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Transfer-related contractual changes void even if beneficial for employees (UK)

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Summary

The Employment Appeal Tribunal (EAT) has ruled that the provision under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) which renders changes to employees' terms and conditions void if they are made because of the transfer applies to changes that are advantageous as well as detrimental to employees. On the facts of the case, this meant that owner-directors who had made significant improvements to their own employment terms before a TUPE transfer could not enforce these against the transferee employer.

Legal background

Regulation 4(4) of TUPE provides that any purported variation of a transferring employee's contract is void if the sole or principal reason for it is the transfer. This ensures that the employee is no worse off as a result of the transfer if the new employer immediately seeks to introduce less generous terms and conditions.

Regulation 4(4) reflects the position in EU law under the Acquired Rights Directive (ARD). In the well-known case of *Daddy's Dance Hall* (C-324/86), the European Court of Justice (ECJ) ruled that changes to a transferring employee's contractual terms are ineffective if the transfer itself is the reason. This applies even where the variation is with mutual consent and any less favourable terms are offset by other changes so that the contract as a whole is no worse.

The issue of variation of contract in the context of transfers under TUPE has always been quite contentious in the UK, although there is surprisingly little reported case law. The leading case is *Power – v – Regent Security Services Ltd* ([2007] EWCA Civ 1188), in which the Court of Appeal (CA) upheld a decision that, while transferring employees could not be deprived of any rights that transferred with them, the transferee was bound by any new, more favourable terms it had agreed with the employees.

Facts

Berkeley Square Estate (the Estate) was a valuable estate in Mayfair and Knightsbridge owned by persons based in Abu Dhabi. It was managed by a company called Lancer Property Asset Management (Lancer) which operated as a single-client business. The claimants in this case were either senior employees of Lancer or supplied their services to it via personal service companies.

In 2016, the owners of the Estate served notice on Lancer that Astrea Asset Management Ltd (Astrea) would take over the management from the end of September 2017 – a change of service provision which would amount to a TUPE transfer from Lancer to Astrea. Relations between the claimants and the owners of the Estate deteriorated and, three months before the transfer was set to take place, the claimants decided to update their Lancer contracts by giving themselves guaranteed bonuses of 50% of salary, more generous contractual termination payments and enhanced notice periods.

The claimants made these changes in the expectation that Astrea would pick up the enhanced liabilities post-transfer. They supplied the new contracts to Astrea on 1 September 2017, just a few weeks before the transfer date. Immediately following the transfer, Astrea dismissed the claimants for gross misconduct.

The claimants brought proceedings in the Employment Tribunal (ET) against Astrea on several grounds, which incorporated a claim for the contractual termination payments set out in the new contracts. The ET made various findings, including that the claimants' variations to their contracts just before the transfer were void "considering regulation 4(4) in light of the EU abuse of law principle". The ET also considered the claimants to have acted dishonestly by seeking to take advantage of TUPE, in the expectation that Astrea would have to pick up the additional liabilities. The claimants appealed to the EAT.

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Judgment

The EAT said that a literal interpretation of regulation 4(4) of TUPE would mean that any changes made to terms by reason of the transfer are void, whether they are detrimental or beneficial to the transferring employees. However, this had to be interpreted in light of the purpose of the ARD.

The claimants argued that the variations referred to in regulation 4(4) must mean *adverse* changes, relying on *Power – v – Regent Security Services Ltd* (above). They argued that the CA's ruling in that case had been widely interpreted to mean that employees should be able to rely on positive variations made because of the transfer. The claimants also pointed to current UK government guidance suggesting that TUPE's underlying purpose was to ensure employees are not penalised when a transfer takes place, and changes to terms and conditions which are "entirely positive from the employee's perspective" are not prevented.

However, noting that this guidance "can only be of limited persuasive value", the EAT observed that there were significant differences between *Power* and the present case. The CA in *Power* had ruled that the ARD does not prevent an employee from agreeing with the transferee to obtain additional rights by reason of the transfer. According to the EAT, this was not the same as concluding that the ARD positively required that any variations which are advantageous to an employee cannot be deemed void.

Turning to the ARD itself, the EAT said that its purpose was to 'safeguard' the rights of employees, rather than improve them. Applying a broad, purposive interpretation, the EAT decided that the words 'any purported variation' in regulation 4(4) should cover all variations, whether adverse to the employee or otherwise. Among other things, this interpretation avoided difficult questions about whether a change in terms is beneficial or disadvantageous.

The EAT also found significance in the ECJ's observation in *Alemo-Herron and Others – v – Parkwood Leisure Ltd* (C-426/11) that the ARD's purpose is to seek to ensure a fair balance between the interests of transferring employees on the one hand and those of the transferee on the other.

