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**Collective Redundancy Consultation for Employers facing Insolvency**

Response by the Association of Business Recovery Professionals to the Call for Evidence issued by the Insolvency Service in March 2015

## Introduction

1. R3 represents insolvency practitioners authorised to practise in all jurisdictions of the UK. Its 3,000 members work in firms of all sizes, from global accountancy firms to high-street practices and sole practitioners. R3's membership also includes insolvency lawyers and other professionals who work in the field of insolvency and corporate recovery.

## Executive Summary

2. R3 welcomes the Call for Evidence. We hope that the evidence collected will allow government to then introduce positive changes. The challenges of employee consultation in insolvency has been highlighted by the insolvency profession and have been recognised by government and stakeholders, for some time. R3 wrote to the Department on this issue in October 2004 and January 2010, and responded to the Call for Evidence issued by The Insolvency Service in November 2011. A further paper was submitted to the Service in October 2013, and meetings held to discuss the issue from time to time, most recently in September 2014.

3. R3 remains concerned that there is a clear tension between employment law and insolvency law on this matter. However, the key point to note is that where there are breaches of the consultation requirements in insolvency situations, this is generally a result of the circumstances and exigencies of the individual case, and not a deliberate and unheeding neglect of that law. Even in cases where full compliance is not possible, Insolvency Office Holders will try to mitigate the effects of redundancies by providing as much information and support to employees as possible. Failure to consult is often a result of simply not having access to the necessary funds within the estate to facilitate a normal consultation process. Furthermore, the circumstances of the case will often mean that there are no realistic alternative courses of action on which it is possible to have meaningful consultation. We comment in more detail on the position faced by insolvency practitioners in our answer to Questions 1 and 7.

4. In addition, there is another side to the issue affecting insolvency practitioners which is not discussed in the Call for Evidence, and that is the approach taken by the Employment Tribunals. This is a major concern to practitioners, because Tribunals will often make substantial awards even in cases where they are made aware of the constraints caused by lack of funds. We comment further on this in our answer to Question 18.

5. R3 believes that the following steps should be taken.

   (i) Practical guidance for insolvency office holders contemplating and undertaking collective redundancies which caters for the problems likely to be encountered in an insolvency (essentially no/insufficient funds and no viable alternatives) should be produced by government with the help of the insolvency profession, unions, the Employment Tribunals and other stakeholders.

(ii) Government should engage with the Employment Tribunals and, with support from the insolvency profession, explain the challenges in employee consultation when businesses are insolvent in order to bring coherence and consistency to the length of the protective awards awarded by the Tribunals.

(iii) The current HR1 form which provides information to government about the expected redundancies is not fit for purpose in the majority of insolvency situations. R3 has proposed (and drafted) a revised HR1 form for consideration by government and it is hoped that these changes can be introduced soon.

(iv) The Memorandum of Understanding (MoU) between Job Centre Plus, the Insolvency Service and R3 representing the insolvency profession should be updated and re-signed under the new Government, in order to emphasise the importance of providing advice and support for those individuals facing redundancy. Government should consider replicating the MoU's non-regulatory 'approach', to address challenges in employee consultation in insolvent businesses.

(v) The Government should reconsider the status of protective awards in insolvencies. Awards are currently treated as wages. This means that in the first instance the Government pays them out of the National Insurance Fund, and then claims the cost against the company's assets. The cost of the awards therefore ultimately comes out of the funds available for the general creditors. However, the tribunals have stated that awards are intended as a penalty, so treating them as wages in cases where the employees are already fully compensated is manifestly inappropriate.

(vi) The Government should consider whether imposing penalties is appropriate in formal insolvencies where the previous management is no longer in control and penalties can serve no deterrent, or other, useful purpose.

**Responses to the questions**

6. In this response our comments are concerned primarily with the position of insolvency practitioners (as insolvency office holders, unless otherwise stated), although we also comment on the position of directors where this is within the direct experience of our members.

