

# M&A employment law support – TUPE and changes to terms



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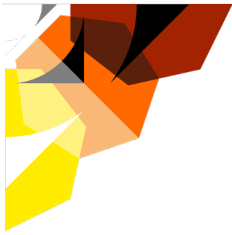
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The Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) can raise some difficult employment law issues during mergers and acquisitions. This Inbrief examines the challenge for a buyer of changing employees' terms and conditions once the deal is done.

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### Buying a business – does TUPE apply?

When a business is sold, employees may become employed by the buyer under TUPE as a result of the transaction. TUPE provides that where there is a transfer of assets amounting to “an economic activity which retains its identity”, any of the seller’s employees assigned to that economic activity will transfer with it. This would include a business sold as a going concern, where there will be an element of continuity in what the business does once the buyer owns it.

By contrast, in a share purchase, the default position is that TUPE will not be triggered, because the identity of the employer remains the same before and after the sale - it is simply ownership of the target company which changes hands. However, it is fairly common for a buyer to move the business and employees of the new subsidiary to one of its own entities as part of its post-completion integration plans, placing employees on its own terms and conditions. This is likely to trigger TUPE.

TUPE may arise following a share purchase even where there is no intention to transfer employees’ terms and conditions to the buyer. This can happen if the buyer becomes responsible for carrying on the new subsidiary’s business, takes on the obligations of the employer, or takes over the day-to-day running of the business.

An unexpected TUPE transfer can lead to claims for failure to comply with the relevant rules, especially for failure to inform and consult about the transfer. An example of a case in which TUPE was triggered following a share sale is discussed in our article [here](#).

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### Transfer of terms and conditions under TUPE

TUPE aims to protect employees in the event their employment is transferred to a new employer under a relevant transfer. Under regulation 4 of TUPE, “all the transferor’s rights, powers, duties and liabilities under or in connection with any such contract” transfer to the transferee.

This means that contractual employee entitlements such as salary, holiday and notice period will transfer, and the new employer will be obliged to honour these.

It is sometimes thought that discretionary entitlements do not transfer, which is not quite right. They may pass to the new employer as liabilities and powers in connection with the employment contract.

For example, an employee’s contract may contain an entitlement to receive a discretionary bonus. An employer is obliged to act in good faith when considering whether to award a bonus or not. Where a TUPE transfer occurs, the new employer cannot simply disregard the discretionary entitlement. Instead, the new employer would be required to act in good faith in any decision not to award a discretionary bonus under the contract – in the same way that the old employer would have been required to do this.

TUPE preserves rights; it does not create rights if none existed in the first place. This means that a purely non-contractual policy would not be enforceable against the new employer if it was not legally enforceable against the previous employer prior to the transfer. Staff handbooks and other non-contractual policies would arguably only transfer to the extent they had been incorporated into the



employees' contracts, either expressly or impliedly.

Implied contractual rights are an important area to consider in due diligence. For example, a bonus scheme which is described as discretionary but which is applied in a similar manner year on year – whether the calculation metric, the target amount or both – may give rise to an implied contractual right to receive a bonus (or certain level of bonus).

In relation to pensions, there are express exclusions from the automatic transfer principle for old age, survivor's and invalidity benefits under occupational pension schemes. However, rights to enhanced redundancy payments or early retirement under an occupational scheme will transfer. As a buyer, it is therefore important to understand what pension schemes are in operation and what rights they may give to employees.

Due diligence is paramount, and a buyer should raise further enquiries to get as much clarity as possible on the contractual status of any particular right or liability.

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### When is a change to employment terms and conditions permitted?

The starting point under TUPE is that any variation to a transferring employee's contract is void if the sole or principal reason for the variation is the transfer – even if the employee consents to the variation.

However, there are limited circumstances where a change will be permitted, which are as follows:

- ▶ The reason for the contractual variation is completely unrelated to the transfer.

