SUMMARY

2014/37 Transfer despite insolvency (NL)

<p>The owner of three companies purposely caused them become insolvent^[1]. Before doing so, he incorporated three new companies. Immediately following the insolvencies, those new companies took over the activities that the insolvent companies had previously performed and took over almost all of the employees. The owner relied on the provision of Dutch law according to which the transfer of activities from an insolvent employer is not subject to the rules on transfers of undertakings. He counted on the new companies not having to pay the employees their salaries and other benefits that the insolvent companies had left unpaid. However, the court described the combination of events as a transfer of the undertakings and ordered the new companies to pay the salary arrears.</p>

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ordered the new companies to pay the salary arrears.

Facts

The defendants in this case were three limited liability companies: Jan de Roos Transport B.V., Jan de Roos Montage B.V. and Jan de Roos Verhuur Lemmer B.V. (the 'old companies'). The old companies, as well as several other companies, formed part of one group of legal entities ultimately controlled by Mr Jan de Roos. This group was organised in such a way that one of the companies (the 'owner company') - which was not one of the old companies - held legal title to all of the group's operational assets, including equipment, and entered into contracts with customers. It then subcontracted the work to other companies including the old companies and leased the necessary assets to them. The old companies owned no assets themselves.

The plaintiffs were 20 employees of the old companies.

On 23 May 2014, Mr Jan de Roos made an appointment with a civil law notary (notaris) to incorporate three new limited liability companies: Jan de Roos Transport Lemmer B.V., Jan de Roos Montage Lemmer B.V. and Jan de Roos Verhuur B.V. (the 'new companies'). The new companies were legally incorporated on 27 May. That same day, by order of the court and at their own request, the old companies went into liquidation (*faillissement*), i.e. became insolvent, and the court appointed a receiver (*curator*).

The new companies offered employment to 19 out of the 20 employees. They accepted the offer. One of the 19 was offered employment for 16 hours per week whereas she had previously worked 24 hours per week. The remaining 18 employees were offered the same terms of employment as they had when employed by the old employers. The one employee who was not offered employment by one of the new companies was dismissed by the receiver.

The owner company stopped subcontracting the work for its customers to the old companies and subcontracted that work to the new companies. Thus, from the perspective of both the customers and 18 employees, the work continued without interruption as if nothing had changed. The new companies used the same premises, equipment, website, telephone numbers and permits that the old companies had used.

The receiver refused to dismiss the 19 employees who had crossed over to the new companies, taking the position that there had been a transfer and that, therefore, the 19 employees had become employees of the new companies. The Employment Board (*UWV*), which for The Netherlands is the guarantee institution as provided in Directive 2008/94, refused to pay the

plaintiffs the salary and other amounts that the old companies owed them for the period up to 27 May.

The plaintiffs brought summary proceedings against the new companies, seeking – by way of provisional order pending regular court proceedings – payment of salary and other arrears for the period up until 27 May (and, in the case of the part-time employee and the employee who was not rehired, additional relief).

Judgment

The defendants raised two defences. First, they argued that the legal basis of the claims was too complex to adjudicate in summary proceedings, which are only suitable for simple cases. The court rejected this argument. The second defence was based on the fact that Dutch law has made use of the exception provided in Article 5(1) of Directive 2001/23:

"Unless Member States provide otherwise, Articles 3 and 4 shall not apply to any transfer of an undertaking, business or part of an undertaking or business where the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of a competent public authority (which may be an insolvency practitioner authorised by a competent public authority)."

The Dutch *faillissement* proceedings fulfil these requirements. Accordingly, Article 7:666 of the Dutch Civil Code provides that the rules on transfers of undertakings do not apply in the event the transferor was insolvent at the time of the transfer.

Applying the case law of the ECJ, and specifically referencing *Spijkers* (C-24/85) and *Abler* (C-340/01), the court held that, if the old companies had not been insolvent, the circumstances (uninterrupted activities, use of same premises, equipment, permits, etc., offers of employment, close timing of insolvencies and incorporations) were such that there would, without doubt, have been a transfer of the undertakings. The issue was whether Article 7:666 Civil Code should lead to a different outcome.

