, however, apply where the service provision relates to the supply of goods (rather than supply of services) or where there is a 'one-off' purchase of services.[83]

A new requirement for the transferor to notify the transferee of the identity of the employees and of various rights and liabilities that would pass to the latter has been introduced under Regulation 11 of TUPE 2006. Joint and several liabilities in respect of obligations, which, hitherto used to fall on the transferee[84] and, which

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[81] A particular source of conflict arose from the ECJ decision in *Ayse Suzen v Zehnacker Gebäudereinigung. GmbH Krankenhausservice* [1997] IRLR 225, which sought to distinguish between labour-intensive (i.e. services such as cleaning and security services where there was little need for equipment or materials) and asset -intensive industries (where the transfer of labour was less important to the business than machinery and equipment that were used). The ECJ ruled in that case that in the absence of a transfer of assets or the taking over of an essential part of the workforce, the ARD was not applicable. In relation to TUPE 1981, this meant that in a labour-intensive business, importance was attached to the question of whether a significant proportion, in terms of number or function, of the employees transferred and, if they did not, TUPE did not apply. In asset-intensive cases however, the transfer of employees was secondary to the question of whether or not a significant proportion of the assets used in the business had transferred.

[82] Regulation 3(1) (b) TUPE 2006 defines a service provision change as a situation in which:

> (i) activities cease to be carried out by a person ("a client") on his own behalf and are carried out instead by another person on the client's behalf ("a contractor");
> (ii) activities cease to be carried out by a contractor on a client's behalf (whether or not those activities had previously been carried out by the client on his own behalf) and are carried out instead by another person ("a subsequent contractor") on the client's behalf; or
> (iii) activities cease to be carried out by a contractor or a subsequent contractor on a client's behalf (whether or not those activities had previously been carried out by the client on his own behalf) and are carried out instead by the client on his own behalf...

[83] See e.g. *Hunt v Storm Communications Ltd (1); Wild Card Public Relations Ltd (2); Brown Brothers Wine (Europe) Ltd (3)* ET/2702546/06.

[84] Prior to this provision being introduced, it was held in the case of *Alamo Group v Tucker* [2003] IRLR that liability was transferred to the transferee, even where the duty to inform the workforce had fallen on the transferor. The 2006 TUPE Regulations have therefore reversed this position. It is pertinent to note however, that since TUPE 2006 do not deal with the failure to inform and consult in a redundancy situation, *Kerry Foods Ltd v Creber* [2000] IRLR, will continue to be the law. This means

without the regulation would have continued to do so, have now been introduced in two areas. Under Regulation 15 (9), the transferor and the transferee would be jointly and severally liable for failure to inform and consult appropriate employee representatives as required under Regulation 13.

However, it is in relation to insolvency that TUPE 2006 has made very important and specific changes. These changes were intended to promote the 'rescue culture'. Before considering the specific insolvency-related changes made by TUPE 2006, it would be useful to, first, summarise some of the problems the original Transfer Regulations posed to insolvent transferors.

7.6.2 TUPE and transfers of insolvent businesses: the old law

Prior to 2006 when the revised TUPE Regulations came into force, TUPE 1981, there was a perception that the Regulations were pro employment protection and 'contra[85] business rescues. TUPE 1981 deterred potential buyers from buying insolvent businesses by according maximum protection to the rights of employees during transfers of insolvent businesses. There was no in built mechanism in the original TUPE to limit its application or to cushion the effects of protecting the acquired rights of the employees in relation to insolvent businesses which could have been rescued via going concern sales. There were two major obstacles that stood in the way of business rescues under TUPE 1981. Although these have already been considered in the previous chapter, it is important to recap what these obstacles were so as to fully appreciate, subsequently, the difference that the new and special insolvency measures introduced by TUPE 2006 have made to the 'rescue culture' in the UK. The two most problematic issues with the 1981 TUPE Regulations are summarised below.

7.6.2.1 Compulsory transfer of employment contracts

In the context of insolvent business transfers, a major problem with TUPE 1981 was that upon the occurrence of a relevant transfer, not only was the transferee obliged to take on all of the transferor's employees and on their existing terms of employment, the transferee was also obliged to take over all existing liability of

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that liability for failure to inform and consult in redundancy situations will continue to transfer to the transferee.

[85] This view does not, however, discount the usefulness of the ETO route discussed in the previous chapter which, if carefully employed by the transferor could facilitate business rescue. See 'using the ETO defence as an escape route' in section 6.12 of chapter 6.

the transferor to its transferred employees in tort and for anything done by the transferor that was capable of resulting in a dismissal or discrimination based claim.[86] This practice created a disincentive for prospective buyers who would otherwise have wanted to step into the shoes of insolvent transferors. The prospect of inheriting onerous and sometimes uncertain or unpredictable liabilities provided no incentive for potential buyers to buy such businesses.

7.6.2.2 Inability to make changes to terms of employment

Another problem with the old TUPE Regulations was that it was very inflexible in respect of the employers' ability to make changes to employees' terms and conditions of employment post-transfer. An employer may need to change the employee's terms of employment for practical economic, organisational and employee relations' reasons after the business has been transferred. For instance, in respect of the transferee employer, changing terms and conditions of employment may be necessary to avoid having two sets of employees with different terms and conditions within the transferee's workforce so as to avoid potential equal play claims by employees on inferior terms. Changes to terms may also be needed simply for reasons of fairness and work place harmony and for administrative efficiency of the acquired business.

However, the 1981 Transfer Regulations made making changes to employees' terms and conditions extremely difficult if the transfer of the undertaking was the reason for the changes.[87] To be able to lawfully make changes to terms and conditions, the employer was required to demonstrate that the change entailed 'changes in the workforce.' This was interpreted by relevant employers to mean that there had to be a reduction in the employer's entire workforce.[88] If this construction of the provision was correct, it could be argued that this was contrary to the promotion of employment protection as the requirement was capable of increasing the number of redundancies rather than foster continued employment following the transfer of a business.

Perhaps the biggest problem was the fact that the rule against variation to terms and conditions post transfer of an insolvent business applied whether or not the employee consented to the change and even if the package of changes to the

[86] TUPE 1981, reg. 4.
[87] See *Daddy's Dance Hall* case [1988] ECR 739.
[88] See the Court of Appeal's decision in *Berriman v Delabole Slate Limited* [1985] ICR 546.

employees' terms was overall to the employee's advantage.[89] In effect, transferee employers were generally not allowed to 'buy out' onerous or inconvenient terms within the contracts of transferring employees even in circumstances where doing so could have helped in rescuing the insolvent business and preserve some jobs[90] given that changes to terms and conditions are generally considered as a means of avoiding job losses and redundancies.

The consequences of requiring an employer to take on all transferring employees on the same terms and conditions as they enjoyed with the transferor was that apart from extinguishing the common law freedom that employers had in respect of negotiating changes to the employees' contract terms, the provision was damaging to the rescue culture. This view held true in respect of a transferred insolvent business in which its survival was predicated on the transferee's ability to harmonise the contract terms of the transferred employees and those of its existing workforce.[91]

7.7 Towards fostering the 'rescue culture': the new law

It was in recognition that the application of TUPE without qualification to insolvent business transfers operated as a disincentive to potential purchasers from acquiring such businesses, that the Government decided to revise the TUPE Regulations to bring them in line with the ARD. It was obvious that each time a buyer could not be found to buy an insolvent but viable business due to employee liabilities' concerns represented a missed opportunity to rescue such a business. This, in turn, was to the disadvantage of the employees TUPE was originally intended to protect when viewed against the employment protection background of the regime. A business closure is also a big loss to the local community in which the business is situated. It represents loss of revenue to the tax authority and to auxiliary businesses that provide services to it.