7. Our answers to the questions posed in the Call for Evidence are set out below. Where the document asks for examples we have encouraged our individual firm members to respond with their experience from dealing with specific cases.

**Q.1 What are the considerations undertaken when deciding whether or not to start consultation? How is this decided in practice where an employer is facing, or has moved into, insolvency?**

Pre-insolvency

8. In cases where a company is in financial difficulties and management is considering the options available to resolve the situation, the focus of the directors will be on preserving the company/business as a going concern. Any redundancies made in these circumstances will usually be carried out with the full intention of complying with the consultation requirements.

9. Although insolvency practitioners are regularly consulted by distressed businesses, they are unable to direct or control the actions of the company at that stage. The role of the insolvency practitioner when advising in these situations will usually be closely circumscribed by the terms of the practitioner's engagement, and will be concerned primarily on advising on the financial position of the company and in contingency planning. In certain cases it may be appropriate to advise the directors to seek separate advice on employment issues. In these 'zone of insolvency' situations the directors are often also taking advice from lawyers; they too will be mindful of the employment laws and issues.

10. The decision by a board of directors to have their company enter a formal insolvency process is not taken lightly; the consequences are often a crystallisation of loss of value and additional costs (e.g. the costs of the formal process itself). Thus, it is usually a 'last resort' and only pursued when all other avenues to preserve the company as a going concern have been exhausted. Thus, the decision to enter an insolvency process is usually made relatively suddenly, typically when liquid cash resources are very limited or have been consumed.

Post-insolvency

11. It is only after the commencement of a formal insolvency process that insolvency practitioners are in a position to exercise control over a business. On appointment the practitioner can only deal with the situation as he or she finds it, which in all cases will be a business which is in extreme financial distress, often (as noted above) having little or no readily available funding.

12. Generally speaking, there will be broadly three types of situation inherited by insolvency practitioners:

- The company will have completely run out of cash and means to generate more cash, meaning that ongoing trading will not be possible and an immediate shutdown will be necessary.
- The company will have, or have access to, limited funds, but only sufficient to enable trading to continue for a limited period and to a limited extent.
- The company will have sufficient funds to enable ongoing trading for a reasonable period.

13. The considerations affecting the ability of the insolvency officeholder to consult will depend on the circumstances of the case. In the first of the above situations the insolvency practitioner will be unable to consult meaningfully, because there will be no funds available to continue trading for the duration of the required consultation period. The workforce will be made redundant immediately.

14. In the second situation, whether trading requires all or only some of the staff for the entire expected trading period, it may be possible to consult to a limited extent, but perhaps not for the full statutory consultation period. Furthermore, there will probably be competing claims on those available funds. For example, there may be other statutory obligations which the company has to comply with under health and safety or environmental legislation, or other statutory or regulatory obligations to address. The insolvency practitioner will be faced with the question of how the available funds should be applied. This may shorten the time available for consultation, or require some redundancies to be made at an early stage.

15. In the third situation, it might be possible to consult for the full statutory period.

16. Even where it is not possible to consult for the full statutory period, insolvency practitioners will try to mitigate the effect on workforce by providing as much information and support as possible in the circumstances, including making contact with the various support agencies to begin a coordinated approach to dealing with the proposed redundancies and supporting those employees affected.

17. It needs to be borne in mind that the difficulty with consultation in insolvency is often not just a question of funds, but also that there is nothing meaningful to consult on. Consultation is more than providing information; it requires employers to seek the views of the representatives and to consider their proposals. In insolvency, the options have usually been exhausted before the appointment and the outcome is more or less determined: e.g. closedown, trade on for a limited period to realise value of certain assets, or seek a buyer as quickly as possible.

18. The insolvency legislation recognises that the interests of creditors, including employees, will be

harmed by an insolvency. This why there is generally only a potential cause of action against an office holder if the interests of creditors are unfairly harmed by the office holder's actions. The office holder has to balance the interests of many, including the employees, so as not to harm them unfairly. What the office holder cannot do is use available funds to favour one set of individuals (the employees in this case) to the unfair harm of creditors and others with a financial interest in the insolvent estate.