Article 7:666 Civil Code was introduced following, and as a codification of, the ECJ's 1985 ruling in the (Dutch) case of *Abels* (case 135/83). With this introduction, Parliament aimed to increase the ability of receivers to execute a 'restart' (*doorstart*) in order to maintain employment as far as possible. A *doorstart* as envisaged by the legislature is where the receiver sells an insolvent company's assets to a third party and the third party, with or without the insolvent company's personnel, continues the business. After the ECJ had ruled in *Abels*, the case returned to the Dutch Supreme Court, which applied the ruling to the case. Based on the

Supreme Court's post-ECJ ruling in *Abels*, the court in the present case held that the insolvency exception contained in Article 7:666 Civil Code does not apply where the owner of a company expressly steers towards insolvency with a view to continuing business with the same assets and (most of) the same staff *without* the cooperation of the court-appointed receiver. Accordingly, the defendants were ordered (i) to pay all 20 plaintiffs all salary and other benefits that they had earned but not received up to 27 May, with 10% penalty interest and compensation for legal expenses; (ii) to continue paying the part-time employee on the basis of a 24-hour working week; and (iii) to hire the employee who had not been offered new employment, with effect from 27 May.

Commentary

The original Acquired Rights Directive 77/187 dates from 1977. It was silent on whether the directive applies in insolvency situations. That issue came before the ECJ 17 years later in the case of Abels, in which the ECJ held, briefly stated, as follows:

the directive's scope cannot be appraised solely on the basis of a textual interpretation. Its meaning must therefore be clarified in the light of the scheme of the directive, its place in the system of Community law in relation to the rules on insolvency, and its purpose (§ 11-13);
given the facts (i) that the rules on liquidation proceedings and analogous proceedings are very different in the various Member States and (ii) that insolvency law is the subject of specific rules both in the legal systems of the Member States and in the Community legal order, it may be concluded that if the directive had been intended to apply also to transfers of undertakings in the context of such proceedings, an express provision would have been included for that purpose (§ 15-17);
there is difference of opinion as to whether having the directive apply in insolvency situations would benefit workers or would do precisely the opposite; given this uncertainty, it cannot be ruled out that extending the directive's scope to insolvency situations would deteriorate the working and living conditions of workers, contrary to the objectives of the EC Treaty; "It cannot therefore be concluded that Directive No. 77/187 imposes on the Member States the obligation to extend the rules laid down therein to transfers of undertakings [...] taking place in the context of insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of the competent judicial authority" (§ 22-23);
the reasons for not applying the directive to transfers of undertakings taking place in liquidation do not exist where a company is the subject of proceedings, such as the Dutch "surséance" proceedings, taking place at an earlier stage (§ 28-29).

In *Abels* (and in the subsequent judgments in *Botzen*, case C-186/83, *Wendelboe*, case C-19/83,

and *Industriebond FNV*, case C-179/83), the ECJ made a distinction between insolvency proceedings that aim to liquidate an undertaking and those that aim to enable the undertaking to continue in business by suspending its debts and reaching a settlement with its creditors. The Acquired Rights Directive applies to the latter, not the former.

In 1998, the Acquired Rights Directive was amended, becoming Directive 98/50. This directive contained a new Article 4a, essentially codifying *Abels*. It consists of four paragraphs:

"Unless Member States provide otherwise, Articles 3 and 4 shall not apply to any transfer of an undertaking […] where the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of a competent public authority (which may be an insolvency practitioner authorised by a competent public authority)."
This section allows Member States in certain situations and under certain conditions to (a) provide that the transferor's debts do not go across to the transferee and/or (b) provide that the employee's terms of employment may be amended.
This section allows Italy even further derogation on behalf of transferors "in a situation of serious economic crisis".
"Member States shall take appropriate measures with a view to preventing misuse of insolvency proceedings in such a way as to deprive employees of the rights provided for in this Directive."