Astrea also relied upon the principle of abuse of EU law. The ECJ's judgment in *Skatteministeriet – v – T and Y* (joined cases C-116/16 and C-117/16) identified two elements characterising an abusive practice:

- objective circumstances showing that, despite formal observance of EU rules, their purpose has not been achieved;
- a subjective intention to obtain an advantage from the EU rules by artificially creating the conditions for obtaining it.

The EAT considered that both elements had been satisfied in this case. The variation of the claimants' contracts went further than safeguarding their rights, so the purpose of the ARD had not been achieved, and the claimants' intention was to obtain an improper advantage by artificially obtaining improvements to their contracts in contemplation of the transfer.

Accordingly, the EAT concluded that the claimants should not be able to rely on the varied terms and dismissed their appeal.

Commentary

This decision brings a degree more clarity to the issue of enforceability under TUPE of advantageous aspects of a varied contract, a question described by the CA as "not easy to answer" in *Credit Suisse First Boston – v – Lister* ([1998] IRLR 700). It now seems clear that the position of transferees is protected in egregious situations where senior employees manoeuvre to boost their own contractual provisions in anticipation of an imminent transfer. Nonetheless, in practical terms it remains advisable to ensure the relevant agreements provide that no changes to the existing service provider's employment terms are permitted after notice has been served.

The facts of this case were quite dramatic and extreme, with the claimants having themselves created a situation in which the purported variations clearly went further than protecting their rights to the point that they could be regarded as seeking to punish the transferee. One can envisage more nuanced situations arising in future concerning the enforceability of beneficial contractual variations, where the application of ARD and TUPE principles is rather less clear-cut.

Comments from other jurisdictions

Austria (Hans Georg Laimer and Lukas Wieser; Zeiler Floyd Zadkovich): This is an interesting judgment as the Austrian Supreme Court has solved similar situations of modifications of employment contracts to the disadvantage of a third party (e.g. an insolvency fund, a transferee, etc) immediately before the transfer in a similar way. However, the Supreme Court has not so far stipulated that all changes to employment agreements due to a transfer of undertaking are null and void under Austrian law. Thus, changes to the advantage of the employee may be validly agreed under Austrian TUPE law to the advantage of the employee before a transfer.

However, the Austrian Supreme Court has already ruled that changes immediately before the transfer, which effectively only burden the transferee, may qualify as a contract at the expense of a third party and, thus, are null and void. Moreover, changes to the employment contract by the transferor with the intention of harming the transferee are considered improper and, thus, also null and void (*c.f.* Austrian Supreme Court 9

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ObA 197/99g). Therefore, in our view Austrian courts would have come to the same result to the case in hand.

Germany I (Thorsten Tilch, Luther Rechtsanwaltsgesellschaft mbH): In Germany there is no provision comparable to Regulation 4(4) of TUPE. The provision of Section 613a, Subsection 1, Sentence 1 of the German Civil Code (*Bürgerliches Gesetzbuch*, 'BGB'), which is applicable under German law in corresponding case constellations, merely states that in the event of a transfer of business the party acquiring the business enters into the rights and obligations arising from the employment relationships existing at the time of the transfer. Nevertheless, in 2008 the German Federal Labour Court (*Bundesarbeitsgericht*, 'BAG') already had to deal with the admissibility of a change in the employment contract prior to the transfer of the business – even if this was to the employee's disadvantage. Specifically, it concerned a waiver agreement between the employee and the seller of the business which, in the opinion of the BAG, was invalid because it was an impermissible circumvention of the mandatory legal consequence of Section 613a, Subsection 1, Sentence 1 BGB, which must also be interpreted in the light of the requirements of European law.

This was certainly true in the case decided by the BAG, since the employee's waiver of backlogged Christmas and holiday pay, which was the subject of the dispute here, had been agreed solely on condition that the transfer of the business actually took place. The waiver was therefore *de facto* only to have an effect in the event of a transfer of business and only to the benefit of the business acquirer.

However, as far as can be seen, the BAG has (so far) not decided whether its decision is also applicable to other constellations of employment contract amendments prior to a transfer of business – even if the written substantiation of the above-mentioned judgment is abstract and general. In German legal literature this question is controversial. In the above decision, the BAG at least indicated that corresponding contractual amendments could probably also be effective, at least if so-called factual reasons exist. Whether this is also possible in the absence of such factual reasons and also applies to contractual amendments which are exclusively advantageous for the employee is unclear. This has to be taken into account in the drafting of contracts in connection with transfers of undertakings as well as the general principles of the German law of obligations (in particular the nullity of legal transactions which are contrary to common decency).