19. The difficulties faced by practitioners in formal insolvencies have been recognised by ministers in the past. In a letter to R3 in March 2009 the Minister for Employee Relations and Postal Affairs said:

> 'Although I recognise that it will not always be practicable to consult in line with the statutory obligations where a company has entered an insolvency procedure, I would ask that you engage employees and their representatives as soon as is practicable in any process that is likely to result in redundancies with a view to minimising the impact on those individuals concerned. Even where it is not possible to consult in line with the statutory obligations, I would expect you to keep employees and their representatives informed of the situation regarding their employment as soon as is reasonably possible and on a regular basis thereafter.'

We believe that most insolvency practitioners act in accordance with this guidance.

**Q.2 How does meaningful consultation with a 'view to reaching agreement' work in practice? How does notification work in practice?**

20. In an insolvency the nature and extent of consultation will be dictated by the circumstances of the case, as indicated above. Where trading continues the objective will be to minimise losses (which may have been the cause of the insolvency in the first place) and limit the outflow of cash by reducing the cost base, including employee costs. The insolvency practitioner is under a duty to preserve assets and value for creditors as a whole. In doing so it may be necessary to discontinue some/all of the company's (loss-making) activities, which will involve redundancies. The only meaningful consultation possible in these circumstances is likely to be simply communicating to employees how these objectives are to be achieved.

**Q.3 What do you understand to be the benefits of consultation and notification where an employer is facing, or has become insolvent? Please provide examples where possible. What further benefits do you think we could encourage?**

21. Generally, in an insolvency the main benefit is to provide clear information to the workforce about the insolvency and its possible outcome, and to provide employees with a timetable to help them plan to look for alternative employment and make personal decisions in light of the new circumstances. Depending on the situation there may be some opportunity to consult on the selection of staff for redundancy where for example the insolvency practitioner is seeking to restructure the business to make it potentially viable for sale. However, in many cases, consultation is unlikely to change the outcome of the insolvency and the inevitable redundancies that accompany that process.

**Q.4 In practice, what role do employees and employee representatives play in considering options to rescue the business and to help reduce and mitigate the impact of redundancies?**

22. As noted above, there is usually limited scope for considering alternative courses of action in a formal insolvency (though there will, inevitably, be some exceptions). Where business rescue is an option and forms part of a formal process (usually only in administration) employees and employee representatives can have a role to play in assisting the insolvency practitioner to explore such options and identify aspects of the business and relevant employees that may be transferred. This in itself may reduce and mitigate the number of redundancies.

**Q.5 What factors, where present, best facilitate effective consultation when an employer is imminently facing, or has become insolvent?**

23. The ability to engage in effective consultation depends primarily on whether there is (i) a possibility of a rescue or (ii) a closedown. Without a continuing business consultation cannot have any practical effect on the outcome of the process (employment cannot continue), and the most that can be achieved is transparency in terms of communication with employees rather than 'meaningful consultation' resulting in a mitigation of the number of redundancies and costs. It is recognised however that from an employee's perspective this very communication can help mitigate the effects of the redundancy on their pursuit of future employment, which is the third statutory purpose of consultation[1].

**Q.6 What factors, where present, act as inhibitors to starting consultation or notifying the Secretary when an employer is imminently facing, or has moved into an insolvency process?**

24. In the period preceding formal insolvency, the main inhibitory factors are likely to be management's desire to keep the fact of the company's financial difficulties confidential in order not to prejudice its position in the market, and to preserve employee morale in order to avoid losing key staff at a crucial time. These will be important considerations as long as a successful rescue remains a possible outcome. By the time formal insolvency proceedings are instituted the financial position of the company may have deteriorated to the point where the ability to continue trading will be severely constrained, if it is possible at all, and the eventual outcome of the process will be uncertain. This makes it difficult, if not impossible, to complete the form HR1 because the information required by the form will not be known at this stage – see further the comments in paragraphs 30 and 35 below. Furthermore, as noted above there is no scope for meaningful consultation at this stage because of the limited range of possible outcomes. The absence of employee representatives can also be a problem – see question 10.

