Pre-Packs, employees and the spirit of EU law

Jenny Gant contrasts recent cases that look at the human element when considering the continuation of the undertaking

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> *The new Proposal … is a patchwork that aims to harmonise a few very specific, if not non-controversial, areas of insolvency law*

The new Proposal for a Directive on the harmonisation of certain aspects of insolvency law[1] is a patchwork that aims to harmonise a few very specific, if not non-controversial, areas of insolvency law.

Among those provisions is the pre-pack, which in Article 20(1) appears to exempt itself from the operation of the Acquired Rights Directive (**ARD**):[2]

"*[T]he liquidation phase shall be considered to be bankruptcy or insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of a competent public authority.*"

Regardless of the intention of the pre-pack procedure on the facts of any given case, the wording of Article 20(1) is unequivocal in exempting pre-packs from the operation of the ARD. This rests on the idea that the *Heiploeg* judgement[3] has settled whether employment contracts migrate to a purchaser of a business transferred subsequent to a pre-pack. However, in examining the rationale of the CJEU, it is not clear whether this exemption can be made unequivocally.

The insolvency exception

The story of the insolvency exception in the ARD and its applicability to situations of insolvency, begins in the Netherlands with *Abels*.[4] This is the case, where it was first recognised that an exemption was needed for certain insolvency situations in the interests of economic efficiency and asset value preservation, which was then implemented in Article 5 of the second ARD in 2001. Here is where the controversy begins as to where the line should be drawn between transfers done 'with a view to the liquidation of the assets' and transfers in a insolvency procedure where there is 'a transfer of an economic entity which retains its identity, meaning an organised grouping of resources which has an objective of pursuing an economic activity, whether or not that activity is central or ancillary.'[5]

The latter aspect is often referred to simply as 'business continuation', but one could argue that on the wording it could be much broader than this, which brings into question the most recent judgement in this area upon which Article 20(1) of the Proposal appears to rely as settled case law. It is arguable if not doubtful that this is the case.

In *D'Urso,*[6] it was noted that where the primary purpose of a procedure was to give the undertaking some stability allowing its future activity to be safeguarded, then the social and economic objectives pursued could not justify employees losing rights conferred by the ARD when there was a transfer of undertaking. On a similar question, in the *Smallsteps* case,[7] the court held that where the primary purpose was to ensure the 'continuation of the undertaking', this would not satisfy the requirement that the insolvency exception should only apply to pre-packs instituted with a view to the liquidation of the assets of the transferor.

The CJEU explained in *Heiploeg* that 'a procedure is aimed at ensuring the continuation of the undertaking when that procedure is designed to preserve the operational character of the undertaking *or of its viable units*.' This is contrasted with a procedure focusing on asset liquidation aimed to maximise creditors' collective claims. The key is whether the primary objective is aimed to ensure continuation which means safeguarding the undertaking concerned.

In *Smallsteps*, it was clear that the procedure was intended to continue the undertaking to preserve value and employment, thus the procedure's primary purpose was not liquidation of assets. Not applying the ARD in such circumstances would be contrary to the spirit of the ARD. The loss of employment rights could therefore not be justified.

This can be contrasted with *Heiploeg*. Critically, the judgement specifies if a proceeding is instituted in order to obtain the highest level of repayment, then, *in principle*, the conditions for the insolvency exception will be satisfied. However, the court also notes clearly that each situation must be verified to determine the true purpose of the procedure: to liquidate and maximise returns or with a view to reorganisation. Outcomes could, of course, also be a mixture of both.

On this point, the court conceded that the exception will be satisfied where the transfer under a pre-pack is instituted under statute and has as its

primary aim enabling liquidation as a going concern to maximise creditor returns – and preserving employment as far as possible. Adding to that, if the transfer is not 'an economic entity that retains its identity' then the rationale stands. However, if the business in question continues as an 'organised grouping of resources that has the objective of preserving an economic activity', whether central or ancillary, then it must be argued that, regardless of the liquidative aspects of other parts of the process, where the undertaking transferred meets these criteria, then the transfer provisions should apply to align with the spirit of the ARD.

The exception in the new insolvency proposal

On the basis of the reasoning above, the exception provided under Article 20(1) may not be adequate to exempt all types of pre-packs, given the variety of forms that they may take. It seems clear that, if the CJEU is faced by a decision of this sort, on its own declaration, the applicability of the insolvency exception will continue to be dependent upon the facts of the situation at hand.

There is also an issue of continuity in the proposed pre-pack insofar as it should always fall within the insolvency exception: Why should it be required to transfer executory contracts and not also require the transfer of employment contracts? If the transferred undertaking needs executory contracts to continue its operation – those executory contracts being one of the 'organised grouping of resources' - surely by definition it is continuing its operation and functioning as an independent economic activity. Although other assets are being liquidated, the continuing (reorganised) business, as long as it is also retaining its identity as an organised grouping of resources, should also attract the application of the employment transfer provisions under the ARD.

The final point must be to note that insolvency does not only have a financial impact on capital markets; it has an inherent impact on society. The specific nature of insolvency law is acknowledged clearly in earlier discussions, noting its connection with social security law and the need to balance various stakeholder interests. This characterisation has been lost in the final form that the Preventive Restructuring Directive took and the context discussed for the new Proposal.

Conclusion

It should be remembered that corporations, being human constructs, should operate in the service of humanity. Corporations do not function save through their human operators, in particular the employees who provide their firm specific human capital, time, and loyalty, without recourse to diversify their risk in the event of corporate failure. This fact alone should give employees a higher importance than other stakeholders who may be able to adjust or choose their relationship with the company. As such, insolvency procedures should incorporate this perspective to comply with the social contract we owe as humans to each other. Whilst true that a balance needs to be achieved to provide the best solutions, those solutions should not be at the expense of the human element of the corporate form. ■

Footnotes:

1 COM/2022/702 final - Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL harmonising certain aspects of insolvency law.

2 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses OJ L 82/16.

3 C 237/20 *Federatie Nederlandse Vakbeweging v Heiploeg Seafood International BV and Heitrans International BV.*

4 C-135/83 *Abels v Bedrijfsvereniging voor de Metaalindustrie en de Electrotechnische Industrie.*

5 Article 1(1)(b), ARD.

6 C-362/89 *Giuseppe d'Urso, Adriana Ventadori and others v Ercole Marelli Elettromeccanica Generale SpA and others.*

7 C-126/16 *Federatie Nederlandse Vakvereniging and Others v Smallsteps BV.*

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