

# EMPLOYEES AND BANKRUPTCY PROCEEDINGS

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## A FRENCH PERSPECTIVE

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Protection of employees and employee claims is a key aspect of French bankruptcy law (the “Bankruptcy Law”)<sup>2</sup>.

The bankruptcy provisions aim at defending the employees both as partners and as creditors of the ailing enterprise.

Employees are informed of the opening of the bankruptcy proceedings and their developments. They are heard by the Court before it renders any major decision. The employees are indeed part of the enterprise’s capacities. The involvement of the employees in the proceedings purports to preserve these capacities.

In addition, maintaining employment is a core goal of the Bankruptcy Law. Dismissing the employees or modifying their employment contracts are subject to specific conditions which may restrict the powers of the debtor’s management and the bankruptcy authorities.

Also, employee claims enjoy a particularly favourable priority treatment. Furthermore, under certain conditions and up to certain limits, payment of such claims is guaranteed.

Protection of employees and employee claims, however, may be altered in case of cross-border bankruptcy proceedings. The cross-border situation, due inter alia to the possible application of foreign laws, the involvement of various bankruptcy authorities and judges in the proceedings and communication difficulties, generates uncertainties and may adversely affect the otherwise protective treatment of employees.

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<sup>2</sup> The Bankruptcy Law is codified in Book VI of the Commercial Code. Recently, bankruptcy provisions have been substantially modified. Few of the recently enacted modifications relate to employees or employee claims.

Various provisions have been introduced, mostly at the EU level, to reduce these uncertainties and, at least to some extent, to restore this protection. On various occasions, courts have followed this approach in cases where EU law did not apply.

This paper

- analyses the main features of the protection of employee and employee claims in the context of the following bankruptcy proceedings: safeguard proceedings (procédure de sauvegarde)<sup>3</sup>, judicial reorganisation proceedings (redressement judiciaire) and liquidation proceedings <sup>4</sup>(II); and

examines how this protection may be modified in cross-border situations (III).

In preliminary remarks, it briefly describes the basic characteristics of these bankruptcy proceedings under the Bankruptcy Law (I).

## **I. Bankruptcy proceedings – Brief description**

### **A. Safeguard proceedings**

The safeguard procedure is a procedure available to a debtor that has not yet ceased its payments<sup>5</sup>, but that is undergoing financial difficulties which may lead to such situation in the future.

The safeguard procedure is intended to reorganize the debtor's enterprise, under the supervision of a court-appointed administrator at an early stage of the financial difficulties, with a view towards maintaining the debtor's activities and employment, and ensuring the payment of the debtor's creditors. It may be characterized as an early judicial reorganisation procedure which is initiated prior to the debtor's cessation of payments.

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<sup>3</sup> These proceedings are often considered as judicial reorganisation proceedings opened at an early stage. See below.

<sup>4</sup> The other proceedings are so-called amicable proceedings. Under the mandataire ad hoc proceedings, the President of the Court may appoint a so-called mandataire ad hoc (*ad hoc* agent) to assist an undertaking facing financial difficulties. The President determines the mandataire's mission. Under the conciliation proceedings, the Court designates a conciliator who negotiates agreements with the debtor's main creditors and draws up a plan for reorganizing the enterprise. This procedure is a four-month voluntary settlement process renewable for one month.

<sup>5</sup> The debtor has ceased its payments when it may not pay its debts due with its available assets. Article L. 631-1 of the Commercial Code.

## **1. Commencement of safeguard proceedings**

The Court initiates a safeguard procedure after having heard the debtor, the workers' committee<sup>6</sup> (or the personnel's delegates<sup>7</sup>) and any other party it deems necessary. The Court appoints inter alia a judicial administrator (administrateur judiciaire) and a judicial agent (mandataire judiciaire)<sup>8</sup>. An observation period<sup>9</sup> is then commenced. During this period, the administrator assisted by the debtor will establish a thorough economic and social inventory of the debtor's enterprise and draw up a proposed safeguard plan to allow the enterprise to continue its activity.

## **2. Effects of the safeguard procedure**

In principle, the debtor remains in possession. It may continue to exercise its activity and maintains management control over the concerned enterprise. The judicial administrator may only supervise or assist the debtor's management. It may not represent the debtor.

The opening of the safeguard procedure suspends the claims against the debtor and its individual sureties, guarantors or joint obligors. In principle, it prevents the debtor from paying any claims having arisen prior to the judgment which opened the safeguard procedure.

During the safeguard procedure, the administrator and the debtor will negotiate reorganization measures with the creditors. Negotiations are conducted with a view towards drawing up a reorganization plan.

A safeguard plan is then drawn up and approved by the Court if there is a "*serious possibility that the enterprise may be safeguarded*"<sup>10</sup>. A safeguard plan may provide, for example, for the sale of all or parts of the branches of activities of the debtor's enterprise and/or change in its capital structure, and/or the replacement of the debtor's management.

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<sup>6</sup> Setting up a workers' committee is mandatory when the enterprise employs more than 50 employees.

<sup>7</sup> The election of personnel's delegates is required when the enterprise employs at least 11 employees.

<sup>8</sup> The judicial administrator is in charge of supervising the debtor's management or assisting the debtor in connection with all or certain of its management activities. Article L. 622-1 of the Commercial Code. See infra. The judicial agent has authority to act on behalf and in the collective interests of the creditors. Article L. 622- 20 of the Commercial Code.

<sup>9</sup> The maximum duration of the observation period is six months. It may be renewed once upon request of the administrator, the debtor or the public prosecutor. Exceptionally, it may be extended upon request of the public prosecutor for a maximum period of six months . Article L. 621-3 of the Commercial Code.

<sup>10</sup> Article L. 626-1 of the Commercial Code.

If the debtor subsequently does not perform its obligations under the safeguard plan, the Court may terminate the plan depending upon the underlying circumstances and, in particular, the seriousness of the debtor's breach.

## **B. The judicial reorganisation process**

The judicial reorganization procedure's objective, namely, maintaining the debtor's activity and employment, and ensuring the payment of the debtor's creditors, is identical to the one set out under the safeguard procedure. The judicial reorganization procedure is, however, necessary as the commencement of the safeguard procedure rests only on the debtor's initiative. Also, the debtor may cease his payments during the safeguard proceedings.