**Q.7 What factors, where present, negatively impact upon the quality and effectiveness of consultation when an employer is facing insolvency, or has become insolvent?**

25. In a formal insolvency the negative factors can be summarised as: lack of resources, lack of time, and lack of available options. We have already touched on these in answer to Question 1.

26. When an insolvency office holder is appointed, it will be because the business is already in serious financial difficulty. In many cases it will have run out of cash, or be in imminent danger of doing so. The insolvency practitioner must assess the situation and decide on the best strategy for dealing with the business within very tight time constraints. In many cases there will be some uncertainty whether a going concern sale is possible, and it is not unusual for the insolvency practitioner to keep trading to maximise the chances of this. This will be a commercial judgement which involves taking into account all the risks and liabilities against the prospects and benefits of a going concern sale. In these circumstances this strategy will usually be shared with the employees.

27. An administrator has a duty to carry out the statutory functions in the interests of the creditors as a whole. An administrator who continued to trade the business without good reason in a manner which diminishes the likely return to creditors would be at risk of being in breach of this duty. This may mean that it is often simply not possible to continue the business for the period of time required to comply with the statutory consultation requirements. However, this is a consequence of the circumstances in which insolvency practitioners are usually appointed: it does not mean that practitioners are acting out of wilful neglect.

28. The difficulties faced by practitioners in formal insolvencies have been recognised by government in the past. See the letter to R3 in March 2009 from the Minister for Employee

[1] s.188(2) Trade Unions and Labour Relations (Consolidation) Act 1992 ('TULRCA 92')

Relations and Postal Affairs referred to in to in our response to question 1 above.

**Q.8 Are advisors (accountants, HR professionals, or where an insolvency practitioner is acting as an advisor pre-insolvency) informing directors of their need to start consultation when there is the prospect of collective redundancies? How do directors respond to such advice?**

29. As noted in our response to question 1, insolvency practitioners acting in an advisory role are circumscribed by the terms of their engagement. While insolvency practitioners can and do advise directors of their duties and responsibilities they cannot compel directors to take any particular course of action. Sometimes HR advisers or specialist lawyers are engaged to advise on employment issues. However, in pre-insolvency or 'zone-of-insolvency' situations, directors are usually focused on pursuing options for recovery/turnaround and avoiding the need for collective redundancies, and the potential consequences in the event of failing in that strategy - of a formal insolvency process and the likely redundancies - are not going to take priority in their thinking or actions. It should be borne in mind that consultation at too early a stage could adversely affect the business, and hence the prospect of a rescue, by causing its difficulties to become public knowledge, and the insolvency becoming self-fulfilling as stakeholders withdraw their support for the company.

**Q.9 Are directors facing insolvency starting consultation, and notifying the Secretary of State, as soon as collective redundancies are proposed and at the latest when they first make contact with an insolvency practitioner? If not, how can this be encouraged?**

30. In our experience notification rarely happens prior to the insolvency practitioner being approached; this may be for good reason if redundancies are not envisaged and rescue or sale options are being explored and are a reasonable prospect. In cases where the directors ought to have known that redundancies were inevitable, this will form part of the standard conduct report prepared by the office holder under the Company Directors Disqualification Act. It should be noted that in any case the present form HR1 is unsuitable for use in insolvencies, because even where it is possible to notify the Secretary of State that there are likely to be redundancies, it is often not possible to provide the degree of detail specified in the form in the required time frame. It is for this reason that R3 has been in discussions with the Redundancy Payments Service on the development of a simplified HR1 which could be used in the early stages of an insolvency.

**Q.10 Normally are employee representatives already in place? What are the practicalities of appointing employee representatives when no trade union representation is in place?**

31. In most larger organisations union representation is already in place. Where this is not the case, the situation can be more difficult. Consultation with a non-unionised workforce can be very time-consuming. There has to be a nomination and election process and the office holder has to ensure that those employees away from work (for example holiday, sick leave or maternity/paternity leave) are included. The experience of our members is that the process can take several weeks and, in the meantime, key decisions have to be taken about the business.

