Onderzoekcentrum Onderneming & Recht

Ondernemingen in financiële moeilijkheden en de arbeidsrechtelijke positie van hun werknemers

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Summary

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ONDERNEMINGEN IN FINANCIËLE MOEILIJKHEDEN EN DE ARBEIDSRECHTELIJKE POSITIE VAN HUN WERKNEMERS

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Rapport aan het WODC uitgebracht door

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SUMMARY

Commissioned by the Research and Documentation Centre (WODC) of the Department of Security and Justice, the Business & Law Research Centre of the Faculty of Law at Radboud University in Nijmegen has conducted an empirical study with regard to the research question: *'What are the consequences of the employment-law position of employees for the possibilities or impossibilities to solve the problematic financial situation of undertakings and for the future of the undertaking?'*

The study focuses on defining the state of affairs in practice, with the aim to provide insight into the role that the employment-law position of employees plays with respect to the way in which it is attempted to reorganise undertakings in financial distress and into the impact that the chosen procedure has (had) on the stakeholders involved. The study is therefore exploratory and descriptive in nature. It is not designed to systematically compare the studied cases with each other.

The study primarily consists of research into and analysis of 26 recent cases of restructurings of undertakings in financial distress either before or after bankruptcy.

Various written sources have been used to examine the selected cases. Furthermore, a total of 94 interviews were held with persons involved in the selected cases, in particular liquidators (*curatoren*) and administrators (*bewindvoerders*), advisers of the undertakings concerned, banks, trade unions, works councils, and (former) management.

In order to answer the research question, eight sub-questions have been formulated. The questions are designed to gain insight into the role that the employment-law position of employees plays in the financial difficulties experienced by debtors and the solutions sought to eliminate these difficulties in the cases examined. The first seven questions mainly concern the description and analysis of the actual situation in the cases examined and will be discussed in chapters 2 and 3. The role of the labour factor in the emergence of financial difficulties of the undertaking is addressed in chapter 2. Chapter 3 subsequently examines the role of the labour factor in the way in which the undertaking overcomes its financial difficulties. This chapter describes the findings of the study with regard to the manner in which the undertakings examined have sought a solution for the difficult financial situation encountered by them, which factors have played a role in this respect, and, in particular, the impact of the employment-law position of employees on the reasons underpinning their decisions. Chapter 4 abstracts from the cases examined whilst focusing on the question as to how changes in the employment-law position of employees can be expected to contribute to the ability of undertakings to reorganise.

The scope of the study was not limited to the examination of the 26 cases. At an experts' meeting held in Nijmegen on 25 September 2015, the (initial) findings of the study and any consequences to be drawn from it for the possible preparation of new legislation have been discussed with the experts. Chapter 5 provides a report of the experts' meeting.

The study shows that the financial difficulties of the undertakings examined are hardly ever attributable to a single cause. For the most part, this involves a combination of factors that led to an undertaking's difficult financial situation. In the cases examined the employment-law position of employees was only in two cases the key reason for the difficult financial situation of the undertakings examined. The other cases did not reveal that the employment-law position of employees was the sole or decisive factor for the difficult financial situation of the

undertakings concerned. The principal causes of financial distress that emerge from the study are:

- Decreasing turnover due to a decline in market demand
- A business model that is not (or no longer) in tune with market developments
- Problematic levels of indebtedness
- Investment decisions resulting in unexpected drawbacks
- Excessive housing costs
- Customers with payment problems
- Problematic relationship with financier(s)
- Inefficient organisational and production structure
- Problematic financing structure
- Credit insurers limiting the insurance coverage
- Wage costs for personnel

The study identifies a number of problem areas with regard to the possibility of adapting the workforce or expenditure on staff to altered circumstances outside insolvency proceedings. The study reveals that in some cases the rules on dismissal of employees are (or were) an impeding factor in the implementation of an appropriate and effective employment restructuring. Reference can be made in that regard to the costs and time involved in dismissal procedures in some cases. The reflection principle (a*fspiegelingsbeginsel*) has also been mentioned as an obstacle to achieving an effective reorganisation. A further problematic factor appears to be the scaling down of pay-and-benefit packages, such as a (temporary) cut in pay, as may be necessary to implement in view of the undertaking's financial situation.