The stated purpose of TUPE 2006 in relation to insolvency is to incentivise purchases of insolvent businesses by lessening the burdens assumed by potential purchasers of such businesses. This, the Government sets out to achieve by

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[89] *Credit Suisse First Boston (Europe) Ltd v Litster* [1998] IRLR 700.

[90] ibid.

[91] See Charles Wynn-Evans, 'The Ongoing Saga of TUPE and Contractual Variations' (2007) 36(4) ILJ 480.

ensuring that the liabilities that pass across to a purchaser following a business transfer are significantly reduced [92] so that both the 'rescue culture' and employees' job security are not imperilled by TUPE. Accordingly, the two liberalising or optional provisions of Article 5 introduced into the 2001 ARD discussed above and, which were introduced to foster rescues of insolvent businesses in Member States, have been taken up by the UK Government and incorporated into the 2006 TUPE Regulations.

In the context of insolvency and, particularly, with a view to ensuring the continuous survival of insolvent but viable businesses, some flexibility is allowed Member States by virtue of Article 5 of the consolidated 2001 ARD. The flexibility introduced is a compromise meant to institute a cooperative partnership philosophy to business transfers - a partnership capable of fostering competitiveness and employment flexibility by helping insolvent transferors transfer businesses on a going concern basis without walking over the rights of the employees affected by the transfer. [93] The Article 5 measures of the ARD were, in other words, intended to strike a fine balance between the employment protection goals of employment law on the one hand and, the rescue objective of insolvency law on the other. [94]

The two special [95] insolvency provisions which are expected to promote rescues of insolvent businesses in the UK are contained in Regulations 8 and 9 of TUPE 2006. In theory, the new provisions have taken cognizance of the fact that the existing obligations to employees often contribute to the problems leading to the insolvency of businesses and have therefore provided the prospective purchasers with the opportunity to address the issue when purchasing businesses that are insolvent. It appears, however, that in practice, the new provisions continue to be beset with problems of clarity just as the provisions of the original Transfer Regulations were.

Below we consider the two insolvency provisions, how they operate, how they might help promote rescues of insolvent businesses (which will indirectly protect

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[92] McMullen, (n 5)132; M Sargeant, 'Business Transfers and Corporate Insolvencies-the Effect of TUPE' (1998) 14 IL & P 4.
[93] This was the view expressed by Mr McCartney, the then DTI (now BIS) Minister of State during the Council of Ministers meeting in Luxemburg on June 4, 1998.
[94] Catherine Barnard, *EC Employment Law*, (2nd ed. OUP, Oxford 2000), 445.
[95] There are special insolvency provisions because there only apply to businesses which at the time of transfer are subject to 'relevant insolvency proceedings'. See generally TUPE 2006, Regulations 8 & 9.

employment opportunities for employees), and whether they are effective or not in that respect.

7.7.1 The Regulation 8 option: partial transfer of debts

One of the new provisions introduced to advance the rescue of insolvent businesses is to limit the liabilities which transfer to buyers of such undertakings or businesses in a relevant TUPE-transfer. The aim is to free prospective buyers from the burden of liabilities which, otherwise, would have applied in certain defined circumstances. According to Regulation 8(5), in relevant insolvency proceedings,[96] 'Regulation 4[97] shall not operate to transfer liability for the sums payable to affected employees under the relevant statutory schemes.'[98] The questions therefore are what the effect of Regulation 8 is and how does this provision assist business rescue initiatives?

7.7.1.1 Effects of Regulation 8

The main effect of Regulation 8 TUPE 2006 is that in a TUPE-transfer involving an insolvent business, certain accrued and employee-related liabilities will not pass[99] to the buyer of the business or undertaking. Rather, the relevant employees (including those dismissed before the transfer took place in the circumstances that Regulation 7(1) makes automatically unfair) will retain their claims against the National Insurance (NI) Fund under the statutory provisions of ERA 1996 instead.[100] Technically, what Regulation 8 does is to mitigate the employees' liabilities that pass to the purchaser of an insolvent business both by

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[96] The term 'relevant insolvency proceedings' is defined in chapter 6.

[97] Regulation 4 TUPE 2006 requires contracts of employment and all of the transferor's rights, powers, duties and liabilities to automatically transfer the transferee following a business transfer)

[98] The relevant statutory schemes applicable here are (a) Chapter VI of Pt XI of the ERA 1996 Act; and (b) Pt XII of the ERA 1996 Act. It is pertinent to note also that according to the recent EAT's decision in *Pressure Coolers Ltd v Molloy* [2011] IRLR 630, the relevant debts had to arise before the transfer in order to come within the Secretary of State's guarantee under Part XII of ERA 1996 insolvency payments.

[99] It would have been much more helpful and indeed easier to ascertain which liabilities will or will not pass to a transferee if the Regulations had spelled this out clearly. But as it is, it is difficult to know exactly which liabilities the Secretary of State is prepared to let the NI Fund to pay or not. In fact, on April 3, 2006, only three days before the Regulations were due to come into force, the Redundancy Payment Office (RPO) issued a statement of its own. In the statement, the RPO suggested that where there is a transfer or an unfair dismissal made in connection with a transfer, it will only pay the arrears of pay and accrued holiday pay- which are often minimal or even non-existent. This, it is submitted, is going to be another area that will breed controversies and litigation. However, for the possible liabilities that will transfer, see chapter 6, particularly the section on: 'What Transfers'.

[100] The relevant statutory schemes applicable here are (a) Chapter VI of Pt XI of the ERA 1996 Act; and (b) Pt XII of the ERA 1996 Act.

means of a statutory cap and the operation of the state guarantee scheme, which throws certain past liabilities on to the Secretary of State (and presumably) then technically back on to the insolvent transferor through the Secretary of State's right to subrogate having paid out.

In effect, this is a remedial approach which amounts to subsidising going concern sales of insolvent businesses by the Government. It is the Government's effort to foster business rescues in the UK.[101] There is no doubt that with the partial relief afforded to prospective buyers by Regulation 8, insolvent businesses may become attractive purchase targets under TUPE 2006 in comparison to what they were under the original TUPE. However, it is unclear whether the Regulation 8 provision will, in practice, promote the rescue culture since transferees could still inherit substantial liabilities, such as back pay and contractual redundancy entitlements over and above the statutory guaranteed payments. The possibility of increased business rescues would have been enhanced even further, it is submitted, if transferees were given an entirely clean slate on all pre-transfer debts owed to the employees by insolvent transferors. Another way the Government could promote the rescue culture may be to amend insolvency legislation to allow some of the liabilities that pass to transferees to be paid to affected employees by the NIF instead. That way, the liabilities that potential purchasers would inherit would be further reduced and more insolvent businesses would be rescued.

7.7.2 The Regulation 9 option: variations to contract terms

In addition to capping the liabilities that can pass to a transferee, TUPE 2006 has also provided greater scope for making variation to employees' terms and conditions of employment in rescue situations. Under Regulation 9, when a transferor is involved in relevant insolvency proceedings 'permitted variations' of contract can be agreed by either the transferor or transferee (or an insolvency practitioner) and the representatives of the employees.[102]

[101] See generally R Dhindsa, The Draft TUPE Regulations and Insolvency' (2006) 19 Insolvency Intelligence 8; Malcolm Sargeant, 'TUPE- The Final Round' [2006] JBL 549.
[102] TUPE 2006, Regulation 9 (1).

