Consolidated criteria from an employment and social security perspective concerning the transfer of a production unit within insolvency proceedings

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Given the jurisdictional and material difficulties arising in the context of insolvency proceedings, the conclusions reached by judges specialised in corporate and commercial matters, in their various regular meetings, are invariably of tremendous interest. The recent conference held in Pamplona at the beginning of last November was no exception, particularly so, as far as this paper is concerned, in relation to the employment and Social Security aspects of a production unit transfer.

As is well known, the referral of arts. 146 *bis* and 149(4) of the Insolvency Act (abbrev. LC) to art. 44 of the Employee (Rights and Responsibilities) Act (abbrev. LET) for application of the transfer-of-undertaking regime, and this article's own referral to the rules governing the joint and several liability for debts with the Social Security [former arts. 104(1) and 127(2), respectively, of the Social Security Act (abbrev. LGSS), current arts. 142(1) and 168(2) of the new consolidated text (Royal Legislative Decree 8/2015, of 30 October)] gave rise to a great deal of disagreement, not only in terms of jurisdiction, but also of a substantive and procedural nature, between companies courts judges and employment courts judges. Now, following the conclusions agreed by the latter at their last meeting, we can take a series of – previously controversial – criteria as consolidated. Below follow such criteria, noting, however, that despite the efforts at reaching a consensus, some issues remain unresolved.

Executive Summary

1) Companies Court judges accept that, within the framework of insolvency proceedings and in connection with a company's liquidation, the determination in respect of a transfer of undertaking lies with the employment judiciary.

2) The delimitation of the production unit for the purpose of its transfer within insolvency proceedings is referred to the employment jurisdiction, which shall reach a decision according to the employment-law concept of transfer of undertaking.

3) In this regard, there is a transfer of undertaking when the transfer affects an economic entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary.

4) The need to stipulate the taking on of the payment of debts to the Social Security is confirmed, pursuant to arts. 146 *bis* and 149 LC.

5) Said interpretation extends to the composition-with-creditors stage, where required by referral of art. 100(2) LC to article 146 *bis* of the same.

6) This also requires a rejection of the old view that prioritised the application of art. 148 LC (liquidation plan) over art. 149 LC (liquidation rules) in the case of a purchase offer with full acceptance of debts, as it is deemed to be subject to a single legal regime (liquidation stage) and the referral is identical (employment and Social Security legislation) regarding a transfer of undertaking.

7) There are doubts as to extending the taking on of the payment of debts to the Social Security only to the employment contracts that are

transferred. Companies Court judges argue in favour of not making a pronouncement on this matter in the decision authorising the sale of the production unit, but of allowing the employment courts to decide.

8) Pending legislative amendments or specific consolidated case law on insolvency matters from the employment judiciary, art. 44 LET and arts. 142(1) and 168(2) LGSS, respectively, are to be applied to their full extent, imposing, *a priori*, the taking on of all prior debts.

9) For the time being, clearance certificates (assurance of inexistence of debt) provided for contractors and subcontractors are not recognised, as for a transfer of undertaking regulatory intervention in the issuance of certificates that involve an "assurance of non-liability for the transferees" is deemed necessary. Depending on the wording of the same, at most it is accepted that there is "no claim for overdue debts".

10) Notwithstanding the above, a number of issues of interest have not been settled yet, including:

    a) The interpretation of art. 44(1) LET ("any change of ownership of a company, worksite or autonomous production unit will not in itself terminate an employment relationship, and the new employer shall take on the former's Social Security and employment-related and rights and obligations"), which must mean that certain employment relationships may have been terminated prior to or during the change of ownership (as can be deduced from art. 44(9) LET) and have no effect after the same.

    b) Art. 142(1) LGSS which, when referring to the obligation to make Social Security contributions, extends the joint and several liability of a transfer of undertaking under art. 168 LGSS (joint and several liability for any "benefits paid") to the "full amount of debts incurred prior to the transfer", but does not specify if this is in respect of all previously existing contracts or only those taken on by the company. In general, the first hypothesis shall prevail, in order to prevent a fraudulent loss for the Social Security by the transferor defaulting and the transferee not taking on the debts. But it is also true that the aforementioned Social Security provisions refer to obligations between the company and "its" workers (art. 142(1) LGSS), not those that are not.

    c) The unjustified different treatment of clearance certificates (assurance of inexistence of debt) in respect of contractors and subcontractors and the referral to a future regulation on the issuance of certificates in the event of a transfer of undertakings (art. 168(2) LGSS) is maintained.

    d) Finally, the wording of art. 149(2)(b) LC, which exceptionally recognises that payment of tax and Social Security debts does not lie with the transferee, "even when the security interest survives" (with reference to property and rights that are transferred with survival of a security interest), when involving tax "and Social Security" claims, does not help to dispel doubts on this issue, which requires better legislative drafting and greater political involvement.

