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SOCIAL PROTECTION: PENSIONS & PRIORITIES

WEAVING THE SAFETY NET FOR AN AGING WORKFORCE
IN THE NEW WORLD OF GLOBALIZATION
(COMPARATIVE LESSONS AND EXPERIENCE)

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Introduction

A country’s employees are its most valuable assets. Yet, in some countries, the pressure to compete under enormous legacy costs creates an unsustainable burden on businesses, sometimes forcing them to restructure their workforce or become insolvent.

In the golden age of business, employees often worked at a single company for their entire career and enjoyed ample pensions during their retirement years. Those days are long gone in many, maybe most, countries around the world. With extended life spans and increasing competitive pressures on businesses globally, it is difficult enough to ensure employment, much less to maintain the high legacy costs of the past. In an increasingly global economy, businesses face enormous competitive pressures to minimize costs and maximize returns often at the expense of domestic labor. Of course, there are winners and losers in this process, as jobs from one country are outsourced to another and the market forces restructurings and insolvencies that have an enormous impact and social cost on the employees of businesses.

Examples abound of the recent casualties of the competitive global pressure cooker -- Asia Pulp & Paper, Calpine, Collins & Aikman, Enron, Parmalat and Worldcom. Sometimes competition creates behavior that leads to the demise of the business. 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 globally and with uncertain ability to access entitlements owed to them.

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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, 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 we can say had both positive and negative effects.

The real magnitude of these issues are 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, estimated above 25%, 3 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) which are being crushed by the weight of 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 7 billion dollars in claims; and more recently, GM announced savings of approximately $15 billion by renegotiating its labor 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 policymakers to reexamine systems that provide for employee protections in the event of their employer’s financial demise. Unfortunately, there are difficult choices that are not politically popular, as the road to salvation is ironically 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.

Part I of this paper addresses some of the issues facing pension and retirement systems as viewed through the prism of the experience in the United States, United Kingdom and Germany. Part II of the paper reviews the experience involving treatment of labor claims in the context of an employer’s insolvency and offers a comparative examination of the experience and solutions to some of the challenges facing treatment of claims and the priorities for payment of labor claims.

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PART I

PENSIONS: LESSONS LEARNED FROM PENSION AND INSOLVENCY SYSTEMS IN THE UNITED STATES, UNITED KINGDOM AND GERMANY

“Respect for one’s parents is the highest duty of civil life.”

-- Chinese Proverb

These words carry particular significance today. As life expectancies increase and birth rates fall around the world, the global population is aging rapidly. This phenomenon already has reached a critical point in many developed nations. In 1995, there were 4.2, 2.7, 3.6, 2.6, 2.3, and 1.3 workers per retiree in the United States, United Kingdom, Canada, Japan, Germany, and Italy respectively. By the year 2050, it is predicted that there will only be 2.3, 2.1, 1.6, 1.5, 1.2, and .7 workers respectively per retiree in these countries. Meanwhile, developing nations are also in the midst of a major demographic shift. Indeed, while nearly 60 percent of the elderly currently live in developing countries, that percentage is projected to increase to 80 percent by 2050. In developing economies such as China, Indonesia, and South Korea the percentage of these countries’ populations over 60 is expected to be over 30 percent by 2050. In a trend similar to that in developed countries, the ratio of workers to the elderly in China is expected to drop from 9 to 1 to 2.6 to 1 over the next 40 years.

With fewer workers to support pensioners in developed countries, these nations currently have daunting agendas of pension reform, which include substantial overhauls of government supported social security systems. In addition, corporations in these countries currently offering occupational pension plans, particularly defined benefit pension plans, are finding it difficult to sustain these retirement vehicles for employees. Indeed, it is fair to say that certain developed nations, such as the United States and the United Kingdom, are in the throes of a defined benefit pension crisis. Germany, which does not rely as heavily as the U.S. and U.K. on funded pension systems, is also, nevertheless, experiencing certain problems in this arena. Each of these countries’ respective experiences with defined benefit pension plans provides some lessons for developing countries to consider as they formulate their own occupational pension systems and their corresponding insolvency laws.


I. The United States

The coalescence of a number of forces in recent years, including a decline in the U.S. stock market, the lowering of interest rates, and an increase in the ratio of retirees to active workers, has saddled U.S. employers with massively underfunded defined benefit pension plans. Defined benefit plans, which set the level of benefits that an employee will receive upon retirement, place the risk of loss of pension plan assets on employers. Thus, if, for example, a defined benefit pension plan’s investment returns are lower than expected, then assets in the plan may not be sufficient to pay retirees their benefits. As a result, the plan is deemed underfunded, and the employer is responsible for the difference. This is in contrast to defined contribution plans where employees make contributions to retirement accounts and bear the risk of loss in the event of a market decline.