7.7.2.1 Effects of Regulation 9

Under Regulation 9 the transferee may be able to reduce pay and establish other inferior terms and conditions of employment post-transfer. The rationale behind this provision is that the employees of an insolvent business should be able to agree variations to their terms and conditions if this is necessary to save their jobs. It is submitted that this provision would help to reduce the equal pay disputes that characterised the old TUPE. However, the collective mechanism through which the agreement to vary terms may be obtained is, as shown below, a cumbersome one.

7.7.2.2 Conditions for varying terms

Although 'permitted variations' to employees' terms and conditions following a business transfer is now allowed under the new Regulation 9 of TUPE 2006, this is subject to several strict rules. The first condition that must be satisfied for variation to be valid is that the transferor must be subject to 'relevant insolvency proceedings.' This means that variation to employees' terms is permitted only if the business employing the employees is insolvent.

The second requirement is that any variations must be agreed with appropriate representatives of the employees. This makes it unnecessary for the employees themselves to individually agree to the changes made to the terms of their employment contracts for the variations to be valid. It is sufficient, and indeed essential, that the representatives of the affected employees give their consent to the variations.

Professor McMullen has argued that this provision 'coincides with the model role for employment law in the context of insolvency and restructuring' as it allows employees' acquired rights to be waived only 'through the mechanism of employee representation'.[103] Whilst this is an important safeguard against abuse of the right to makes changes to terms by employers, the time it takes to reach agreements between the relevant employer and the employee representatives may, in practice, trivialise or hamper the intended effects of the provision. Moreover, there is nothing in the Regulations that says what can, or should be

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[103] McMullen (n 5) 134. John Armour and Simon Deakin have also echoed the same view. See J Armour & S Deakin, `Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) University of Cambridge CBR Working Paper (No. 204) <http://www.cbr.cam.ac.uk/pdf/wp204.pdf> accessed 11 May 2011.

done, in a situation where there is a protracted negotiation or where an agreement cannot be reached by the parties on the issue at all. Perhaps, it would be time saving and important for the preservation of the value of the insolvent business to have a default provision which allows new terms to be substituted on a temporary basis pending when an agreement can be reached by the parties.

The third condition for varying terms is that variation must only be done if it would safeguard 'employment opportunities' by ensuring the survival of the business transferred. The words 'employment opportunities' rather than 'employment' were carefully chosen because they have wider connotations. Apart from offering justification for varying terms, they allow variations to terms to be argued expansively on the basis that the business is rescued and that this will in turn safeguard employment opportunities that may be created by it in the near or distant future.[104]

7.8 TUPE 2006: 'new wine in old wineskins' or 'old wine in new wineskins?'[105]

Whilst the new insolvency measures introduced are commendable, it is not clear whether they will achieve the aim of making insolvent businesses more attractive purchase targets or whether these provisions simply displace old problems by introducing new ones, which will take some time and costly litigation to address. There is the view that the 2006 Transfer Regulations are no different from their predecessors as they are drafted in an unclear and ambiguous language. Concerns have been expressed about the way the 2006 Transfer Regulations are drafted. It has been contended that due to the way they are drafted, the 2006 Regulations are as problematic as their predecessors. They are said to be drafted in:

> …a language that is so loose and imprecise it is not possible to discern with any clarity how they are supposed to work. Instead of bringing clarity, they bring confusion to new, unprecedented heights.[106]

[104] See Malcolm Sargeant, 'Legislative Comment: TUPE-The Final Round' [2006] JBL 549, 563.

[105] In one of the several parables told by Jesus in the New Testament, Jesus told his disciples that 'no one tears a patch from a new garment and sews it on an old one. If he does, he will have torn the new garment, and the patch from the new will not match the old' and 'no one pours new wine into old wineskins. If he does, the new wine will burst the skins, the wine will run out and the wineskins will be ruined.' Luke 5: 26-37.

The major problem with the 2006 Regulations is that they have failed, once again to expressly specify the types of insolvency proceedings in the UK to which they are intended to apply. TUPE 2006 transposes the vague generic language employed by Article 5(2) (a) of the 2001 ARD[107] without attempting to specify how they are to apply in the context of specific UK insolvency proceedings. TUPE 2006 merely consolidates the ECJ's position in *Abels v Administrative Board*[108] by drawing a distinction between two types of insolvency proceedings: those opened with a view to the liquidation of the assets of the transferor and those opened not with that intent. What this means is that whether a particular insolvency procedure is covered by the Regulations will depend on the purpose of the procedure opened. This approach has been described as 'unsatisfactory and incoherent.'[109] On a straight reading, the distinction between the different types of proceedings makes no sense at all in the context of UK insolvency since assets are sold in virtually all insolvency proceedings. From the UK perspective, therefore, it is unclear what the phrase 'not with a view to the liquidation of the assets of the transferor' means precisely since it is almost impossible to ascertain from the outset what the purpose of a particular procedure is going to be. [110]

This lack of clarity and specificity, it is submitted, will only serve to create more confusion. The consequence will be that the chances of rescuing insolvent businesses and preserving jobs will be reduced significantly. This then raises the question: is TUPE 2006 a case of 'new wine in old wineskins' or putting 'old wine into new wineskins'- that is, a much more hopeful but still perilous enterprise? Whichever way one looks at this, the point here is whether the new and special insolvency provisions introduced into the 2006 Regulations are merely patch work designed to dress up the 'image' of an already defective regime, or whether they are capable of achieving the purpose for which they were introduced to achieve?

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[106] Lord Hunt of Wirral, House of Lords debate, Hansard May 3, 2006 Col. 534 <http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060503/text/60503-25.htm> accessed 25 November 2011.

[107] The Government has taken the easiest route by 'copying out' the provisions of Article 5 of Directive 2001/23 which provides in a similar manner that Articles 3 and 4 of the 2001 ARD do not apply to insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of a competent public authority.

[108] Case 135/83 (1985) ECR 469

[109] Paul Davies, 'Acquired Rights Directive, Creditors Rights, Freedom of Contract, and Industrial Democracy' (1993) Yearbook of European Law.

[110] McMullen (n 5) 132; M Sargeant, 'Business Transfers and Corporate Insolvencies-the Effect of TUPE' (1998) 14 IL&P 4.

This is an apt question as ‘cracks’ are already beginning to appear in the application of the ‘purpose of insolvency’ approach *vis-a-vis* the UK insolvency system. The difficulty in determining whether TUPE applies or not to a business transfer based on the purpose for the insolvency proceedings opened in relation to the transferor came to a head in the two recent cases of *Oakland v Wellswood (Yorkshire) Ltd* [111] and *OTG Ltd v Barke and ors* [112] in which two conflicting decisions were also reached by the courts.

In *Oakland,* the question was whether the ‘pre-packed’ sale of a business of an insolvent company *(Wellswood)* to a Newco by the administrator was caught by Regulation 8(6) (meaning that the insolvency proceedings that were opened in relation to it *was not* with a view to the liquidation of its assets) or whether Regulation 8 (7) applied (meaning that the insolvency proceedings that were opened in relation to the transferor were ‘with a view to the liquidation of its assets) because if they were, the employment contract of the claimant would not transfer. Both the ET and the EAT found that the claimant’s employment contract had not transferred to Newco under TUPE because of the exception in Regulation 8 (7).

The implication of the tribunals’ decisions was that the transferor employer (even though in administration at the time) was subject to an insolvency proceeding instituted with a view to the liquidation of its assets. The decision was influenced by the fact that the administrators themselves admitted that selling the business as a going concern was not going to be achievable and that their primary concern was to maximise creditor return. It follows that both the ET and EAT had formed the view that the administrators were appointed with the aim of liquidating the business which meant that Regulation 8 (7) applied to prevent the contracts of employment of the transferor’s employees from automatically transferring to the transferee.