Twelve of the cases examined by us concern reorganisations without insolvency proceedings ('informal reorganisation'). Eight of these informal reorganisations have been successful (i.e. on 16 December 2015, the closing date of the study): the businesses concerned operate in the black again, expect to do so soon, or see in any case an improvement in the results. However, this does not mean that no problem areas were identified throughout the reorganisation process. In four cases bankruptcy looms or has already occurred.

Fourteen of the undertakings we examined have been restructured by means of an insolvency procedure ('formal reorganisation'). With one exception the reorganisation was effected by way of a sale of the business out of bankruptcy. In seven of the cases examined such sale of (parts of) the business took place following a preparatory phase under the supervision of an envisaged liquidator and supervisory judge (a 'pre-pack'). In six of the cases examined the sale took place without a pre-pack. In three cases bankruptcy followed a brief period in suspension of payments proceedings.

The study shows that in the cases examined a substantial part of the jobs have been retained after a sale of the business out of bankruptcy, both with and without a pre-pack. In the cases where only a small percentage of employees had been taken over by the buyer, there was a changed business model that required less employees or – according to the parties involved – more jobs could have been retained if the sale had been prepared properly and in good time.

In the vast majority of cases, the employment-law position of employees had no impact whatsoever on the specific follow-up because the difficult financial situation was caused by entirely different factors than personnel costs or was only one of the factors for which a solution had to be sought. In the latter case various factors play a role in determining the feasibility of an informal reorganisation. The financial problems of the undertakings examined were hardly ever attributable to a single cause. For the most part, this involves a combination of factors that led to the undertaking's difficult financial situation. In many

cases, in order to cope with the difficult financial situation, a reduction of the costs at all levels, in particular personnel costs, financing costs, and housing costs, must take place alongside an operational reorganisation and disposal of unprofitable segments and/or divisions that are not part of the undertaking's core business. Under the laws currently in force, achieving such a comprehensive solution requires, however, the consent of all parties involved, which proves to be a challenge at times and is not always feasible. In the context of accomplishing an informal reorganisation, it is also relevant to what extent the problem areas identified in this study can be resolved. Furthermore, it is necessary to secure funding. If financiers or shareholders are no longer prepared to absorb losses, bankruptcy will be unavoidable.

The interviews clearly reveal that bankruptcy (whether or not prepared under the supervision of an envisaged liquidator and supervisory judge) is for the most part considered undesirable by the stakeholders involved. The parties concerned indicated that they would rather avoid bankruptcy and that they are ready to make a great deal of effort to accomplish that. The sale of (parts of) the business out of a pre-packaged bankruptcy is considered an option that is not taken lightly by most interviewees. The usefulness of the silent preparatory phase in accomplishing a sale and consequently the retention of jobs was emphasised during the interviews. None of the cases examined revealed that bankruptcy was applied for with the sole aim of restructuring (part of) the workforce. That abuse of bankruptcy proceedings is a rare phenomenon is consistent with the views of the consulted experts (and is furthermore consistent with published case law on abuse of the bankruptcy laws and the findings of HSI's earlier study from 2005).

With regard to the extent in which the Works Council and trade unions are involved in the process, a clear distinction is visible between informal reorganisations and formal reorganisations.

In the informal reorganisations examined where a Works Council has been set up and trade unions play a role, consultation has always been sought. However, the moment and the way in which this consultation has taken place vary. Also in the cases examined where no Works Council exists, employees have been involved in the reorganisation plans at some point in time.

In most of the cases examined where a reorganisation had taken place after bankruptcy, the Works Council and trade unions, in so far as they had been set up and/or involved, were only informed immediately prior to or after a petition for bankruptcy was filed or bankruptcy proceedings had been opened. In all cases examined there appears to have been no employee participation in the insolvency petition (and the preparatory phase of a sale of the business). In most of the cases examined this also applied to a sale of the business negotiated during bankruptcy.

Below, we give an overview of the advantages and disadvantages of informal reorganisations on the one hand and formal reorganisations on the other, which have emerged from the study. In this respect, we focus on the perspectives of employers and employees.

