SUMMARY

2016/1 Do the rules on transfer of undertaking apply in a 'pre-pack' insolvency? A Dutch court asks the ECJ for guidance (NL)

<p>A day care provider, Estro Groep B.V., ('Estro') went into pre-arranged ('pre-pack') receivership. Immediately afterwards, a large part of its business was taken over by another day care provider, Smallsteps B.V. ('Smallsteps'). The latter did not offer employment to all of Estro's employees, taking the position that the takeover did not constitute the transfer of an undertaking. This position was based on the fact that Estro was in receivership at the time of the takeover. According to the Dutch law transposing the Acquired Rights Directive, such takeovers are exempted from the rules on transfers of undertakings. A union and five of the employees whom Smallsteps had not offered jobs, relying on the wording of Article 5(1) of the Directive ("insolvency proceedings which have been instituted with a view to the liquidation of the assets"), claimed that they had become Smallsteps employees. The court referred questions to the ECJ for a preliminary ruling.</p>

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undertaking. This position was based on the fact that Estro was in receivership at the time of the takeover. According to the Dutch law transposing the Acquired Rights Directive, such takeovers are exempted from the rules on transfers of undertakings. A union and five of the employees whom Smallsteps had not offered jobs, relying on the wording of Article 5(1) of the Directive ("insolvency proceedings which have been instituted with a view to the liquidation of the assets"), claimed that they had become Smallsteps employees. The court referred questions to the ECJ for a preliminary ruling.

Background

Article 5(1) of Acquired Rights Directive 2001/23 states:

"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 [.....]".

The Netherlands have not provided otherwise within the meaning of this Article 5(1). Hence the Dutch law transposing the Acquired Rights Directive (Article 7:666(1)(a) of the Civil Code) provides that it does not apply where the transferor is in receivership. This is relevant because of the following.

Under Dutch employment law, it is frequently difficult and/or costly for an employer to terminate the employment contracts of permanent staff. An exception is where the employer is in receivership (faillissement). Where an individual has been declared bankrupt, or a court has issued a receivership order in respect of a legal entity (e.g. a company or association), the court appoints a receiver (curator), whose task it is to satisfy the debts of the business (to the extent possible), as a rule by liquidating the assets and closing down the business. The receiver operates under the supervision of a judge (rechter commissaris) who is appointed for that purpose. The receiver is not bound by the normal rules of employment law and can, and usually does, dismiss all of the employees within the business quickly, without formalities and without paying them severance compensation.

Staffing costs are an important reason why companies in The Netherlands go out of business.

The foregoing has for many years led to the use or, as some would say (and as in some instances courts have held

Where the sole reason to apply for receivership is to separate from surplus staff, the courts

may find this to constitute abuse and refuse to grant, or withdraw, the insolvency status. However, in most cases, the desire to shed staff is not the sole motive, there being real financial difficulties.

A few years ago, employers wishing to make use of insolvency proceedings in order to shed staff started to employ a method that lacks this drawback. Borrowing from the UK, where the method was invented, it is known a 'pre-pack'. The essence of a pre-pack operation is that Oldco, before applying for receivership, identifies Newco, i.e. a party willing to take over at least a major part of its business. A contract is negotiated, but not yet executed, in which Oldco and Newco spell out in detail what will happen immediately after the court has issued the receivership order. The parties ask the court to identify the individuals who will be appointed as the receiver and the rechter commissaris if and when Oldco goes into receivership (respectively, the 'proposed receiver' and the 'proposed rechter commissaris'). The receiver-to-be acquaints himself with Oldco and prepares the dismissal of its staff. Newco prepares the employment contracts of the individuals to whom it will be offering jobs as soon as Oldco has gone into receivership. Once these preparations and the paperwork have been completed, Oldco applies for receivership and literally one minute after the court has issued the receivership order, the (now) receiver dismisses the employees and Newco offers the pre-selected lucky ones new contracts (in many cases, on less favourable terms).