These decisions contradicted the guidance[113] issued by the Government which stated that administration would always fall within Regulation 8(6) rather than

[111] UKEAT/0395/08.
[112] UKEAT/0320/09/RN.
[113] This guidance was issued by the then Department for Business, Enterprise and Regulatory Reform’s (BERR) (currently the Department for Business, Innovation and Skills –BIS). Note however that this guidance is not binding and has been widely criticised particularly by R3- the Association of Business Recovery Professionals. The body had argued that the use of generic wording resulted in uncertainty

Regulation 8(7) as its purpose (or main purpose) is to enable the business to continue trading rather than liquidating it. According to the guidance, 'the correct approach is to look at the main or sole purpose of the procedure rather than its outcome in a particular instance. The main purpose of bankruptcy proceedings is to realise free assets and expenses amongst all the debtor's creditors. This, it is submitted, is not the main purpose of administration.[114]

However, on further appeal the CA reversed the EAT's decision. In coming to its decision the CA focused not on TUPE, but on section 218(2) of the Employment Rights Act 1996.[115] The section states (irrespective of the application of TUPE) that the transfer of a business does not break the continuity of any employee who transfers with it. In spite of not making its decision based on the TUPE Regulations, the CA did indicate (*obiter dictum*) that it considered that it was unlikely that Regulation 8(7) would apply in relation to pre-packed administration sales. *Oakland* is another good example of how far the courts may be willing to push at the boundaries of statutory language to protect employees in insolvent business transfer situations. The case also exemplifies the tension between business rescue and employee protection that exists when an insolvent undertaking is transferred on a going concern basis. Here, whilst the ET and EAT's decisions were pro-business rescue, they would not, if they had stood, have afforded the employees the full protection the ARD intended for them in business transfers caught by TUPE. It could be argued that the CA's decision, on the other hand, was pro employees and contra business rescues because whilst the decision was good for the employees in terms of job security and continuity of service, it had the

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about the types of insolvency procedures covered by the regulations and that interpretation of regulation 8(7) to exclude administration was flawed because:

(a) while the purpose of administration is set out in the form of a hierarchy, with the first objective being rescue of the company, this objective can rarely be achieved. In most cases the purpose of the administration will be achieved through the second objective of achieving a better result for the creditors as a whole than would be likely on a winding up. This will usually be effected through the sale of the whole or part of the business (the business being an asset of the company) or the sale of assets on a piecemeal basis. Such activity should be characterised as a realisation, i.e. liquidation, of assets; and.

(b) it was wrong to state that administration is not instituted 'with a view to' liquidation of the assets on the ground that the first objective is to rescue the company and that the other objectives only come into play once that objective proves impossible. It may be apparent at the very beginning of the process that it will not be possible to save the company.

[114] For the purpose of administration, see IA 1986, Schd. B1, para. 3

[115] On this, see the section on 'overlap between section 218 and TUPE' in chapter 5.

potential of reducing the use of pre-packs to rescue insolvent businesses. From a theoretical perspective the tribunals' decisions would have pleased the Proceduralists and the creditors' bargain theorists as it meant that the business could be sold freely and, perhaps, for its full market value, without the encumbrances of employees' liabilities. On the contrary, TPT and the Traditionalists would have applauded the CA's decision for the protection it gave to the employees.[116]

The *Oakland* 'drama' was not the last. One of the most recent cases that looked at whether TUPE apply to sales by companies which have gone into administration under Schedule B1 of the Insolvency Act 1986 is *OTG Ltd v Barke and Ors.*[117] This case involved five conjoined appeals.[118] If TUPE apply to administration sales, the new employer will be liable under Regulation 4 for all of the employees' accrued liabilities transferred to him or her. Prior to the case going to appeal, the employment tribunal had to decide whether administrations could never fall within Regulation 8(7) (the absolute approach); or whether they could if, as a matter of fact, it is found that the administration proceedings were instituted with a view to the liquidation of the transferor's assets (the fact-based approach). The ET followed the EAT's decision in *Oakland* which required that tribunals decide the question as one of fact based on the reason for which the company went into administration. Accordingly, the ET held that Regulation 4 of TUPE was disapplied by the application of Regulation 8 (7) because the administrator in that case had clearly been appointed with a view to the liquidation of the assets of *OTG.*

On appeal to the EAT, the question was whether administration proceedings under Schedule B1 constituted 'insolvency proceedings' within the meaning of Regulation 8 (7) of TUPE. A differently-constituted EAT from that in the *Oakland* case took cognizance of the fact that in insolvency-related business transfers, there is usually a tension between safeguarding the rights of individual workers, namely those who are likely to be dismissed or to have their terms of employment downgraded on the one hand, and the interests of the workforce and the company more generally on the other hand, but that the ARD chooses not to allow the rights

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[116] The views of Proceduralists and Traditionalists on insolvency law are discussed extensively in chapter 2.

[117] UKEAT/0320/09/RN

[118] *Olds v Late Edition Ltd* (UKEAT/0321/09/RN); *The Sec. of State for Business, Innovations and Skills v Coyne* (UKEAT/0444/09/RN); *Key2Law (Surrey) LLP v De' Antiquis* UKEAT/0493/09/RN; *Head Entertainment LLP v Walker* (UKEAT/0302/10/RN).

of the employees to be trumped altogether in such situations. Accordingly, the EAT took a different view from the one in *Oakland*. It followed what it called the 'absolute approach'[119] and decided that administrations (including pre-packs) are not capable of constituting bankruptcy proceedings or any analogous insolvency proceedings, instituted with a view to liquidation of the assets of the transferor' within the meaning of Regulation 8(7) of TUPE 2006. The effect of this decision is that the normal TUPE principles under Regulation 4 on transfer will continue to apply to sales effected by administrators: the employees transfer to the buyer as do all their outstanding and unmet liabilities.

TUPE's primary purpose is to safeguard the rights of the employees in the event of a business transfer resulting in a change of employer. This objective, it is submitted, is best realised through the application of the 'absolute-approach' rather than the 'fact-based' approach as the latter approach could allow employees to be left without the protection afforded to them by the ARD and TUPE in several transfer situations. It is submitted, that there will certainly be times in which employees would be better off as a result of the *OTG* ruling since TUPE will apply.[120] Particularly, in a situation in which the employees are made redundant, they will be able to bring claims for unfair dismissal against the new employer. However, this approach has to be balanced with the fact that overall, its strict application could make the employee worse-off. It could result in fewer businesses in administration being bought. This will in turn impact negatively on business rescues due to the employee-related costs which TUPE will induce. Ultimately, the collapse of a business that could have, save for TUPE, been rescued would leave employees without jobs. Tribunals and courts need to have a rethink about the 'absolute-approach' since a 'fact-based' approach (although capable of increasing the likelihood of disputes over who would be liable for the

[119] The EAT preferred this approach to what was termed 'the fact-based approach'- in which the application of TUPE's automatic transfer provisions was said to be dependent on individual circumstances of each administration. See, 'Sale of a business by administrators automatically transfers employees to buyer' <http://www.freshfields.com/publications/pdfs/2011/mar11/29994.pdf> accessed 06/December/2011.

[120] The Court of Appeal's decision in *Key2Law (Surrey) LLP v De' Antiquis* [2011] EWCA Civ 1567. has helpfully clarified the applicability or otherwise of TUPE in insolvency situations. The CA in that case held that all administrations fall outside the scope of Reg 8(7) of TUPE because they are not insolvency proceedings 'instituted with a view to the liquidation of the assets' of the transferor. Thus, the law is that all administration proceedings are covered by TUPE Regulations and are not exempt by virtue of Regulation 8(7).

transferor's obligation, and could result in costs, delay and uncertainty) has greater potential of yielding high percentages of business rescues and job preservation in comparison to the 'absolute-approach'.