In 2005, corporate America’s unfunded pension liabilities were estimated to be $146 billion. As a result, companies in the United States with burdensome pension “legacy” costs increasingly have been turning to Chapter 11 of the United States Bankruptcy Code to eliminate the effects of these obligations on their balance sheets and remain competitive in the global marketplace.

A. Pension Termination

The basic principles of pension plan termination in the United States’ Chapter 11 context are as follows. Under the Employee Retirement Income Security Act of 1974 (“ERISA”), a pension plan sponsor may terminate its defined benefit pension plan if, among other things, a bankruptcy court finds that termination of that plan is necessary for the sponsor to operate outside of bankruptcy. This is often referred to as “voluntary” or sponsor-initiated termination. The Pension Benefit Guaranty Corporation (“PBGC”), which is the quasi-governmental agency that insures and oversees the defined benefit pension system in the United States, may approve a sponsor-initiated “distress termination” of a pension plan if certain termination criteria are met. But PBGC may not process a sponsor-initiated termination that “would violate the terms and conditions of an existing collective bargaining agreement.”


7 See 29 U.S.C. § 1341

8 Id.

plan sponsor must obtain relief from its collective bargaining obligations under Section 1113 of the Bankruptcy Code, which affords special protection to these contracts. In contrast, in ERISA § 4042, Congress vested in PBGC the right to seek an “involuntary” termination of a pension plan if it determines that, among other things, the plan has not been properly funded, or PBGC’s possible long-run loss with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated. Importantly, PBGC may terminate a pension plan under ERISA § 4042 notwithstanding any alleged limitations that may exist in the plan sponsor’s collective bargaining agreements with its unions.

For example, in the United Air Lines, Inc. Chapter 11 case, PBGC agreed through a settlement with the company to terminate the company’s defined benefit pension plans by invoking its involuntary termination power thereby abrogating the need for the company to seek Section 1113 relief in its Chapter 11 case from its collective bargaining agreements, which had required maintenance of defined benefit pension plans. PBGC accepted a package of consideration from United—including notes (some of which are contingent on the reorganized company satisfying certain performance metrics) and stock—in exchange for settling all pension issues with the company. Although a number of United’s unions challenged PBGC’s power to enter into such an agreement with an employer, the courts have upheld United’s settlement agreement with PBGC.

1. **PBGC’s Role after Termination**

   Upon an employer’s termination of a defined benefit pension plan through the Chapter 11 bankruptcy process, PBGC takes over the plan and administers it going forward by, among other things, paying pension benefits up to a guaranteed amount to plan participants; the maximum PBGC guaranty is capped at approximately $47,000 USD per year and depends on factors such as a retiree’s age. However, because pension plans terminated in the bankruptcy context often do not have sufficient assets to pay plan participants’ statutorily guaranteed benefits, PBGC is now running a deficit of approximately $24 billion as a result of terminated, unfunded benefit plans. With some three-quarters of the companies on America’s S&P 500 index having defined benefit pension plans and PBGC estimating its future exposure at

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12 In re UAL Corp., 428 F.3d 677 (7th Cir. 2005) (Circuit Court ruling affirming lower courts’ approval of United-PBGC settlement agreement).
approximately $108 billion on account of future plan terminations, some believe that the defined benefit pension crisis in the U.S. has yet to reach a crescendo.\textsuperscript{13}

2. **PBGC’s Rights**

While ERISA provides PBGC with certain statutory lien rights to protect itself when certain events occur in connection with an underfunded pension plan \textit{(e.g., the sponsor ceases making minimum funding contributions)}, after a Chapter 11 filing is commenced the Bankruptcy Code’s automatic stay generally prevents PBGC from attaining secured or priority status in a bankruptcy case. PBGC has crafted many arguments over the years in an attempt to increase its recovery in bankruptcy cases, but has had little success in bankruptcy courts. PBGC thus has lobbied diligently for a change in the Bankruptcy Code’s priority scheme to protect PBGC’s interests. PBGC also has sought to change ERISA’s minimum funding rules to help prevent plans from becoming too underfunded in the first place. However, PBGC has not succeeded in these endeavors.

While PBGC has yet to improve its own stead through its lobbying efforts, PBGC’s very existence has mitigated the impact of the defined benefit crisis in the U.S. by providing retirees who lose their pension benefits with some recovery. Indeed, certain workers’ earned pension benefits may not be affected at all in a bankruptcy case because PBGC’s statutory guaranty will cover them.\textsuperscript{14} The question remains whether PBGC will be able to sustain itself over the years if PBGC takes over responsibility for many more underfunded pension plans.