- ▶ The terms of the employment contract expressly permit the employer to make the variation they wish to make.
- ▶ The changes are to terms incorporated from a collective agreement, provided that the variation is made more than one year after the transfer and the changes leave the employee in no worse position overall.
- ▶ The change is made for an economic, technical or organisational reason entailing changes in the workforce and is agreed by both the employer and employee.
- ▶ The transferor is in administration and the modified TUPE rules for changing terms have been met.

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### What is an ETO reason?

Where an employer can show they had an economic, technical or organisational reason entailing changes in the workforce (an ETO reason), they can make valid changes to terms and conditions, provided the employee agrees to them.

An economic reason may relate to the profitability or market performance of the new employer's business. A technical reason may relate to the nature of equipment or production processes which the new employer operates. An organisational reason may relate to the management or organisational structure of the new employer's business.

The ETO exemption is rarely helpful in the context of contractual variations given the need for there to be "changes in the workforce". This requires the existence of a clear link between the contractual variations and other changes to the numbers, functions or workplace locations of the affected employees. A change to the

place of work clause is an obvious example that would be permitted.

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### Harmonisation of terms and conditions

Following a TUPE transfer, it is common for the buyer to want to harmonise the terms and conditions of the incoming employees with its current workforce. This may be to ensure equality between the two groups or to streamline administration.

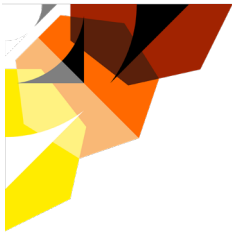
Variations made with the intention of harmonising terms and conditions will normally be viewed as happening because of the transfer and will therefore be void – meaning the buyer is technically unable to enforce the varied terms, even where the employee has agreed to the changes.

The employee would be entitled to rely on the terms they had with their old employer. Employees may even "cherry pick" terms, meaning they can choose whichever of the old and new employers' terms they prefer, and seek to rely on those.

In practice, changes which benefit the employee, or which are broadly neutral are unlikely to be challenged. Changes which are negative are likely to be more contentious. In that case, the buyer may need to consider alternative approaches to secure employee buy-in.

### Bridging arrangements

A "bridging" arrangement is common, where the buyer honours the employee's existing entitlement for a period of time before moving onto its own terms. For example, an employee might continue to receive 35 days of holiday in years one and two post completion, and thereafter that entitlement is reduced to 30 days in line with the buyer's other employees.



This approach is sometimes seen with salary as well.

While technically such changes are likely to remain void (albeit that changes many years down the line could be argued as unconnected to the TUPE transfer), the hope is that such inducements will reduce the practical risk of an employee bringing a claim.

### **Can the buyer dismiss and re-engage?**

Another strategy to achieve harmonisation is dismissal of the affected employees coupled with an offer of re-engagement on the new terms. It is doubtful whether this would be successful, as it is effectively a back-door change to terms and conditions, without an ETO reason entailing changes in the workforce and employee consent.

Dismissals because of a TUPE transfer are automatically unfair and the strategy of dismissal and re-engagement could well fall within that category. It is worth remembering, however, that an employee still needs 2 years' continuous service to bring that claim - so for workforces with shorter tenure, there may be more flexibility to try this approach.

Employers should remember that where there is a proposal to dismiss 20 or more employees within a period of 90 days at one establishment, collective consultation will be required. "Dismissal" in this context can include terminating the current employment contract and placing employees on a new one.

### **Using a settlement agreement**

Another option is to ask employees to agree to new terms in exchange for a settlement agreement.

It is important to remember that a settlement agreement cannot be used to waive an employee's right to bring a claim for failure to inform and consult (known as a protective award). A COT3 agreement (a settlement reached through ACAS) is needed for that. It may nevertheless be possible to include a contractual obligation on the employee to repay, as a debt, any award they may receive if they bring such a claim - so that the settlement agreement includes an effective deterrent in relation to such claims. Further advice should be sought if you are considering this option.