7.9 Conclusions

The flexibility introduced through Regulations 8 and 9 for transferees of insolvent businesses is a very important feature of TUPE 2006. It represents a sensible panacea to the disincentive problem posed to business rescues by applying TUPE to insolvency. Limiting the amount of liability that can transfer to the transferee may be an excellent fillip for an already waning desire to purchase insolvent businesses in the UK. Potentially, more insolvent businesses would be rescued since buyers know that there is now a ceiling on the liabilities that can pass to them under TUPE 2006 in comparison to what obtained under the 1981 Regulations. In a similar vein, the rescue culture would also be strengthened by the employer's ability to vary the employees' terms and conditions of employees' employment following the transfer of an insolvent business. This will avoid problems of equal pay disputes between the employer's existing and transferred workforce and will ultimately boost the efficiency of the transferred business.

These changes demonstrate how the revised TUPE Regulations have attempted to secure a trade-off between employee protection and business rescue: certain of the employees' acquired rights are waived so as to ensure the continuity of the business employing them. On the other hand, when the business survives (albeit under a different management post transfer) the new owner is obliged to compensate the employees by ensuring that they in turn keep their jobs. From this perspective it could be argued that TUPE 2006 represents the type of labour legislation which, though intended to protect employees during transfers of insolvent businesses, has also given consideration to, and indeed even contributed to, the rescue of such businesses.[121] The revised TUPE has somehow managed to reconcile employment security with labour market flexibility. There is a balance between the rescue of insolvent businesses' objective pursued by English insolvency law and that of employment protection championed by employment law on the other hand.

[121] Loubser (n 29) 57-69.

In theoretical terms, the concerns of the Proceduralists and creditors bargain theorists that the TUPE-type protection ‘over-deters’ sales of insolvent businesses is cured to some degree by the provisions of Regulations 8 and 9 which now makes it easier to sell an insolvent business as a going concern for the benefit of its creditors.. Also, the Traditionalists and TPT’s concerns that ‘over-incentivising’ business rescues could lead to a diminution or complete erosion of the protection TUPE was intended to give to the rights of employees during going concern transfers of insolvent undertakings have also been allayed, first, by the distinction made in the type of insolvency proceedings to which TUPE will or will not apply and second, by the stringent conditions the employer has to satisfy before it could avail itself of the new insolvency measures. However, whether or not these measures will aid business rescues in the UK will depend on their construction by the courts.

The next chapter will offer normative justifications for the policies behind the rescue of insolvent businesses and employee protection and then conclude the research.

CHAPTER EIGHT

CONCLUSION

8.1 Introduction

The relationship between business rescue and employee protection is not an easy one. Where rescue of an insolvent business takes the form of a going concern sale of the business, there is a strong tension between business rescue and employee protection policies. This is due, first, to TUPE's 'over' protective disposition towards the employees and second, to its application to transfers in the context of insolvency. TUPE involves compulsory novation of contracts and the preservation of the pre-transfer terms and conditions of the employees' contracts of employment. [1] These have posed serious problems to sales and rescues of insolvent businesses.

This chapter concludes the research. It summarises how theory has been used to explain the tension arising between business rescue and employee protection in transfers involving insolvent undertakings in the United Kingdom (UK). The chapter highlights the main insights that emerged from the research. It offers normative justifications for business rescue and employee protection policies. Lastly, the original contribution made by the research to knowledge and the limitations of the study are highlighted.

8.2 Research focus and insights

The research focused on the tension between business rescue and employment protection in corporate insolvency and how theory can help to achieve an appropriate balance. The study has traced the genesis of the employment protection legislation in the United Kingdom to the EU's inclusion of social goals within its legislative sphere of competence. It traced how EU's social policy actions have impinged on the UK.[2] A notable example is the impact that the social protection courses of actions pursued by the EU has on UK domestic businesses.

[1] TUPE 2006, Reg. 4

[2] S Leibfried and P Pierson, *European Social Policy: Between fragmentation and integration* (Brookings Institute, Washington DC 1995).

One major implication of EU social policy for the UK is that employment matters that hitherto used to be the exclusive preserve of the UK employment law can no longer be determined solely by domestic developments without reference to EU labour law. The encroachment of EU law into the UK's employment law space has forced changes in certain aspects of employment relationships.[3]

It was noted in chapters 3 and 4 that it was through the UK's mandatory fulfilment of its EU obligation in the context of implementing the European Union Acquired Rights Directive (ARD) on the safeguarding of employees' rights in the event of a transfer of the business or undertaking employing them to another person that TUPE became part of the UK's employment law. The implementation of the ARD, which was adopted in 1977 as social policy legislation by way of TUPE, altered the balance that once existed in business transfers when the common law regulated transfers of undertakings in the UK.[4] As far as the rights and status of the employees in the context of insolvent business transfers are concerned, TUPE has completely 'rewritten' employees' rights and altered the status of the employee when an insolvent business is transferred to a third party purchaser on a going concern basis.[5] With TUPE, the beneficial pendulum in business transfers has swung in favour of the employees to the disadvantage of the employers when compared to what it was when the common law regulated business transfers.[6]

The research found that applying TUPE to transfers of insolvent business has not been helpful to the rescue culture. Rather, TUPE's application to insolvency has tended to harm the business rescue course. It was evident in the study that sometimes rescuing a business requires radical measures such as reducing the size of the workforce to be taken if the business is to be sold as a going concern, but that TUPE makes the use of this technique to rescue very difficult.[7] The research has demonstrated that from the employee protection perspective, TUPE

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[3] Bob Hepple, 'Individual Employment Law' in G S Bain (ed.), *Industrial Relations in Britain* (Blackwell, Oxford 1983).

[4] B Bercusson, *European Labour Law* (Butterworth, London 1996); J McMullen, 'An Analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006' [2006] ILJ 113.

[5] Bob Hepple, 'Workers' Rights in Mergers and Takeovers: The EEC Proposals' (1976) 5 ILJ 197; S Hardy and N Adnett, 'Entrepreneurial Freedom versus Employee Rights': the Acquired Rights Directive and EU Social Policy Post-Amsterdam (1999) 9 Journal of European Social Policy 127.

[6] See *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014 (HL). See further chapter 5 of thesis.

[7] Sandra Frisby, 'TUPE or not TUPE? Employee Protection, Corporate Rescue and ''One Unholy Mess''' (2000) *Company Financial & Industrial Law Review*. 249 -271; H Collins, 'Transfer of Undertakings and Insolvency' (1989) 18 ILJ 144-158; Paul Davies, 'Amendments to the Acquired Rights Directive' (1989) 27 ILJ 365-375.

is a very good law. TUPE's application to insolvent business transfers is beneficial to the employees because it has limited the transferor's ability to dismiss them to facilitate a sale which used to be permissible under the common law rule that was enunciated in the seminal *Nokes'* case[8] discussed extensively in chapter 5.

