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Pre Packs, Employees and the Spirit of EU Law

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Introduction

The hot topic in European insolvency has migrated from the implementation of the Preventive Restructuring Directive to the Proposal for a Directive on the harmonisation of certain aspects of insolvency law, published in December 2022 and the focus of the discussion panels at the first in-person CERIL (Conference on European Restructuring and Insolvency Law) event, held 21-22 April in Leiden. It was agreed by all that the Proposal is largely a patchwork approach that aims to create harmonisation and approximation opportunities in a few very specific, if not non-controversial, areas of insolvency law. Among those provisions is the pre-pack.

Pre-Packs and the Impact on Employees

There will be plenty of future discussion on the technical aspects of this provision and many will point out its benefits, risks and everything in between. However, there is one article in particular that may conflict with the operation and indeed the spirit of the Acquired Rights Directive (ARD). Article 20(1) states the following:

“For the purposes of Article 5(1) of Council Directive 2001/23/EC, the 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.”

The Proposal seems to fully exempt its pre-pack process from the operation of the ARD, regardless of the intention of the particular procedure on the facts of any given case. This rests on the idea that the *Heiploeg* judgement (C-237/20) has settled the matter of whether employment contracts migrate to a purchaser of a business transferred subsequent to a pre-pack. However, in examining the rationale of the Court of Justice in the *Heiploeg* case, it is not clear whether this statement can be made unequivocally. This assertion is based on a close reading of the decision-making process among the cases that have been held on this issue.

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The story of the insolvency exception in the ARD, and its applicability to situations of corporate rescue, begins in the Netherlands with *Abels* (C-135/83). This case is 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 passed 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 corporate rescue 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’ (Art 1(1)(b)).

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 upon as settled case law. It is arguable if not doubtful that this is the case.

The *Heiploeg* judgement helpfully provides a summary analysis of some the key findings in this area, including *D’Urso* (C-362/89), in which 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, the *Smallsteps* case (C-126/16), 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* (at paragraph 44) 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 the primary objective that is aimed to ensure continuation which means safeguarding the undertaking concerned. In the *Smallsteps* case (another Dutch referral), 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.

In *Heiploeg*, this position was further supported and explained on a different set of facts. Critically, the judgement specifies if, like in *Heiploeg*, a proceeding is instituted in order to obtain, in liquidation, 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 concedes 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 rational 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 in order to align with the spirit of the ARD.

On the basis of the reasoning above, the exception provided under Article 20(1) may not be adequate to exempt all styles of pre-packs given the variety of forms that they may take. It seems clear if the CJEU is faced by a decision of this sort, on its own declaration, the applicability of the insolvency exception in Article 5 of the ARD 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.

Summary

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. While it is 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.