Germany II (Othmar K. Traber, Ahlers & Vogel): As far as can be seen, a similar case has not yet been decided by a German higher court or the Federal Labour Court itself. As a rule, however, the situation is reversed: either the transferor of the business tries to change working conditions to the detriment of the employees shortly before the transfer of the business in order to make the takeover of the business possible in the first place or to have a positive effect on the purchase price, or the transferee tries to agree amicable amendments to the contract with the employees after taking over the management of the business, provided that these are not necessarily regulated by works councils agreements or collective agreements. Both situations are not to be assessed uncritically in Germany and should always be carefully weighed up in the light of the previous case law of the Federal Labour Court. It is true that the fifth senate of the Federal Labour Court decided in its judgment of 7 November 2007 that Section 613a BGB does not prevent employees and business transferors from lowering the remuneration agreed with the business acquirer after a transfer of business by individual agreement (BAG, judgment of 7 November 2007 – 5 AZR 1007/06). Insofar as a provision transferred unchanged pursuant to Section 613a, Subsection 1, Sentence 1 BGB is subject to the disposition of the parties to the employment agreement, it can be changed by agreement with the old or new owner. An objective reason for such an agreement is not required. Nevertheless, this statement may not be applied without hesitation as a generalising principle, as there will certainly be restrictions on it, for example in the area of occupational pension schemes. Moreover, it is unclear whether this principle also applies to agreements concluded before a transfer of an undertaking. In the literature, it is probably predominantly argued that an employee should also be able to conclude agreements with the seller and/or acquirer prior to the transfer of the business regarding changes in their working conditions for the period after the transfer of the business, provided that these are subject to their contractual disposition, i.e. are not binding by law, collective agreement or works council agreement. A restriction is only to be made to the extent that the waiver of claims which have already finally arisen may not be made dependent on the occurrence of a transfer of business. A waiver by the employee of claims which have already arisen and are subject to their contractual disposition after a transfer of business has already taken place is presumably possible without infringing the protective purpose of Section 613a BGB.

In the light of these previous decisions of the Federal Labour Court, the decision would probably not have been based on a violation of the provisions governing the transfer of business, since these are designed as employee protection law according to the current understanding in Germany and are not intended to prevent improvements in working conditions. However, the effectiveness of these contractual amendments would probably also have had to be rejected as a result, as they would at least have had to be qualified as an impermissible contract to the detriment of third parties due to the temporal connection with the transfer of business and would also have been contrary to good faith. It might also have been possible to consider these contractual amendments as null and void for breach of a prohibitory law, Section 138 of the German Civil Code, because these amendments could also be regarded as a crime, such as breach of trust.

Romania (Andreea Suciu, Teodora Mănăilă, Suciu | The Employment Law Firm): The issue of contractual changes prior to the effective transfer of an undertaking has not been analysed by the Romanian courts so far. However, the actions of the employees in the above case law represent a challenge every transferee may face in the context of a transfer of undertakings.

From this point of view, it should be noted that the national provisions which transpose 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 (i.e. Law No. 67/2006 on the protection of employees' rights in the case of a transfer of undertakings, business or parts thereof ('Transfer of Undertakings Law')) expressly state that the regulations apply *for the protection of employees rights* in case of a transfer of undertakings.

Thus, it appears that the national legislator does not share the ECJ's point of view from *Alemo-Herron and Others – v – Parkwood Leisure Ltd* (C-426/11) that the Acquired Rights Directive's (which was replaced by Council Directive 2001/23/EC) purpose is to ensure a fair balance between the interests of the transferring employees on the one hand and those of the transferee on the other.

Such perspective can be appreciated as a consequence of the employment relationship being considered a relationship of subordination between the employer and the employee, the employee being the more vulnerable part of the relation.

Given that any amendments to the employment contract are based on the agreement of the two parties involved, in the absence of any legal provision similar to the one prescribed by the UK legislator, should such situation arise, the Romanian transferee would have to rely on and argue the existence of abuse of law in order to obtain the invalidation of such contractual changes. Respectively, the transferee would have to demonstrate the abusive exercise of the principle of free negotiation of the employment contract as both parties, the employer (i.e. the transferor) and the employee, know that the economic consequences of any such variation of the contract would have to be paid for by the transferee, which did not take part in such negotiations.

Article 6 of the Transfer of Undertakings Law regulates the transferor's obligation to notify the transferee of all rights and obligations that shall be transferred. Furthermore, the non-observance of such obligation will not impact their transfer to the transferee or the rights of the employees in this respect. Consequently, the transferee would have to initiate judicial proceedings in order to obtain the annulment of any such contractual changes performed.

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