However, it has been argued in this study that the effects of TUPE should not be considered solely from the employment protection perspective. Looking at TUPE from a sale and business rescue perspective, it was evident from the analysis carried out in this thesis that TUPE is a cog in the wheels of insolvent business rescues. A key finding of the research was that TUPE not only hinders business rescues by obstructing the transferor from effecting dismissals to achieve a sale, but it also impedes rescues in its requirement that the transferee has to take the insolvent business with all of the transferor's employees on the same terms of employment in addition to debts owed to them. This practice was identified in the thesis as increasing the costs of business rescues to the transferees. The study noted that consequent upon this approach to employee protection, the weight of employee-related obligations 'over-deters' purchasers. The consequence is that the prospects for successful going concern sales of insolvent businesses are undermined. It was noted that where a business cannot be sold on a going concern basis, its closure inevitably results in job losses for the employees.[9]

8.3 Normative justifications for business rescue and employee protection policies

It was evident in the study that in circumstances where a sale could not be achieved, the only option open to the Insolvency Practitioner is to close down the business, make the employees redundant and sell its assets piecemeal. It was noted that where that happens, TUPE would not, as articulated by Frisby, represent '...so much a route to job security as a threat to it'.[10] TUPE would be counter-productive to its professed aim of protecting the rights of the employees since the closure of the business means job losses for all affected employees. However, in spite of this obvious problem with the regime, employee protection

[8] *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014 (HL).
[9] John Armour & Simon Deakin, 'The Rover Case (2) –Bargaining in the Shadow of TUPE' (2000) 29 ILJ 395; Frisby (n 7); Collins (n 7).
[10] Frisby (n 7) 253.

acolytes[11] are concerned that 'over-incentivising' going concern business rescues by carving insolvent business transfers wholly out of TUPE would seriously jeopardise the protection given to the employees during transfers.[12]

In spite of the problem that TUPE poses to business rescues, its continued relevance and application to insolvent business transfers, provides an opportunity therefore for considering normative justifications for the employment law objective of employee protection and the insolvency law goal of business rescue during transfers of insolvent undertakings. The use of theory has enabled an argument to be made that TUPE 'is a necessary evil'. That is, even those who do not like TUPE understand that it has to be accepted sometimes or that TUPE has to exist if the rights of employees are not to be trampled upon during transfers. The use of theory has also provided the means to normatively examine the revisions made to the ARD and TUPE on the policy trying to balance the policy goals of employment and insolvency laws respectively as these relate to insolvent business transfers.

Given that in theoretical terms the Proceduralists generally and, in particular, the creditors' bargain theorists'[13] core argument is that insolvency law should limit itself to protecting the interests of the creditors only, the implication is that these theorists would only support an insolvency law framework that facilitates going concern sales of insolvent businesses on the theory that the preservation of going concern value of the business is beneficial to the creditors. This is based on the notion that the preservation of a business maximises its sale value for the creditors as the legal owners of the assets of the insolvent business.[14] It follows

[11] D Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993) 71 Texas Law Review 541; L M LoPucki, 'A Team Production Theory of Bankruptcy Reorganization' (2004) 57 Vanderbilt Law Review (3) 741, 769; K Gross, Failure and Forgiveness: Rebalancing the Bankruptcy System (YUP, New Haven 1997); K Gross, 'Taking Community Interests Into Account in Bankruptcy An Essay' (1994) 72 Wash. U.L.Q. 1031; E Warren, 'Bankruptcy Policy' (1987) 54 Uni. Chi. L. Rev. 775, 800; E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. 336-387.

[12] Samuel Etukakpan, 'Business Rescue and Continuity of Employment: Analysing Policy through the Lens of Theory' (2011) 32 Company Lawyer 99, 109.

[13] See chapter 2.

[14] Thomas Jackson, for example, has opined that under much modern corporation law it is most useful to view shareholders, unsecured creditors, and secured creditors as the owners of the firm. They have different packages of rights to the assets at different times, but they all have the right to call on the firm's assets under one set of circumstances or another… Once one identifies those with rights against the assets, one has the pool of owners. Jackson T H, *The Logic and Limits of Bankruptcy,* (HUP, Cambridge, MA 1986) 32. See furher D G Baird, 'Bargaining After the Fall and the Contours of the Absolute Priority Rule' (1988) 55 Uni. Chi. L Rev 738; W J Blum, 'The Law and Language of

therefore, that any restriction imposed within the structure of the insolvency law framework which is likely to reduce the capacity of the creditors to capture full going concern value of the sale of an insolvent business, would be regarded by these schools of thought as a 'foul'.[15] What this means is that the Proceduralists in general and the creditors' bargain theorists in particular would loathe TUPE for the type of protection it offers to the employees during transfers of insolvent businesses. However, it seems that without the external interference of TUPE, these theorists would acclaim English insolvency law for its creditor friendly disposition in insolvency.[16]

The study has shown on the other hand that, based on their employee protection stance, Traditionalists in general, and LoPucki, the progenitor of team production theory of bankruptcy reorganisation (TPT), in particular, would be likely to support TUPE's maximum protection for continuity of employment.

Traditionalists in general do not have any issues with TUPE applying to insolvent transfers since these theorists contend that insolvency resulting in the sale of the business is when employees' need protection the most.[17] This group of scholars

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Corporate Reorganization' (1950) 17 Uni. Chi. L Rev. 565; Blum, 'The "New Directions" for Priority Rights in Bankruptcy Reorganization' – A Reappraisal' (1958) 25 Uni. Chi. L Rev. 417.

[15] Jackson (n 9) above; T H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, (1982) 91 Yale Law Journal 857, 860; T H Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 Stan. L. Rev. 725; Jackson T H & Scott R, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Virginia L. Rev. 155; D G Baird & T H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chicago L. Rev. 97; D G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Leg. Stud. 127,133; D G Baird 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 Uni. Chi. L. Rev. 815; D G Baird, 'A World without Bankruptcy' (1987) 50 Law & Contemp. Probs 173; C W Mooney Jr., 'A Normative Theory of Bankruptcy Law: Bankruptcy Law As (Is) Civil Procedure' [2003] Institute for Law and Economics Research Paper (No. 03-27), University of Pennsylvania Law School <http://ssrn.com/abstract id=425120> accessed 10 January 2009.

[16] See discussion on 'aligning English insolvency law with extant insolvency theories' in chapter 3.

[17] Warren (n 11a & b); V Finch & S Worthington, `The Pari Passu Principle and Ranking Restitutionary Rights' in F Ross (ed) *Restitution and Insolvency* (London, 2000); V Finch, *Corporate Insolvency law: Perspectives and Principles* (2nd edn, CUP, Cambridge 2002); M Frank, `The Rights of Employees in the Event of the Employer's Insolvency: A comparative Approach to the Rights of Employees during Restructuring in the United States and Europe' (2005) 1 New Zealand Postgraduate Law E-Journal 7; M Gronow, 'Insolvent corporate groups and their employees: The case for further reform' (2004) Legal Studies Research Paper No.130, Melbourne Law School <http://ssrn.com/abstract=81424> accessed 27 January 2011; Gross (n 11a & b); D Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1993) 71 Texas Law Review 541; J Sarra, 'Creditor Rights and the Public Interest: Restructuring Insolvent Corporations' (University of Toronto Press, Toronto 2003); J Sarra 'Widening the Insolvency Lens: The Treatment of Employee Claims' in Paul J Omar (ed.) *International Insolvency Law: Themes and Perspectives* (Ashgate Publishing Ltd, Hampshire 2008) L M LoPucki, 'The Unsecured Creditors' Bargain' (1994) 80 Virginia Law Review, 1887, 1896 -1902. L M

would argue that TUPE is not designed to deliberately prevent business owners from restructuring their businesses whenever the economic need to do so arises - even though this is how TUPE is sometimes perceived especially where the business cannot be sold due to its effects. For them, what TUPE does is to ensure that relevant employers do not walk over the rights of the employees during transfers and especially during insolvent business transfers.[18] The mandatory nature of TUPE makes it more difficult for parties to have arrangements, however mutually desirable, to circumvent the effects of TUPE in transfer situations.[19]