### **1. Commencement of a judicial reorganization process**

The judicial reorganization procedure may be initiated upon the debtor's request within forty five days following its "*cessation of payments*". It may also be commenced upon the creditors' or the public prosecutor's request and, as a matter of right, by the Court.

The provisions as to the commencement of an observation period in view of establishing a thorough economic and social inventory of the debtor's enterprise, as well as the drawing up of proposals to allow the enterprise to continue its activity applicable under a safeguard procedure are also applicable during a judicial reorganisation process.

### **2. Effects of a judicial reorganization procedure**

Under a judicial reorganization procedure, the Court may decide either to confide the management of the debtor's enterprise to an administrator appointed by the Court, or to require that the current management of the debtor's management be assisted by this administrator.

The above discussed provisions as to the establishment of a reorganization plan under the safeguard procedure are also applicable under the judicial reorganization process.

Although a debtor's enterprise is not to be put up for sale during a judicial reorganization procedure, interested buyers may submit purchase offers.

## **C. The judicial liquidation procedure**

A judicial liquidation is initiated when the debtor has ceased its payments and the rescue of its business is "*manifestly impossible*". As defined by the Bankruptcy Law, this procedure is designed to terminate the enterprise's activity and to sell the debtor's assets in all or in part<sup>11</sup>.

### **1. Commencement of a judicial liquidation procedure**

A debtor must file for liquidation within 45 days from its cessation of payments if it has not begun a conciliation procedure<sup>12</sup>. If there is no ongoing conciliation procedure, the public prosecutor or a creditor may also request that a judicial liquidation procedure be commenced. In addition, this procedure may be commenced as a matter of right by the Court<sup>13</sup>.

In its judgment, the Court designates in particular a liquidator who must establish, within one month of his appointment, a report on the situation of the debtor<sup>14</sup>. This report is designed to assist the Court in determining whether a simplified liquidation procedure should be commenced. The simplified liquidation process is intended to accelerate the liquidation of small companies that do not own real estate property, and whose annual turnover and number of employees do not exceed certain thresholds<sup>15</sup>.

### **2. Outcome of the judicial liquidation procedure**

The liquidation procedure may lead to the transfer of the debtor's business.

The transfer plan is part of the judicial liquidation. The sale of the debtor's enterprise under a judicial liquidation procedure is intended to maintain those activities that are autonomously sustainable and the employment attached thereto, and pay the debtor's outstanding debts<sup>16</sup>. A party interested in purchasing all or part of the debtor's

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<sup>11</sup> Article L. 640-1 of the Commercial Code, second paragraph.

<sup>12</sup> See footnote 4 supra.

<sup>13</sup> Article L. 640-5 of the Commercial Code. A liquidation procedure may also be commenced if the conciliation procedure has failed. Article L. 640-4 of the Commercial code. Likewise, it may be opened during the observation period of safeguard or judicial reorganization proceedings or during the related plan when the debtor has ceased its payments. Articles L. 622-10 and L. 626-27 of the Commercial Code.

<sup>14</sup> unless the Court opens a liquidation procedure during an observation period.

<sup>15</sup> Article L. 641-2 of the Commercial Code. The simplified liquidation procedure applies when the number of employees and the annual turnover are respectively inferior or equal to 5 employees and 750 000 euros (exclusive of taxes) during the 6 month period prior to the commencement of the proceedings.

<sup>16</sup> Article L. 642-5 of the Commercial Code.

enterprise must submit a detailed offer to the Court, which the Court may accept or deny.

The Court chooses the offer which best insures on a durable basis that the employment attached to the transferred elements will be preserved, that the creditors will be paid and that offers the strongest guarantees of performance<sup>17</sup>.

## **II. Protection of employees and employee claims – main features**

### **A. Information and consultation of employees – standard provisions**

Generally, the workers' committee must be informed and consulted in regard to the organisation, management and operation of the enterprise and, in particular, in respect of measures which may affect the number of employees and the working conditions.

The committee is further informed and consulted in regard to modifications of the legal or economic organisation of the enterprise, for example in case of mergers, transfers or substantial modification of the production structures<sup>18</sup>.

In addition, the workers' committee may request explanations from the employer as to worrisome information regarding the enterprise's economic situation<sup>19</sup>.

### **B. Employees 'participation in bankruptcy proceedings**

#### **1. Prior to the commencement of the bankruptcy proceedings**

a. Generally, before the proceedings are opened, the workers' committee (or the personnel's delegates) exercise their powers in accordance with standard applicable provisions.

In addition, this committee (or the delegates) may communicate to the President of the Court or the public prosecutor any information which may reveal the employer's cessation of payments<sup>20</sup>. These authorities, if they deem it appropriate, may refer this matter to the Court which may then trigger an investigation in regard to the employer's situation.

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<sup>17</sup> Article L. 642-1 of the Commercial Code.

<sup>18</sup> Article L. 432-1 of the Labour Code. The workers' committee is also entitled to receive the same information as the one provided to shareholders. Article L. 432-4 of the Labour Code.

<sup>19</sup> Article L. 432-5 of the Labour Code.

<sup>20</sup> Articles L. 631-6 and L. 640-6 of the Commercial Code.

b. Prior to filing a petition for bankruptcy, the employer must inform and consult the workers' committee (or the personnel's delegates)<sup>21</sup>.

c. The Court may not commence safeguard, reorganisation or liquidation proceedings without having heard the representative of the workers' committee (or the personnel's delegates)<sup>22</sup>.

The workers' committee (or the personnel's delegates) may participate in the court hearings (which are held in camera). They may present observations and file briefs.

d. Prior to rendering its decision, the Court must verify that all prescribed requirements regarding employees have been satisfied.

In the bankruptcy judgment, the Court shall request the workers' committee (or the personnel's delegates) to designate representatives<sup>23</sup>.

## **2. After the commencement of the bankruptcy proceedings**

### **a. During the observation period**

In case of safeguard or reorganisation proceedings, the judicial administrator must prepare a report regarding the economic and social situation of the employer's enterprise. This report analyzes the origin, the magnitude and the nature of the difficulties faced by the enterprise<sup>24</sup>.

The judicial administrator must advise the workers' committee of the advancement of this report. Also, he must consult the committee as to the measures he envisages proposing to the Court further to the information and offers he has received<sup>25</sup>.

