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iGlobal Strategic Guidance Series 5: Outsourcing

Employment Issues arising from Outsourcing agreements and Transfers of Undertakings

Business Process Outsourcing (BPO) to third parties whether local or off-shore remains an important business option for specialized skills, cost arbitrage or managing time intensive or less profitable parts of your services or production.

BPO vendors in Europe must deal with employment protection rules and regulations that do not exist in the US. These can significantly change the scope or cost of the outsourcing deal. All parties must factor these rules into the deal structure, service levels and price at the outset.

This iGlobal Strategic Guidance provides a high level view of the key employment law issues to take into account when evaluating a BPO service transfer. It considers the risk issues from the point of view of the acquiring BPO vendor, the transferring or retiring BPO vendor and the BPO client.

A checklist of key issues appears at the end.

European Acquired Rights Directive Overview

The overarching legal framework in the European Union is established by the Acquired Rights Directive (“ARD”). This is implemented locally by national regulations which vary considerably.

Most importantly, where a buyer acquires the assets of another company but leaves behind the legal entity (and perhaps other assets), EU legislation comes into play to protect employees and ensure they are not left behind, compromised or cut out.

ARD can also apply when BPO arrangements transfer between vendors or get taken back in-house but employees here are generally less well protected than on business asset acquisitions. The important exception to this is the UK (see below).

Note also that in some cases, the law might deem internal restructuring as an ‘asset acquisition’ even if no third party business group is involved. For example, this might cover moving operations from Subsidiary A to Subsidiary B within a country, or relocating work from a subsidiary in one country to a subsidiary in another. The ARD can apply across borders and even beyond the EU.

In English, the concept is often referred to as ‘TUPE’, after the corresponding UK Transfer of Undertakings (Protection of Employment) Regulations. Employees automatically transfer to the acquiring company on existing terms and conditions. This includes recognising continuity of service. Dismissing employees in anticipation of the transfer is often automatically unfair or even void under the law.

Similar rules apply in some non-EU jurisdictions in both Europe, for example Russia and Switzerland, and elsewhere in the world, such as Mexico.

There is much local case law on when exactly TUPE is triggered, but one thing is clear: if it is triggered, then the acquiring company is obliged to take on the employees whether they are needed or not. If the employees are not required, it will be for the acquiring company to carry out (and bear the cost of) the layoffs in accordance with the local rules.

Outsourcing Agreements – Beware the UK

BPO transfers in many jurisdictions are generally less protected by the ARD than are business asset acquisitions. However, there are circumstances, particularly for labor-intensive activities, where automatic transfers may be triggered.

The UK is a major exception to this general rule. Where activities in the UK are outsourced to a third party, taken back in-house from an outsourcing provider or moved from one outsourcing provider to another, it is highly likely that TUPE rules will apply and the automatic transfer would be triggered. This means that employees carrying out the outsourced services must continue to provide them once the services transfer, even if that means they move from one outsourcing company to a competitor. It is not relevant whether the company taking over the provision of the services wants to take on the employees or not.

TUPE therefore often becomes a major issue in UK outsourcings because, in most cases (unlike with business acquisitions), the incoming supplier will want to perform the tasks from its own site, using its existing or locally-sourced workforce. This may well be far from the current service location or even abroad. If automatically transferred employees are subsequently terminated by the new supplier, this could generate significant severance and exit costs, expensive litigation, and even the need to inform the UK government beforehand.

Since TUPE protection on BPO transfers is largely specific to the UK, take care to ensure that your deal teams are fully aware of its implications when negotiating a UK BPO. We have seen some significant miscalculations of deal value as a result of this misunderstanding. Remember that TUPE on outsourcing can be triggered even if the incoming service provider has no intention of supplying any of the services from the UK. It may not even have a UK operation. The key question is where the services are currently being supplied?

How should the parties deal with this?

Checklist of Key Points:

1. Importance of Early Employment Due Diligence

Whether you are making an asset purchase or entering into an agreement as or with a BPO vendor, make sure you identify all the employment liabilities/risks before negotiations are finalised so they are taken into account in the deal terms. Liabilities/risks might include:

> **Do the TUPE rules apply?** Parties (and their lawyers) sometimes disagree. Where the existing services are supplied from is critical. An agreed position is usually necessary to progress the deal but ultimately it is a matter of law. Get the law right.

> **The cost of exiting unwanted staff**. Quantify this taking a short, medium and long term view of staff need. These costs can arise at the front or back end of the outsourcing arrangement.