In theoretical terms, TUPE provides the necessary checks and balances on managerial (IP's) prerogatives on many fronts. It inhibits, without completely eroding, the transferor's ability to pursue wealth maximisation for the creditors during insolvent business sales without due regard to the interests of the employees who have made value enhancing human capital contributions to the business. The transferor's capacity to increase creditors' wealth in a transfer involving an insolvent business is limited by how stringent the conditions are that TUPE places on achieving sales or enhanced prices for insolvent business via a reduction in the size of the workforce. It does not prevent or outlaw dismissals, but that they have merely required that dismissals should be made in a legal and fair manner. For Traditionalists, TUPE re-emphasises the notion that employees dismissed should be compensated for their loss of employment. They argue also that contrary to what it seems is the case; TUPE does not vest employees with new rights. It does not give them rights over and above what they already had. What TUPE does is to preserve the employees acquired rights. From that perspective

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LoPucki (n 11); L M LoPucki & W C Whitford, 'Corporate Governance in the Bankruptcy Reorganizations of Large Publicly-held Companies,' (1993) 141 University of Pennsylvania Law Review, 669-800.

L M Lopucki & J W Doherty, `Bankruptcy Fire Sales' (2007), UCLA School of Law, Law and Economics Research Paper Series, 5 research paper No. 07-07 <http://ssrn.com/abstract=980585> accessed 22 October 2009; S Whelan & L Zwier, 'Employee Entitlement and Corporate Insolvency and Reconstruction'<http://www.cclsr.law.unimelb.edu.au/researchpapers/Protection%20of%20employee> accessed 12 December 2009.

[18] Roger Tynan, 'TUPE and Insolvency: Interpreting the Regulations' (2009) Employers' Law Magazine <http://www.personneltoday.com/articles/2009/07/07/50077/tupe-and-insolvency-interpreting-the-regulations.html> accessed 14 May 2012.

[19] On transfers and the effect of TUPE on structuring a transfer to circumvent TUPE, see the House of Lords decisions in e.g. *Litster v Forth Dry Dock and Engineering Co Ltd* [1990] 1 AC 546; *Celtec Ltd v Astley* [2006] IRLR 635 *; G4S Justice Services (UK) Ltd v Anstey* [2006] IRLR 588. On changes in the contractual terms of employment, see *Foreningen AF Arbejdsledere I Danmark v Daddy's Dance Hall A/S* [1988] IRLR 315. Contrast this with the House of Lord's decision in *Power v Regent Security Services Limited* [2007] IRLR 226.

therefore, Traditionalists would regard TUPE as a good law that is worthy of having.

The important role theory plays as a tool for explanation and interpretation is ostensible throughout in the research. Theory provides a lens through which to explain not just the tension between business rescue and employment protection but also the values of the policies behind rescue and employee protection practices. By refining TPT to accommodate the UK context of business rescue as opposed to corporate reorganisation, theory helped in explaining how a balance could be achieved between business rescue and employee protection.

Through theory, the need for achieving a balance between the incompatible policy goals of employment and insolvency laws during transfers of insolvent businesses was highlighted. It was possible to demonstrate that balancing will ensure that the existing tension between competing policy goals during insolvent business transfers is effectively managed. Balancing ensures that employment protection oriented law does not undermine the rescues of insolvent but viable businesses and vice versa. In theoretical terms, the balancing of these competing policy objectives is sacrifice implicit. For the employees, this may involve the waiving, under clearly specified conditions, of their acquired rights in order to facilitate rescues of insolvent businesses and safeguard employment for some of the employees.[20] For the employers, balancing may involve limiting managerial powers to restructure businesses as freely as they would have wished to. This invariably means that managers of insolvent businesses can no longer dismiss the entire workforce when selling an insolvent business on a going concern basis to a third party as was the case in the common law era.

Using theory, the research has been able to demonstrate how a balance between rescue and employee protection in insolvency has been achieved. It was argued in chapter 7 that this balance, broadly speaking, has been effectively struck by the trade-offs made in the revised ARD and TUPE regimes. TUPE 2006 places greater emphasis than the 1981 version on the rescue and sale of businesses as a going concern. The advantage of rescuing a business lies in its ability to potentially preserve, to a greater or lesser extent, employment opportunities for

[20] J Amour & S Deakins, 'Insolvency, Employment Protection and Corporate Restructuring: The Effects of TUPE' (2001) University of Cambridge CBR (Working Paper No. 204); J McMullen, 'An analysis of the Transfer of Undertakings (Protection of Employment) Regulations 2006(2006) ILJ 113.

the employees.[21] Thus, in the revised 2006 TUPE Regulations, the basic protective starting point in the original legislation has been watered down by the inclusion of special insolvency provisions aimed at furthering business rescues. The obligation placed on the transferee by the old TUPE to assume all debts in relation to the employees of the insolvent transferor and to take on the affected employees on their existing terms and conditions have been amended.

Under TUPE 1981, a relevant transfer of an undertaking had the effect of transferring all existing contracts of employment including liabilities, rights and obligations in connection with the contracts to the transferee. The limitless transfer of liabilities was criticised as problematic to the achievement of going concern business rescues. This problem has now been remedied under the 2006 Transfer Regulations to bring them in line with the revised ARD. There is now a statutory cap on the amount of liability that may transfer to the purchaser. Under Regulation 8 (5), if at the time of a relevant transfer the transferor is subject to 'relevant insolvency proceedings', [22] some of its debts *vis-a-vis* any contracts of employment or employment relationships payable to the relevant employees under the relevant statutory schemes shall not pass to the transferee. Thus, while preserving continuity of employment, TUPE 2006 limits the extent of liability that may transfer to the transferee.

The 'rescue culture' is given a further boost by the 2006 TUPE Regulations. The statutory capping of transferable liabilities so as to boost sales of insolvent businesses is followed by the introduction of another rescue mechanism to be found in the regulation 9 provisions. The rule which tended to hamstring employers from making changes in the contracts of employment if the sole or principal reason for them was the transfer itself or a reason connected with the transfer[23] that was not an ETO[24] reason entailing changes in the workforce[25] (see below) has also been relaxed.

[21] P L Davies, 'Employee Claims in Insolvency: Corporate Rescues and Preferential Claims' (1994) 23 ILJ 141.

[22] Under Reg. 8 (6) of TUPE 2006, 'relevant insolvency proceedings' simply denotes in insolvency proceedings which have been opened in relation to the transferee not a view to the liquidation of its assets and which are under the supervision of an insolvency practitioner (IP).

[23] *Wilson v St Helen's Borough Council* [1996] IRLR 320 .

[24] As part of the effort to bring clarity to the TUPE Regulations, the new reg. 7(3)(b) of TUPE 2006 makes it clear that redundancy is an example of an ETO reason.

[25] See e.g. *Delabole Slate Ltd v Berriman* [1985] IRLR 305 CA; Gibson *v Ciro Citterio (Menswear) plc* (EAT/276/97); *Martin v South Bank University* [2004] IRLR 74.