In addition, the workers' committee (or the personnel's delegates)

- are informed by the judicial administrator of the proposals regarding the payment of creditors' claims,

- must be heard by the Court before it takes any decision regarding the possible replacement of the enterprise's managers or transfer (or non-transferability) of the shares held by these managers<sup>26</sup>.

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<sup>21</sup> Article L. 432-1 of the Commercial Code.

<sup>22</sup> Article L. 621-1 of the Commercial Code.

<sup>23</sup> Article L. 621-4 of the Commercial Code.

<sup>24</sup> Article L. 623-1 of the Commercial Code.

<sup>25</sup> Article L. 623- 3 of the Commercial Code.

## **b. Safeguard or reorganisation plans**

The judicial administrator files with the Court the report analysing the economic and social situation of the debtor and, as the case may be, proposes a safeguard or reorganisation plan for the rescuing of the employer's enterprise.

The Court must hear the Committee (or the delegates) before it renders its decision on the proposed plan <sup>27</sup> and subsequently, in case it decides to substantially modify its means and objectives.

## **c. Recourses**

The Bankruptcy Law vests the workers' committee (or the personnel's delegates) with powers to challenge certain decisions of the Court or the bankruptcy authorities.

For example, this committee (or the delegates) may take an appeal against the Court's decisions pronouncing judicial liquidation, approving, rejecting or modifying a safeguard or reorganisation plan<sup>28</sup>.

## **d. Dismissals.**

In case of reorganisation or liquidation proceedings, the judicial administrator and the liquidator must inform the workers' committee (or the personnel's delegates) of these dismissals and consult with them on the proposed measures<sup>29</sup>.

## **C. Protection of employment**

### **1. Preliminary remarks – standard provisions**

#### **a. Economic dismissals**

Generally, employees are extensively protected against dismissals and in particular, dismissals due to the economic difficulties faced by the employer (the so-called economic dismissals).

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<sup>26</sup> Article L. 626-4 of the Commercial Code.

<sup>27</sup> Article L. 626-9 of the Commercial Code.

<sup>28</sup> Article L. 661-1 of the Commercial Code. Illustratively, the workers' committee of France Soir (a leading French newspaper currently undergoing bankruptcy proceedings) took an appeal against the decision of the Lille Commercial court ordering the transfer of France Soir's business to certain transferees. Le Monde, April 21, 2006.

<sup>29</sup> Article L. 321-9 of the Labour Code. Article L. 631-17 of the Commercial Code.



a.1. For the present purposes, it shall only be noted that the employer, prior to proceeding with these dismissals, must endeavour to find alternative positions for the employees to be dismissed (within his enterprise or within the group to which this enterprise belongs)<sup>30</sup>.

a.2. In case of dismissals by enterprises employing at least 50 employees and when these dismissals concern at least 10 employees over a 30 day period, a so-called safeguard employment plan (plan de sauvegarde pour l'emploi) must be established<sup>31</sup>.

Courts closely examine the validity of safeguard employment plans. Dismissals carried out pursuant to employment safeguard plans which do not comply with prescribed requirements are void.

a.3. The employee who has been dismissed on economic grounds enjoys a rehiring priority. Any position which subsequently becomes available and is compatible with this employee's qualifications must be proposed to this employee<sup>32</sup>.

## **b. Transfer of businesses**

Article L. 122-12 of the Labour Code provides that in case of transfer of the employer's enterprise, existing employment contracts shall be automatically transferred to the transferee. This rule applies regardless of the legal modification to which the employer's enterprise may be subject (for example, mergers, succession, sale or transformation of the going concern). Article L. 122-12 may not be contracted out by the parties.

A similar solution has been adopted at the EU level pursuant to Council Directive 2001/23/EC<sup>33</sup>.

The new employer is liable vis-à-vis the employees for the performance of the previous employer's obligations existing as of the transfer date<sup>34</sup>.

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<sup>30</sup> Article L. 321-1 of the Labour Code.

<sup>31</sup> Article L. 321-4-1 of the Labour Code.

<sup>32</sup> Article L. 321-14 of the Labour Code.

<sup>33</sup> Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses. As opposed to EU law, French law does not grant the employee the right to object to his transfer.

<sup>34</sup> The new employer may seek reimbursement from the previous employer of the sums due to the employees as a result of obligations accrued prior to the transfer date.

## **2. Bankruptcy**

### **a. Protection of employment - a main goal of the bankruptcy proceedings**

Preserving employment is one of the major goals of the Bankruptcy Law<sup>35</sup>. Maintaining employment is indeed expressly mentioned as one of the three leading objectives of safeguard, reorganisation and liquidation proceedings<sup>36</sup>.

Illustratively, the measures to be taken in respect of employment constitute one of the main components of safeguard or reorganisation plans.

Generally, the safeguard or reorganisation plan to be proposed by the judicial administrator must determine the prospects for rescuing the debtor's enterprise on the basis of the debtor's activities, the market conditions and the available financing means<sup>37</sup>.

The draft plan, however, must also set forth the prospects for employment as well as the social conditions which are envisaged in view of continuing the debtor's activities<sup>38</sup>. In case of economic dismissals, the draft plan must also specify the measures to be taken in order to facilitate the finding of new positions by the employees to be dismissed and their indemnification.

### **b. Dismissals – judicial authority**

In principle, the commencement of the bankruptcy proceedings is not a cause for the termination of the employment contracts. These contracts remain in force and are governed by the same contractual conditions as those which applied prior to the opening of the proceedings.

Employees, however, may be dismissed during the course of the proceedings.

#### **b.1. during the observation period**

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<sup>35</sup> Reportedly, bankruptcy proceedings concern 300 000 employees each year. These proceedings lead to 150 000 dismissals. 90 per cent of these proceedings concern enterprises employing less than 10 employees. Debates before the National Assembly, March 2, 2005 ("Debates").

<sup>36</sup> See Articles L. 620-1, L. 631-1 and L. 642-5 of the Commercial Code.

<sup>37</sup> Article L. 626-2 of the Commercial Code.

<sup>38</sup> Id.

The bankruptcy judge has exclusive authority to decide upon economic dismissals<sup>39</sup>. These dismissals are decided at the judicial administrator's request.

The judge's order must specify the number of employees to be dismissed as well as the concerned activities and categories.

