



INSOLVENCY AND SOCIAL PROTECTION: EMPLOYEE ENTITLEMENTS IN THE EVENT OF EMPLOYER INSOLVENCY

by Gordon W. Johnson

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1) Introduction

The most valuable assets of any country are its employees, and economic progress and development often hinge upon the degree to which the citizens of a country can be gainfully employed on a sustainable basis. In an increasingly global economy, businesses face enormous competitive pressures to minimise costs and maximise returns, often at the expense of domestic labour. Of course, there are winners and losers in this process, as jobs from one country are outsourced to another. Traumatic as this is, it is part of an inevitable cycle and is not nearly as traumatic as the more abrupt losses that befall employees when their employer files for bankruptcy.

The collapses in recent years of a number of mega-corporations (like Asia Pulp & Paper, Calpine, Collins & Aikman, Enron, Parmalat and WorldCom) represent only the latest casualties of competition, market volatility, poor management, or corporate demise by other forces that challenge business today. Enron's collapse, the largest corporate insolvency in United States history, placed the spotlight once more on the topic of employee's rights to entitlements in the event of corporate bankruptcy. The Enron catastrophe left over 4 500 staff unemployed and with uncertain ability to access entitlements owed to them under their work contracts. Even worse, employees and other investors who had invested their life's savings in Enron's stock and pension fund were left with nothing, while many of Enron's management and upper echelon walked away with large bonuses and severance packages, or managed to sell their own Enron stock before the real collapse. A tragedy of epic proportion, it led to a number of regulatory reforms in the areas of corporate governance, and accounting and auditing practices which, with hindsight, can be said to have had both positive and negative effects.

The real magnitude of these issues is difficult to measure in quantitative terms. In the context of systemic crises, such as the Asian financial crisis of 1997, the impact was so widespread that it led to civil unrest in some countries and threatened unrest in others. Argentina still has one of the highest unemployment rates in Latin America today

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(estimated at above 25%), three years after the crisis. At no time have we been more acutely aware of the challenges facing our oldest bedrock companies that have been the foundation of our economies (companies like Ford, General Motors, United Airlines and many others) who have either filed for bankruptcy or face the threat of insolvency due to unsustainable “legacy liabilities” that are impossible to satisfy in the competitive global markets of today. Some of these companies have successfully shed billions of dollars of liabilities to become more competitive and preserve thousands of jobs. Notable examples include United Airlines, which emerged from bankruptcy in June, having saved some USD 7 billion (United States dollars) in claims. More recently, GM announced savings of approximately USD 15 billion by renegotiating its labour and pension liabilities. This is a start, but it represents only the tip of the iceberg in our rapidly changing world.

The consequences of these failures, or the problems of financial distress, compel policy makers to re-examine systems that provide for employee protections in the event of their employer’s financial demise.¹ Unfortunately, there are difficult choices that are not politically popular, as the road to salvation is often marked by sacrifice. Some jobs must be lost or claims reduced to return the business to financial health and thereby save as many jobs as possible, and provide an opportunity for the company’s growth and expansion in the future.

2) Policy considerations and issues

Should employee rights receive special attention above and beyond that of other trade creditors? Employees sometimes possess a contractual right to entitlements accrued under their work contracts. In terms of relative priority, these entitlements and rights are no different than those of other unsecured creditors holding contractual rights and claims to payment. Both groups of creditors are on an even legal footing to be paid from the general assets of the company, as distinct from the rights of secured creditors whose *in rem* rights entitle them to satisfaction from specific assets in the event of a default.

Employees are commonly the silent or lost voice in bankruptcy proceedings, however, and often have little influence or bargaining power (outside the collective bargaining process). Yet, they stand to lose the most. Wages generally constitute a significant portion of employees’ wealth, leaving them with few options to fall back on in the event of their employer’s default.² Moreover, the overwhelming majority of employees have not intentionally assumed the risk that their employer might fail to pay them. Unlike creditors who can factor such defaults into their pricing or lending rates, employees typically are left with no recourse. They generally begin and maintain their course of employment without information as to the precise economic condition of their employer.³ Even if such economic information were available and understandable by the staff member, under a standardised contract, there is little an employee can do to factor in the risk of insolvency. In the event that an employee does learn of the financial ill-being of his/her employer before a formal declaration of bankruptcy, that individual may still remain powerless, as job prospects and mobility tend to be limited.⁴

Regular trade creditors, on the other hand, have access to financial and economic data on the debtor and can (theoretically, if not realistically), set their terms of trade to reflect their assumed risk. So too, trade creditors will often have a variety of sources of income, whereas employees usually only work for a single organisation.

The financial security of employees in the event of employer insolvency is an issue capable of having a far-reaching societal affect. For example, employees holding pension benefits derived from their business’ ongoing operations or stock, may discover that their pension plans have been tapped to cover expenses of the business or that their mutual funds (invested with the employer’s stock) are now worthless as they face their retirement

years. Thus, the insolvency of a company may cause workers to lose their retirement benefits, as in the case of Enron, placing them at the mercy of taxpayer-sponsored state support and forcing them to extend their employment well into the retirement years.

Unemployment and insolvency are an even worse combination in the context of troubled economies with high unemployment rates. Developing and transition economies typically have weak social protection systems for unemployed workers, whose numbers spiral when companies in financial distress downsize their workforce to rationalise their costs. In systemically affected countries, there is a greater potential for social unrest.