32. It is also often difficult to find employees willing to stand as representatives and to ensure that all parts of the business are covered. Our understanding is that if all the parts of the business are not covered by representatives, it is necessary to consult with all of the employees.

33. Time constraints are also an issue. As an example, in one case reported to us by one of our members redundancies were made on the first day of the insolvency. At the same time, the office holders started an election process for employee representatives in case they had to make further redundancies. The business was then sold for best outcome with no time to consult with the new representatives on TUPE issues.

**Q.11 How does the hand over from directors to insolvency practitioners work when a company becomes insolvent in relation to engagement with employees?**

34. There is rarely a formal hand-over in relation to engagement with employees, and as far as we are aware there has never been a hand-over of a consultation process already in progress. Generally, the approach will depend on the nature of the insolvency and the prior relationship between workforce and management. In many cases, especially in significant businesses, the insolvency practitioner will have a team of specialist employment staff who will attend from day one to ascertain the employee position and liaise with the workforce. They will not, however, necessarily have any substantial prior knowledge. Whatever the case insolvency practitioners take employee issues very seriously.

**Q.12 How might the process for notifying the Secretary of State and sharing information with third parties be improved?**
**Q.13 Could the process requirements for consultation be further clarified or improved?**
**Q.14 Would further guidance be helpful and if so, what should this cover, who should it be aimed at and how could it be marketed most effectively?**

35. As mentioned above, the current HR1 procedure is unsuitable for use in insolvencies because the necessary information is not usually available at an early stage of the process. The hope is that this can be addressed through the simplified HR1 which is currently being discussed with the Redundancy Payments Service. It would be helpful to have some further clarification from the Service on what information they need and why.

36. With regard to the consultation itself, the main constraints are those referred to above, and no further clarification or guidance will change this.

**Q.15 How can Government best incentivise or disincentives the behaviour of directors and insolvency practitioners to ensure that consultation and notification are conducted in a timely and effective way in insolvency situations?**

37. The conduct of consultation and notification are determined by circumstances; as far as insolvency practitioners are concerned it is not a matter of wilful disregard of the law. It is not a question of incentivisation. However, were public funds made available to the insolvency office holder to enable employees to be retained and paid, then that would in all likelihood facilitate compliance, but we anticipate that would not be an acceptable policy for government at this time.

**Q.16 What would most encourage constructive engagement by employees when in this situation? And do you have any suggestions for how employee representatives can best be supported?**

38. The key factors are access to information and support (e.g. from Job Centre Plus). Some training for employee representatives would be useful.

**Q.17 Do you have any examples of where constructive consultation and engagement has happened in an insolvency situation? If so, what was done and how?**

39. We have encouraged our individual member firms to respond to this.

**Q.18 The current sanctions against employers who fail to consult take the form of Protective Awards. Do you think these are proportionate, effective and dissuasive in the context of employers who are imminently facing, or have become insolvent? Is the situation different as it applies to directors and insolvency practitioners respectively?**

40. It is arguable that in a formal insolvency the protective award regime ceases to serve any meaningful purpose, and acts only to create inflated claims to the detriment of the general body of creditors.

41. The leading case of *Susie Radin Ltd v GMB* set out the following principles governing protective awards:

- The purpose of a protective award is to provide a sanction for the failure to consult and not to compensate the employee for his loss;
- The tribunal should focus upon the seriousness of the employer's default; and
- The tribunal must assess the length of the protective award, but where there has been no consultation, it should start with the maximum period and reduce it only if there are mitigating circumstances.

42. While these principles may make sense in the context of a solvent trading company by encouraging management to abide by the law, they are less readily applicable in formal insolvency cases. First, a protective award serves no purpose from the point of view of correcting the conduct of an errant management and encouraging future compliance. Secondly, an award merely acts a drain on public resources (as it is initially paid out of the National Insurance Fund) and ultimately reduces the funds available for the general body of creditors.