3. **Transition to Defined Contribution Plans**

It should also be noted that the trend in the U.S. (and other countries) is now toward employer offerings of defined contribution plans—\textit{in lieu of defined benefit

\textsuperscript{13} Indeed, the U.S. Congressional Budget Office estimates that PBGC’s shortfall will expand to $86.7 billion by 2015.

\textsuperscript{14} In contrast, other employee losses—such as wage or job loss—suffered by employees in U.S. bankruptcy cases are provided fewer protections. For example, the U.S. Bankruptcy Code only allows workers unsecured, priority claims against their employer of up to $10,000 for unpaid wages earned up to 180-days prior to the company’s bankruptcy filing. 11 U.S.C. § 507(a)(4). If the employer ultimately fails to emerge from bankruptcy, then the employee may not be paid for lost wages because his or her claim will only be paid after claims of higher priority—\textit{e.g., secured or other priority creditors}—are paid in full. As one commentator sees it, the U.S. system relies on market forces to correct temporary setbacks such as job or wage loss, rather than an institutional backstop such as PBGC. \textit{See} Steven L. Willborn, Workers in Troubled Firms: When Are (Should) They Be Protected? 7 U. Pa. J. Lab. & Empl. L. 35 (Fall 2004). An employee that loses his or her job can simply look for another job at another company. On the other hand, loss of a benefit such as pension compensation, which has taken considerable time to earn, requires some sort of social safety net, because an employee cannot simply turn to the marketplace to recoup their loss.
plans. Thus, employees will bear the market risk of diminution in pension assets going-forward. “As a general matter, worker interests in defined contribution plans are not affected by corporate reorganizations or bankruptcy.”\(^\text{15}\) This does not mean, however, that defined contribution plans are fully protected because the funds in an employee’s defined contribution account ebb and flow with the vicissitudes of the market thereby leaving workers exposed to potential pension benefit loss. The Enron bankruptcy case in the United States highlighted this stark reality.\(^\text{16}\) In that case, employees’ defined contribution plans were heavily invested in Enron’s stock, which as a result of the company’s bankruptcy filing was rendered worthless. In addition, under U.S. pension law, Enron’s rapid stock decline prevented employees from unloading the Enron stock in their defined contribution accounts. Thus, with Enron employees chained to rapidly declining stock, their defined contribution plans suffered significant diminutions in value.

II. The United Kingdom

The U.S. is not alone in its pension crisis. A number of British businesses face similar issues, including British Airways and Corus—respectively operating in the airline and steel industries both of which have been protagonists in the U.S. defined benefit pension crisis.\(^\text{17}\) Pension liabilities also have struck the British retail industry by derailing takeover bids at Marks & Spencer and WH Smith.\(^\text{18}\) Approximately 60,000 people have lost part or all of their pension benefits in the United Kingdom as a result of recent pension terminations there.\(^\text{19}\)

A. The Pensions Act of 2004

The British government recently has passed legislation—the Pensions Act of 2004—to stem the tide on the country’s pension problem. The Act has introduced the Pension Protection Fund (“PPF”), which is modeled after the United States’ PBGC, to pay compensation to members of defined benefit pension plans when an employer becomes insolvent or when there are insufficient assets to cover guaranteed levels of PPF pension compensation.\(^\text{20}\) Like the PBGC, the PPF is not supported by the

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\(^{15}\) Steven L. Willborn, Workers in Troubled Firms: When Are (Should) They Be Protected? 7 U. Pa. J. Lab. & Empl. L. 35 (Fall 2004).

\(^{16}\) Id.

\(^{17}\) The Economist, supra note 3.

\(^{18}\) Id.


government—rather it is funded by compulsory premiums charged to employers with pension plans covered by the PPF’s program. In addition, benefits are capped at approximately 25,000 British pounds per year. Finally, the Pensions Act effectively has increased employer’s pension funding requirements by adding in a risk based premium, which is calibrated to the risk of a particular plan’s termination (including its underfunded status). To avoid this risk premium, some British companies have been using creative means to remedy their plans’ underfunded status. For example, Marks & Spencer used capital raised from a debt issuance to improve its plan’s funding status.21

B. Powers of the Pension Regulator

Where an English pension scheme is underfunded and the principal employer of the scheme is subject to an event—for example a takeover, sale of assets, payment of dividend the Pensions Regulator (“TPR”—an ombudsman created by the Pensions Act—may seek to secure extra financial support for the pension scheme by issuing a financial support direction (“FSD”) or contribution notice (“CN”). These demands may be issued against the principal employer or a group company which, directly or indirectly, holds more than 30% of the principal employers share capital (“Associates” and “Connectees”).