Article 4a of Directive 98/50 became Article 5 of the present Directive 2001/23.

Dutch law makes it difficult, time consuming and/or expensive to dismiss staff for reasons of performance or for other than strict business reasons. Dismissing employees who are redundant for business reasons is, as a rule, less difficult, but such dismissals must follow a principle known as "mirroring", which is an age-adjusted variation of the well-known "seniority" or "last in first out" principle. The effect of the mirroring principle is often that the employer is obliged to retain employees whom it would have preferred to shed and to dismiss employees whom it wanted to retain. This is one reason - but by no means the only reason - why some employers resort to "restart" (*doorstart*) tactics.

The *doorstart* process works as follows (1) the employer files for receivership, (2) the employer is declared insolvent and the court appoints a receiver (*curator*); (3) the receiver - who is not bound by most of the rules on dismissal - dismisses all or most of the staff and then (4) proceeds to sell the business to another legal entity, frequently owned by the same person(s) or entity that owned the business before it went into receivership (in UK jargon: a

"phoenix company").

Filing for receivership, which is the classical way initiating the restart process, is wasteful. The receiver is not appointed until the court declares a company insolvent. The receiver does not know of his appointment until he receives notice from the court. He lacks knowledge of the company and needs to spend time investigating the company before being able to make decisions on whether to close down the business or to look for potential buyers, whom to dismiss, etc. Meanwhile, customers are lost, deliveries cease, creditors repossess goods, etc.

The solution to overcome these drawbacks is simple. It is known as "pre-pack". In a pre-pack scenario, a company contemplating a restart ('Oldco') arranges with the court (informally) for the selection of a person (the 'future receiver') who will become the receiver once the company has been declared insolvent. Contracts are prepared between the receiver (acting on behalf of Oldco, the future insolvent company) and the company that will be taking over the business (usually a company incorporated for that purpose) ('Newco') and it is decided which of Oldco's employees are to be (re-)hired by the transferee. Once all the documents are ready to sign, the company in question files for insolvency. The court declares the company insolvent and appoints the previously selected individual, who now becomes the receiver. One minute later the receiver and Newco sign the contracts and the receiver dismisses the entire staff. Newco hires those former employees whom it had previously picked as being desirable employees (more often than not, the young, healthy and cheapest staff). The net effect is that Newco (essentially the same company as before, merely a different legal entity) continues in business without interruption, now with only those staff that it wished to retain, and in many cases without a works council or with a new, more amenable works council.

The first time a pre-pack construction was used in The Netherlands was, to my knowledge, in 2011. It is said that the construction was imported from the UK, where pre-packs have been in common use for many years.[2] Since 2011, pre-packs have become increasingly popular in The Netherlands. In 2013, the government announced that it was preparing legislation that will regulate the use of pre-packs.

Not surprisingly, the unions as well as some politicians and scholars are up in arms. One of the many arguments they advance against pre-packs is that the "mirroring" method of selecting redundant employees is not used, thus opening the door to arbitrary redundancy selection. In their resistance to the spread of pre-packs, the unions are now arguing that a transaction between a pre-pack receiver and a Newco qualifies as a transfer of an undertaking within the meaning of Directive 2001/23 and the Dutch implementing legislation. I see two lines of argument that could support such a stance:

a. although the documents selling the business are not executed (signed) until after the court has declared the transferor to be insolvent, the actual agreement is entered into - verbally, at least - before that time, so the exception under Article 5 of the Directive does not apply;

b. the insolvency is not really an insolvency, in that its purpose is not to liquidate the business but to enable the business to continue. It is in fact, if not in theory, more like a "surséance" procedure (i.e. a debt moratorium designed to enable continuation of the business).

Technically, argument a. is not strong because, even supposing it can be argued that the actual agreement to sell the business was entered into before the court order had been delivered, that agreement was conditional and does not come into effect until the condition precedent - the court order - has been satisfied. However, in practice the condition is usually no more than theoretical. This is particularly the case where the new owner is none other than the old owner in the form of a new legal entity. As the UK Insolvency Service noted[3], "Pre-packs have attracted criticism because it can appear that an insolvent company has reformed without any redress to its creditors - a concept known commonly as 'phoenixism'".

