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Selling insolvent businesses: TUPE does apply to pre-packs

In an important judgment delivered last week by the Employment Appeals Tribunals, it has been decided that TUPE does apply to administrations, including pre-pack administrations. In doing so, the EAT disagreed with an earlier case which found that a pre-pack administration was analogous to a liquidation and so the key provisions of TUPE did not apply.

The latest decision

As part of the amendments to TUPE that were made in 2006, insolvency provisions were introduced with a view to promoting a "rescue culture" for insolvent businesses. There are two types of insolvency provision: "terminal" insolvency proceedings and "non-terminal" insolvency proceedings. If a business is subject to terminal insolvency proceedings, certain fundamental principles of TUPE will not apply (employees will not automatically transfer to the buyer, the buyer will not inherit the seller's employment-related liabilities and employees will not have enhanced protection against dismissal). In non-terminal insolvency proceedings, these key principles of TUPE will apply and there is instead a less significant relaxation of the TUPE rules (e.g. the buyer will be able to look to the National Insurance Fund to pick up certain debts owed to employees and has greater scope to vary transferring employees' terms of employment).

Whilst liquidations clearly constitute terminal insolvency proceedings, it was initially assumed that administrations did not, since the primary aim of an administration is to rescue the business as a going concern, rather than to liquidate its assets. To the surprise of many, in 2009, the EAT decided that a "pre-pack" administration constituted a terminal insolvency proceeding (the case of *Oakland v Wellswood*). In a pre-pack administration, the insolvency practitioner, who is to become the administrator, negotiates in advance of his appointment the sale of the business of the company immediately after his appointment. Advantages of pre-packs include the saving of time and expense. In particular, there may be better prospects of preserving goodwill and, as a result, the business may attract a better price.

The factors in the *Oakland* case which led the EAT to consider the pre-pack in the case to be a terminal insolvency proceeding included two key points:

1. the fact that the business was not traded at all by the administrator (it was sold immediately upon the administrator's appointment); and
2. in their report to creditors, the administrators had made statements about their eventual intention to liquidate the company.

Many commentators doubted the correctness of the *Oakland* decision and so it is not surprising that the EAT has now come to a different conclusion.

The decision on Thursday (*Olds v Late Editions*) arose from five consolidated cases all dealing with the same issue. The EAT had no doubt that administrations are not terminal insolvency proceedings. The decision focussed on the objective of an administration when it is first instituted. Under the Insolvency Act, an administrator is obliged to follow one of three objectives, with the result that he must consider first whether the primary objective of rescuing the company as a going concern is achievable. Only if it is not, can he consider the alternative objectives, including achieving a better result for creditors than would be obtained in a liquidation. The EAT accepted that an administrator may come to a view that a rescue is not achievable but they must first ask the question. As such, it could not be said that at the point of instituting the administration, the object was to liquidate the assets of the company.

What now?

Although we now have two conflicting decisions of the EAT, it is our view that this decision is likely to be preferred by employment tribunals going forward. The result as far as TUPE is concerned, is that administrations (including pre-packs) will always be non-terminal insolvency proceedings. As such, they will attract only the very limited relaxations to TUPE. The core principles (transfer of employees, employment liabilities and dismissal protection) will still apply.

While it is unlikely that the decision will affect the use of pre-pack sales in appropriate cases, it highlights the fact that administrators and potential purchasers should exercise caution when conducting business sales to ensure that unintended parts of a business (and related employees) are not transferred.

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