An FSD can only be issued where the principal employer is a service company (i.e., the only income of the principal employer is from supplying services to the group), or the value of the assets of the principal employer and its Associates/Connectees are less than 50% of the scheme when valued on a buyout basis (the cost of purchasing annuities to provide all the benefits that the scheme promises). Meanwhile, a CN may only be issued where the employer has acted with a purpose so as to avoid pension liabilities—the valuation basis for any liability being calculated on a buyout basis.

It should be noted that for either an FSD or a CN to be issued, the pension scheme must be underfunded on an FRS17 basis—which is the pension valuation accounting standard used by U.K. companies—and an event must have occurred. Additionally, a CN can be issued against a natural or legal person whereas an FSD can only be issued against a corporation. An FSD can be issued up to a year after an event, and a CN can be issued up to six years after an event.

III. Germany

Germany, in contrast, does not rely heavily on funded pension plans. The German system is based on a three tier system of pensions. The first tier is the state-

21 See Hewitt Assocs., supra note 17.
run mandatory pension system (“Rentenversicherung”),\textsuperscript{22} which covers all employees and certain other beneficiaries. The second tier is made up of company-sponsored occupational pension schemes (“Betriebliche Altersvorsorge”), while the third tier consists of private pension planning. Companies are not required to offer pensions at all, but if they offer pensions they need to abide to mandatory law (Gesetz zur Verbesserung der Betrieblichen Altersversorgung)\textsuperscript{23} which prescribes, \textit{inter alia}, how pensions fare in a restructuring or an insolvency of the company.\textsuperscript{24}

In contrast to the U.S. and the U.K., the second tier company sponsored pension plans usually do not need to be “funded” and they are backed by the general assets of a company (as opposed to a specific asset pool set aside for the beneficiaries).\textsuperscript{25} The liabilities are recorded as general unsecured liabilities of a company. Accordingly, there are no “underfunded” pension plans—as long as the corporation is solvent the pension obligation is deemed to be covered. If the company commences a formal insolvency proceeding, a collective insurance scheme—the Pensionsicherungsverein (PSV) takes over. The PSV is funded through contributions of those companies that have non-funded pension plans.\textsuperscript{26} In an insolvency, the PSV assumes the pension liabilities and is subrogated (as a general unsecured creditor) to the claims of the beneficiaries.\textsuperscript{27} Because of the historically low return to unsecured creditors in German insolvencies, the PSV usually has to shoulder the burden of an insolvency, and there is an increasing trend by distressed investors in Germany to strategically use insolvency proceedings to shed burdensome pension liabilities.\textsuperscript{28} The PSV already has raised concerns as to its financial health based on demographic trends in Germany (particularly, an aging populace) and waning contributions to the PSV as a result of German corporations’ transition to pension plans not covered by the PSV.\textsuperscript{29}

\textsuperscript{22} See Schaub ArbR-Hdb. § 80 et seq. for a detailed description of the “Rentenversicherung”.

\textsuperscript{23} Gesetz zur Verbesserung der Betrieblichen Altersversorgung (BetrAVG) vom 19.12.1974, BGBl. I, S. 3610

\textsuperscript{24} See § 7 - 15 BetrAVG.

\textsuperscript{25} See Mercer Human Resource Consulting, Pension Funding in Germany (June 2005), http://www.mercerhr.com/referencecontent.jhtml?idContent=1181340 for a more detailed overview.

\textsuperscript{26} See § 10 BetrAVG

\textsuperscript{27} See § 7 (1) and (2) BetrAVG

\textsuperscript{28} In certain defined circumstances the PSV can also take over pension obligations in an out-of-court restructuring, see § 7 (1) (2) BetrAVG. However, the instances where the PSV has consented to such an out-of-court restructuring are rare as the PSV usually wants to avoid creating a precedent, thus incentivizing companies to offload their pension liabilities in an out-of-court restructuring.
It will be interesting to see how Germany deals with its upcoming pension problem and whether there will be an increasing trend towards “funded” pension plans.

