Insolvency: What does HR need to know?

By Raoul Parekh and Kate Potts - 21 August 2020

Where businesses are faced with the possibility of becoming insolvent, the impact on employees is significant. Human resources teams are often at the heart of responding to these challenges, but many HR professionals may also be facing this situation for the first time.

As the economic impact of the coronavirus crisis begins to hit home, we have prepared an outline of the relevant issues for HR teams. Insolvency processes are inherently complex, so we have designed this article to provide a simplified summary of the employment issues that crop up in an administration process and highlight the key things HR practitioners need to know.

What kind of insolvency is it anyway?

There are multiple types of insolvency situations, the primary being:

- Administration;
- Liquidation; and
- A company voluntary arrangement ("CVA"),

with various sub-types within those general categories. Readers should be aware that this article focuses on administration (which, in our experience, is the insolvency situation that engages most employment law issues), and that the rules which apply to each type of insolvency scenario are very different.

Early warning signs

Before a company officially becomes insolvent, management may try to put in place some cost saving measures to reduce the risk of insolvency, including, of course, redundancies.

There are a variety of other measures that could be put in place including reducing salaries, cutting staff's working hours, but these are not the focus of this note. See our article on cost cutting measures for more information.

HR may also be asked to assist with the company's ongoing need to assess solvency and ability to perform a solvent winding up. This could involve the HR team being asked to help identify areas for restructuring and to 'price-up' redundancy of the whole workforce in accordance with statutory and contractual obligations.

It's not all bad news

Administrators are appointed with three statutory objectives, one of which is to turn the company around so that it can be rescued as a going concern. Therefore, in an administration process it does not necessarily follow that the administration will involve large scale job losses.

The appointment of an administrator does not amount to a change of employer, and employment contracts do not automatically terminate in an administration. Where jobs are cut, the usual risks around unfair and wrongful termination still apply.

The administration timeline and the 'moratorium'

When an administrator is appointed there is a 14 day 'moratorium' which allows the administrator to assess the business' solvency. During this period, nothing which the administrator does (or omits to do) will cause the contracts to be 'adopted' by the administrator. Adoption of contracts will occur when the administrator continues after the 14 day 'moratorium' to employ and pay employees in line with their contracts. One of the primary consequences of adoption is that certain employee debts rank higher (meaning employee creditors have a greater chance of being paid in full). Because of this, administrators will normally have performed an assessment of the workforce prior to appointment to determine which are essential to the prospect of rescuing the business (or part of the business) as a going concern and terminate the employment of the remainder before 14 days.

Collective consultation obligations and HR1 form

If large scale job losses are proposed (20+ job losses) within a period of this article for more details on collective consultation.

It will be very important to ensure that consultation takes place at the right time, particularly as this will impact on when the HR1 form can be lodged with the Department for Business, Energy & Industrial Strategy ("BEIS").

The HR1 form essentially allows BEIS to ensure that appropriate resources are in place to respond to localised job losses and is usually of limited importance to a typical collective consultation process. It is usually a straightforward compliance step that requires little time compared to the more controversial steps of appointing representatives or the selection of at-risk roles. However, it is often a key focus of administrators because failure to file a HR1 appropriately attaches potential criminal liability to the company in addition to

any director, manager, secretary or other officer with whose consent or connivance was committed. This issue came to prominence after three directors of delivery firm City Link were charged with criminal offences in 2015 in relation to a failure to submit an HR1 form – although all were ultimately acquitted.

The timing of filing an HR1 form and beginning redundancy consultation is a tricky issue for a business facing potential insolvency. On the one hand, failing to meet these obligations could crystallise serious and substantial liabilities. On the other, starting large scale redundancies could sound the death knell for the prospect of selling the business as a going concern, which may breach the obligations owed to creditors. Balancing these competing obligations can be difficult and advice should be taken.

I got bills I gotta pay ...

The majority of employee debts are unsecured and rank second to last in the order of priority when the business' assets are realised – in practice, this means unsecured creditors receive only a small fraction of the sums owed to them. However, if employment contracts are adopted by the administrator, then certain employee liabilities will become 'super priority' claims, meaning they rank higher even than the administrator's fees and expenses (which are normally paid before any other debts).

Certain employment debts are ranked higher, however, as employee creditors are owed their 'remuneration' (capped at £538 per week) as a preferential debt. If the employer is unable to pay employment debts, the Government – via the National Insurance Fund (*"NIF"*) - will pay out certain debts. See here for more information on what can be claimed from the NIF.

When an administrator is appointed, they will normally provide information to the employees about how to make a claim on the NIF and provide them with a reference number to use on the necessary forms.

TUPE with a twist

Finally, if the administrators are able to rescue the business by finding a purchaser, TUPE may apply to the transaction. For relevant insolvency proceedings, there are some specific TUPE rules which aim to reduce the burden on the purchaser of taking on the insolvent company's employees by:

- Providing that the purchaser will not inherit all of the insolvent company's employee debts; and
- Providing greater scope to change terms and conditions of employment.

For more information about the role of HR in a business sale from insolvency see our top tips for HR.

While insolvency is never an indication of financial health in a company, it is also often far from terminal. Leaders have a responsibility to try to preserve the core of a viable business if they can, and one way HR professionals can help that aim is by ensuring compliance with employment law to prevent unexpected liabilities. Morale is also vital during challenging trading conditions, and of course is very difficult to maintain when news is not good. HR teams are often a channel to employee sentiment and the first port of call for those with welfare concerns. HR will be a vital part of any employer's recovery and administration plans, and we hope this article will provide some of the tools to enable that.

If you or your organisation wish to seek advice regarding insolvencies, please get in touch with your usual GQ|Littler contact or email .