GUIDANCE NOTE

Buying a Business that is in Administration

February 2012

This guidance note sets out the key employment issues you will need to consider before buying a business that is in administration.

1. The role of the insolvency practitioner

If an insolvent company cannot improve its financial position, it is likely to enter into an insolvency process (for example, administration), in which an insolvency practitioner will take over its affairs. You will therefore be dealing with an insolvency practitioner acting as the seller's agent during the sale process. The asset sale agreement is likely to include the insolvency practitioner, the seller and you as parties.

2. How is the purchase affected by TUPE?

- TUPE is an acronym for the Transfer of Undertakings (Protection of Employment) Regulations 2006. Where TUPE applies, employees automatically transfer from one employer to another with their terms of employment and continuity of service intact. TUPE will apply when a business or part of a business is sold.
- If you are buying a business that is in administration, the normal TUPE principles will apply. For example, employees transfer to the new employer on their existing terms of employment and with all related employment rights, powers, duties and liabilities. Old age, invalidity and survivors' benefits under occupational pension schemes are excluded.

2.1 TUPE insolvency provisions

Some of the normal TUPE principles are modified when the seller is in administration:

- You are not liable for some pre-existing debts owed to employees (for example, statutory redundancy payments, arrears of pay and holiday). The Secretary of State pays these liabilities from the National Insurance Fund (NIF) up to statutory limits. However, you are liable for debts that are not covered by the NIF or exceed the statutory limits. In addition, the Secretary of State has no liability for debts arising after the transfer, such as the basic award for a post-transfer dismissal.
- You have greater flexibility in relation to the variation of contractual terms.

3. Due diligence process

- When buying any business you should undertake a thorough due diligence process to obtain information on:
    - the business;
    - its assets; and
    - any areas of liability.

  Due diligence is essential to help you decide whether to proceed with the sale or attempt to renegotiate the purchase price.

- In the context of buying a business that is in administration, it is often impractical to carry out a comprehensive due diligence process because:
    - the timescale of such a transaction is often tight. An insolvency practitioner usually only has enough funds to trade the business of the seller for a limited period; and
    - there may be limited available information. The insolvency practitioner may have little or no knowledge of the operation of the business. In addition, the books and records of businesses in administration are often incomplete.

- However, there are certain key employment-related areas that you should get information on, including:
    - the number of employees in the business and the roles undertaken;
    - key terms of employment (for example, salary, benefits and notice periods);
    - details of any debts owed to the employees of the business;
    - details of recent dismissals and any proposed dismissals, including the reasons for the dismissals and details of any procedure followed (or not to be followed); and
    - details of any ongoing or threatened employee litigation.

4. Employee liability information to be provided by the seller

- The seller must provide you with certain information not less than 14 days before the sale takes place (for example, the disciplinary and grievance records of the transferring employees).
- Where a business is administration, it is possible that the information may not be provided or may be incomplete or late. You should consider taking steps to assist the seller to provide the information (for example, by providing them with a pro forma schedule which clearly sets out what information is required).

5. Analysis of potential liabilities

- As part of your due diligence, you should analyse the potential level of any employment liabilities you could incur if you were to proceed with the purchase of the business.
- You should obtain an insolvency practitioner's opinion at the start of the process to assess your potential liabilities and negotiate the asset purchase agreement accordingly.
- The following liabilities may be of concern to you if you are buying a business:
    - overall employment costs;
    - debts owed to the employees in the business, as you will inherit any residual debts that are not covered by the NIF guarantee; and
    - potential liability associated with any existing or potential litigation (for example, any transfer-related dismissals).

6. Warranties and indemnities

- In the context of buying a business that is in administration, it is rare for the asset purchase agreement to contain warranties or indemnities in your favour.
- It is likely that the insolvency practitioner will require you to indemnify the seller and the insolvency practitioner against any liabilities to third parties that arise as a consequence of the sale.
- Even where warranties and indemnities are given by the seller, they are unlikely to be worth much in reality. Liabilities undertaken by the seller rank as unsecured claims and so have limited commercial value.

7. Alternative means of buyer protection against future liabilities and costs

In the absence of indemnity protection under the asset purchase agreement, you should consider alternative means of protecting yourself against future liabilities and costs, for example:

- A reduction in the purchase price to reflect the likely level of liabilities you may incur (for example, in relation to pre-transfer dismissals).
- A portion of the purchase price to be held in a retention fund for a number of months after completion, pending any employment claims against you. Any successful employment claims or settlement of claims would then be paid out of that account.

The comments in this guidance note are of a general nature only. Full advice should be sought on any specific problems or issues

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