#### b.2. further to the adoption of a reorganisation plan

The court adopts or rejects the reorganisation plan. The plan specifies the dismissals which must be effectuated within one month of the adoption plan upon the judicial administrator's notification (subject to applicable notice periods)<sup>40</sup>.

The judgment mentions the number of employees to be dismissed and the activities and categories concerned. Only such dismissals are authorized. The other dismissals are subject to the standard provisions applicable to economic dismissals.

#### b.3. further to the liquidation

Dismissals do not require specific prior authorisation. The liquidator is authorized to proceed with dismissals as result of the liquidation judgment.

The court may adopt a plan whereby the debtor's enterprise will be transferred to a third party<sup>41</sup>. The plan must provide for the dismissals which shall be effectuated within one month of the transfer judgment<sup>42</sup>.

### **c. Modifications to the standard provisions and case law.**

Various modifications to the standard solutions have however been introduced in order to take into account the particular constraints resulting from bankruptcy proceedings (such as the urgent character of certain measures required to rescue the debtor's enterprise).

c.1. The procedural requirements as to economic dismissals in case of reorganisation or liquidation proceedings are less restrictive.

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<sup>39</sup> Article L. 631-17 of the Commercial Code.

<sup>40</sup> Article L. 631-19 of the Commercial Code. Standard provisions apply to the economic dismissals decided in connection with safeguard plans.

<sup>41</sup> Article L. 641-4 of the Commercial Code.

<sup>42</sup> Article L. 642-5 of the Commercial Code.

For example, only one meeting of the workers' committee is necessary in case of dismissals involving at least ten employees during a thirty-day period<sup>43</sup>.

In case of reorganisation or liquidation proceedings, economic dismissals are not subject to prior consultation with the labour administrative authorities. These authorities must only be informed of the proposed dismissals<sup>44</sup>.

c.2. In case of reorganisation, the bankruptcy judge may authorize the judicial administrator to proceed with economic dismissals when such dismissals are urgent, unavoidable, and indispensable<sup>45</sup>. The judicial administrator must annex to his request evidence of the steps he has taken in order to find new positions for the persons to be dismissed and ensure their being indemnified.

c.3. The standard protective rules in the event of transfers of undertakings do not apply in case of transfers of the debtor's enterprise decided upon further to the adoption by the Court of a transfer plan<sup>46</sup>.

These transfer plans purport *inter alia* to maintain the debtor's activities which may be operated on an autonomous basis and preserve the employment related to such activities. When adopting the plan, however, the Court may approve the prior dismissals of employees working for the enterprise to be transferred<sup>47</sup>. The provisions of the Labour Code regarding the automatic transfer of employment contracts do not apply in this case. The Supreme Court has ruled that Article L. 122-12 does not apply under such circumstances and upheld the validity of these dismissals.<sup>48</sup>

In addition, the transferee is only liable *vis-à-vis* the employees whose contracts have been transferred for the obligations under these contracts which accrued as of the transfer date. Accordingly, the debtor remains liable for the paid vacation indemnities which accrued prior to the transfer date or for bonuses whose payment date was prior to the transfer.

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<sup>43</sup> Article L. 321-9 of the Labour Code.

<sup>44</sup> Article L. 321-8 of the Labour Code.

<sup>45</sup> Article L. 631-19 of the Commercial Code. As to liquidation proceedings, see Article L. 631-17 of the Commercial Code. This rule does not apply in case of safeguard proceedings. The rationale of this exception is to avoid an abusive use of safeguard proceedings by the debtor as a tactical legal vehicle to easily dismiss employees.

<sup>46</sup> The Supreme Court has also ruled that Article L. 122-12 does not apply to the employees dismissed during the observation period further to the judge's authorisation. Cass. soc., October 27, 1999, n°) 244.

<sup>47</sup> Articles L. 631-19 and L. 642-5 of the Commercial Code. In his offer to be presented to the judicial administrator, the transferee candidate must specify the employment level and prospects which are justified in regard to the activities to be transferred. Article L. 642-2 of the Commercial Code. This provision impliedly acknowledges that such activities may be subject to a social reorganisation by the transferee. Béraud, *En finir avec les incertitudes pesant sur le sort des contrats de travail en matière de cession d'unités de production*, *Revue des procédures collectives* 2003, p. 92.

<sup>48</sup> Cass. soc., October 26, 1994, n°) 93-42.274.

## **D. Employee claims**

Employee claims enjoy a particularly favourable treatment:

- such claims are not subject to the otherwise standard prior submission requirement (1);
- they enjoy high ranking priority (2);
- up to certain limits, their payment is guaranteed (3).

### **1. No prior submission**

In principle, all creditors whose claims accrued prior to the bankruptcy judgment must submit proof of their claims to the judicial agent<sup>49</sup>.

Employees, however, are exempt from this requirement.

In practice, the list of the employee claims is prepared by the judicial agent under the control of the employees' representative and the bankruptcy judge<sup>50</sup>. This list, once finalized, is stamped by the bankruptcy judge and filed with the clerk of the Court<sup>51</sup>. Each employee is informed of whether his claim has been admitted and if so, for which amount.

The employees whose claims have not been admitted may contest this decision before the labour court.

### **2. High ranking priority**

Employee claims enjoy the benefit of various privileges and guarantees.

#### **a. Claims accrued prior to the commencement of the bankruptcy judgment**

##### **a.1. The so-called super privilege**

Certain employee claims are so-called super privileged. In principle, this super privilege prevails over any other privileges and securities<sup>52</sup>.

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<sup>49</sup> Article L. 622-24 of the Commercial Code.

<sup>50</sup> Article L. 625-2 of the Commercial Code.

<sup>51</sup> Article L. 625-6 of the Commercial Code.

<sup>52</sup> Article L. 143-10 of the Labour Code.

The super privilege applies in case of safeguard, reorganization or liquidation proceedings.

The super privileged claims include, up to certain limits, the claims relating to any remunerations due to the employees in respect of the past 60 days prior to the commencement of the bankruptcy proceedings<sup>53</sup> as well as the paid vacation indemnities in respect of a past 30-day period<sup>54</sup>.

The super privileged claims must be paid upon the order of the bankruptcy judge within 10 days of the bankruptcy judgment (provided that the necessary funds are available)<sup>55</sup>.