There is presently no legal basis for the pre-pack procedure. However, a Bill is pending in Parliament that will provide a legal basis.

For the sake of completeness, it should be noted that there is a milder form of insolvency under Dutch law, known as surseance (debt moratorium). It is not aimed at liquidation but at continuation of the business and it does not offer the above-mentioned advantages of receivership.

Facts

Estro, 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 identical to 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.

Five of the plaintiffs in this case were employees who were not offered employment by Smallsteps. The sixth plaintiff was a trade union.

The plaintiffs brought legal proceedings against Smallsteps in which they asked the court, inter alia, (i) to issue a declaratory judgment that the rules on transfers of undertakings apply to the takeover of the 251 day care centres by Smallsteps, (ii) to order Smallsteps, on pain of a penalty of € 250 per day per employee, to inform all former Estro employees that they had transferred into the employment of Smallsteps on 5 July 2015, with retention of all their existing terms of employment and (iii) to order Smallsteps to pay the employees that it did not consider as having transferred certain arrears of salary.

The plaintiffs based their request on two arguments. The first was that a pre-pack, such as the one at issue, does not meet the requirements of Article 5 (1) of The Acquired Rights Directive, given that it was not institu|ted with a view to the liquidation of Estro's assets but, on the contrary, was instituted with a view to the continuation of (part of) Estro's business. Therefore, there is no "bankruptcy" or "analogous insolvency" situation within the meaning of the Directive, and, as Dutch law is to be construed in line with the Directive, there is a transfer within the meaning of Dutch law. The plaintiffs referred to the ECJ's judgments in Abels (C-135/83), D'Urso (C-362/89), Spano (C-472/93) and Dethier (C-319/94).

In the alternative, the plaintiffs based their claim on the argument that, although technically the transfer did not occur until after Estro had gone into receivership, in reality it had taken place before that time. The plaintiffs referenced the ECJ's judgment in Celtec (C-478/03), in which the ECJ interpreted Article 3(1) of the Acquired Rights Directive "as meaning that the date of a transfer within the meaning of that provision is the date on which responsibility as employer for carrying on the business of the unit transferred from the transferor to the transferee. That date is a particular point in time which cannot be postponed to another date at the will of the transferor or transferee".

Smallsteps argued that the relevant provision of the Acquired Rights Directive is so clear, and has been so clearly interpreted by the ECJ in favour of its position, that it constitutes an acte clair within the meaning of the ECJ's case law or, alternatively, an acte éclairé.

Judgment

The court (one judge sitting alone), referencing the ECJ's judgment in Europièces (C-319/94) as well as national precedent, found there to be sufficient doubt as to the correct interpretation of the Acquired Rights Directive to warrant asking the ECJ the following questions:

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Is the Dutch faillissement procedure compatible with the aim and intended meaning of Directive 2001/23 and is Article 7:666(1)(a) of the Dutch Civil Code (still) compatible with that directive, if the transfer of the business in receivership is immediately preceded by a pre-pack that is under judicial supervision and is explicitly aimed at continuation of (parts of) the business?

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Does Directive 2001/23 apply where, prior to the receivership order, a 'proposed receiver', identified as such by a court, acquaints himself with the debtor's situation, explores the possibilities of continuation of the business by a third party immediately after the receivership order and prepares the actions that need to be taken immediately after that order in order for the continuation of business by means of an asset transfer to be successful (transfer of the debtor's business or a part thereof as per the date of the receivership order or soon thereafter and (almost) uninterrupted continuation of the activities)?

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Should distinction be made between (i) the situation where continuation of the business is the pre-pack's primary goal; (ii) the situation where the 'proposed receiver', by executing a pre-pack and selling the business on a 'going concern' basis immediately after the receivership order, aims primarily to maximise the revenue collected on behalf of the debtor's creditors; and (iii) the situation where agreement is reached in respect of an asset transfer (in the form of continuation of the business) before the receivership order and that agreement is formalised and/or put into effect afterwards? What if the aim is both continuation of the business and revenue maximisation?