While employee entitlements clearly deserve special attention, numerous policy questions arise with regard to the treatment of these issues. For example, should general employee claims take precedence over claims of other unsecured creditors? If so, should the increase in risk to trade creditors be passed on to the debtor in the form of higher priced goods and services, putting labour intensive businesses at risk and inadvertently hindering job creation? If no, what other options are there to protect what is perhaps the most vulnerable of creditor groups?

This paper does not support a definitive model on legal treatment of employee entitlements in the case of insolvency. Rather, it examines some of the approaches currently adopted by different legal systems in order to protect employee entitlements in the event of employer insolvency. Section II briefly describes the position of two international bodies (the International Labour Organization and the European Union) on employee entitlements in insolvency, followed by a description of the four basic models in use around the world, with the aim of informing the debate on effective protection measures for a country's most important assets—its employees. Section III discusses a number of strategies and policy considerations in the establishment and use of insurance and guarantee fund systems. The paper recognises the need for more research and focus on this increasingly important issue in the current global analysis of insolvency principles and practice.⁵

It should be noted that there is a variety of treatments for employee contracts on the insolvency of a business. While some states, such as Russia, opt for the maintenance of work contracts through the long-term government administration of a failing business, unless otherwise indicated, this paper assumes the South African model of instantaneous termination of employee contracts in the event of bankruptcy. So too, many insolvency laws allow for a company suffering financial difficulties to be taken over or merged resulting in the downsizing or transfer of its workforce. While this process often results in large scale redundancies, and raises issues of whether a subsequent employer is liable for entitlements accrued under former employment, for the sake of simplicity in this paper, it has been assumed that all staff have been made redundant on the insolvency of the enterprise.

3) The international experience

The International Labour Organization

As early as 1949, the International Labour Organization (ILO), whose members include all the countries discussed in this paper, produced a Protection of Wages Convention in which it addressed the effect of insolvency on workers' wages.⁶ Article 11.1 states:

In the event of the bankruptcy or judicial liquidation of an undertaking, the workers employed therein shall be treated as privileged creditors either as

*regards wages due to them for service rendered during such a period prior to the bankruptcy or judicial liquidation as may be prescribed by national laws or regulations, or as regards wages up to a prescribed amount as may be determined by national laws or regulations.*⁷

Nevertheless, Article 11.3 acknowledges that national laws and regulations are to determine *the relative priority of such debts*. If the workers' claims are protected by a guarantee institution, however, they may be relegated to a lower privileged status. By giving individual nations the right to limit the privileged nature of employee claims to a certain extent, the ILO may have surrendered a degree of its leverage regarding the rights of workers.

In 1982, the ILO issued a convention regarding the termination of employment.⁸ Part II, Article 11, requires that employers provide employees on the verge of unemployment with either reasonable notice of such termination or compensation for the lack of reasonable notice. The ILO also seeks strong and direct participation by worker representatives in employment termination, particularly in light of major restructuring, downsizing or terminations due to employer insolvency.

European Union

In contrast to the ILO requirements, the European Union (EU) directives are binding on members. In 1980, the Council of the European Communities issued a directive regarding the protection of employees in the event of their employer's insolvency.⁹ It was updated by the European Parliament in 2002.¹⁰

Section II, Article 3.1, requires that guarantee institutions secure employees' outstanding claims relating to their employment. Section II, Article 4.2, compels member states to ensure that outstanding claims from the last 18 months are paid. Nonetheless, Section II, Article 4.3, authorises member states to set limits on the liability for employees' outstanding claims as long as the states notify the Commission of the methods they used in order to reach those limits.¹¹

Council Directive 98/59/EC requires that any employer considering collective dismissals consult with workers' representatives first, with a goal of reaching an agreement and thereby curtailing the need for such measures.¹²

Survey of country experience

The ILO and EU requirements have been interpreted and implemented in myriad ways. What follows below is a brief analysis of four different systems and variations on models used throughout the world in an attempt to address the social protection concerns raised by employer insolvency.

Model one: Pro-employee approach

China has implemented a very pro-employee approach to staff redundancies.¹³ The Chinese model encompasses compulsory unemployment insurance that goes well beyond mere monetary compensation for entitlements owed, though not all workers are covered by it. The cost of the insurance is carried by both employers and employees. The system allows (in addition to receiving priority in insolvency to cover outstanding entitlements), for employees to be paid up to 80 percent of the national minimum wage for up to two years. It also aims to enhance the competitiveness and employability of the unemployed through training and job referrals in an attempt to speed their rejoining the workforce. Austria also has adopted a sector specific training programme financed by unemployment

insurance, which has improved considerably the employment prospects for its participants.¹⁴

Critics have called for the transformation of the current Chinese insolvency system. The system is not always consistent in its effort to maximise pacification and settle affected worker claims.¹⁵ Trade creditors' claims are often ignored due to the weak enforcement of contract law, and the employee rehabilitation fees paid out can vary between employees within the same company, creating further inequality.¹⁶ Thus, there is a lack of consistency in the treatment of claims in bankruptcy. China has been rapidly moving to modernise its laws to embrace and enable the new market-oriented economy, including in the area of insolvency, where a new draft insolvency law is on the verge of being passed. The current insolvency law has often not been applied to its full and logical extent. In a climate of high unemployment and an unstable economic environment, state-run enterprises, in particular, are reluctant to declare bankruptcy, and employees themselves attempt to delay the onset of insolvency proceedings due to the loss of the security of what was once considered to be a job for life. The unfortunate result of this is that employees are often forced to work for a second enterprise while awaiting the uncertain enforcement of the right to the entitlements still owing from the first.¹⁷ Under the new law, however, at the time of this writing, the author was informed that some difficult challenges have been taken to compromise between labour priorities and priorities for secured creditors. This marks a monumental achievement.

