Outsourcing – The People Issues

As businesses continue to explore ways to increase efficiency and focus on 'core' activities, many functions continue to be outsourced. On the face if it, this seems like a straightforward process – what could be simpler than appointing a supplier to carry out activities that you don't want to? Unfortunately, there are many issues to consider, not least what the impact is for the people delivering the services that will be outsourced. To make matters more complex, similar issues arise if you to replace an existing external provider with a new provider.

Does TUPE Apply?

TUPE will usually apply to outsourcing, both on the initial outsourcing and on any subsequent or "second-generation" outsourcing. This will mean that the employees who are currently "wholly or mainly" engaged in carrying out the relevant activities will transfer from the customer/existing supplier to the new supplier at the start of the outsourcing arrangement, and from the supplier back to the customer or to a replacement supplier (depending on whether the services are taken back in-house or moved to a new supplier) at the end of the contract.

This means that all of the TUPE obligations that apply on business/asset sales will apply to the outsourcing, including in particular:

• the requirement the inform and consult prior to the transfer;

• the restrictions on dismissing employees/changing their terms and conditions due to the transfer; and

• the provision of "employee liability information" about the employees who will transfer.

Redundancies

Often, part of the rationale for outsourcing is that the services can be done more efficiently and third party providers are likely to operate a different business model to deliver the services cost-effectively. This means that, often, the third party provider will not require all of the employees who transfer to it. TUPE does not preclude genuine redundancies from being made, but:

• to be fair, the redundancies should be made after the transfer and selection should include the new providers existing staff and the employees who transfer to it under TUPE;
• if the current employer makes redundancies before the transfer, the dismissals will be unfair;
• if 20 or more employees are to be made redundant in 90 days or less, the employer must carry out collective consultation.

Outsourcing Agreement

Given these issues, and especially where commercial requirements will create employment related liabilities, it is essential to cover and allocate the potential issues and liabilities in the outsourcing agreement. The employment provisions in the agreement should deal with the following issues:
• the transfer of the employees at the start of the outsourcing arrangement, including a list of the employees will transfer;
• the provision of additional information in relation to the employees beyond the minimum “employee liability information”;
• warranties in relation to the due diligence information provided in respect of the transferring employees;
• indemnities to cover which party will be liable for the pre-transfer liabilities (usually the pre-transfer employer (commonly referred to as the “transferor”);
• indemnities to cover which party will be liable for the post-transfer liabilities (usually the post-transfer employer (commonly referred to as the “transferee”);
• indemnities to apportion any liability for failing to carry out TUPE consultation;
• indemnities to cover claims by “wrong pocket employees”, i.e. employees who are not on the list of transferring employees, but claims that they should have transferred under TUPE;
• the arrangements and liability apportionment in relation to employees who are assigned to the services at the end of the contract, which may include terms that prevent the supplier from moving employees around (e.g. replacing good employees with poor performers so that the poor performers transfer at the end of the contract) or changing their terms of employment so that a replacement supplier (or the customer, if the services are to be taken back in-house) will inherit poor staff, additional liabilities or unfavourable arrangements;
• depending on the commercial arrangements, specific arrangements may be entered into. For example, a supplier may demand that it is not required to take on any staff from the customer/previous supplier and that,. If any employees do transfer under TUPE, it can dismiss them, with the resulting liabilities being covered by the customer.

This list is an overview of the types of issues that need to be covered. In reality, the issues differ in each individual case, which makes it essential to have appropriate employment provisions in the outsourcing agreement.

In addition, when negotiating a “second generation outsourcing (i.e. replacing the existing supplier with a new one), the customer must ensure that it does not agree with the new supplier that it will assume liability for things that it is not covered for under the agreement with the existing supplier. This is often referred to as “back-to-backing” the indemnities.

All-in-all there is a lot to think about and we haven’t even mentioned cross-border TUPE, but we’ll leave that for another edition!

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