Shared services, 'pre-existence' and the case of Lorenzo Amatori

JOHN McMULLEN, Wrigleys Solicitors LLP and CATERINA RUCCI, Bird & Bird, Milan

A recent European Court case concerns the rights of employees in employers' shared services arrangements and whether, and in what circumstances, their transfer to a third-party shared services vehicle is protected by the EU Acquired Rights Directive 2001/23 and hence the Transfer of Undertakings (Protection of Employment) Regulations 2006.

Shared services: the commercial background

In the UK, the appetite for shared services in the public sector is relatively longstanding. There are many examples of regional and national services procurement arrangements. Many of these do not involve a transfer of employees or change of employer. However, certain joint ventures or collaboration models may result in the creation of a third-party vehicle to carry out the shared services previously performed by the operating company. In such a case the question of whether there is a TUPE transfer arises.

The appetite for shared services in the UK, particularly in the public, education and third sectors, is likely to continue with the creation of VAT exemption for cost-sharing groups. The Finance Act 2012 introduced a new group 16, schedule 9 of the VAT Act 1994. The new exemption applies where two or more organisations (whether businesses or otherwise), with exempt and/or non-business activities, join together on a co-operative basis to form a separate independent entity, a cost-sharing group (CSG), to supply themselves with services at cost and exempt from VAT.

The exemption applies to suppliers of certain qualifying services that are made by the representative members of the CSG to other members of the CSG. These suppliers must be 'directly necessary' for the exempt and/or non-business supplies made by the individual qualifying member. The above summary relies on HMRC Revenue & Customs Brief 23/12.

There has been considerable take-up of this opportunity, especially in the UK further education sector. Having regard to these commercial developments, a legal decision in the area of shared services, especially from the European Court, is of both interest and importance.

Amatori: the facts

The question for the European Court in *Amatori* was whether, on the creation of a shared services vehicle by an operating company, employees working in the services concerned automatically transferred to the shared services company even where:

- the part of the business transferred was not a functionally independent economic entity already existing before the transfer and identifiable as such by the transferor and the transferee at the time when it was transferred (an issue of particular relevance in Italian law); and
- after the transfer, the transferor undertaking wielded 'in-depth and supreme' control over the transferee, a relationship which manifested itself through a 'tight commercial bond' and the 'commingling of business risk'.

In this case, Lorenzo Amatori worked for a part of Telecom Italia in IT operations. In 2010 Telecom Italia spun off the operational and support activities relating to its business, subsequently transferring it to Shared Services Center, a subsidiary of Telecom Italia.

Following the transfer, the employees, including Lorenzo Amatori, continued to perform services for Telecom Italia. Shared Services Center was also subsidised by Telecom Italia and not required to make a profit in the first instance (though subsequently it began to offer its services to third parties). Amatori and others objected to the transfer of their employment and contended that the Italian Civil Code was wrong to allow a transfer of their employment on two grounds. First, they said, there could not be said to have been a functionally autonomous economic entity before

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the transfer. Secondly, the shared services operation was under the control of Telecom Italia and subsidised by it. As such, they argued, this could not amount to a transfer of an undertaking and they could not be transferred without their consent.

The 'pre-existence' point

The court ruled that if the entity transferred did not have sufficient functional autonomy before the transfer, the transfer would *not* be covered by Directive 2001/23. However, there was nothing to prevent member states from providing for the safeguarding of employees' rights in that situation, as did the Italian Civil Code.

Italian law

Italian law on employees' rights on transfers of undertakings is contained in s.2112 of the Italian Civil Code. A legislative decree 18 of 2001 amended the provisions so as to require the 'pre-existence' of the part of the business to be transferred as a condition for a transfer. The 'pre-existence' principle had already been applied in the *Ansaldo* cases decided by the Corte Di Cassazione.

The *Ansaldo* cases appear to post-date the 2001 legislative decree but in fact the litigation had commenced some time before 2001. The outcome of the *Ansaldo* litigation, which the 2001 decree codified, was a policy decision designed to prevent the practice of 'misuse' of business transfers whereby employers could, without there being a genuinely pre-existing autonomous entity, unilaterally transfer out groups of employees to smaller companies in order to exempt the employer from the consultation rules on mass redundancies and certain other remedies (such as reinstatement) for termination of the employment contract.

However, since 24 October 2003, the Italian legislative decree 276 of 2003 abrogated the requirement of 'pre-existence' or, at least, allowed transfers of 'part of a business' so defined by transferor and transferee and which did not exist as such before, by putting together different activities (for example, business-wide functions) which did not constitute an autonomous entity beforehand and to transfer the concerned employees and assets under s.2112 (ie without the need for the employees' consent).