43. Because of the principle that awards should first be awarded for the maximum period and only reduced if there are mitigating factors, the tribunals frequently use the same starting point for solvent situations, and often make 90 day awards in insolvency cases; this seems unreasonable in the circumstances. Furthermore, there appear to be inconsistencies in the approaches taken by individual tribunals. It would be helpful if some sort of guidance could be provided to tribunals so that the length of the award can be balanced against the effort made by the insolvency practitioner to conduct as meaningful a consultation as possible in the circumstances and awards reduced accordingly. In this regard, if tribunals applied more effectively the special circumstances exception to distressed and insolvent situations recognising that it was not reasonably practical to fully comply with the obligation to consult and that if all such steps towards compliance as were reasonably practical were taken, this would be an improvement on the current position.

44. One case, which is probably similar to many others, can serve as an example of the futility of protective awards in insolvencies. In this case there were no employee representatives in place when insolvency practitioners were appointed. It was clear that the only option for the company was to trade out its remaining work in progress and then close down. The office holders undertook a nomination and election process for employee representatives and traded the business for several months to realise the work in progress. The office holders provided the representatives with full information on what they were doing. However, there was nothing to consult on (in terms of seeking alternative solutions to avoid the redundancies) and so despite the efforts to engage, a full 90-day protective award was made.

45. There is a strong case for the Government to review the status of protective awards. If they are supposed to be penal in nature, treating them as wages is manifestly inappropriate. In insolvencies the employees already receive compensation in the form of pay in lieu of notice and redundancy pay, in addition to any arrears of pay and holiday pay, which they will also receive. The effect of treating protective awards as wages is merely to create inflated claims, which in the first instance have to be paid by government out of the National Insurance Fund, but which are seldom fully recovered, and which ultimately dilute the funds available for the other unsecured creditors. This is clearly an unsatisfactory situation. Furthermore, penalties are pointless in insolvencies because they neither deter nor punish bad behaviour.

**Q.19 How well is the memorandum of understanding between R3, Job Centre Plus and the Insolvency Service working?**

46. The Memorandum of Understanding (MoU), signed by R3, Job Centre Plus (JCP) and the Insolvency Service in 2009 and re-signed in 2011, has helped over 120,000 individuals affected

by redundancy. The initiative encourages insolvency practitioners to contact their local JCP in cases where 20 or more redundancies are likely to be made, so that JCP can provide information and support. R3 surveyed members in April 2015[2] and found that the initiative continues to work well. Headline figures include:

- Of those R3 members who work in corporate insolvency, 76% have not been appointed to a firm where 20 or more redundancies needed to be made in the last six months; 19% have been appointed to a firm where 20 or more redundancies needed to be made and did contact JCP; and 5% have been appointed to a firm with 20 or more employees but did not contact JCP.
- Of those R3 members who work in corporate insolvency and did not contact JCP, most say that they did not do so because all or the majority of jobs were transferred to a new employer. Some say that they had no time to get JCP involved.
- Of those who contacted JCP, 78% said that this contact was beneficial to employees.
- Of those who contacted JCP, 51% said that it was beneficial to them as an IP.

47. The anecdotal feedback from Insolvency Practitioners is that the initiative continues to work well, but it would benefit from a 'boost' from R3 and JCP at a local level. R3 would be keen to see this initiative updated and re-signed under the new Government. R3 feels that the success of the MoU as a non-regulatory solution to a problem first raised by Phil Wilson MP in an Early Day Motion (see R3 report for further information[3]), could be adopted in other areas, and could go a long way in addressing some of the challenges regarding employee consultation in an insolvent business.

Association of Business Recovery Professionals
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[2] An on-line survey conducted by ComRes 26 March-6 April 2015 to all R3 members working in corporate insolvency: 239 responses

[3] https://www.r3.org.uk/media/documents/working_in_parliament/MoU_Report_2012.pdf