#### a.2. General privileges

Certain employee claims enjoy general privileges over the debtor's movables and immovables<sup>56</sup>. These claims mainly include the claims relating to the

- salaries to be received for the last six months during which the employees effectively provided services;
- damages due as a result of wrongful dismissals;
- annual paid vacation and notice period indemnities;
- severance indemnities.

The privilege over the debtor's movables ranks behind the general privilege granted to tax claims and special privileges (for example privileges granted to landlords and secured creditors) and on equal footing with the general privilege granted to social security claims.

#### **b. Claims accrued after the bankruptcy judgment**

##### b. 1. Claims arising from the performance of employment contracts

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<sup>53</sup> This period covers the last 60-day period during which employees effectively provided services even if such period does not immediately precede the bankruptcy judgment.

<sup>54</sup> Article L. 143-11 of the Labour Code.

<sup>55</sup> Article L. 625-8 of the Commercial Code. Prior to establishing the list of employee claims and after being authorized by the bankruptcy judge, the judicial administrator must pay to the employees an amount equal to one monthly salary unpaid. Id.

<sup>56</sup> Articles 2331 and 2375 of the Civil Code.

In case of continuation of the debtor's activities, the claims which validly accrue after the bankruptcy judgment are paid upon maturity<sup>57</sup>.

These claims include the claims arising from the performance of employment contracts during the observation period or, in case of liquidation, the authorized period during which the debtor's activities are continued<sup>58</sup>.

The administrator or, as the case may be, the liquidator are responsible for ensuring the payment of these claims.

If not paid upon maturity, these claims prevail over any other claims (except for the claims which are covered by the super privilege, judicial expenses, claims resulting from certain cash flow facilities and certain secured claims)<sup>59</sup>.

### b.2. Claims arising from the breach of employment contracts

These claims are covered by the general privileges mentioned under Paragraph II. D.2.a.2. supra.

## **3. Employee claims - payment - guarantee**

### **a. AGS - the insurance<sup>60</sup> institution**

Any employer is required to insure its employees against the risk of non-payment of claims arising from employment contracts, in case of safeguard, reorganization or liquidation proceedings<sup>61</sup>. The insurance system is managed by an association, the so-called AGS (Association pour la gestion du régime d'assurance des salaires), through its various local management centers, the so-called CGEAs<sup>62</sup>. This association was created by national professional employers' organisations<sup>63</sup>.

The insurance is financed through the employers' contributions. The contributions are assessed upon the employees' remuneration.

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<sup>57</sup> Article L. 641-13 of the Commercial Code.

<sup>58</sup> Except for the employee claims whose payment has been made further to advances extended by the AGS. See below.

<sup>59</sup> Article L. 641-13 of the Commercial Code.

<sup>60</sup> For the purpose of this paper, the term insurance is used in a generic sense.

<sup>61</sup> Article L. 143-11-1 of the Labour Code. In various instances, this system also enables the debtor's enterprise to alleviate its cash flow difficulties and thus to avoid liquidation. This system, therefore, may facilitate the transfer of the debtor's enterprise and thus indirectly help to preserve employment. Soenne, L'AGS est-elle en faillite?, *Revue des procédures collectives*, 2003, p. 291 (« Soenne »).

<sup>62</sup> In 2003, the AGS indemnified 294 000 employees. The indemnities paid by the AGS amounted to 2 billion euros. See Debates.

<sup>63</sup> Article L. 143-11-4 of the Labour Code.

## **b. Coverage**

b.1. Up to certain limits<sup>64</sup>, the insurance system covers the claims arising from the performance as well as the breach of employment contracts<sup>65</sup>.

Within these limits, it guarantees inter alia the payment of

(i) the sums due to the employees<sup>66</sup> upon the judgment commencing reorganization or liquidation proceedings<sup>67</sup>.

These sums include the vacation paid indemnities or the damages due as a result of wrongful dismissals.

(ii) the claims resulting from the termination of employment contracts which occurs

.during the observation period;

.within a month following the judgment approving the safeguard, reorganization or transfer plans;

. within 15 days following the judgment pronouncing the liquidation and during the period when the debtor's activities may be continued<sup>68</sup>;

(iii) in case of liquidation, up to one month and a half of salary, the sums due to the employees in consideration for the performance of the employment contracts during

. the observation period;

. the 15 days following the liquidation judgment;

. the period when the debtor's activities were temporarily continued<sup>69</sup>.

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<sup>64</sup> The amount of these limits varies depending upon the seniority of the employees. For example, in 2006, the aggregate amount of coverage per employee is 62 136 euros provided that the employment contract was entered into with the employer at least two years prior to the judgment commencing the proceedings. Due to the financial difficulties encountered by the AGS, these amounts were decreased in 2003. Soinne, at 292.

<sup>65</sup> Article L. 143 11-1 1°) of the Labour Code.

<sup>66</sup> As an exception, the insurance system does not cover the sums due further to economic dismissals effected pursuant to agreements entered into or the employers' unilateral decisions notified less than 18 months prior to the judgment commencing the safeguard, reorganisation or liquidation proceedings. Article L. 143-11-3 of the Labour Code.

<sup>67</sup> It should be noted that the AGS does not cover the sums due upon the opening of safeguard proceedings. According to the parliamentary debates, the AGS coverage of these sums might have induced certain debtors to resort to safeguard proceedings for the purpose of reducing their salary costs. See Taquet, *Le nouveau champ d'application de l'AGS*, *Revue des procédures collectives*, 2005, p. 295 (« Taquet »).

<sup>68</sup> Article L. 143-11-1 2°) of the Labour Code.



To be covered, the claims must appear on the list of employee claims prepared by the judicial agent or be recognized further to a judgment rendered by the labour court.

**c. Payment – procedure**

The AGS receives the list of accepted employee claims.

In the event the employee claims may not be satisfied out of the sums available, the judicial agent requests the AGS to advance the funds required (within the prescribed limits)<sup>70</sup>.

The funds must be paid to the agent and not to the employees. Depending upon the type of employee claims, the payment must be made within 5 to 8 days of the date when the AGS received the list of employee claims. The judicial agent then transfers the relevant amounts to the employees.

**d. Subrogation**

The AGS may collect from the debtor the sums paid to the employees<sup>71</sup>.