Model two: Bankruptcy priority–No insurance approach

At the other extreme is the Mexican system, which has no insurance scheme to cover the difference between the entitlements owed and the value of the assets realised.¹⁸ Like a number of civil law systems, however, it does award first priority in bankruptcy to certain worker entitlements, such as payments of up to three months' wages in lieu of severance pay. Despite being a new law (having been enacted as recently as 2000), the Mexican insolvency law has come under considerable criticism, especially for furthering the old law's practice of favouring employees in a biased manner.¹⁹ This approach undermines the fundamental principle of secured creditors' rights and increases the insolvency risk in commercial relationships. Moreover, in actuality it does not significantly enhance the protection of workers' entitlements. Employees of insolvent, asset poor enterprises are often unable to find sufficient assets to assure payment even of the first priority employee claims in an employer's bankruptcy and must fall back on Mexico's underdeveloped social security system in a difficult labour market. This problem is compounded as owners and managers of financially distressed but viable companies operate them to the point of no return, while avoiding outside assistance for fear of being subjected to criminal sanctions for fraud.²⁰ In this regard, the United States has also fared poorly on workers entitlement protection in international comparisons, due to its pro-debtor stance and relegation of certain worker entitlements to third priority status within the unsecured creditor class.²¹ In the US, however, these priorities must be counterbalanced by Sections 1113 and 1114 of the US Bankruptcy Code which lay out special provisions for the treatment of collective bargaining agreements and the handling of insurance benefits for retired employees.

Model three: Bankruptcy priority–Guarantee fund approach

Most developed countries use a hybrid system that gives workers' predetermined entitlements some priority in bankruptcy, but also provides unemployment insurance in acknowledgement that the remaining assets are often insufficient to cover outstanding entitlements. For example, the Danish system gives the highest priority among unsecured

creditors to claims for salaries, wages and other employee benefits (behind administrative costs), with a guarantee fund as a safety net, should the assets prove to be insufficient.²² While this affords the employee greater security in their rights to entitlements, and grants ready access to collateral for the secured creditors, it still raises concerns. Is it equitable, or indeed desirable, to deprive other unsecured creditors (such as trade creditors who, after all, possess the same contractually based claims as employees) equal access to the remaining assets? Predictability of outcomes underpins many of the principles of commercial law and should apply to secured and unsecured creditors alike; the process of priorities in bankruptcy can seriously undermine creditor/lender confidence in a system if it is difficult to determine what percentage of remaining assets one is likely to receive. An example of a system that clouds predictability by the retention of complicated priority structures is Australia's, which delineates no less than fourteen claims that have priority over regular creditors in the unsecured creditors class.²³

Model four: No priority–Guarantee fund approach

One of the more predicable systems for creditors is that of Germany. The German model treats all unsecured creditors, including employees, the same and accordingly allows all of them equal access to the remaining available assets of an insolvent enterprise. Worker entitlements not satisfied through bankruptcy are paid out of a national insolvency fund.²⁴ The only exception to this flat priority structure is the creation of a social welfare plan for those who face severe disadvantages due to their employer's insolvency. Employees under the welfare plan are then awarded first priority in insolvency, albeit with a limitation to one-third of all assets, thereby ensuring greater clarity and, consequently, greater creditor confidence in the process.

4) Strategy and policy considerations

The concept of an entitlement insurance protection scheme has been widely adopted throughout the developed world, and would appear to offer the most protection for worker entitlements while not interfering with the efficient distribution of credit in the market. What follows is a discussion of some elements to be considered in the construction of an insolvency social protection system.

Bankruptcy priority

The approach adopted should properly balance policies that promote commercial confidence with those that support social protection measures. Principle 16 of the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems addresses claims resolution in terms of the treatment of stakeholder rights and priorities.²⁵ It states that insolvency and creditor rights systems, through commercial laws, should both preserve the legitimate expectations of creditors and, most importantly, encourage greater predictability in commercial relationships by upholding, to the maximum extent possible, the relative priorities of creditors established prior to insolvency.²⁶ The easiest way to ensure this is to have a flat hierarchy of priorities, which only consists of two levels: first, secured creditors maintain recognised priority in their collateral; second, following satisfaction of administration costs, the remaining proceeds are to be distributed equally among the remaining creditors.²⁷ The World Bank principles state that there should be few if any deviations from this general rule, and these rules of priority should encourage creditors to manage credit effectively.

Principle 16 of the 2001 version and Principle C.12 of the revised principles articulate a rule of best practice. It is not a straitjacket and there may be exceptional

circumstances that would justify a priority. Indeed, so important is the issue, that the revised principles introduced a new sub-principle C.12.4 specifically calling for flexibility and careful consideration in the treatment of employee rights. This paper does not examine that question. Rather, it is suggested that the essence of Principle C.12. (former Principle 16) strikes a proper balance and should be the goal even in regard to employee entitlements.

Put differently, the contract governing the employment relationship should be treated the same way as other trade or service contracts. In many developing countries, where private sector growth is imperative to ensure economic and social prosperity, ready access of private enterprises to credit at reasonable terms is paramount. The more predictable and transparent the insolvency process, and the greater the chance of retrieving collateral in the advent of bankruptcy, the more willing lenders should be to lend at rates that reflect lower risk premiums. This is not to say that the repayment of employee entitlements is of less importance than payment of collateral, but rather that there may be more efficient ways of ensuring workers entitlements while still preserving a strong, predictable financing market.²⁸

Insurance funds

One way to ensure the payment of employee entitlements, while maintaining market confidence, is through an insurance fund. Insurance funds can reduce the burden of the unemployed on the state for interim social protection, although they would not entirely displace the necessity of providing protection for purposes of unemployment, retraining and other needs. On an economic level, an insurance fund may provide a higher degree of reliability to the markets while at the same time affording stronger protection to employees to fulfil social objectives. Of the four models examined above, clearly the most effective are those that establish a guarantee fund as a backstop to the payment of employee claims in bankruptcy. In this author's view, however, even those models do not go far enough.