IV. Lessons Learned

While the recent experience in developed Western countries is no doubt unique—particularly in the U.S. where employer defined benefit plans have been battered by a “perfect storm” as the U.S. stock market has declined and America’s so-called “baby-boomer” generation has reached retirement age—developing countries may still glean some important lessons. As occupational pension plans became more generous in Western economies, particularly in the United States, they became less sustainable for businesses operating in a competitive global marketplace. With more businesses turning to insolvency and the respective institutional pension backstops in the U.S., U.K., and Germany likely to be facing their own financial problems in upcoming years, consideration will be given to providing these key players with more protection in insolvency proceedings. After all, without such backstops, many pensioners would be even worse off in insolvency proceedings. Any additional protections afforded to pension insurers would have to considered cautiously, however, as overbroad rights for these parties could stifle reorganization proceedings designed to maximize the value of corporations by maintaining their healthy core operations. Other approaches such as higher pension premiums to increase revenues of pension insurance funds also might be considered.

With Western corporations’ transition toward defined contribution systems new challenges lie ahead, as evidenced by the Enron experience in the United States. Provided that employees are given control over their investments, employees will have the opportunity to manage their own retirement responsibly and the situation that occurred in Enron could be avoided. While corporations in developing countries, which are also in the midst of profound demographic change, embark on implementing new occupational pension plans to attract and retain talented employees, they would be well advised to monitor the state of occupational pension plans in developed countries. While developed countries attained their economic prosperity before their populations became too old, developing countries are getting old before they ultimately get rich. Thus, while developing countries can assess with hindsight the occupational pension mistakes made in developed countries, their situation is

29 Companies can opt out of the PSV or significantly lower their contributions to the PSV by converting to “funded” models or by transferring their pension liabilities to a third-party such as a pension-insurance fund or life insurance company. Alternatively, the companies can opt to segregate an asset pool (Pensionsfonds) and back pension obligations with external investments as is the case in other countries such as the United States and United Kingdom, see European Pensions and Investment News, German Pensions Insolvency Protection Fund Proposes to a Full-Funding Model (May 2005), http://www.epn-magazine.com/news/fullstory.php/aid/1520/German_pensions_insolvency_protection_fund_proposes_move_to_a_full-funding_model.html for more details.
somewhat precarious as an aging population will need support for years to come from economies that may yet to have hit their stride.

**PART II**

**PRIORITIES: TREATMENT OF EMPLOYEE ENTITLEMENTS**

As mentioned earlier, insolvency can have a harsh impact on employees. Adding insult to injury, employees often are made to wait until late in the proceeding to recover on prepetition claims, and have often been viewed as the silent class with little voice in the process, unless there happens to be a union or collective labor organization involved to represent their constituencies. As such, the problems facing employees are often among the most difficult and raise a number of challenges for lawmakers, politicians and public officials seeking to remediate the harsh impact on employees. These choices are often not without tradeoffs to other stakeholders, which can also have a significant effect on progress, particularly in the credit markets.

For example, 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. 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. Even if such economic information was available or able to be understood by the staff member, under a standardized 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

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31 Id.
bankruptcy, that individual may still remain powerless, as job prospects and mobility tend to be limited.\textsuperscript{32}

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 organization.

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 rationalize 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 labor 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

\textsuperscript{32} The World Bank, \textit{Principles and Guidelines for Effective Insolvency and Creditor Rights Systems} 45 (April 2001). The World Bank \textit{Principles}, as revised and updated in 2005, carry forward the same general principles in treatment, but add a principle calling for special recognition and treatment of labor 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.”
position of two international bodies (the International Labor 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 – the employees. Section III discusses a number of strategies and policy considerations in the establishment and use of insurance and guarantee fund systems. The paper recognizes the need for more research and focus on this increasingly important issue in the current global analysis of insolvency principles and practice.\footnote{33}

It should be noted that there are 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.

THE INTERNATIONAL EXPERIENCE

A. \textit{International Labor Organization}

As early as 1949, the International Labor 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.\footnote{34} 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.\footnote{35}

\footnote{33} For purposes of this paper, the more detailed treatment on a country-by-country basis has been omitted.

\footnote{34} International Labor Organization, C95 Protection of Wages Convention (1949).

\footnote{35} \textit{Id.}
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.\(^{36}\) 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 the workers’ representatives in employment termination, particularly in light of major restructuring, downsizing or terminations due to employer insolvency.

