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Insights

REDUNDANCY OR WORKFORCE REPLACEMENT? THE HIDDEN TRAP IN THE ERA THAT COULD CATCH EVERY RESTRUCTURE

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Summary

The fire and rehire provisions in the Employment Rights Act have had less focus than some of the more headline grabbing changes. However, they do represent a big change for employers. Getting even less attention, tucked alongside the key provisions on varying terms is a further reform, a provision that creates a separate category of automatically unfair dismissal where an employer dismisses an employee in order to have their work done by a non-employee. It is aimed at preventing employers from dressing up workforce replacement as redundancy. But is the ambit of this provision wider than intended?

What is proposed?

From January 2027, section 104K of the Employment Rights Act will make a dismissal automatically unfair if the reason, or principal reason, is that the employer wants the dismissed employee's work to be carried out by a person who is not an employee. That covers contractors, consultants, agency workers and anyone else engaged outside a contract of employment. No qualifying service is required, compensation is uncapped, and the employer bears the burden of proving the dismissal was for a different reason.

On the surface, this sits neatly alongside existing redundancy law. Currently, a redundancy arises where the requirement for employees to carry out work of a particular kind has ceased or diminished. If the volume of work has genuinely reduced and roles are no longer needed, a redundancy dismissal remains potentially fair. Section 104K does not change that.

Where it gets difficult

The problem arises where the work itself has not reduced but the employer wants it done differently. If a business dismisses employees and engages contractors to carry out the same activity to save costs, that is not a redundancy. Previously, we may have treated it as fair for some other substantial reason, now it is a workforce replacement, and section 104K makes it automatically unfair. This is true even if the restructure is commercially sensible, even if it saves cost, and even if the employer follows a reasonable redundancy process.

The grey areas will be where the real disputes arise. Consider a business that automates part of a process, reducing headcount but engaging contractors to manage the new technology. Or a restructure that consolidates two teams into one and fills the gaps with agency workers. In each case, the employer may argue the need for employees to do that work has genuinely diminished. But a tribunal applying section 104K will ask a different question: was the real reason for the dismissal to have the work done by someone who is not an employee? If the answer is yes, the dismissal will be automatically unfair, regardless of the commercial rationale.

There are further uncertainties. Section 104K focuses on replacing an employee with a person who is not an employee, but it requires the replacement non-employee to provide services pursuant to a contract to which the employer is a party. It therefore appears possible to circumvent the new provisions by entering into new arrangements via a group company structure. However this is unclear.

There is also a question mark over how section 104K, and indeed the fire and rehire provisions in general, operate alongside TUPE. Where a restructure involves a service provision change, employees transfer automatically under TUPE, and any dismissal connected to the transfer is already subject to its own fairness regime. How section 104K interacts with those protections, and whether a dismissal can be automatically unfair under both regimes simultaneously, has not been addressed in the legislation and will likely need to be resolved by the tribunals.

What should employers do?

Employers planning any restructure that involves replacing employees with non-employees should take steps now:

- document the genuine business reason for each dismissal separately from any decision to engage contractors, so the two are clearly distinct;
- ensure any redundancy can be justified under on its own terms, with evidence that the requirement for employees to do the work has actually reduced;
- avoid sequencing that links dismissals directly to contractor appointments, since a tribunal will look closely at timing;
- take advice before any restructure that involves outsourcing, insourcing technology or replacing permanent roles with flexible resource, as the line between a fair redundancy and an automatically unfair dismissal under section 104K may be finer than it appears.

Section 104K has not attracted the same attention as the fire and rehire reforms, but for employers planning workforce restructures it may prove just as significant. With no compensation cap and no qualifying service requirement, the cost of a misstep is severe. The safest course is to assume the provision has teeth and plan accordingly.

For further information, please get in touch with your usual BCLP employment contact.

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