The guarantee fund models rely on a “bankruptcy payment first” concept that requires employees to wait for a period of time (in some cases, months or even years) before they can top up the shortfall in their recovery from the guarantee fund. Many employees and their families can be left destitute while they await the accrued entitlements they are owed. This hardship can be magnified if there is a lengthy delay for payment on back wages and claims. Rather than forcing employees to linger during a potentially drawn out liquidation process where assets have to be identified, realised and distributed, consideration should be given to establishing an immediate right of payment from the insurance or guarantee fund to settle worker claims up front.²⁹ Upon satisfaction of the claims, the guarantee fund would be subrogated to the employee's claims against the debtor to recoup any distributions to which the workers would be entitled. For example, if an employer in Belgium is unable to pay entitlements within fifteen days of the close of the business, the Fund for Closures immediately commences payment on its behalf.³⁰

Critics of insurance funds claim that they are expensive to run, punish successful companies, and benefit only certain employees.³¹ However, all these accusations are difficult to substantiate empirically, as a pure entitlement insurance fund system does not appear to have been comprehensively tested as yet. Although there may be greater cost burdens for business, the burden of the risk of insolvency would appear to be better carried through an insurance fund system prior to insolvency rather than the employees (or the general creditors) afterwards. Shifting the risk to the business and taxpayers in protecting employees is more consistent with the responsibilities and obligations assumed by the debtor and the state.

There are a number of ways in which a country considering such a system can attempt to reduce the cost burden to business. The existing forms of insurance already used widely throughout the developed world (albeit usually in a hybrid system that requires some alteration to be made to the order of priority in bankruptcy) are a good example of this. Some countries may require compulsory insurance through a government-run commission, while other countries require companies to have private insurance to cover worker entitlements in the case of bankruptcy. Still others require contributions by employees, although the question remains as to whether the workers themselves are best placed to bear these costs.

Another alternative used by many countries to minimise the cost of such a scheme to business (and particularly to small business) is to limit compulsory insurance to only those companies with a predetermined minimum number of employees, *e.g.* businesses larger than 20 employees. Another option still is to limit the size of the payout either to a predetermined amount or to a percentage of entitlements owed. In Italy, for instance, an employee can only recover up to 80 percent of entitlements owing.³² Belgium restricts compulsory insurance to the for-profit sector. However, this creates uncertainty as to the security of entitlement payouts for employees in the non-profit sector.

Another option assumed by states attempting to reduce the cost burden of entitlement payouts is to limit the types of entitlements that employees can claim. Some states expressly exclude outstanding holiday pay from priority payments, while others use a combination of included/excluded entitlements, such as commissions, outstanding sick leave, and maternity leave. The availability and level of severance pay also varies widely.

Employees should be able to expect a base level of entitlements in the event of an employer's insolvency. In Part II, Article 12, the ILO clarifies what entitlements workers should expect upon termination of employment.³³ They include a severance allowance or separation benefits based upon length of service and amount of wages to be paid by the employer directly or by an employer contribution fund, as well as unemployment insurance or social security. Part II, Article 6, stipulates that the privilege protection shall include:

- Workers' claims for wages for a period of three months or more prior to the insolvency or termination of employment;
- Workers' claims for holiday pay due as a result of work performed that year and the year before;
- Workers' claims for amounts due for other types of paid absences dating three months or more before the insolvency or termination; and
- Severance pay due to workers upon the termination of their employment.

Some countries do not have worker entitlement insurance that covers some or all of an employee's unpaid wages or retirement claims. In times of crisis, the absence of such "safety nets" may create additional hurdles to recovery and may need to be supplemented with an economic stimulus package as opposed to immediate satisfaction of back claims. The absence of social safety nets or adequate programmes where claims are not likely to be covered in a bankruptcy by the available assets makes for a high wire act of rectifying the past or building for the future. Countries with more scarce resources would no doubt find little justification to follow the path to the past.

Notwithstanding the above, an ideal employee entitlement insurance system would allow for the prompt repayment of 100% of worker entitlements owing. But in the initial stages of building this fund from scratch to a point where it could withstand a major insolvency may take considerable time. To overcome this problem, one solution may be

the Australian model, which consists of a temporary government fund designed to cover entitlement payouts until the newly implemented insurance system has built sufficient capital to operate in its own right.³⁴

A major consideration of any insurance system is what form of corporate governance it will possess. Ideally, it would be administered entirely by the private sector, but this may be unrealistic in countries with undeveloped financial markets. If it were to be controlled by a state—and indeed in many countries, the social security administration may be best placed to operate such a fund—there would nonetheless need to be very tight controls in place to ensure that such a fund is free from corruption and accounted for individually, so profits did not simply become consolidated government revenue.

Other considerations

Although beyond the scope of this paper, another element for consideration would be the role of outstanding contributions to pension/superannuation schemes. This raises the issue of employees who are left with a savings portfolio that consists either of currently worthless stock in their former employer, or an employer-administered pension plan which is now subject to liquidation. Consequently, a country looking to implement an insurance scheme would need to consider whether such a scheme should be obliged to cover outstanding payments to pension funds, or whether this would be considered too great a cost burden.