To this effect, the AGS is subrogated into the employees 'rights when it advanced funds for the payment of the sums due to the employees in respect of

(i) any claims accrued during safeguard proceedings<sup>72</sup>;

(ii) claims covered by the super privilege;

(iii) in case of liquidation, the sums due to the employees in consideration for the performance of the employment contracts during

. the observation period;

. the 15 days following the liquidation judgment;

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<sup>69</sup> Article L. 143-11-1 3°) of the Labour code.

<sup>70</sup> Article L. 143-11-7 of the Labour Code. Upon commencement of safeguard proceedings, the debtor is not in a state of cessation of payments. In case of such proceedings, the AGS may therefore require the judicial agent to justify that the sums available are not sufficient to pay the sums due. Id.

<sup>71</sup> In 2003, the AGS collected from debtors about 34.9 percent of the sums advanced to employees. Two thirds of the advanced amounts are not repaid. Senate Report 335, 2004-2205.

<sup>72</sup> Article L. 143-11-9 of the Labour Code. According to the parliamentary debates, the purpose of this provision is to not jeopardize the financial situation and the recovery rate of the AGS. See Taquet, at 295.

. the period when the debtor's activities were temporarily continued.

The other employee claims paid through the AGS, however, will be treated for AGS purposes as claims accrued prior to the bankruptcy judgment (and enjoy the benefit of the related privileges<sup>73</sup>). Therefore, as to those claims, the subrogation mechanism is altered<sup>74</sup>.

### **III. Cross-border proceedings**

Treatment of employees may greatly vary depending inter alia upon their place of work.

For the purpose of this paper, only the situation of employees working in France for the French branch or subsidiary of a foreign company subject to bankruptcy proceedings abroad will be addressed.

#### **A. Information and participation of the employees in the bankruptcy proceedings**

##### **1. Workers' committee (or personnel's delegates)**

French rules as to employees' representation and employees' information apply to French establishments of foreign companies<sup>75</sup>.

The Supreme Court has held that the location abroad of the company's registered seat should not prevent the employees from receiving information as to the enterprise's economic situation<sup>76</sup>.

##### **2. Absence of a workers' committee (or personnel's delegates)**

In the absence of a workers' committee (or personnel's delegates), the employee may resort to the standard provisions of the EU Regulation on insolvency proceedings (the "EU Regulation")<sup>77</sup>.

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<sup>73</sup> Article L. 143-11-9 of the Labour Code.

<sup>74</sup> Failing this modification, the dismissals decided during or at the end of the proceedings might create excessive liabilities that may in turn jeopardize the rescue of the debtor's enterprise. Under certain conditions, the Court may order that payment of the claims which accrued prior to the bankruptcy judgment be deferred. Article L. 626-18 of the Commercial Code.

<sup>75</sup> French rules as to employees' representation and information are mandatory. They apply as a matter of public policy to any businesses carrying out their activities in France. See generally, Urban, La protection juridique incertaine des salariés dans une procédure collective transfrontalière, JCP G 2006, p. 545 (« Urban »).

<sup>76</sup> Cass. soc., December 6, 1994, n° 92-21.437. See at the EU level, Article L. 439-6 of the Labour Code.

<sup>77</sup> Council regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings. The EU Regulation applies to proceedings where the centre of the debtor's main interest is located in the Community. Preamble of the EU Regulation, Paragraph 14.

Article 40 of the EU Regulation provides that as soon as insolvency proceedings are opened in a Member State, the Court of that State having jurisdiction or the liquidator shall immediately inform the creditors who have their habitual residence in the other Member States<sup>78</sup>.

The EU Regulation, however, does not contain any provision which supports the participation of the employees in the proceedings.

To this effect, employees must resort to the domestic provisions of the Member States. Commentators express the opinion that under such circumstances, the participation rights of the employees are governed by the law of the Member State where the proceedings are opened<sup>79</sup>.

### **3. Secondary proceedings**

Should the law governing the bankruptcy law limit (or not provide for) employees' participation, the employees may seek the opening in France of secondary proceeding<sup>80</sup>. Pursuant to Article 28 of the EU Regulation, the law applicable to the secondary proceedings will be French law. The employees would then enjoy the benefit of the French rules as to information and participation<sup>81</sup>.

Such proceedings, however, may present disadvantages for the employees working in France. Secondary proceedings must be liquidation proceedings<sup>82</sup>. Clearly, the liquidation may seriously reduce the possibilities of preserving employment.

### **4. The EU Regulation and groups of companies.**

Courts of the Member States increasingly apply the EU regulation in the context of groups of companies<sup>83</sup>.

Pursuant to this case law, Courts of the Member State in which the group's headquarters are situated find that the centre of the main interests of this group's

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<sup>78</sup> Article 40 of the EU Regulation details the information to be provided.

<sup>79</sup> Article 4 of the EU Regulation provides that except as otherwise provided, the law applicable to insolvency proceedings and their effects is that of the Member State within the territory of which such openings are opened. As to the possible application on this issue of the law governing the employment contract, see discussion in Urban, at 547.

<sup>80</sup> See Urban, at 547. Under Article 3.2 of the EU Regulation, secondary proceedings may be opened by the courts of a Member State only if the debtor possesses an establishment within the territory of that State.

<sup>81</sup> See supra Paragraph II. A.

<sup>82</sup> See Article 27 of the EU Regulation.

<sup>83</sup> On this issue, see Gaillot, The application of the EU regulation on insolvency proceedings to groups of companies – A French perspective, to be published in the September 2006 issue of the Insolvency, Restructuring and Creditors' Rights Newsletter (IBA).

foreign subsidiaries is also located in that Member State and open main proceedings against those subsidiaries.

Illustratively, UK judges opened main proceedings against the foreign subsidiaries of the MG Rover group (including the French Rover subsidiary). In December 2005, the Versailles Court of Appeals upheld the judgment rendered by the Court of lower instance recognizing in France the opening of such proceedings in England and ruled that such recognition was not contrary to French public policy<sup>84</sup>. The Court of Appeals further stated that under the circumstances of this matter, this recognition prevented French courts from opening secondary proceedings.

Several significant aspects of the Versailles Court of Appeals' decision relate to the treatment of employees' rights in the context of foreign bankruptcy proceedings.

The French public prosecutor objected to the recognition of the UK judgment on several grounds. Inter alia, the prosecutor advanced that UK law ignored employees' rights to be represented, informed of the bankruptcy developments and to exercise their various prerogatives. On this basis, the public prosecutor argued that the UK judgment was not compatible with French public policy.