1. The concept of 'transfer of a production unit': that set out by the employment jurisdiction

1. Considered a starting premise for the application of the provided legal regime, four different concepts are proposed in addressing when a production unit is regarded as transferred. First, a classic or strict concept ("grouping of human and material resources used in the pursuance of the insolvent's activity"). By way of the same, a combination of two elements is required in order to talk of a production unit. On the one hand, the material resources (rights, obligations, tools, etc.) and, on the other, the human resources (personnel). Only the combination of these elements will determine the pursuance of the economic or business activity regulated by the Insolvency Act. Second, a flexible concept under which it is considered that the existence of employment contracts (human resources) is not an indispensable requirement in order to talk of a production unit. Third, a relative concept advocating a casuistic interpretation of a production unit, developed in tandem by the insolvency practitioner and the insolvency judge, whereby the perimeter of the production

unit can be delimited in the petition for insolvency proceedings, in the insolvency practitioner's report or in the transfer application. In previous meetings, the conclusion had been reached that it lies with the insolvency judge to set the perimeter of the production unit on sale, which includes both the assets (attached to the production unit) and the Social Security and employment-related liability on which the legal effect of the transfer of undertaking impinges. And last, a concept of production unit as an 'establishment' (worksite). Based on the judgment of the Court of Justice of the European Union (CJEU) of 13 May 2015 (C-392/13, *Rabal Cañas v Nexea Gestión Documental SA and Fondo de Garantía Salarial*), a production unit is equated to establishment, understood as the entity to which the workers made redundant are assigned to carry out their duties. It therefore considers that by virtue of art. 149(4) LC and art. 44(2) LET the issue boils down to whether it is necessary or not, to be regarded as a production unit, that such has human resources (employment contracts or employees).

Of the above options, a majority of Companies Court judges are of the opinion that positions of employment or human resources are unnecessary to establish the existence of both the production unit and its transfer. In any case – and as a conclusion that will be repeated in the examination of other aspects – it is believed that this concern is no longer relevant to fix or delimit the perimeter of the production unit following the judgment of the Supreme Court (Employment Division) of 29 October 2014, Ar. 6149, by which the employment jurisdiction is conferred jurisdiction over the taking on or not, by the transferee of the production unit, of the contributions to the Social Security. The employment concept of transfer of undertaking thus takes precedence. It exists, therefore, where the transfer affects an economic entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary, pursuant to art. 44(2) LET.

2. It should be remembered, for this purpose, that the CJEU has been stating that the decisive criterion for establishing that the transferred undertaking retains its identity is primarily that operations will continue or resume. All the facts characterising the transaction concerned must thus be considered, including in particular the type of undertaking or business concerned, whether or not its tangible assets, such as buildings and movable property, are transferred, the value of its intangible assets at the time of the transfer, whether or not the majority of its employees are taken over by the new employer, whether or not its customers are transferred, the degree of similarity between the activities carried on before and after the transfer, and the period, if any, for which those activities were suspended.

   However, all of the above circumstances are merely single factors in the overall assessment which must be made and cannot therefore be considered in isolation (judgments of the CJEU of 6 March 2014, C-458/12, *Lorenzo Amatori and Others v Telecom Italia SpA and Telecom Italia Information Technology Srl*, of 15 December 2005, *Nurten Güney-Görres (C-232/04) and Gul Demir (C-233/04) v Securicor Aviation (Germany) Ltd and Kötter Aviation Security GmbH & Co. KG*, or of 20 November 2003, C-340/01, *Carlito Abler and Others v Sodexho MM Catering Gesellschaft mbH*). And so, the judgment of 9 September 2015 (C-160/2014, *João Filipe Ferreira da Silva e Brito and Others v Estado português*) has interpreted that the fact that that the entity whose assets and a part of whose staff were taken over was integrated in a new and different organisational structure, without that entity retaining an autonomous organisational structure, is irrelevant for the purposes of applying Article 1(1) of Directive 2001/23, since a link was preserved between, on the one hand, the assets and staff transferred and, on the other, the pursuit of activities previously carried on by the company that had been wound up. As noted by the judgment of the CJEU of 12 February 2009 (C-466/07, *Dietmar Klarenberg v. Ferrotron Technologies*

GmbH), what is relevant for the purpose of finding that the identity of the transferred entity has been preserved is not the retention of the specific organisation imposed by the employer on the various elements of production which are transferred, but rather the retention of the functional link of interdependence and complementarity between those elements.