In addition, while not addressed in detail above, many countries also provide a substantial role for worker unions in determining the most appropriate way to deal with mass redundancies and ensuing worker entitlements. There remains room for further discussion as to how a collective bargaining insolvency agreement would affect the order of creditor priority and, indeed, whether they would be necessary under an insurance scheme such as the one proposed above.

Other specific issues worthy of consideration in a law relating to employee entitlements is the place of victims of work-related injuries who, perhaps, stand to lose the most in countries without well-developed social protection systems, if the former employer becomes insolvent. Brazil³⁵ and, to a lesser extent, Australia³⁶ have made specific provisions for compensation to injured workers to be given higher priority in bankruptcy.

Section III, Article 8, of the Council of the European Communities Directive 80/987/EEC seeks to protect the rights of employees who left a business before its insolvency and had maintained rights with regard to old-age benefits in company pension schemes outside the national statutory social security schemes.³⁷

5) Conclusion

Currently there does not seem to be a perfect legal scheme for handling employee entitlements in the event of employer insolvency. Some are clearly more effective than others. Each of the schemes examined in this paper are flawed in certain ways, as 100 percent of employee entitlements are never fully protected or predictability for creditors is decreased. Employees in insolvency proceedings tend to be treated as neither creditors nor equity, with no vested financial stake in the bankrupt entity (outside of employee stock option plans). Yet, employees universally have the most to lose, as their families' livelihood generally depends upon the wages and benefits for work performed.

Many, maybe the majority, of families around the developing world live on the edge or hand-to-mouth, making the consequences of unemployment even more burdensome for

them and the state. Additionally, employees are generally not privy to the exact financial status of their employers, so bad news may be highly unexpected and not well planned for. As perhaps the most vital part of businesses everywhere, the employee deserves to have legal protection of his/her employment claims.

The purpose of this paper has been to examine the varying legal treatments of employee entitlements in the case of employer insolvency and to encourage developing countries to develop insolvency laws which both achieve market strength and efficiency while protecting the rights of those most vulnerable in the insolvency process.

This paper does not aim to suggest that an entitlement insurance fund is a cure-all in times of large corporate redundancies. Clearly, such a system needs to be supported by active labour market programmes, such as retraining, job search assistance and public works programmes. Insurance or guarantee fund systems, however, could significantly increase the potential for employees to realise their entitlements while minimising the insolvency risks for other commercial stakeholders, and providers of credit and goods.

ANNEX: INSOLVENCY AND SOCIAL PROTECTION: ENTITLEMENTS IN THE EVENT OF EMPLOYER INSOLVENCY

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered
Argentina		Written notice of dismissal at least one month in advance.		Special priority in liquidation for certain claims. A general priority is provided for employees by granting a lien on general assets of the debtor where special priority claims are not	Wage arrears up to 6 months prior to filing, redundancy claims up to 3 months salary.	Special priority for wage arrears, redundancy claims, last month payment <i>in totum</i> , payment in lieu of notice, unfair discriminatory dismissal, worker injury, holiday pay and certain other	No programme.	

12 – CHAPTER TITLE

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered
				paid. No priority over secured claims on immovable assets.		compensations.		
Australia				Priority over unsecured debts and claims. Priority also over claims secured by floating charge (when assets insufficient). No priority over fixed charges.		Wages and superannuation contributions; injury compensation; industrial instrument leave of absence; and retrenchment payments.	After 09/11/01, the General Employees Entitlements and Redundancy Schemes (GEERS) applies to provide terminated employees with unpaid entitlements. In addition, employers must purchase insurance to protect employees' entitlements.	EES: Payments to AUD 20 000 (Australian dollars), unpaid wages leave and redundancy to 4 weeks, pay instead notice up to 5 weeks, service leave up to 12 GEERS: AUD 75 200 02; AUD 81 500 for 0

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims C
Belgium	No.	Employers having 20+ employees must notify the government. If contract is immediately terminated, the salary and benefit claims must be made within 15 days of the close of business.		<p>Preferential claim for unpaid wages, social security contributions.</p> <p>Claims are subordinate claims secured by specific assets.</p>	<p>Wages up to approximately EUR 7 500 (euros), and unlimited for payment in lieu of notice;</p> <p>Social security contributions, including holiday pay, worker injury, social security, and payments to worker indemnity fund.</p>	Workers comp.	Fund for closures.	
Brazil				<p>Priority over tax and general unsecured claims.</p> <p>Partial priority over secured claims, which now rank ahead of tax claims.</p>	<p>Worker comp. Claims have highest priority; followed by wages up to 150 monthly minimum wages (<i>i.e.</i> about USD 13 000).</p>	<p>Compensation for work-related injuries (highest priority), labour and social security, including salaries, vacation pay, and bonuses, severance pay.</p>	No.	

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered
Canada	No.	Written notice or pay. If layoff is temporary or short term, advance written notice or reason for layoff is not required. However, a recall date must be provided.		4 th ranking priority: preferred status over unsecured creditors (except entitlements for severance and termination pay). Secured creditors have priority (except banks holding secured claim under Bank's Act, where employee priority is senior up to 3 month.		Salaries, wages, vacation pay during the six month period prior to bankruptcy.	No specific fund, but unpaid wages, vacation or termination pay may be claimed under Canadian Employment Standards Act, but may not protect an employee if the employer has begun bankruptcy proceedings.	Directors are personally liable for up to 6 months of wages and 12 months of vacation pay under OBB and 6 months of wages under CBCA.
China				Claims of employees are settled first for wages and insurance fees, followed by taxes, and unsecured creditors. Under the SOE		Wages and labour insurance fees.	Unemployment insurance. Minimum living security.	Unemployment insurance system for staff workers in state-owned enterprises pay dismissed employees to 80% of the national minimum wage for 2 years. Minimum living security.