(a) 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.\(^{37}\) It was updated by the European Parliament in 2002.\(^{38}\)

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, authorizes 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.\(^{39}\)


\(^{39}\) Id.
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.\(^{40}\)

(b) Survey of Country Experience

The ILO and EU requirements have been interpreted and implemented in a myriad of 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.\(^{41}\) The Chinese model encompasses a compulsory unemployment insurance that goes well beyond mere monetary compensation for entitlements owed, though not all workers are covered by it. The cost burden for 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 program financed by unemployment insurance, which has improved considerably the employment prospects for its participants.\(^{42}\)

Critics have called for the transformation of the current Chinese insolvency system. The system is not always consistent in its effort to maximize pacification and settle affected worker claims.\(^{43}\) Trade creditors’ claims are often ignored, due to the weak enforcement of contract law, and the employee rehabilitation fees paid out can

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\(^{43}\) The World Bank, East Asia and Pacific Region Private Sector Development Unit, *Bankruptcy of State Enterprises in China – A Case and Agenda for Reforming the Insolvency System*, i and ii (September 20, 2000).
vary between employees within the same company, creating further inequality.\textsuperscript{44} Thus, there is a lack of consistency in the treatment of claims in bankruptcy. China has been rapidly moving to modernize 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.\textsuperscript{45} Under the new law, however, at the time of this writing, the author is informed that some difficult challenges have been taken to compromise between labor priorities and priorities for secured creditors. This marks a monumental achievement.

\textit{a) 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 realized.\textsuperscript{46} 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 favoring employees in a biased manner.\textsuperscript{47} This approach undermines the fundamental principle of secured creditors’ rights and increases the insolvency risk in commercial relationships. Moreover, in actuality it

\textsuperscript{44} 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.

\textsuperscript{45} 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.


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 labor 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. 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. In the US, however, these priorities must be counterbalanced by Sections 1113 and 1114 of the US Bankruptcy Code laying out special provisions for the treatment of collective bargaining agreements and 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 often the remaining assets will be 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. 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,

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which delineates no less than fourteen claims that have priority over regular creditors in the unsecured creditors class.\textsuperscript{51}

\hspace{1cm} \hspace{1cm} \textbf{b) 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.\textsuperscript{52} 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.

\textbf{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.

\hspace{1cm} \hspace{1cm} \textbf{(c) 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 \textit{Principles and Guidelines for Effective Insolvency and Creditor Rights Systems} addresses claims resolution in terms of the treatment of stakeholder rights and priorities.\textsuperscript{53} 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.\textsuperscript{54} The easiest way to ensure this is to have a “flat”

\begin{itemize}
\item \textsuperscript{51}Australian Commonwealth Corporations Act 2001 <http://scaleplus.law.gov.au>.
\item \textsuperscript{52}German Federal Parliament, \textit{Insolvenzordnung (InsO)} (1999), <http://www.bmj.bund.de/images/11317.pdf>.
\item \textsuperscript{53}The World Bank, \textit{Principles and Guidelines for Effective Insolvency and Creditor Rights Systems}, supra n. 5.
\item \textsuperscript{54}Id.
\end{itemize}
hierarchy of priorities, which only consists of two levels: first, secured creditors maintain recognized priority in their collateral; second, following satisfaction of administration costs, the remaining proceeds are to be distributed equally among the remaining creditors. The World Bank Principle states 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* articulates a rule of best practice. It is not a straightjacket and indeed 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.

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55 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 recognizes 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 sale 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.

56 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.
(d) 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 fulfill 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, realized 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. 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.

Critics of insurance funds claim that they are expensive to run, punish successful companies, and benefit only certain employees. 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

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57 This assumes a claims resolution process either in bankruptcy or through another administrative procedure that would be dispositive of employee claims.


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, is 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 some question remains as to whether the workers themselves are best placed to bear these costs.

Another alternative used by many countries to minimize the cost of such a scheme to business, and particularly to small business, is by limiting 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. 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 by limiting 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 advent of an employer’s insolvency. In Part II, Article 12, the ILO clarifies what entitlements workers should expect upon termination of employment. 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:

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• 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 employees unpaid wages or retirement claims. In times of crisis, the absence of such “safety nets” make create additional hurdles to recovery and may need to be supplemented with an economic stimulus stimulus package as opposed to immediate satisfaction of back claims. The absence of social safety nets or adequate programs 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.62

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 was free from corruption and accounted for individually, so profits did not simply become consolidated government revenue.

62 Australian Workplace, General Employee Entitlements and Redundancy Scheme (GEERS), <http://www.workplace.gov.au/Workplace/WPDisplay/0,1251,a3%253D3649%2526a0%2526a1%253D623,00.html>.
(e) 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 an 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. Brazil63 and, to a lesser extent, Australia64 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.65

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 be treated as neither “fish nor fowl” – 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 common employee deserves to have legal protection of his/her employment claims.