Argument b. is based on the distinction in Dutch law between - on the one hand - insolvency (*faillissement*), which is designed with liquidation of the assets on behalf of the creditors in mind and - on the other hand - debt moratorium (*surséance*), which is designed with continuation of the business and an arrangement with the creditors in mind. In practice, however, this distinction is not a bright line one. Receivers frequently sell a business rather than liquidating its assets, and debt moratoria more often than not evolve into insolvency.

As Professor Catherine Barnard (EU Employment Law, 4th edition (2012), page 621) notes, the distinction drawn by the ECJ between insolvency and pre-insolvency proceedings may be based on a false premise. Professor Barnard analyses four ECJ judgments with a view to determining "on which side of the line the national rules fall": *d'Urso* (C-362/89), *Spano* (C-472/93), *Dethier* (C-319/94) and *Europièces* (C-399/96), but she does not provide an answer.

The UK Court of Appeal has tried to find the answer. Reference is made to its eminently readable judgment in *Key2Law (Surrey) LLP - v - Gaynor De' Antiquis* [2011] EWCA Civ 1367 delivered on 20 December 2011, in which it analysed the distinction between, on the one hand, "bankruptcy proceedings or any analogous insolvency proceedings ...." within the meaning of Article 5(1) of Directive 2001/23 and, on the other hand, other types of insolvency proceedings. The case involved a law firm "DK" that became the subject of an "administration order" under the British Insolvency Act (as amended in 2003). The court appointed two administrators,

who proceeded to liquidate the law firm and to sell its assets, by entering into a "management agreement" with another law firm (Key2), under which Key 2 was to collect DK's unbilled work in progress on behalf of the administrators in consideration of commission equal to 25% or 50% of the sums collected. A few days before going into administration, DK dismissed one of its solicitors, Ms De' Antiquis. She claimed that the agreement between (the administrators acting on behalf of) DK and Key2 qualified as a transfer of the undertaking within the meaning of the UK legislation transposing Directive 2001/23 ('TUPE') and that, therefore, Key2 was liable to her under various heads, including unfair dismissal and sex discrimination.

Key2 based its defence on Regulation 8(7) of TUPE which (almost literally repeating the wording of Article 5 of Directive 2001/23) provides:

"Regulations 4 and 7 do not apply to any relevant transfer where the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of an insolvency practitioner."

The central issue in the case was whether the proceedings that led to DK going into administration qualified as "analogous insolvency proceedings" within the meaning of Regulation 8(7) of TUPE and, hence, Article 5 of Directive 2001/23. In view of the ECJ's rulings in *Abels, D'Urso, Spano, Dethier* and *Europièces*, this issue boiled down to determining the purpose of the administration order.

Paragraph 3(1) of Schedule B1 to the UK Insolvency Act provides:

"The administrator of a company must perform his functions with the objective of:

(a) rescuing the company as a going concern, or

(b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or

(c) realising property in order to make a distribution to one or more secured or preferential creditors."

Paragraphs 3(3) and 3(4) add that the administrator may only perform his functions with objective (b) if objective (a) cannot be achieved or if objective (b) would achieve a better result for the company's creditors, and he may only perform his functions with objective (c) if objectives (a) and (b) cannot be achieved. In other words, there is a hierarchy: first (a), then - if (a) is not the best option - (b) and finally - if neither (a) nor (b) are achievable - (c).

In the case at hand, DK argued that it was clear from the outset that objective (a) was not realistic. It was hoped that the administrator would be able to sell the law firm (= objective b), but as it turned out, this proved impossible and, instead, the law firm was liquidated (= objective c). Therefore, in DK's view, the proceedings that led to the administrative order were "instituted with a view to the liquidation" of its assets and, hence, the exemption under Regulation 8(7) of TUPE applied.