Country	TREATMENT OF CONTRACTS				PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered	
				insolvency law, employee claims have ranked prior to secured claims. The new draft Enterprise Bankruptcy Law maintains a partial priority over secured claims.				ensures minimal standard of living for workers.	
Denmark	No.	Estate has two weeks to decide whether to adopt employment contracts; contracts rejected in 2 weeks are preferential, while others enjoy preference from date of adjudication to notice.		4 th Rank following secured, admin. costs and costs acquired by debtor during the suspension period.		Salaries, wages and other benefits owed to the employee, unpaid pensions, holiday pay, redundancy payments, unfair dismissal, reasonable legal costs.	Employees' Guarantee Fund. Funded by employer contributions.	Covers employee claim wages, vacation pay and severance pay earned during the 6 months before the bankruptcy proceeded up to DKK 110 000 (Danish kroner). EGF subrogates to employee preference claims.	

Country	TREATMENT OF CONTRACTS				PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered	
Finland	No.				Up to FIM 90 000 (Finnish markka, in use until 1/1/02).	Wages.	Wage guarantee system funded by employers.	When the government pays out employee claims on behalf of the insolvent employers, employers are to repay the government within 10 years, unless financial standing would render re-payment unreasonable.	
France	No.			Super-preference for wages not paid in last 60 days; General preference over personal property and real estate for unpaid wages for 6 months prior to adjudication; Priority over secured claims, but not those	Super preference for last 60 days; general preference for last 6 months wages	Wages, paid leave, improper termination and certain dismissal allowances.	Compulsory insurance fund. Association Pour la Gestion du Régime d'Assurances des Créances des Salaries (AGS). Payments required by all <i>in bonis</i> companies.	Employees may recover when insufficient assets recovery is expected to protract. Employees not contribute. By law c May 2004, compensatic agreements concluded 1 months prior to filing ar not covered by AGS.	

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS				SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered	
Germany	No.	With proper notice.		with retention of title. Preference only for worker claims arising after the opening of proceedings. Pre-petition worker claims are treated as general unsecured. Preference ranked <i>pari passu</i> with administrative claims.	Up to the amount of the preference.	Can include wages, holiday pay, bonuses, comparable entitlements and pensions (so long as post-bankruptcy).	Federal Employment Agency for unpaid wages up to 3 months). Claims for unpaid pension obligations can be recovered from the <i>Pensions SicherungsVerein</i> .	Up to 3 months for wages against FEA. Unspecified for PSV. FEA and PSV both subrogate the employees rights against employer. In other words, for general unsecured or preferential claims.	
Hong Kong, China				General priority: -Admin costs. -Fixed charges. -Preferential claims	Wages, severance pay, payment for lack of termination notice, and holiday pay and annual leave.	Wages and severance pay up to HKD 8 000 (Hong Kong dollars), lack of termination notice up to HKD 2 000/1 month's pay, entire amount of	Employees are entitled to payments from Protection of Wages on Insolvency Fund (PWIFB).	Up to HKD 36 000 for HKD 22 500 for payment lieu of notice. HKD 50 000/50% of claim over that amount for severance pay, nothing lost holiday.	

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS				SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered	
				(including employee). -Floating charges. -General unsecured.		holiday pay.			
India				Highest priority. Accorded <i>pari passu</i> treatment with secured claims. Seem also to be ranked equally among taxes and fiscal claims.	Wages or salaries not exceeding 4 months in prior year, accrued holiday pay, amounts owed under Employees State Insurance Act and Workmen's Compensation Act, and pension fund benefits.		Under the Companies (Second Amendment) Act 2002, enacted but not as yet notified, provides for a rehabilitation fund to be established.	Rehabilitation fund provides for interim payments of workmen's dues pending rehabilitation and pursuant to section 529 of the Companies Act.	

Country	TREATMENT OF CONTRACTS				PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Capped	
Ireland	No, insolvency does not create proper grounds for dismissal, either.			Preferential claims rank below admin claims and fixed charges, but ahead of floating charges and general unsecured.		Wages, holiday and sick pay, maternity leave, redundancy, wrongful dismissal, leave and benefits pay.	Social Insurance Fund.	Up to specified amount, any claim capped at absolute maximum of EUR 500 per week). Preference claims not payable in full if employer bankrupt. Minister for Enterprise Trade and Employment subrogates employee preference.	
Italy	No.	Proper notice.	In insolvency, reduced production, or restructuring, only collective dismissal is allowed. Employers must notify their employees of these dismissals in writing and contribute to the cost of up to 9	General priority over movable property for matured wages, retirement indemnity claims and unfair dismissal claims. No priority over claims secured by fixed or immovable assets.		Wages, severance pay, retirement/indemnity, sickness compensation, payment in lieu of notice, holiday pay, redundancy.	Wages Insurance Fund. (<i>Fondo de Garanzia Inps</i>). CIGS for extraordinary unemployment for workers of insolvency employers.	Protects the income of employees of insolvent employers by paying up to 80% of their lost wages. CIGS allows recovery for a maximum of 12 months or 18 months in 5 year period	

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered
			months' availability allowance for each dismissed employee to the INPS.					
Japan				Preferred status for employee's unpaid wage claims over other debts of employer, but not over secured debts, such as tax payments and mortgages.	Salary, severance pay and bonuses.	Salaries earned 6 months prior to bankruptcy (even if bankruptcy court decides to discharge certain debts of the debtor) 1/3 of retirement allowance.	Japan Labour Health and Welfare Organization (JLHWO) allows recovery by employees (who left an insolvent company 6 months prior to and up to 2 years after filing) of up to 80% unpaid wages and retirement allowance. The retirement allowance varies based on age.	No limit on the amount Civil Code states that months of unpaid wages be claimed.