The purpose of this paper has been to examine the varying legal treatment 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 labor market programs, such as retraining, job search assistance and public works programs. Insurance or guarantee fund systems, however, could significantly increase the potential for employees to realize their entitlements while minimizing the insolvency risks for other commercial stakeholders and providers of credit and goods.
## Comparative Chart - Employee Entitlement and Claims Treatment

<table>
<thead>
<tr>
<th>Country</th>
<th>Automatic Termination</th>
<th>Termination requirements</th>
<th>Collective bargaining Agreements</th>
<th>Priority of Claims</th>
<th>Social Protection</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Argentina</strong></td>
<td></td>
<td>Written notice of dismissal at least one month in advance.</td>
<td></td>
<td>Special priority in liquidation for certain claims.</td>
<td>No program</td>
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<tr>
<td><strong>Australia</strong></td>
<td></td>
<td></td>
<td></td>
<td>Priority over unsecured debts and claims; Priority also over claims secured by floating charge (when assets insufficient)</td>
<td>EESS: Payments to $A 20,000, unpaid wages, annual leave and redundancy pay up to 4 weeks, pay instead of notice up to 5 weeks. GEERS: $A 75,200 for 01-02; $A 81,500 for 02-03.</td>
</tr>
<tr>
<td><strong>Belgium</strong></td>
<td>No.</td>
<td>Employers having 20+ employees must notify the employees and the government. If contract is immediately terminated, the salary and benefit claims must be made within 15 days of the close of business.</td>
<td>Preferential claim for unpaid wages, social security contributions. Claims are subordinate claims secured by specific assets</td>
<td>Wages up to approximately EUR 7500, and unlimited for payment in lieu of notice. Social security contributions including holiday pay, worker injury, social security, and Workers comp.</td>
<td>Fund for Closures.</td>
</tr>
<tr>
<td>Country</td>
<td>Priority Over</td>
<td>Priority Over</td>
<td>Priority Over</td>
<td>Compensation for</td>
<td>Directors are personally liable for up to 6 months of wages and 12 months of vacation pay under OBCA and 6 months of wages under CBCA.</td>
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<tr>
<td>Brazil</td>
<td>tax and general unsecured claims.</td>
<td>Worker comp.  Claims have highest priority, followed by wages up to 150 monthly minimum wages (i.e., about USD 13,000).</td>
<td>Compensation for work-related injuries (highest priority), labor &amp; social security, including salaries, vacation pay, and bonuses, severance pay.</td>
<td>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.</td>
<td>Unemployment Insurance System for Staff Workers of State-Owned Enterprises will pay dismissed employees 70 to 80% of the national minimum wage for 2 years. Minimum living security ensure minimal standards of living for workers.</td>
</tr>
<tr>
<td>Canada</td>
<td>Written notice or pay. If lay-off is temporary or short term, advance written notice or reason for lay-off is not required. However, a recall date must be provided.</td>
<td>4^{th} Ranking Priority - preferred status over unsecured creditors (except entitlements for severance and termination pay).</td>
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<td>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.</td>
<td>Unemployment Insurance System for Staff Workers of State-Owned Enterprises will pay dismissed employees 70 to 80% of the national minimum wage for 2 years. Minimum living security ensure minimal standards of living for workers.</td>
</tr>
<tr>
<td>China</td>
<td>Claims of employees are settled first for wages and insurance fees, followed by taxes, and unsecured creditors.</td>
<td>Under the SOE insolvency law, employee claims have ranked prior to secured claims.</td>
<td>The new draft Enterprise Bankruptcy Law maintains a partial priority over secured claims.</td>
<td>Wages and labor insurance fees</td>
<td>Minimum living security ensure minimal standards of living for workers.</td>
</tr>
<tr>
<td>Country</td>
<td>Adopt Employment Contracts</td>
<td>Estate's Decision</td>
<td>Employee Preferences</td>
<td>Employee Guarantee Fund</td>
<td>Government Claims</td>
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</tr>
<tr>
<td>Denmark</td>
<td>No</td>
<td>4th rank</td>
<td>Salaries, wages and other benefits owed to the employee, unpaid pensions, holiday pay, redundancy payments, unfair dismissal, reasonable legal costs.</td>
<td>Employees' Guarantee Fund. Funded by employer contributions</td>
<td>Covers employee claims for wages, vacation pay and severance pay earned during the 6 months before the bankruptcy proceedings.</td>
</tr>
<tr>
<td>Finland</td>
<td>No</td>
<td>Up to FIM 90,000.</td>
<td>Wages.</td>
<td>Wage Guarantee System funded by employers.</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>No</td>
<td>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 with retention of title.</td>
<td>Wages, paid leave, improper termination and certain dismissal allowances</td>
<td>Compulsory insurance fund (“Association pour la gestion du régime d'assurance des créances des salariés” (“AGS”)). Payments required by all “in bonis” companies.</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>No</td>