A settlement agreement can be used effectively to cover other claims, including waiving other claims against the seller. Where the buyer is planning to ask employees to sign new terms, a settlement agreement may give the buyer certainty that the employee will not seek to enforce the contractual rights they enjoyed with the seller.

However, this must be done carefully. A waiver alone is unlikely to be sufficient to vary terms, as this would contradict TUPE which provides for an automatic transfer of the contract. It is therefore common for the settlement agreement to terminate the employee's employment by mutual agreement, or to obtain their objection to the transfer under regulation 4(8) of TUPE.

The agreement can provide that: (1) the employee's employment with the seller ends immediately prior to completion; (2) the employee does not transfer under TUPE; and (3) the buyer is free to have the employee enter into new employment terms – which are sometimes attached to the settlement agreement. The seller, buyer and employee may all be parties to this type of agreement.

An employer is likely to need to offer an incentive for signing a settlement agreement. A payment made in connection with the termination of employment from the seller may qualify for the £30,000 tax exemption for termination payments, but a payment which is effectively an incentive for entering into the new employment contract with the buyer will be subject to tax and National Insurance contributions. Individuals may also be concerned about the settlement agreement and/or any objection to the transfer leading to a break in their continuity of employment, albeit there are workarounds that can help to resolve this issue.

Settlement agreements should not be a knee jerk reaction when changing terms. There can be considerable administrative effort and cost involved, particularly in larger scale acquisitions involving a significant number of employees.

For a settlement agreement to be legally binding, the individual must receive independent legal advice on its terms – and lawyers may well argue for an increase in the value of any offering under the agreement, which is commercially undesirable. For all of these reasons, the settlement agreement approach is usually only considered worthwhile when dealing with very senior employees or where effective variations to valuable incentive arrangements are required.

It is also worth noting, however, that new employers may want to use a settlement agreement where they have discovered serious drafting deficiencies in the current contracts, and/or if they want certainty that their own post-employment restrictions will apply in place of the current ones.

## Drafting provisions under the sale and purchase agreement

Sometimes a buyer will seek assurances under the sale and purchase agreement that the seller will support any process to persuade important or key employees of the target business sign up to the buyer's own terms. That may include the seller allowing the buyer to meet directly with employees or employee representatives and requiring the seller to offer the buyer's own terms (and settlement agreements if applicable) to employees/representatives.

In some acquisitions, the viability of the purchase depends on a commitment from certain key employees that they will sign up to the buyer's terms (and possibly also that they remain with the business for a set period post completion), which can be drafted for under the sale and purchase agreement.

## Key points to remember

When devising a strategy for making any changes to terms and conditions following an acquisition, a buyer should remember the following:

- ▶ TUPE does not bite for changes that are unconnected to a TUPE transfer. Leaving a significant period between completion and making the changes or linking the changes to other events such as a promotion or payment of a bonus, may help to demonstrate that the changes are not connected to the transfer.

- ▶ Beneficial changes are unlikely to be contentious. Where some changes will be beneficial and others detrimental, it is a common negotiation tactic for an employer to present the overall package as being more favourable (but remember that detrimental changes connected with the transfer will still not be binding).
- ▶ Certain types of changes are less likely to be challenged than others. For example, an employee may accept the addition of a clause entitling the new employer to pay them in lieu of notice, but not accept a reduced salary or holiday entitlement. Employers may wish to focus on the priorities, rather than seek all changes at once.
- ▶ Harmonisation for harmonisation's sake is unlikely to be lawful, meaning there is a risk that the employee seeks to rely on their previous terms – whether in whole or in part. If this causes concern to the buyer, it is worth exploring the possibility of a settlement agreement, under which the employee's previous employment with the seller comes to an end and they waive their rights to enforce previous terms.

This is a complicated area. Please get in touch with your usual Lewis Silkin contact if you need any support in understanding whether TUPE applies and its effects in any acquisition context.

## For further information on this subject please contact:



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