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered
Malaysia				Preference over unsecured claims. Priority over floating charge where assets are insufficient to meet entitlements; No priority over fixed charges.	Wages or salary; workmen's compensation, vacation leave, contributions to superannuation and provident funds for retirement benefits.		No government programme for payment of employee entitlements.	
Mexico				First priority for wages owed within 2 years prior to employer's bankruptcy.	3 months' salary/wages and seniority payment of 12 days' pay for each year of employment.		No private or government sponsored unemployment insurance schemes.	
Netherlands	No.	Trustee or administrator may terminate on maximum 6 weeks notice, and in co-operation with	Governmental permission is required in collective dismissals in the event of	Tax and social security claims have super-preference. Employee claims have	Full time employees up to 13 weeks of wages, unpaid leave entitlements, and termination pay up to		Wage guarantee scheme under the Unemployment Act pays the claims from the Netherlands' social	Arrears and wages up to 6 weeks of wages, termination pay up to 6 weeks.

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims Covered
		management.	bankruptcy.	preference over general unsecured creditors' claims.	6 weeks.		security system. Guarantee fund subrogates to preference status.	Holiday pay/allowances and pension premiums to one year.
New Zealand	Not necessarily; the official assignee may require an employee to continue work anyway.			Preferential claim. Where assets are insufficient, partial priority over claims secured by accounts receivable and inventory (but not assets transferred or subject to purchase money security interest.	Wages, salary and related earnings, holiday pay and redundancy payments, and employee grievance claims.	4 months prior to employer's liquidation and up to NZD 15 000 (New Zealand dollars) of amounts afforded priority.	No government backed programme for employee entitlements, although the Liquidation Surplus Account has been used to settle employee entitlement claims.	
Norway	No.			Yes, claims for wages (worth up to 6 months) or pensions maintain priority in debt, second rank, following the	Wages worth up to 6 months (must be within 4 months of the bankruptcy filing), holiday remuneration	Wages, pensions, holiday remuneration.	Wage guarantee scheme administered by the government.	

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds	Amount/Claims C
				claims for the bankruptcy proceedings costs.	up to 30 months' worth (must have arisen within the 24 months prior to the insolvency).			
OHADA				Employers may be held personally liable.	Wages must be paid within 1 year.			
Philippines		Written notice to the workers and the Dept. of Labour 1 month prior to the termination date. In addition, termination pay equal to at least 1 month's pay or 1 month's pay for every year of service, whichever is higher.		Preferential status; however, arguments in the interpretation of the law exist.				

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds or Statutory Protection	Amount/Claims Coverage
Russian Federation				Preference for worker injury, wages and severance claims. Ranks ahead of secured creditors.	Salaries and wages, severance pay, vacation and related pay, recovery and priority hinge on type of procedure applied.		State development fund in the making to protect further employee entitlements, but no such fund currently exists.	
South Africa	Yes, insolvency terminates all employment contracts.			Limited preference against unencumbered (free) assets of the estate. No preference over secured.	First ranked are wages up to 3 months/ZAR 12 000 (South African rand); Next ranked (all paid <i>pari passu</i>) are holiday up to ZAR 4 000, paid leave up to ZAR 4 000, and severance up to ZAR 12 000.		No fund other than the general benefits of Unemployment Insurance Act.	

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
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UK	No.			<p>Preference payment. Ranked equally with Crown claims.</p> <p>Preference is after admin. costs and fixed charge claims, but ranked ahead of floating charge claims and general unsecured creditors.</p>	<p>Maximum of 8 weeks, up to GBP 800 (United Kingdom pounds) for unpaid wages during 4 months prior to date of insolvency.</p> <p>Up to 6 weeks unpaid holiday pay accrued during 12 months prior to date of insolvency. Unpaid wages and accrued holiday/sick pay. If not possible, division of profits from its remaining assets among employees.</p>		<p>Redundancy Payment Service. RPS gets a super-preference.</p>	<p>RPS pays up to GBP 277 weekly for up to 8 weeks and up to 12 months for pension contributions.</p>

Country	TREATMENT OF CONTRACTS			PRIORITY OF CLAIMS			SOCIAL PROTECTION	
	Automatic Termination	Termination Requirements	Collective Bargaining Agreements	Priority	Allowed Amount	Elements Included	Funds or Statutory Protection	Amount/Claims Coverage
United States			WARN applies to employers with 100 or more full-time employees or part-time employees whose weekly hours amount to 4 000. Requires employers to give employees 60 days of written notice before mass layoffs and/or close of business.	Post-petition wages have highest priority as administrative claims. Pre-petition unpaid wages have preference over general unsecured.	Up to USD 4 650 and must arise from the period of 90 days prior to bankruptcy filing employee. Benefit plan contributions must be within 180 days from bankruptcy or termination of business.	Earned wages, salaries, commissions, vacation pay, sick leave pay, severance pay, and contributions to employee benefit plans.	Single and multi-employer pension plans are guaranteed by the Pension Benefit Guarantee Corporation (PBGC).	PBGC takes over the situation if the employer's obligation to pay guarantee benefits exceeds the statutory maximum amount. PBGC then guarantees the claim against the debtor. With a multi-employer plan: if the employer becomes insolvent, PBGC pays the guaranteed benefits up to USD 6 000 per year per employee.

