SUMMARY

# ECJ 22 June 2017, case C-126/16 (Smallsteps), Transfer of undertakings

***<p>A 'pre-pack' agreement is outside the scope of Article 5 of the Acquired Rights Directive. In this situation, the protection of workers guaranteed by Articles 3 and 4 of that directive is maintained.</p>***

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**Facts**

Estro Groep BV, which consisted of several companies, was the largest day care provider in The Netherlands. It had 380 day care centres employing a total of 3,600 employees. Smallsteps was incorporated on 20 June 2015 with a view to taking over part of Estro's business. Its main shareholders and financial backers were the private equity companies KKR and Bayside. Its management was partly the same as that of Estro. Following the latter's receivership on 5 July 2015, Smallsteps took over 251 day care centres and about 2,600 of Estro's former employees but in the end over a thousand employees were dismissed.

**National proceedings**

A trade union, the FNV, and the four joint applicants, who worked in childcare centres taken over by Smallsteps, but were not offered new contracts of employment after the insolvency of Estro Groep, brought an action before the referring court. In that action, they primarily sought a declaration that Directive 2001/23 applied to the 'pre-pack' concluded between Estro Groep and Smallsteps and that, therefore, those four joint applicants must be regarded as henceforth working for Smallsteps, as of right, while retaining their conditions of employment. In the

alternative, they sought a declaration that Article 7:662 et seq. of the Dutch Civil Code still applied, given that the transfer took place before the date of the insolvency of Estro Groep. Smallsteps contested the merits of the applicants' claims. The Rechtbank Midden-Nederland (District Court, Central Netherlands) decided to stay the proceedings and refer questions to the ECJ for a preliminary ruling.

For the case report on this decision, see EELC 2016/1 (Peter Vas Nunes, "2016/1 Do the rules on transfer of undertaking apply in a 'pre-pack' insolvency? A Dutch court asks the ECJ for guidance (NL)", European Employment Law Cases, 1, (2016): 4-8).

**Questions put to the ECJ**

(1) Is the Netherlands insolvency procedure, in the event of an assignment of the insolvent undertaking in a situation where the insolvency is preceded by a judicially monitored 'pre-pack' procedure which is expressly aimed at securing the survival of (parts of) the undertaking, compatible with the objective and purpose of Acquired Rights Directive 2001/23 (ARD), and is Article 7:666(1)(a) of the Dutch Civil Code, in that light, (still) in conformity with the directive?

(2) Does the ARD apply in a case where the 'prospective insolvency administrator' appointed by the Rechtbank acquaints himself, before commencement of the insolvency procedure, with the situation of the debtor and investigates the chances of a restructuring of the activities of the undertaking by a third party, and also prepares for acts which must be carried out shortly after the insolvency in order to enable the restructuring to take place by means of an asset transaction through which the undertaking of the debtor, or part thereof, will be transferred at the date of the insolvency or shortly thereafter, and those activities, in their totality or in part, are continued (virtually) without interruption?

(3) Does it make any difference in this regard whether the continuation of the undertaking is the primary objective of the pre-pack, or whether the (prospective) insolvency administrator's primary objective with the pre-pack and the sale of the assets in the form of a going concern immediately after the insolvency is to maximise the proceeds for all of the creditors, or that, in the context of the pre-pack, consensus on the transfer of assets (continuation of the undertaking) is achieved before the insolvency and its implementation is formalised and/or effected after the insolvency? And how should the matter be viewed if it is sought to secure both the continuation of the undertaking and the maximisation of proceeds?

(4) In the context of a pre-pack preceding the insolvency of the undertaking, is the date of the transfer of the undertaking for purposes of the applicability of the ARD and of Article 7:662 et seq. of the Dutch Civil Code arising from it, determined by the consensus on the transfer of the

undertaking achieved before the insolvency, or is that date determined by the point in time at which responsibility as employer for carrying on the business of the unit shifts from the transferor to the transferee?

**ECJ's findings**

The ECJ followed the opinion of Advocate General Mengozzi of 29 March 2017.

First, the ECJ pointed out that the ARD seeks to protect employees by ensuring their rights are safeguarded in the event of a change of employer. By way of derogation, Article 5(1) of the ARD states that the protection referred to in Articles 3 and 4 does not apply to transfers of undertakings carried out in the circumstances specified within that provision. However, these derogations should be interpreted narrowly.It is a requirement of Article 5(1) of the ARD that the transferor be the subject of bankruptcy proceedings or analogous insolvency proceedings. Further, those proceedings must have been instituted with a view to the liquidation of the assets of the transferor and be under the supervision of a competent public authority. This condition may not extend to a process which prepares for insolvency proceedings but does not result in a declaration of insolvency. In the case at hand, although the 'pre-pack' procedure was prepared before the declaration of insolvency, it was only put into effect after the declaration and may therefore be covered by the concept of 'bankruptcy proceedings or any analogous insolvency proceedings', within the meaning of Article 5(1) of the ARD.