2. Delimitation of jurisdiction: prevailance of the employment judiciary

1. Notwithstanding initial disagreement, the Companies Courts had been upholding the jurisdiction of the insolvency judge not only to order the transfer of the production unit within insolvency proceedings, but also to regulate its effects, pursuant to arts. 146 *bis* and 149(4) LC. Since art. 149(4) LC does not limit the subject-matter jurisdiction of the insolvency judge, such judge must make a pronouncement on the effects of the sale. For several reasons. On the one hand, because art. 148 LC states that property must be sold free and clear of all charges and liens. Moreover, the principle of legal certainty that must govern commercial relations means that the buyer should know exactly what is being bought and what liabilities are taken on in order to reach a determination, freely and knowingly consent and make an offer. Thus, when faced with a sale in insolvency proceedings, such must be be governed by the rules of insolvency law and not by the rules of sectorial legislation, which applies only to non-judicial sales. Moreover, insofar that the current art. 149(4) LC notes that a transfer of undertaking is so "for Social Security and employment-related purposes", said article apparently recognises the subject-matter jurisdiction of the insolvency judge to decide on such issues given that, *a contrario sensu* and in the absence of any provision of the insolvency law stating otherwise, there is no transfer of undertaking in respect of debts which the insolvent may have with the tax authorities or the National Insurance Fund (abbrev. FOGASA).

2. However, another view has ended up prevailing; perhaps not shared, but certainly accepted. This is the doctrine derived from the judgment of the Supreme Court of 29 October 2014, Ar. 6149, which posits that an examination of a transfer of undertaking under art. 44 LET, including the sale of a production unit within insolvency proceedings, rests with the employment jurisdiction. And so, any pronouncement made by Companies Court judges on this matter will be merely of a preliminary and non-binding nature for Employment Courts, except for the possibility of releasing the buyer from Social Security and employment-related debts covered by FOGASA pursuant to art. 33 LET. By virtue of this pronouncement, the question of whether there has been or not a transfer of undertaking is a matter for the employment jurisdiction.

3. Compulsory taking on of Social Security debts and scope of the same

1. In relation to a transfer of undertaking and the payment of contributions to the Social Security provided in arts. 146 bis, 148 and 149 LC, respectively, the need for establishing the taking on of the same is confirmed. It cannot be denied insofar that the literal wording of art. 146 bis and of Directive 2001/23 prevents such denial. In fact, it is an interpretation that extends to the new wording of art. 100(2) LC, recalling that the previous wording of said article included in the final sub-article the necessary acceptance by the buyer of the continued activity of the transferred production unit and the payment of creditors' claims according to the express terms of the composition. The current wording, however, contains no reference to the payment of creditors' claims, and the question arises as to whether, now, after the amendment, an exemption from preferential claims, whether they be related to wages or the Social Security, is permissible. In this regard, a clear majority of the Companies Courts judges are of the opinion that the reference in art. 100(2) LC to art. 146 bis LC, which, in turn, refers to the compulsory taking on of Social Security and employment-related claims under art. 149 LC, necessarily entails the enforceable payment of both Social Security and employment-related preferential claims.

   Ultimately and nowadays, all that is doubtful is whether it is deemed possible

to limit the taking on of Social Security contributions to those referring to transferred employment contracts or to all existing contracts at the time of transfer by the transferred production unit. As on previous points, virtually all Companies Courts judges consider that the judgment of the Supreme Court of 29 October 2014, Ar. 6149, which assigns jurisdiction for the determination of the taking on of Social Security contributions to the employment jurisdiction, prevents adopting a solution on this issue at a Companies Court. For this reason, it is advocated that the insolvency judge should not rule on the issue in the order authorising the sale of a production unit.