The Court of Appeals, however, did not follow the public prosecutor's argumentation. The Court referred to Paragraph 22 of the EU Regulation's preamble whereby recognition of judgments delivered by the courts of the Member States should be based on the principle of mutual trust and grounds for non-recognition should be reduced to the minimum necessary<sup>85</sup>. The Court also noted that under Article 26 of the EU Regulation, recognition of a Member State judgment must be refused only if such recognition would be manifestly contrary to public policy, in particular the fundamental principles or the constitutional rights and liberties of the individuals<sup>86</sup>.

The Court observed that under the circumstances of the particular case, it had not been demonstrated that UK law either deprived employees of any means of information and participation or that the employees had been unable to express their opinions and grievances<sup>87</sup>. The Court further noted that according to the UK trustees, the employees were kept informed of the proceedings and their developments and

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<sup>84</sup> Court of Appeals, Versailles, December 15, 2005, *Gaz Pal*, February 10 -11, 2005, p. 4 ("Versailles Decision"). The Versailles Court had previously adopted the same solution in the *Daisytek* matter. Court of Appeals, Versailles, September 4, 2003, *Revue des Sociétés*, Oct-Dec 2003, p. 891.

<sup>85</sup> Versailles Decision, at 7.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

that they consulted the employees<sup>88</sup>. On these bases, the Court concluded that recognition of the UK judgment could not be refused.

## **B. Dismissals**

A cross-border situation raises numerous issues. In particular,

- which person or court have authority to dismiss the employees (1)?
- which law governs the dismissal procedure (2)?
- which forum may adjudicate the dispute arising from such dismissals (3)?

These issues will be discussed in turn.

### **1. Authority to dismiss**

Commentators express the view that the foreign receivers have the authority to dismiss the employees working in France<sup>89</sup>.

### **2. Law governing the dismissal procedure**

#### **a. Applicable law**

The question arises as to whether the dismissal should be subject to the law governing the bankruptcy or the law governing the employment contracts of the employees to be dismissed<sup>90</sup>.

Based on Article 10 of the EU Regulation, the law governing the employment contract will apply. This provision states that the effects of insolvency proceedings on employment contracts and relationships are solely governed by the law of the Member State applicable to the employment contract.

Under the present situation, further to Article 6 of the Rome Convention<sup>91</sup>, the law applicable to this issue will be French law. French domestic rules as to dismissals

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<sup>88</sup> Id. The Court of Appeals also added that French law requires that the workers' committee must be consulted when the insolvency proceedings produce effects on the employment contracts. Id.

<sup>89</sup> Jault-Seseke, *Le sort des salariés in L'Effet international de la faillite: une réalité?*, p. 151, at 152 (« Jault-Seseke »). As to the powers of foreign receivers in France, see Gaillot, *Effects of Foreign Bankruptcy Judgments and Powers of Foreign Receivers – A French Perspective*, in *Current Issues in Cross-Border Insolvency and Reorganizations*, at 245.

<sup>90</sup> As to this debate, see Urban, p. 547.

relate to public policy and apply on a mandatory basis to the contracts performed in France.

The note issued by the Ministry of Justice regarding the coming into force of the EU Regulation follows the same solution<sup>92</sup>. Under the Note, the conditions under which a receiver may dismiss employees working in France is an issue which should be governed by French law<sup>93</sup>.

### **b. Practical aspects**

In practice, combining French law (the law applicable to the dismissal procedure) and the foreign law governing the bankruptcy may raise complex difficulties.

For example, under the Bankruptcy law, the conditions and procedure applicable to economic dismissals may vary depending upon the type of bankruptcy proceedings. The foreign bankruptcy law may not necessarily provide for the same distinctions. Also, the employee's representative renders an advisory opinion on the proposed dismissals. The question arises as to how this employee may deliver his opinion before the foreign bankruptcy authorities in the event the foreign bankruptcy law ignores the institution of such a representative<sup>94</sup>.

The case law on these issues is still very scarce.

### **3. Forum**

In two decisions of October 2001, the Supreme Court held that the employees working in France for a foreign company which had fallen bankrupt could bring an action against their employer before a French labour court<sup>95</sup>. French courts' jurisdiction was asserted on the basis of the standard rules as to venue contained in the Labour Code<sup>96</sup>.

### **C. Employee claims - submission – priority**

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<sup>91</sup> EEC Convention of June 19, 1980 on the law applicable to contractual obligations (the "Convention"). Article 6 (1) of the Convention provides that the contractual choice of law may not deprive the employee of the protection granted to him by the mandatory rules of the law which would be applicable under article 6 (2) in the absence of choice. Under article 6 (2), in the absence of choice, the employment contract is governed by the law of the country in which the employee carries out his work in performance of his employment contract.

<sup>92</sup> Note of March 17, 2003 relating to the coming into force of regulation n°) 1346/2000 relating to insolvency proceedings. Official Journal, July 30, 2003, p. 12 939 ("Note").

<sup>93</sup> Note, Paragraph III.2.2.2.

<sup>94</sup> On these issues, see Urban at 548.

<sup>95</sup> Cass. soc., October 2, 2001, JCP E 2001, p. 1751.

<sup>96</sup> Under Article R. 517-1 of the Labour Code, actions must be instituted before the labour court in the jurisdiction of which the establishment where the employer performs his services is situated.

Under the EU Regulation, the law of the Member State where the proceedings have been opened, determine inter alia

- the rules governing the lodging, verification and admission of claims;
- the rules governing the distribution of proceeds from the realisation of assets and the ranking of claims<sup>97</sup>.

Presumably, these rules will detrimentally affect the employees working in France, the foreign provisions as to the ranking of employee claims likely to be less favourable on this issue than those contained in the Labour Code and the Bankruptcy Law<sup>98</sup>.

#### **D. Employee claims - payment – guarantee**

##### **1. Insurance institution responsible for guaranteeing payment of employee claims**

Institutions guaranteeing payment of employee claims in case of bankruptcy exist in most EU Member States. Identifying which institution is responsible for payment, dealing with foreign institutions and different applicable payment rules however, have created numerous difficulties.

Various EU provisions have been introduced to reduce these difficulties (a).

The solutions adopted by the Supreme Court as to persons working in France for employers situated in non-EU Member States are in line with the EU measures (2).