Regulation 9 (7) provides a leeway for a tripartite and consensual[26] agreement to be reached between the transferee, the transferor (or person or persons exercising the transferor's functions e.g. an IP) and the representatives of the employees jointly, to make 'permitted variation'[27] to terms and conditions of the employees' contracts of employment only in transfers involving insolvent undertakings or businesses.[28] Thus, it is possible to make variations to contract terms whether or not the transfer of the undertaking is the sole or principal reason for the variation or whether the variation is connected to the transfer of the business or undertaking in issue.[29]

While the regulation 9 provision recognises the need for employers to continue running organisations as effective and profitable businesses, it also accentuates the ambivalent nature of TUPE: TUPE's core objective is the safeguarding of employees' rights, but we see here how the employees' legal entitlement to unaltered terms and conditions of employment (provided for under reg. 4) in a relevant business transfer is compromised in a bid to foster the rescue of insolvent businesses. Thus, in dealing with the problem of disincentive *vis-a-vis* business sales, TUPE 2006, rather than enhancing the protection available to the employees affected by transfers in the context of insolvency reduces them instead. On the other hand, and especially taking into account the Regulation 9 (7) safeguards, it may be correct to say that the TUPE regime, in itself, represents the most efficient default rule protecting workers in situations where their livelihoods

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[26] *Power v Regent Security Services Limited* [2007] IRLR 226. Note however that in the earlier cases of *Daddy's Dance Hall* [1988] IRLR 355 (ECJ) and *Credit Suisse First Boston v Lister* [1998] IRLR 700 held that an employer cannot avoid the doctrine by showing that on a fair view of the contract as a whole, the employee was better off under the varied contract.

[27] Regulation 9 (7) defines 'permitted variations' as variations allowed to the contract of employment of an assigned employee where (a) the sole reason for it is the transfer or a reason connected with the transfer that is not an ETO reason entailing changes in the workforce; and (b) variation designed to safeguard employment opportunities by ensuring the survival of the undertaking or business or part of the undertaking or business that is the subject of the transfer.

[28] The contractual variations rule in non-insolvency cases continue to apply. Regulation 4(4) provides:

> ...in respect of a contract of employment that is, or will be, transferred by paragraph (1), any purported variation of the contract shall be void if the sole or principal reason for the variation is the transfer itself, or a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce.

Conversely, reg. 4(5) provides:

> Paragraph (4) shall not prevent the employer and his employee, whose contract of employment is, or will be, transferred by paragraph (1), from agreeing a variation of that contract if the sole or principal reason for the variation is (a) a reason connected with the transfer that is an economic, technical or organisational reason entailing changes in the workforce, or (b) a reason unconnected with the transfer.

[29] TUPE 2006, reg. 9 (7) (a).

are at risk and simultaneously granting them the freedom to negotiate (albeit technically via their representatives) with the employer for a waiver or diminution of their acquired rights where the strict application of its (TUPE) provisions would have yielded a less efficient result (i.e. business closure and loss of jobs) for the employees as a group.[30]

Traditionalists would arguably regard the revisions made to the ARD and TUPE respectively as a sensible balance between the laudable policies goals of rescue and employee protection. They would contend that though some would argue that employment protection and business rescue do not go hand in hand as is evident in the research findings, yet the two can mutually co-exist. They would argue that even though the changes were aimed at facilitating sales of insolvent businesses by transferors, they are poised in a way that rescue is achieved without walking over the rights of the employees. What this demonstrates in theoretical terms is that if business rescue is pursued carefully it could help not only to preserve the economic value contained in the business but also to retain employees that otherwise would have been made redundant in order to facilitate the business sale. Changes to the regimes also demonstrate that employees' rights can be, and should be, protected, but not tenaciously so as not to 'over-deter' purchases and hence going concern rescues of insolvent businesses.[31]

8.4 Research contribution to knowledge

This research has made original contributions to knowledge in the area of corporate insolvency law. The work is the first attempt to consider from a theoretical perspective the existing tension between business rescue and employee protection in corporate insolvency. The research has examined the protection TUPE provides for the employees during the transfers of insolvent businesses and how these deter the rescues of these businesses by looking at the competing theories of insolvency. It concludes through the use of theory that employee protection and business rescue are not mutually incompatible.

The research has demonstrated that neither rescue policy nor employee protection policy should be sacrificed to achieve or foster the other. It became

[30] Wanjiru Njoya, 'The Interface between Redundancy and TUPE Transfers' (2003) 32 ILJ 123-8.
[31] See Adrian Walters, 'The impact of employee liabilities on the administrator's decision to continue trading', (2005) 26 Company Lawyer 321; B Hepple, 'Workers' Rights in Mergers and Takeovers: The EEC Proposals' (1976) 5 ILJ 197-210, 207.

apparent in the research that if business rescue is carefully pursued it could lead to job preservation for employees. Likewise, where employee protection is appropriately limited, it may be possible to guarantee the continuity of insolvent but viable businesses which will in turn provide employment, at least, for some employees. What was required was an effective balance between both policy goals and this balance in theoretical terms has been achieved through the changes made to the employee protection regimes of the ARD and TUPE.

8.5 Research limitations

There were several limitations to the research. First, most of the extant insolvency theories applied in the study have their origins in the American bankruptcy reorganisation law. This posed serious challenges as they had to be adapted and refined to suit the UK context of business rescue. It was equally difficult to find materials analysing TUPE purely from an insolvency perspective. The bulk of materials available for the researcher consider TUPE from an employment law viewpoint. Only passing comments were made in the literature as to TUPE's impact on businesses. Most of the cases that have been considered TUPE took place in the context of solvent transfers resulting in changes of employers and in modes of transfers other than sales and therefore the principles had to be applied to transfers in the context of going concern business sales and in insolvency.

8.6 Conclusion

The initial problems TUPE posed to business rescues, the significance of the changes made to the regime under the Acquired Rights Directive 2001 and TUPE 2006 and the difference that these changes have made to the rescue culture generally are perhaps indicative of the fact that policy-makers should never lose sight of the possible impacts that the interaction of laws can have in corporate insolvency and on business preservation specifically. In the context of this thesis, the focus has been on the interaction between employment protection (TUPE) and business rescue laws, and how the former could impact negatively on the rescue of insolvent businesses in the UK. This thesis has contributed to knowledge in the area of insolvency law by examining how theory may be employed to address the tension that arises between rescue and employee protection when an insolvent business is transferred as going concern. On the one hand, the research has demonstrated through the use of theory that to 'over-incentivise' business rescues by carving insolvent businesses wholly out of TUPE will allow employers to 'walk-over' the rights of employees during transfers. On the hand, it has also showed that the type of protection TUPE gives to UK employees 'over-deters' going concern sales of insolvent businesses. These are the major concerns of the Traditionalists and Proceduralists respectively in relation to the transfer of an insolvent business on a going concern basis. These concerns, the research has shown, have enabled the most appropriate balance between business rescue and employee protection to be achieved.

With the aid of theory, this research has shown that a fine balance has now been achieved following the measures introduced into the revised 2001 ARD and TUPE Regulations 2006 to cater specifically for transfers of insolvent businesses. Theory explains the rationale for the balance and demonstrates that this has been done in a way that employee protection does not hinder business rescues without completely stripping the employees of the protection TUPE gives to them in transfer situations. On the one hand, employees waive some of their acquired rights to ensure that insolvent businesses can be rescued. On the other hand, an insolvent business that has been rescued via a going concern sale cannot continue under new ownership without, at least, some of the transferor's employees transferring with it.

While it cannot be stated unequivocally that the balance that has now been achieved is the ultimate panacea for the existing tension between business rescue and employment protection in the context of going concern transfers, the present situation is, arguably, the best we can hope for in an imperfect system. The balance that has been achieved by the changes effected in the regime would, it is submitted, be satisfactory to both the Proceduralists and the Traditionalists as their concerns regarding 'over-deterrence' to purchases of insolvent businesses (by the protections TUPE gives to employees in transfers) and 'over-incentivising' of going concern rescues (by carving out insolvent business transfers wholly out of TUPE to the detriment of employment protection) respectively have now been remedied.

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