2. It should be recalled that, on this matter, Companies Courts judges have envisaged three possible solutions. First, to deem that art. 44 LET must apply in its entirety in the sale of the production unit, both inside and outside insolvency proceedings. Accordingly, the only noticeable difference between selling a production unit inside or outside insolvency proceedings is the power granted by art. 149(2) LC to the judge to exempt the buyer from the employment-related debt regarding the portion covered by FOGASA pursuant to art. 33 LET. This means that, regarding any Social Security or employment-related debt that exceeds this limit, the provisions of art. 44 LET shall apply in their entirety. Second, to deem that there is a transfer of undertaking only for Social Security and employment-related purposes in respect of the employees taken on and in respect of the entire workforce since the buyer takes on the workers hired but not those who terminated their contract prior to the transfer. Third and last, not far off the second, to deem that a transfer of undertaking is predicable only upon employment contracts that were in effect at the time the offer was made, whether or not the buyer takes them on.

   Initially, the judges were of the opinion that the application was exclusively limited to contracts of employment in effect taken on by the buyer, but not so to Social Security and employment-related debts that the insolvent might hold against the other employees that were not taken on. The reason given is that art. 5 of Directive 2001/23 and the interpretation of the same by the Order of the CJEU of 28 January 2015 (Case C-688/13, *Gimnasio Deportivo San Andrés*) are based on a general and basic principle according to which when you sell a production unit within insolvency proceedings, the buyer acquires such unit free of charges and liens. Only if there is a national rule that expressly provides otherwise, would a different interpretation be possible. And in this regard, art. 146 bis LC builds on a principle that the buyer does not take on insolvency debts payable upon distribution and expenses of the liquidation except those which it has voluntarily undertaken to pay except as provided in art. 149(2) LC. The latter provision states that, when a production unit is sold, there is a transfer of undertaking for Social Security and employment-related purposes, but does not distinguish whether it refers to debt incurred with the employees transferred to the new company or all earlier ones. Well, as it does not distinguish, it can be held that the EU Directive refers only to employment "contracts in force" at the time of sale, so that, in principle, it is referring exclusively to employment contracts the transferee has taken on, not remaining ones.

   A note should be made in this regard. It involves the use of certificates of exemption from debt issued by the Social Security Administration, which, though admitted without reservation in respect of contractors and subcontractors (art. 42 LET and art. 168 LGSS, respectively), find themselves rejected in transfer-of-undertaking cases. The judgment of the Supreme Court (Judicial Review Division) of 21 July 2015, Ar. 3511, rejects, in fact, the submission of certificates applied for by the purchaser and issued by the Social Security Administration. These certificates contained, as often happens, two statements. The first, that "no claim for overdue debts to the Social Security is pending payment" by the transferred company; the second, that such certificate does not give rise to "rights or future entitlements in favour of the applicant or third parties, nor may it be relied on for the purpose of interrupting or staying limitation or revocation periods, nor may it serve as a means of giving notice of proceedings

to which it might refer, nor may it affect what could result from further verification or investigation related thereto." Thus, it follows that the certificates submitted, although valid, are ineffective to release the transferee from joint and several liability, and the cited judgment decides to reject that such certificates support a purported release from debts because the fact that there is "no claim for overdue debts" pending payment does not necessarily mean that there are no debts.

3. Now, by accepting the case law from the Employment Division of the Supreme Court on transfers of undertakings for Social Security and employment-related purposes within insolvency proceedings, the application of art. 44 LET in its entirety is also admitted, with the only limit of the portion covered by FOGASA in accordance with art. 33 LET. In that sense, the buyer, with the right to know what is being bought and what the risks accepted with the transfer, has to consider that a transfer of undertaking can be predicated not only upon the debts accepted in relation to taken-on employees, but all existing at the time of the take-on, regardless of how many remain in the buyer company.

In this manner, some of the views supported before by Companies Courts pass away. On the one hand, the prioritization of the provisions of the liquidation plan under art. 148 LC over the liquidation rules of art. 149 LC, as it is understood that, in both cases, the employment and Social Security rules provided for transfers of undertakings takes precedence. With an expected direct impact: the rejection of offers to buy with full release from Social Security and employment-related debts after accepting all or part of the acquired company's workforce (as shown, for example, by Order of the Alicante Companies Court of 13 March 2015, Ar. 96236). On the other hand, there is a relativization of the referral to arts. 3(1) and 5(2) of Directive 2011/23 and the Order of the CJEU of 28 January 2105 (Case C-688/13, *Gimnasio Deportivo San Andrés*), according to which "the EU legislature has not laid down rules regarding the charges payable by the transferor as a result of contracts of employment or employment relationships terminated before the date on which the transfer takes place". At least until employment case law concludes that, within insolvency proceedings, this is the premise to follow.