##### **a. EU provisions**

Article 8a (Section III a) of Council Directive 80/987/EEC as amended<sup>99</sup> provides that

- when an undertaking with activities in the territories of at least two Member States is in a state of insolvency, the institution responsible for meeting employee outstanding claims is that of the member state where such employees work,

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<sup>97</sup> Articles 4 h) and i) of the EU Regulation.

<sup>98</sup> See Urban, at 548. Complex jurisdictional issues arise in case of refusal of the submitted employee claims by the foreign bankruptcy authorities. Id.

<sup>99</sup> 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 as amended by Directive 2002/74/EC of the European Parliament and of the Council.

- the extent of such employees' rights is to be determined by the law governing the competent guarantee institution.

Accordingly, the place where the employee performs his services is the paramount consideration in determining which institution should pay the employee claims. The employee working in France, therefore, may resort to the AGS even though the bankruptcy proceedings against the foreign employer commenced abroad.

### **b. French case law**

The case law of the Supreme Court as to employees working for employers situated in non-Member States is in line with the EU solution.

In a decision of June 3, 2003<sup>100</sup>, the Court held that the AGS is competent when the employee works in France even though the bankruptcy proceedings have been commenced in a non-EU Member State provided that the bankruptcy decision has been subject to exequatur<sup>101</sup>. The Supreme Court confirmed this solution in a subsequent decision of February 2005<sup>102</sup>.

### **2. Subrogation of AGS – consequences**

As mentioned, the AGS advances the funds required to pay the employee claims. The AGS is then subrogated into the employees' rights.

In a cross-border situation, the ranking of the claims is determined pursuant to the law of the country where the proceedings have been opened. In numerous EU Member States, the treatment of employee claims will be less favourable than the one existing in France and the chances of the AGS to recover any sums may even be illusory<sup>103</sup>.

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<sup>100</sup> Cass. soc., June 3, 2003, n°) 00-45.948.

<sup>101</sup> In the absence of applicable treaty provisions, the opening in France of bankruptcy proceedings would prevent the exequatur of the foreign bankruptcy judgment. Cass. com., January 19, 1988, n°) 86-11080.

<sup>102</sup> Cass. soc., February 8, 2005, n°) 02-47.537. The combination of the foreign bankruptcy law and the provisions of the French Labour Code creates difficulties. As mentioned, under Article L. 143-11-7 of the Labour Code, the judicial agent is required to establish the list of employee claims within certain prescribed time periods. The question arises as to which person may play the role of agent for the purpose of this provision. Also, the foreign receiver may not be aware of the time requirements prescribed for transmitting the employee claims to the AGS under Article L. 143-11-7. On these issues, see Jault-Seséke, at 160. See also Chalgny report, *Droit Social* 2003, p. 837 ("Chalgny"). Under current case law, the exequatur decision has certain retroactive effects. Employee claims which accrued between the date when the foreign bankruptcy judgment was rendered and that of the exequatur decision should presumably be treated as post-bankruptcy claims. Chalgny, at 844.

<sup>103</sup> Deharveng, *Présentation de la circulaire du Ministre français de la Justice pour la mise en œuvre du règlement du 29 mai 2000 sur les procédures d'insolvabilité*, *Petites Affiches*, December 12, 2003, p. 29 (« Deharveng »).



Accordingly, the AGS, as a creditor, might be inclined to seek the commencement in France of secondary proceedings under the EU Regulation in order to benefit from the particularly favourable French ranking of employee claims and satisfy their claims out of the French assets<sup>104</sup>. Such proceedings, however, would be necessarily liquidation proceedings<sup>105</sup>.

### **3. EU Regulation - groups of companies - payment of employee claims - case law**

The Rover matter illustrates the importance that payment of employee claims may have in cross-border insolvency situations.

For the reasons explained below, ensuring that the employee claims in France would be satisfied was indeed one of the major preoccupations of the UK trustees in tailoring their bankruptcy solution and a major element underlying the UK and French decisions.

UK law does not provide for a protection similar to the one granted under French law and for an insurance institution similar to the AGS<sup>106</sup>. The UK judge nevertheless authorized the UK trustees to hold in escrow an amount equivalent to the one which would have been due to the employees working in France in case of French liquidation proceedings. The UK Judge noted that the employees would then be protected in accordance with Article 10 of the EU Regulation.

In taking this measure, the UK trustees sought to avoid secondary proceedings in France and therefore the liquidation of the French subsidiary. The UK trustees would then have lost control of the proceedings and, in addition, all creditors' claims (and not only the employee claims) could have been satisfied out of the French assets<sup>107</sup>.

These considerations are reflected in the UK judgment where the UK judge noted that failing the escrow solution, liquidation proceedings could have been possibly triggered by the employees working in France and that such proceedings would have adversely affected the distribution of the group's assets.

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<sup>104</sup> Deharveng, at 31.

<sup>105</sup> As noted by commentators, the interests of the AGS and those of the employees may be conflicting. See Jault-Seseke, at 161. On this issue in a domestic context, see e.g., Vatinet, *Garantie de l'AGS et sort du contrat de travail en cas de procédure collective*, *Droit Social* 2003, p. 287.

<sup>106</sup> Damman, note under the judgment of May 19, 2005 rendered by the Versailles Commercial Court, *Dalloz* 2005, p. 1787 ("Damman").

<sup>107</sup> Article 27 of the EU Regulation. Damman, at 1791 and 1792.

The Versailles Court of appeals refused to commence secondary proceedings as requested by the public prosecutor. The Court generally held that the opening of secondary proceedings is appropriate only if such proceedings are useful<sup>108</sup>.

The Versailles Court of Appeals refused to commence secondary proceedings as requested by the public prosecutor. The Court generally held that the opening of secondary proceedings did not present any advantages, in particular, in improving the protection of local interests or the disposal of the group's assets<sup>109</sup>.

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<sup>108</sup> Versailles Decision, at 7.

<sup>109</sup> In support of its findings, the Court of Appeals noted that according to the UK trustees' statements (which were not contradicted by the other parties),

- the proceedings were evolving without difficulties;
- such proceedings were preserving all the parties' interests;
- a single procedure allowed the continuation of the debtors' activities (and therefore the sales of the vehicles) over a longer period and permitted to coordinate all the sales transactions over the whole European territory;
- secondary proceedings would unnecessarily increase costs and formalities. Versailles Decision, at 7.