The amendments made to the Italian Civil Code by legislative decree 276 of 2003 are not consistent with the European Court's views in *Amatori*. But the European Court in *Amatori* considered that Italian law could provide differently and that a transfer under Italian law was possible even if there were no 'pre-existence' of the entity or part being transferred.

UK law

In contrast, in UK law, a definable organised grouping of resources is required before a TUPE transfer can occur. In that respect the TUPE regulations are to be interpreted consistently with *Amatori*. For a business transfer (reg 3(1)(a) of TUPE) there must be a transfer of an economic entity that retains its identity. By reg 3(2) 'economic entity' means an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary. European Court jurisprudence also establishes that that economic entity must be 'stable' (see *Rygaard*; for example, the Directive does not apply to an activity limited to the performance of one specific works contract (applied in the UK

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'the degree of control exercised by a client, customer or user company over the shared services company will not prevent the transfer of an undertaking'

in *Mackie*; see the comments of Mummery LJ in *Ward Abbotts* concerning the transfer of 'part' of an undertaking that was partitioned only for the purposes of the transfer, but into two discrete identifiable parts)).

And finally, for a service provision change under reg 3(1(b) of TUPE (service provision change) it is a requirement that immediately before the transfer for such change there is an organised grouping of employees which has, as its principal purpose, the carrying out of the activities concerned on behalf of the client (reg 3(3)(a)(i)). (Incidentally Italian law differs radically from UK law in this regard, since service provision changes are specifically *excluded* from the application of Italian business transfer legislation by sect 29, subs 3, of legislative decree 276 of 2003).

The UK rules for a TUPE transfer therefore meet, we suggest, the condition of prior functional autonomy laid down by the CJEU in *Amatori*.

The control and support point

Secondly, case law of the European Court (*Allen & ors*) has provided that a transfer of an undertaking can take place between two subsidiary companies in the same group and the fact that the companies share not only the same ownership but also the same management and the same premises and that they are engaged in the same works makes no difference in that regard. To develop that idea, a situation such as that based on the facts in *Amatori*, in which the transferor undertaking exercises extensive overriding powers over the transferee, which manifests itself through a tight commercial bond and the commingling of business risk, cannot, of itself, said the Court in *Amatori*, prevent the application of the Acquired Rights Directive.

This is not a new development. It is simply a teleological development of the rule in *Rask and Christensen* where the court held that, in relation to the outsourcing by a company of the management of its canteen facility to a private contractor, it was immaterial that there was a degree of control retained by the customer over the service to be provided by the service provider. Thus 'the fact that the agreement between the transferor and transferee relates to the provision of services provided exclusively for the benefit of the transferor in return for a fee, the form of which is fixed by the agreement, does not prevent the [Acquired Rights] Directive from applying'.

For a UK authority applying this for the purposes of TUPE, we may take, by way of example, *Birch*. There Mummery J (as he then was) stated: 'There may be a transfer for the purposes of [TUPE] even though [the transferor] retained "a very considerable degree of control" … In fact, the degree of control confirms the transfer by emphasising the retention of the identity of the management part of the undertaking in different hands.'

Conclusion

As the majority of services transferred into a shared services company will be discrete and identifiable such as HR, payroll, procurement and so forth, there is likely, in such cases, to be a TUPE transfer either under reg 3(1)(b) or 3(1)(a) of TUPE. And the degree of control exercised by a client, customer or user company (even if powerful) over the shared services company will not prevent the transfer of an undertaking. This gives welcome protection to employees on the transfer of their employment. Conversely, an employee, such as Lorenzo Amatori, who would rather stay in the apparently more secure environment of a parent company, may not be so content.

KEY:

Amatori	*Amatori & ors v Telecom Italia SpA Shared Service Center Srl* Case C-458/12
Ansaldo	*Corte Di Cassazione (cass.25 October 2002, No.15105; cass.*4 December 2002, No.17207)
Rygaard	*Rygaard v Strø Mølle Akustik a/s Case C-48/94;* [1996] IRLR 51
Mackie	*Mackie v Aberdeen City Council* EATS/095/04
Ward Abbotts	*Ward Abbotts Ltd v Botes Building Ltd* [2004] EWCA Civ 83
Allen	*Allen 7 ors v Amalgamated Construction Co Ltd* Case C-234/98 [1999]
Rask and Christensen	*Rask and Christensen v ISS Kantineservice A/S* [1993] IRLR 133
Birch	*Birch v Sports and Leisure Management Ltd* [1995] IRLR 518 (EAT)