	Employers' perspective[1]	Employees' perspective[2]
Informal reorganisations		
Advantages	- maintaining (control over) the undertaking - maintaining control over the reorganisation process - limiting reputational damage (towards the market and personnel) - limiting other disintegration damage - preserving continuity of services within the same legal entity - opportunity to recoup losses	- preserving a substantial part of the jobs - objective selection criteria - chargeability of redundancy benefits - ex-ante assessment of the necessity to reorganise - actual participation - strong protection of the level of employment conditions
Disadvantages	- necessity to secure funding for losses - very limited margin of discretion in the selection of employees - chargeability of redundancy benefits - duration and costs of UWV dismissal procedures (Employed Persons Insurance Administration Agency) - a solution to the financial difficulties requires the consent of all parties involved - a (temporary) pay cut or adaptation of other employment conditions is permissible solely with the individual consent of all employees	- the reflection principle does not take into account the performance of individual staff (well-functioning employees may lose their jobs) - job retention by means of a (temporary) pay cut or adaptation of other employment conditions is permissible solely with the individual consent of all employees - WW risk (reduced unemployment benefit) to employees in case of a (temporary) pay cut
Formal reorganisations		
Advantages	- free selection of employees to be transferred - possibility of adapting employment conditions	- the sale of the business (following a pre-pack) preserves a substantial part of the jobs

[1] We define this as the existing employer (and shareholders) as well as any restarting party.
[2] This includes employees as well as Works Councils and trade unions.

	- no protection from dismissal - no chargeability of redundancy benefits in bankruptcy (nor in a moratorium under the Dutch Work and Security Act, Wwz)	
Disadvantages	- loss of control over the undertaking - loss of control over the reorganisation process - disintegration damage - reputational damage	- very limited participation in practice - no objective selection criteria (no application of the reflection principle) - no protection from dismissal - no redundancy benefits

In the cases examined a different employment-law position of employees would probably not have led to another reorganisation scheme (informal reorganisation versus formal reorganisation). In none of the cases examined was bankruptcy applied for with the sole aim of implementing an employment restructuring. It should be noted, however, that a different employment-law position of employees might have an impact on the outcomes for individual employees in concrete cases. For instance, during the research it has been observed that the possibility of a (temporary) pay cut could have contributed to the prevention of job loss. The selection of employees in a sale of the business out of bankruptcy or in an informal reorganisation also depends on the relevant criteria.

In the interviews and during the experts' meeting we listened to a wide range of answers to the question – independently of the cases examined – as to how changes in the employment-law position of employees can be expected to contribute to the undertakings' ability to reorganise. We summarise these answers as follows.

The study shows that addressing the problem areas identified with regard to informal reorganisations (duration of the dismissal procedure, costs related to dismissal, the reflection principle, possibilities for a (temporary) pay cut) may enhance the possibility of reorganising the undertaking outside insolvency proceedings. Of course, achieving a healthy balance between the interests of the undertaking and the related impact on future employment and the interests of employees who are laid off is of great importance in this respect. The interviewees noted, however, that in this regard a number of options should be available for a tailor-made approach, for example when applying the reflection principle. According to the prevailing view, it was assumed that it is necessary to ensure an objective approach to the selection. The interviews did not produce any directly applicable alternatives to the reflection principle.

With regard to formal reorganisations, it was emphasised from various quarters in the interviews and also during the experts' meeting that one should take particular care not to burden the buyer of the business, and especially a non-affiliated buyer, with a selection based on the reflection principle. The interviewed trade union leaders wanted the reflection principle to be made applicable in the sale of businesses from bankruptcy, but they were the only ones to hold this view. According to the study, both the interviewees as well as the

consulted experts support an objectified approach to the selection of employees to be transferred in the event of a sale.

The selection of employees who are being offered an employment agreement, including the associated conditions of employment, in a sale of the business from bankruptcy is currently in the hands of the buyer. The selection criteria as applied by the acquiring parties are not immutable and vary from case to case. Also the way in which the selection is made varies. Moreover, the liquidator has relatively little insight into these aspects. The criteria applied can be rather arbitrary. In some cases the lack of clarity about the applied selection criteria caused misunderstandings and concerns among the employees of the company in bankruptcy. The type of employment contract (permanent or temporary) of the acquired personnel has, in some cases, been adapted or adaptation of the employment conditions has taken place whilst in other cases no, or hardly any, changes occurred. The study did, however, reveal that the starting point of liquidators is that the bidder should indicate how many employees it is prepared to take over.