> **Changing employment of terms**. Even for retained staff you may want to change employment terms – assess cost/morale implications of the changes you intend to make.

> **Look for hidden risks**. The 'forgotten' employees (e.g. those out on maternity leave or long-term sick); difficult employees; representative bodies (e.g. unions or employee representatives with special protections); and any patterns of systematic failure (e.g. incorrect holiday pay calculations or commission payments) for which you may be left to pick up the cost.

> **Workforce size**. Remember, the larger the workforce the greater the risk of the cost of seemingly minor issues multiplying significantly.

2. Informed Negotiation

Factor the liability risk into the commercial negotiations. In particular:

> make sure your commercial team know and understand the employment risks both at the start and at the end of the arrangement and negotiate the deal on pricing and service delivery accordingly.

> ensure you build in adequate contractual protection as you buy the business or take over the outsourced service.

3. Back End Protection on Outsourcings

In many countries, an outsource vendor who loses a BPO contract will be left with a workforce but without any work for them. If they cannot be redeployed to other accounts, there could be significant severance costs for the employer to pay, even if they did not want to end the BPO agreement. Foreseeing and protecting against this contractually at entry point is key. At the exit point, it is too late.

Conversely, your business may have sourced and trained its own specialist workforce to supply the services. You may wish to hang onto some highly skilled workers when the contract ends, rather than lose them to a client or – worse still – a competitor. You must negotiate this up front.

If you are the client, consider what you want to happen if you envisage bringing services back in-house in the medium term.

4. Offshoring

If your business involves offshoring, remember that TUPE can apply cross-border. In jurisdictions where TUPE on outsourcings applies less readily, you may still need to take on staff in the original location for knowledge onboarding in the short-to-medium term. How long might this process take, are there rules preventing terminations within a certain time and what might it cost to offshore services later? Factor in representative bodies and litigation risk. If costs are large, can you obtain indemnities from the client, or should the price of the services adjust accordingly?

5. Beware the traps

Especially with outsourcings, eagerness to do the deal can lead vendors to agree to rushed, heavily client-friendly agreements that impact the profitability of the service and take away all leverage. Points to note:

> **Workforce Control**: Clients who outsource should not expect to exercise the same amount of control over the workforce as an employer. Vendors should resist client attempts overly to restrict how they manage their staff.

> **Service Level Changes**: Vendors should be wary of contractual rights unilaterally to ramp down or cancel parts of services, especially if these rights are one-way only. Stopping services will not normally result in employees transferring out: clients may use this to ensure employment liabilities remain with the outsourcer.

> **Reasonable assistance**: Ensure clients are contractually obliged to assist with TUPE and be transparent with the facts. When switching suppliers, clients may have a vested financial interest in not having employees transfer across with the service, leaving you to deal with the problem.

> **Fair Risk Apportionment**: Ensure that the BPO contract fairly apportions the risks and liabilities between the parties.

> **Wrong Pocket Employees**: Beware employees who might not be part of the transferring group but nevertheless still transfer under TUPE. Normally, the skilful vendor gets an indemnity for these “wrong pocket” employees if they bring claims.

> **Clients and Key Employees**: It is a common problem that when a client takes the service back in-house, they attempt to solicit key employees of the vendor. Ensure you have adequate protection.

> **Poor Performers**: Clients or outgoing vendors often use the service transfer as an opportunity to move poor performers or those with long service. Ensure you do proper due diligence on the workforce and what you are getting.

> **Good Performers**: Conversely, clients or outgoing vendors often “cherry pick” and try and retain their best employees. Ensure there is adequate protection from this.

Ignore TUPE at your peril

Where TUPE applies by law, it is normally necessary to enter into a period of information and/or consultation with employee representatives prior to any transfer taking place. Failure to do this can result in penalties for either the outgoing or incoming employer, or both. In the UK, for example, this is up to 13 weeks’ salary per employee. For a workforce of 200 employees each earning £20,000 per annum, that is a cost to the company of £1 million (US $1.315 million) – not including any notice or severance costs or potential litigation (e.g. for unfair dismissal).

If the transfer results in large redundancies and the employer (as determined by TUPE rules) fails to notify the UK government sufficiently beforehand, similar entitlements to awards per employee are triggered, together with potential criminal liabilities for the company or its officers.

If TUPE is a risk or a reality, it must be dealt with no matter which side of the deal you are on.

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