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SUMMARY C74(ILRC) C74

TRADES UNION CONGRESS

Principles of Insolvency Law

1. The law should seek solutions to the disruptive effects of insolvencies and liquidations on employment prospects and production (para 1, 9 to 11).

Receivership Law )
Company Winding-Up )

2 Under existing law all employees are automatically dismissed on the appointment of a receiver by the Court or the making of a winding-up order; these provisions need revision (para 12, 21(6)).

3 The Employment Protection Act 1975 requires consultation with unions when redundancies are proposed, but automatic dismissal cuts across this (para 13).

4 Even where redundancies are not made, receivers and liquidators hide behind the statutory definition of their duties to avoid discussion with union representatives (para 13).

5 The right of unions to represent their members' interests in actions or proceedings in the Courts relating to receivership or liquidation of companies in which the union has members should be introduced (para 21(7)). ?

6 Provision should be made for committees, reflecting the balance of interests of employees and other groups, to assist and supervise the activities of receivers and liquidators (para 21(8)).

7 Legal duty should be placed on liquidators and receivers to bring to the attention of the Court any evidence that financial arrangements or transfers between companies, or the placing of tenders at an irresponsibly low level simply to secure a contract, had directly contributed to the illiquidity of a company (para 21(9)).

8 Companies could be rejuvenated by finding orders for component supply or subcontracts, or productive capacity could be sold, so that established skilled workers continue in employment. Receivers and liquidators should have a duty to take account of employee interests and seek to maintain employment (para 16 to 18, 21(5)). ?

Company Winding-Up

9 Consideration should be given to extending the Employment Protection Act's insolvency provisions to groups of persons not at present covered (para 4).

10 Section 231 frustrates proceedings (eg for unfair dismissal) through Industrial Tribunals. Such actions should be exempted from the provisions of Section 231 (paras 7, 8, 21(3)). Yes

11 Problems arise where an employer has become insolvent and terminated employment without consultation before a protective award can be made (para 14).

Unless Ct. otws. directs

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12 Refers to problem of definition of awards for unfair dismissal where companies become insolvent before the awards are paid out, and suggests that the Employment Protection Act be amended to ensure that all awards relating to the period prior to the termination of employment are payable in full from the Redundancy Fund (para 15, 21(4)). not for us.

13 Draws attention to allegations that subsidiaries have gone apparently deliberately into liquidation leaving debts unpaid, and in some cases at a later stage the uncompleted contracts have been taken on and original workers re-employed by another subsidiary without outstanding wages and other payments being met (para 19).

14 Disqualifying directors does not compensate employees or other creditors. Liquidators could be given wider duties, or all liquidations supervised by committees of creditors and tradeunion representatives (para 20).

Creditors Generally

15 Employment debts as a whole should be treated as preferential in relation to all other debts and should be met from the Redundancy Fund (paras 3, 4, 21(1)). not for us

16 Employment debts should include all payments due under contracts of employment, whether paid to or on behalf of an employee, and any voluntary deductions from pay held by the employer (para 5, 6, 21(2)).

17 Powers should be established (in addition to those penalising directors) to enable the Court to direct that the debts of employees and other creditors should be met by the other company concerned (paras 19, 20 and 21(10)).

C74
(ILRC)

# TRADES UNION CONGRESS

## EVIDENCE TO THE INSOLVENCY LAW REVIEW COMMITTEE

1 Except to the extent that they are creditors, employees have wholly inadequate rights when faced with the insolvency and winding up of their employers. To some extent this no doubt reflects the very long period which has elapsed since the last review of insolvency legislation. The redundancy payments legislation and Employment Protection Act have improved the security of workers affected by insolvency and bankruptcy. The review of insolvency law with the possibility of future legislation provides an opportunity for insolvency law to be brought into line. However, the offsetting of the immediate financial effects of job loss arising from an employer's insolvency is only one aspect of the problem. It is perhaps more important that insolvency law should positively seek solutions to the disruptive effects of insolvencies and liquidations on employment prospects and production.

2 The following evidence is divided into two broad sections: specific proposals for improvements to the law as it affects employment debts and actions proceeding in Industrial Courts; and wider ranging suggestions for reforms designed to redress the heavy imbalance in favour of investors and creditors as against employees in insolvency and receivership provisions.

Employment Debts

3 ... Preferential Treatment of Employment Debts The Companies Acts currently provide for the treatment of up to a maximum of £200 of wages and holiday pay as preferential debts in a winding up. Under provisions in the Employment Protection Act the rights of employees as creditors have been improved. The Redundancy Payments Fund has previously provided full payment of redundancy payments to workers whose dismissal has resulted from the insolvency of the employer. The Fund now additionally covers arrears of pay at a rate of £80 a week for a period of not exceeding 8 weeks and other debts including holiday pay and pay in lieu of notice. However, any other monies owing are treated as an ordinary unsecured debt.