The experts discussed the guidelines for the selection of employees in case of a sale from bankruptcy. A number of guiding principles have been mentioned. There should be a relationship between the work to be performed after a sale and employees who have worked in the old company. An employee who seems suitable to perform the work but who has been ill for a brief period of time shortly before the sale should be eligible for a position in the new company. Long-term incapacity for work could well be a reasonable impediment. There should be room for consultation of the employees' representatives who would normally also have been involved in reorganisations (the trade unions and/or Works Council). It was suggested that if, after a short period of contributing ideas, no agreement is reached on the selection criteria to be applied, it should be up to the supervisory judge to take a decision. Conducting an assessment on the basis of a business plan was mentioned as a realistic possibility.

The experts' meeting further suggested that the UWV as the assessing authority in dismissals for business economic reasons might be replaced by the supervisory judge in case of suspension of payments proceedings, provided that this procedure is also covered by adequate safeguards. In this scenario, the trade unions and Works Council could be allowed to exercise their powers of participation.

We experienced a certain amount of support in some interviews and among experts for the idea of considering employees as a separate class in the compulsory settlement procedure under the Continuity of Enterprises Act II (WCO II), on condition that adequate safeguards will be provided. In terms of relevant safeguards, the experts envisaged a judicial review of the economic necessity, the duty to hear the trade unions and Works Council in advance, and applicability vis-à-vis the workers' collective of the undertaking only after acceptance of the proposal by a qualified majority of the employees themselves. The interviews revealed little support for a proposal to accept a structural pay cut. It seems that there might be a broader base of support for a temporary pay cut. In any case, adequate safeguards ought to be included into the procedure and attention should be paid to the influence of such a temporary pay cut on WW entitlements.

The interviews did not produce any new perspectives with regard to the nature and scope of existing regulations concerning informal reorganisations in relation to consultation of trade unions and the Works Council's advisory powers. The regulations concerning employee participation in informal reorganisations are apparently well known and should not cause any particular issues.

The interviews show that the topic of non-disclosure of confidential information about formal reorganisations is considered problematic by most interviewees. The rules provide for consultation of trade unions (Dutch Collective Redundancy (Notification) Act (WMCO), the Rules relating to Mergers) and the Works Council's right of consultation (Works Council Act, WOR), but these rules are being violated in formal reorganisations. The failure to inform especially trade unions can be attributed primarily to the fear of disclosure of confidential information by the trade unions as such disclosure would threaten the chances of success of a reorganisation. Also the interviewees on the part of the trade unions themselves indicated to experience non-disclosure as a dilemma and that in a number of cases they were not, or only for a short time, able to keep confidential information to themselves.

A number of interviews showed that knowledge with regard to existing rights of participation in decision-making (powers and obligations) among the undertakings, receivers, Works Councils, and trade union leaders is not always up to standard.

A large majority of the interviewees underlined the importance of due care in the bidding process for a sale from bankruptcy. A carefully designed bidding process serves as a barrier to abuse of the pre-pack, contributes to an objectification of the state of affairs, and may have a favourable impact on the extent to which employees (and other stakeholders) accept the state of affairs in any given case.

Many interviewees were in favour of a pre-pack, provided that the procedure is covered by adequate safeguards. The suggestion to include the obligation that, in the case of a pre-pack, the supervisory judge will hear the trade unions and Works Council prior to the approval of a sale could count on the support of the experts. They considered it appropriate to ensure the collection of information from other stakeholders with different perspectives.

The suggestions given with respect to the organisation of the procedure surrounding the (pre-packaged) sale of the business out of bankruptcy entail that the (envisaged) liquidator and (envisaged) supervisory judge should be able to assess a business plan and the criteria to be applied for the selection of employees.

The interviewees as well as the experts were generally critical of the successive employership scheme in combination with the chain rule and transition payment as provided for in the Wwz. Some expected fewer sales to non-affiliated parties and a few interviewees considered the possibility that these buyers might be more inclined to retain fewer employees and/or attract new personnel from elsewhere.

Various interviewees noted the fact that, in many cases, businesses that have encountered financial difficulties direct their efforts at achieving a reorganisation at a late stage (or too late). Failure to raise the alarm in time results more frequently in a situation where it is no longer possible to secure funding for the transition payment. This transition payment ceases to be payable in case of bankruptcy or suspension of payments. The transitional payment scheme of the Wwz thus may push companies that need to implement an employment restructuring towards bankruptcy or suspension of payments.