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- ¹ McNulty, Shiela (2002), “Enron Employees Form Coalition”, *Financial Times*, 20 January 2002.
- ² Korobkin, Donald R. (1996), “Employee Interests in Bankruptcy”, 4 *Am. Bankr. Inst. L. Rev.* 5, 6
- ³ *Id.*
- ⁴ The World Bank (2001), *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*. The World Bank principles, as revised and updated, carry forward the same general principles in treatment, but add a principle calling for special recognition and treatment of labour claims. Principle C.12.4 (revised) provides: “Workers are a vital part of an enterprise and careful consideration should be given to balancing the rights of employees with those of other creditors.”
- ⁵ For purposes of this paper, the more detailed treatment on a country-by-country basis has been omitted.
- ⁶ International Labour Organization (1949), *C95 Protection of Wages Convention*.
- ⁷ *Id.*
- ⁸ International Labour Organization (1982), *C158 Termination of Employment Convention*.
- ⁹ The Council of the European Communities (1980), *Council Directive 80/987/EEC on the Approximation of the Laws of the Member States Relating to the Protection of Employees in the Event of the Insolvency of their Employer*.
- ¹⁰ “Social Policy: European Parliament Backs New Insolvency Directive”, *European Report*, 15 May 2002.
- ¹¹ *Id.*
- ¹² Centre for Environmental Informatics (1998), *Employment Protection*.
- ¹³ Lee, Vicky (2000), Research and Library Services Division, Legislative Council Secretariat, *Unemployment Insurance and Assistance Systems in Mainland China*.
- ¹⁴ Winter-Ebmer, Rudolf (2001), “Long-term Consequences of an Innovative Redundancy-Retraining Project: the Austrian Steel Foundation”, *Social Protection Discussion Paper*, No. 0103, 01/2001, the World Bank Group.
- ¹⁵ The World Bank, East Asia and Pacific Region Private Sector Development Unit (2000), “Bankruptcy of State Enterprises in China—A Case and Agenda for Reforming the Insolvency System”, 20 September 2000.
- ¹⁶ *Id.* at iii. These fees have been based on a formula that applies a multiplier to an employee’s current salary and takes into account length of service. In that sense, the formula and its application can be said to be generally consistently applied, even though the results may seem unequal.
- ¹⁷ The Chinese system, though admirable in its aims, still requires more rigorous enforcement by rule of law if the issue of protecting unviable enterprises is to be addressed and workers rights properly protected.
- ¹⁸ Dario U. Oscos, Coria & Oscos Abogados (2001), *The New Mexican Law on Commercial Insolvency*.

- ¹⁹ See Sheppard citing Ignacio Herrera *et al.*, Excelsior, Mexico, 11 December 1999.
- ²⁰ Rowat, Malcolm (1999), “Reforming Insolvency Systems in Latin America, Public Policy for the Private Sector”, Note No. 187, June 1999, The World Bank Group.
- ²¹ Posthuma, Richard A. *et al.* (2000), “Labour and Employment Laws in Mexico and the United States: An International Comparison”, *Labour Law Journal*, 20 (2000).
- ²² EMIRE, *Denmark: Employees’ Pay Guarantee Fund*.
- ²³ Australian Commonwealth Corporations Act 2001.
- ²⁴ German Federal Parliament (1999), *Insolvenzordnung (InsO)*.
- ²⁵ The World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, *supra* note 4.
- ²⁶ *Id.*
- ²⁷ The priority of administration costs over general unsecured creditors reflects the view that the administrator’s efforts in selling assets inures mainly to the benefit of this class, and consequently should be borne evenly by allowing these expenses to be paid first. This general rule recognises exceptions where secured creditors gain a benefit from having the administrator maintain and dispose of secured assets, which might be surcharged for the activities associated with the effort to sell such assets. Other rules may also come into play, such as whether the administrator’s fees are actual, reasonable and resulted in a benefit to the estate.
- ²⁸ It goes without saying that the same logic applies to priorities for public debt, which can also distort expectations in commercial relationships by allocating a firm’s insolvency risks to the general creditors. Notably, the United Kingdom recently moved to classify outstanding payments to the Inland Revenue Service as merely another unsecured debt. See section 251 of United Kingdom Enterprise Act 2002.
- ²⁹ This assumes a claims resolution process either in bankruptcy or through another administrative procedure that would be dispositive of employee claims.
- ³⁰ EMIRE, *Notice, Belgium*.
- ³¹ New Zealand Ministry of Economic Development (2002), *Employee-Related Claims*.
- ³² EMIRE, *Wages Guarantee Fund (CIG), Italy*.
- ³³ International Labour Organization (1992), *C173 Protection of Workers Claims (Employer’s Insolvency) Convention*.
- ³⁴ Australian Workplace, *General Employee Entitlements and Redundancy Scheme (GEERS)*.
- ³⁵ Felsberg e Associados (2000), “Insolvency Overview: Brazil”, *Global Insolvency Law Database*.
- ³⁶ Section 566(f), Australian Commonwealth Corporations Act 2001.
- ³⁷ The Council of the European Communities (1980), *Council Directive 80/987/EEC On the Approximation of the Laws of the Member States Relating to the Protection of the Employees in the Event of the Insolvency of Their Employer*.