4 In perhaps the majority of cases, employment debts are relatively small and can easily be covered by the Employment Protection Act limits. In some cases, however, very significant debts have been built up and employees have geared their domestic financial arrangements to the expectation that these could be met in full. Clearly, the loss of both job and a substantial part of those savings is a considerable blow. There are therefore strong arguments for making employment debts as a whole preferential. Also, given the difference in the ability of employees to stand the loss of substantial wages, when compared with the Exchequer's claims for taxes or local authorities' claims for rates, it will be seen that employees should have a preferential position in relation to all other debts. Consideration might also be given to extending the EP Act's insolvency provisions to groups at present not covered - eg seafarers and freelance writers.

5 Definition of Employment Debts A particular problem has arisen where an insolvent employer has held subscriptions deducted from pay under a check-off arrangement as, in some cases, receivers have treated the subscriptions as unsecured debts owed to the union. As a result, because unsecured debts have a secondary claim against assets there is a high risk that check-off payments are neither paid to the union nor refunded to the member in full. It appears that other deductions from pay, for instance for sports and social club contributions, could be similarly treated.

6 Now, in a check-off arrangement the employer acts only as an intermediary for the employee in the transfer of subscriptions to the relevant union and the money involved should be regarded as the property of the employee until possession has passed to the union. The Truck Acts, which make illegal any retentions by employers from lawful deductions from pay certainly seem to support the view that such deductions remain the property of the employee. To deal with such problems, the definition of employment debts for the purposes of insolvency legislation ought to include all payments due in relation to contracts of employment, whether paid to or on behalf of an employee, and any voluntary deductions from pay held by the employer.

7 Actions Stayed on Winding-up Under section 231 of the 1948 Companies Act, when a winding-up order has been made or a provisional liquidator appointed, no action or

proceeding can be proceeded or commenced against a company except by leave of the court. The purpose of this, apparently, is to prevent assets being further diminished during winding-up through court costs being incurred. The effect of the provision, however, is also to frustrate proceedings, for instance for unfair dismissal, through Industrial Tribunals, although the costs necessarily incurred in defending such proceedings would be minimal.

8 There is clearly a very strong argument for not staying proceedings at all, particularly in the case of employees and former employees for whom the outcome of such actions can be of crucial importance, affecting rights to payments under contracts of employment and redundancy payments, for example. There is equally substance in the arguments for limiting the effects of court costs. However, in the case of actions which can be pursued through the Industrial Tribunals legal representation is not required and the cost arguments are less important. Such actions should therefore be exempted from the provisions of section 231.

The Extension of Employee Rights in Insolvency

9 The preferential treatment of employment debts and the payment of redundancy as compensation for loss of employment are essential income safeguards. However, such provisions are no substitute for continuing employment.

10 The current level of unemployment makes workers particularly anxious to maintain continuity of employment. Company liquidations clearly reduce employment opportunities and because of their repercussive effects on sub-contractors and suppliers the ultimate unemployment effect of a liquidation may be many times the number directly employed.

Reasons for Insolvency

11 Companies become insolvent for a wide range of reasons. The problem might be market changes to which the company was too slow or unable to respond. Or financial mismanagement could lead to a cash crisis. In some cases, of course, the problems can be insuperable. In many instances, however, the difficulty is not the nature of the productive unit or a lack of skills on the part of workers, but misjudgment and managerial inadequacy. In such cases, the clear objective ought to be to seek ways, perhaps by a financial or managerial restructuring or by a product and market change, by which viability could be restored and employment secured.

12 The Effects of Insolvency on Employees At present there is no requirement in law that employee interests should be taken into account when firms are in receivership or being wound up. One aspect of this is that under existing law all employees are automatically dismissed on the appointment of a receiver by the court or on the making of a winding-up order. Often receivers and

liquidators endeavour, at least initially, to maintain companies as going concerns simply to conserve the value of the company, in the expectation that this course is likely to realise a higher price than by splitting the assets and in these circumstances employees are re-engaged. However, the automatic dismissal provisions are indicative of an almost 19th century approach to employee rights which certainly needs revision.

13 The appointment of a receiver, or liquidator, whether by the court or not can result in a significant change in the climate of industrial relations within a company. Even where employees are not automatically dismissed, the duties of receivers and liquidators relate to the conservation of company assets and the interests of debenture holders and creditors rather than employees. The Employment Protection Act requires consultation to take place with trade unions when redundancies are proposed. Automatic dismissal can cut across the operation of such procedures particularly as in trying to avoid consultation it has been claimed that the special circumstances of receivership or winding-up make the procedures impractical. Even where redundancies have not been made, it has often been the experience of trade unions that receivers and liquidators have hidden behind the statutory definition of their duties in avoiding discussions and negotiations with trade union representatives.