In the second place, Article 5(1) of the ARD requires the bankruptcy proceedings or any analogous insolvency proceedings to be instituted with a view to liquidation of the assets of the transferor. A procedure aimed at ensuring the continuation of the undertaking in question therefore does not satisfy that requirement. In relation to the differences between those two types of procedure, a procedure is aimed at ensuring the continuation of the undertaking if it is designed to preserve the operational character of the undertaking or of its viable units. By contrast, a procedure focusing on the liquidation of assets is aimed at maximising satisfaction of creditors' collective claims. Although there may be some overlap between those two objectives, the primary objective of a procedure aimed at ensuring the continuation of the undertaking is the safeguarding of that undertaking.

It is apparent in this case that the 'pre-pack' concerned was aimed at preparing the transfer of the business to enable a swift relaunch of the viable units once the insolvency has been declared. This would avoid the disruption that would be caused by an abrupt stoppage of activities on the day of the declaration of insolvency and would safeguard the value of the business and jobs within it. In those circumstances, the procedure was clearly not aimed at liquidation and the economic and social objectives pursued did not justify the employees

losing the rights conferred under the ARD when the business was transferred. The mere fact that the 'pre-pack' procedure may also be aimed at maximising satisfaction of creditors' claims does not make this a procedure instituted with a view to the liquidation of the assets of the transferor within the meaning of Article 5(1) of the ARD.

As regards the condition that the procedure referred to in Article 5(1) of the ARD must be under the supervision of a public authority, in this case, the pre-pack procedure preceded the declaration of insolvency and was not carried out under the supervision of a court. Rather, it was managed by the business itself. The prospective insolvency administrator and the prospective supervisory judge in fact, had no formal powers and accordingly, the business was not supervised by a public authority.

In addition, very soon after the opening of the insolvency proceedings, the insolvency administrator received authorisation from the supervisory judge for the transfer, which meant that the judge must have been informed of the transaction before the declaration of insolvency. Such an approach does not satisfy the condition for supervision by such a public authority required under Article 5(1) of the ARD.

It follows from the above that a pre-pack procedure such as that at issue in the main proceedings does not satisfy all the conditions laid down in Article 5(1) of Directive 2001/23 and, accordingly, there can be no derogation from the protection scheme laid down in Articles 3 and 4 of that directive.

**Ruling**

The ARD, and in particular Article 5(1) thereof, must be interpreted as meaning that the protection of workers guaranteed by Articles 3 and 4 of that directive applies in a situation, such as that at issue in the main proceedings, in which the transfer of an undertaking takes place following a declaration of insolvency and in the context of a 'pre-pack' where that 'pre-pack' is prepared before the declaration of insolvency and put into effect immediately after that declaration, and, in particular, a court-appointed prospective insolvency administrator investigates the possibilities for continuation of the activities of that undertaking by a third party and prepares for acts which must be carried out shortly after the insolvency to enable such continuation. Moreover, it is irrelevant in that regard that the pre-pack is also aimed at maximising the proceeds of the transfer for the creditors of the undertaking in question.

**Commentary on the case**

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The Smallsteps case will have serious consequences for legal practice in the Netherlands. Until the verdict of the ECJ, insolvency practitioners relied on the text of Article 7:666 of the Dutch Civil Code, which states that none of the provisions in relation to transfers of undertakings – except the obligation to inform staff – apply if the undertaking to be transferred has been declared insolvent. Legal practice had always relied on the verdict in the Abels Case (1985) in which the Court stated that the transfer of an insolvent undertaking does not constitute the transfer of an undertaking under EU law unless it is subject to a rescue operation (under Dutch law: surséance van betaling). The problem has been, however, that Dutch insolvency proceedings (faillissement) have always been used with the dual purpose of both liquidating and rescuing businesses. Labour lawyers have been warning for years that using insolvency law to save a business could constitute the transfer of an undertaking within the meaning of Directive 2001/23. Their concerns fell on deaf ears recently again, when the Ministry of Justice drafted a bill to give the pre-pack a legal basis (Wet continuïteit ondernemingen I). This bill will now have to be seriously reconsidered.

The Dutch pre-pack procedure is, therefore, the end of a Chronicle of a Death Foretold: the Court has judged, unequivocally, that whenever insolvency proceedings – regardless of their name or original purpose – are used with an eye to rescuing a business, the Directive applies. In practice, it will be hard, in non-pre-pack cases, to decide whether the undertaking is being sold with the aim of saving it or just as a by-product of its liquidation (in which case, the Directive would not apply).

The result of the Smallsteps case is even more frustrating for Dutch practice, because the Dutch legislator failed to make use of the possibilities offered by Article 5(2) of the Directive – not to transfer the debts of the transferor and/or to agree alterations to the employees' terms and conditions of employment. In order to avoid the current all-or-nothing result, it would be wise for the legislator to save the good parts of the pre-pack procedure by implementing Article 5 of the Directive properly and making the most of it.

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**Creator**: European Court of Justice (ECJ)
**Verdict at**: 2017-06-22
**Case number**: C-126/16 (Smallsteps)