It is worth reading the Court of Appeals' entire judgment, which can be accessed on www.bailii.org/ew/cases/EWCA/Civ/2011/1567. In brief, the court rejected DK's argument, finding it :

"unsatisfactory in principle that the determination of whether or not administration proceedings are, in any particular case, to be characterised as 'analogous insolvency proceedings' should depend on the evidence leading up to the making of the appointment of administrators. That is because an inquiry of that nature may well produce an uncertain picture as to the objective, or the predominant objective, intended to be achieved by any appointment …"

Secondly, the court regarded

"it as in principle anyway wrong to identify the purpose of an appointment of administrators by reference to pre-appointment considerations as to the particular objective or objectives that it is foreseen that an appointment is reasonably likely to achieve."

Back to The Netherlands. There have been several pre-pack cases recently that have caught the attention of the media and Parliament. The most publicised of these is the Estro case, where hundreds of child care centres were transferred to a phoenix company and thousands of employees were involved. The case is controversial and is sure to influence the coming debate on a Bill that the government plans to introduce into Parliament modernising the Insolvency Act. The government aims to codify the currently informal pre-pack practice.

Comments from other jurisdictions

Germany (Paul Schreiner): German law is different from the legal situation in the Netherlands and the UK. A transfer of undertaking can also happen in insolvency situations. There is no exclusion in section 613a of the German Civil Code regarding a transferor that is in insolvency procedures.

German case law merely modifies certain of the consequences of a transfer of undertaking where the transferor is insolvent, in that the transferee does not have to take over the transferor's obligations in respect of the employment relationships, in particular, the

obligations relating to employee pensions. Generally, only the obligations that accumulated after the transfer must be borne by the transferee.

However, in one respect, there is scope for activity that is similar to pre-pack. Buyers of companies in insolvency procedures often think they have found ways to run the business more efficiently and profitably, but this usually requires restructuring the business. The insolvency administrator is permitted to restructure the business in accordance with the buyer's plans. The measures taken will follow the rules of the insolvency procedure, meaning that termination periods can be shorter than usual and collective agreements can be terminated or concluded in a timely way. In this way, the buyer is able to shape the entity it buys and this is analogous to a pre-pack situation.

Slovakia (Beáta Kartiková): The Slovak legislator transposed Article 5 of Directive 2001/23 into the Slovak Labour Code as follows: "The provisions on the transfer of rights and obligations from employment relationships shall not apply to an employer which has been declared insolvent by a court." This means that the provisions on transfer apply only to restructuring and not to insolvency.

Further, the Slovak Act on Insolvency provides that: "When an insolvency trustee sells an insolvent enterprise, he shall transfer to the buyer all material assets, rights and other assets belonging to the enterprise. Liabilities related to enterprise shall transfer to the buyer only to the extent of liabilities incurred in connection with the operation of the enterprise following the court declaration of the insolvency, and non-monetary employment liabilities shall transfer only to the extent specified in the contract on the sale of enterprise." This wording makes clear that the buyer and the insolvency trustee may agree on which employees the buyer will take over and that only those employment contracts that are specified in the contract transfer.

We are not aware of any cases where insolvency has been used to allow for the transfer of a business without the transferee having to take over all of the staff. The insolvency process in Slovakia can take a long time and in our opinion it is unattractive for undertakings to go through it simply to acquire the business without all of its employees.

An alternative to insolvency proceedings is to transfer part of an enterprise. In other words, if a buyer wishes to buy a business, the parties may decide on sale of part of it on condition that this part creates a separate organisational and economic unit. In such cases, only the employees belonging to the transferred part will transfer. In addition, according to the Slovak Labour Code (transposition of Article 4(1) and (2) of Directive 2001/23), if the working conditions of an employee will undergo significant detrimental change as a result of a transfer

and if the employee does not agree to the change, his or her employment will be deemed terminated by agreement for organisational reasons as of the date of transfer.

Subject: Transfer of undertakings - insolvency

Parties: 20 employees – v – Jan de Roos Transport Lemmer B.V. and others

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