14 Where employers do not carry out the required consultation in advance of redundancy, a complaint may be made to an industrial tribunal by an appropriate trade union and, where the complaint is well-founded, a protective award can be made directing the employer to pay remuneration for the period of the award. In those cases where insolvency or dismissal follow, remuneration under the protective award can be covered by the Redundancy Fund in exactly the same way as ordinary arrears of wages. However, a problem arises when the employer has become insolvent and terminated employment without consultation before a protective award can be made. In such cases the Redundancy Fund cannot stand in the place of the employee and the only recourse open to the employee is to seek payment as a creditor.

15 Another problem concerns the definition of awards for unfair dismissal which are payable from the Redundancy Fund cases where companies become insolvent before awards are paid out. The Act provides only for payment by the Fund of "any basic award of compensation" and thereby excludes the compensatory aspect of such awards. The problems relating to protective awards and compensation for unfair dismissal could best be resolved by amendment to the Employment Protection Act to ensure that all awards relating to the period prior to the termination of employment are payable in full from the Redundancy Fund.

16 The Opportunities for Maintaining Employment Although the objectives of employees may sometimes coincide with the interests of debenture holders and creditors, in trying to maintain a company as a going concern, this is not always the case. It is not always clear, either, that these efforts are pursued sufficiently rigorously. Of course, it is not always the case that employment can be maintained, but it is important that there is sufficient time to make a full examination of the options.

17 In some cases, new managers together with more effective financial controls and perhaps an injection of working capital may be sufficient measures to re-establish viability. In other instances the problem may be more deepseated - perhaps dependence on a declining market or a product innovation which has failed - but if, for instance, orders could be found for component supply, or sub-contracts it might be possible to rejuvenate the company. Yet again, it is possible that productive capacity as opposed to the split up assets could be sold and the established skilled workers employed by another company.

18 In any event, what is needed is time to thoroughly examine the options. It might be that having carried out such an examination it becomes clear that there is no alternative but to sell piecemeal. In this case, the interests of the employees would require that, if they have to lose their jobs, the length of notice should be as long as possible in the circumstances to give the best chance of getting alternative employment.

Insolvency of Subsidiary Companies

19 In the past, the TUC's Construction Industry Committee has drawn attention to allegations that subsidiary companies have gone apparently deliberately into liquidation, leaving debts unpaid and in some cases at a later stage the uncompleted contracts have been taken on and original workers re-employed by another subsidiary of the same parent company without meeting outstanding wages and other payments. Whether workers are re-employed or not, the use of liquidations to achieve a financial advantage at the expense of employees, creditors and customers is clearly indefensible and may have had a seriously disruptive effect in the construction industry in the past.

20 Although it is not clear to what extent such 'tactical liquidations' are still being carried out, it is certain that trade unions still regard this as a potential problem. There are of course actions which can currently be taken under company law provisions and under the Insolvency Act 1976 to disqualify directors of insolvent companies whose conduct makes them unfit to be concerned in the management of a company. However, orders to that effect do not compensate employees, particularly those owed more than the debts covered by the Redundancy Payments Fund, or other creditors. One way of dealing with the problem would be to give liquidators wider duties. However, it might be better to ensure that all liquidations are supervised by committees of creditors and trade union representatives.

TUC Proposals for Changes in Insolvency Law

21 The TUC believes that the following developments in the law relating to insolvency are necessary:

(1) Employment debts as a whole should be preferentially treated in relation to all other debts and should be met from the Redundancy Payments Fund;

(2) The definition of employment debts for the purposes of insolvency legislation should include all payments due under contracts of employment, whether paid to or on behalf of employees, and any voluntary deductions from pay held by the employer;

(3) Industrial tribunal actions relating to the period before the making of a winding-up order or the appointment of a provisional liquidator should not be stopped by the order or appointment. Industrial tribunal action should therefore be exempted from the provisions of Section 23 of the Companies Act 1948;

(4) The Employment Protection Act 1975 should be amended to ensure that all awards relating to the period prior to the termination of employment are payable in full from the Redundancy Fund;

(5) There should be a duty on receivers and liquidators to take account of employee interests and,

wherever possible, to seek to maintain employment;

(6) The principle should be established that the appointment of receivers or the making of winding-up orders by the court does not automatically terminate employment;

correct in law?

(7) The right of independent trade unions to represent their members' interests in actions or proceedings in the courts relating to receiverships and liquidations in respect of the companies in which the union has members should be introduced;

represent collectively

(8) Provisions should be introduced requiring the setting-up of committees, reflecting in their membership the balance of interests of employees and other groups, to assist and supervise the actions of receivers and liquidators;

(9) A legal duty should be placed on liquidators and receivers to bring to the attention of the court any evidence that financial arrangements or transfers between companies, or the placing of tenders at an irresponsibly low level simply to secure a contract, had directly contributed to the illiquidity of a company; and

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(10) Powers should be established, in addition to those already in existence to penalise directors, to

enable the court to direct that the debts of employees and other creditors should be met by the other company or companies concerned.

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JS/HKY
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