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For the purpose of Directive 2001/23 and the Dutch law transposing it, is the point in time where a transfer of an undertaking occurs in a pre-pack situation prior to a receivership order (i) the moment, before that order, when the parties reach agreement on the terms of the transfer or (ii) the moment in which the transferee actually acquires the status of manager of the relevant entity?

Author's Commentary

A somewhat similar case was reported in EELC 2014/37. In that case, the court held that there was a transfer of the undertaking. The Commentary in EELC 2014/37 describes how Article 5 of the Acquired Rights Directive came into being following the ECJ's judgment in Abels (C-3430/01), which judgment was codified by Directive 98/50 in 1998 (the forerunner of what is now Directive 2001/23). It is worth repeating the following portion of that Commentary:

"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.

In 2011, it was estimated that 25% of the 2,808 companies that entered administration in the UK in that year used the pre-pack procedure and that nearly 80% of pre-pack sales were to connected parties: see the Insolvency Service's 2011 Annual Report.

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:

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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;

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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

House of Commons, The Insolvency Services, Sixth Report of Session 2012-2013.

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 UK 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 ach|ievable – (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".

The case reported in EELC 2014/37 was commented on by authors from Germany and Slovakia. German law does not exempt insolvency situations from the rules on transfers of undertakings, so this issue does not exist in Germany. The Slovakian author remarked that in Slovakia, contrary to The Netherlands, the insolvency process can take a long time, so a pre-pack operation would not be effective in Slovakia. However, there is an alternative, being that Oldco rearranges its assets and staff in such a way that only those assets and those staff that Newco wishes to take over are transferred as a separate part of the business.

Pre-pack is but one of many creative legal constructions that have been devised, essentially, to circumvent the rules that make terminating employment contracts under Dutch law so difficult. As long as nothing is done to tackle the root cause of the problem by making termination easier, employers will continue to think up new mechanisms.

Comments from others

The Netherlands (Zef Even): I have two additional remarks. First, one of the issues at hand is that in The Netherlands the difference between the level of employee protection during receivership and outside receivership is so large, that the incentive to reorganise after being declared bankrupt is hard to deny. There are three solutions for that situation: lowering the general level of employee protection, increasing the level of employee protection during receivership or a combination of both. In a fairly recent study (March 2015), scholars concluded that compared to other jurisdictions the level of employee protection during receivership is very low ('Employees and insolvency: a comparative study of the legal position of employees in case of insolvency of their employer'). It therefore makes sense to invest in increasing the level of employee protection in the insolvency stage. Second, the somewhat paradoxical role of this employee protection in the pre-pack procedure is worth mentioning. Although the proposed receiver found that the phase before Oldco went bankrupt fell short in carefulness because the take-over had only been negotiated with Newco – a company that is to be regarded a so-called connected party – and not with other (third) parties, it still continued the pre-pack process. The reason for that decision (taken together with the proposed rechter commissaris) was that a successful pre-pack would benefit a great number of parties, such as the 2,600 employees who could continue their employment, the parents, the body responsible for social benefits, the landlords and the banks. This same paradox is to be found in the already mentioned Abels ruling. Although employees are to be protected under the Acquired Rights Directive, which therefore may seem a good argument to actually offer such protection in case the employees are particularly vulnerable as is the case in a bankruptcy situation, this protection is however not granted, as such protection might dissuade a potential buyer from acquiring the undertaking entailing the loss of all jobs in the undertaking. In other words, the ECJ ruled that by not protecting the employees under the Directive, it in fact protects these employees. Normally, such arguments fall short in court (for instance, the argument that the employment position of young employees is promoted by not offering them the protection under the collective dismissal directive – an argument along the lines of the Abels case – was rejected by the ECJ in the Confédération générale du travail, case C-385/05).

Subject: transfer of undertakings

Parties: Federatie Nederlandse Vakvereniging and five individuals – v – Smallsteps B.V.

Court: Rechtbank Midden-Nederland, locatie Almere (District Court in Almere)

EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

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