<td>Preference only for worker claims arising after the opening of proceedings. Pre-petition worker claims are treated as general unsecured. Preference ranked pari passu with administrative claims.</td>
<td>Up to the amount of the preference.</td>
<td>Federal Employment Agency for unpaid wages “up to 3 months”. Claims for unpaid pension obligations can be recovered from the Pensions-Sicherungs-Verein.</td>
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</tr>
<tr>
<td>Hong Kong</td>
<td>General Priority: Admin costs Fixed charges Preferential claims (including employee) Wages, severance pay, payment for lack of termination notice, and holiday pay and annual</td>
<td>Wages and severance pay up to HK$8,000, lack of termination notice up to HK$2,000 / 50% of any claim over that amount</td>
<td>Employees are entitled to payments from Protection of Wages on Insolvency Fund (PWIFB).</td>
<td></td>
<td>Up to HK$36,000 for wages, HK$22,500 for payment in lieu of notice, HK$50,000 / 50% of any claim over that amount.</td>
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<tr>
<td>Country</td>
<td>Rule</td>
<td>Details</td>
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<tr>
<td>India</td>
<td>Floating charges General Unsecured leave. month's pay, entire amount of holiday pay.</td>
<td>Wages or salaries not exceeding 4 mos 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 interim payments of workmen's dues pending rehabilitation &amp; pursuant to section 529 of the Companies Act.</td>
<td></td>
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</tr>
<tr>
<td>Ireland</td>
<td>No, insolvency does not create proper grounds for dismissal, either.</td>
<td>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 months’ availability allowance for each dismissed employee to the INPS. 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, holiday and sick pay, maternity leave, redundancy, wrongful dismissal, leave and benefits pay. Up to specified amounts for any claim capped at about Euro 500 per week). Preference claims not paid can still be asserted against bankrupt. Minister for Enterprise Trade and Employment subrogates to employee preference.</td>
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<tr>
<td>Italy</td>
<td>No. Proper notice.</td>
<td>Protects the income of employees of insolvent employers by paying up to 80% of their lost wages. CIGS allows recovery for maximum 12 months or 36 months in 5 year period.</td>
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</tr>
<tr>
<td>Country</td>
<td>Preemptive claim</td>
<td>Superiority over claims</td>
<td>Claims priority on bankruptcy</td>
<td>Wage Guarantee Scheme</td>
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<tr>
<td>Japan</td>
<td>Preemptive status for employee's unpaid wage claims over other debts of employer, but not over secured debts, such as tax payments and mortgages.</td>
<td>Salaries earned 6 months prior to bankruptcy (even if bankruptcy court decides to discharge certain debts of the debtor) 1/3 of retirement allowance.</td>
<td>Japan Labor Health and Welfare Organization (JLHWO) allows recovery of 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.</td>
<td>No limit on the amount, but Civil Code states that up to 6 months of unpaid wages may be claimed.</td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>Preference over unsecured claims. Priority over floating charge where assets are insufficient to meet entitlements; No priority over fixed charges.</td>
<td>Wages or salary; workmen's compensation, vacation leave, contributions to superannuation and provident funds for retirement benefits.</td>
<td>No government program for payment of employee entitlements.</td>
<td>No government program for payment of employee entitlements.</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>First priority for wages owed within 2 yrs prior to employer's bankruptcy.</td>
<td>3 months' salary/wages and seniority payment of 12 days' pay for each year of employment.</td>
<td>No private or government sponsored unemployment insurance schemes.</td>
<td>No private or government sponsored unemployment insurance schemes.</td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>Governmental permission is required in collective dismissals in the event of bankruptcy.</td>
<td>Tax and Social security claims have super-preference over employee claims have preference over general unsecured creditors' claims.</td>
<td>Wage Guarantee Scheme under the Unemployment Act pays the claims from the Netherlands' social security system. Guarantee Fund subrogates to preference status.</td>
<td>Arrears and wages up to 13 weeks of wages, termination payment up to 6 weeks. Holiday pay / allowances and pension premiums up to one year.</td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>Preferential claim. Where assets are insufficient, partial priority over claims secured by accounts receivable and inventory (but not reduced by payments, and employee grievance claims.</td>
<td>Wages, salary and related earnings, holiday pay and redundancy payments, and employee grievance claims.</td>
<td>No government backed program for employee entitlements, although the Liquidation Surplus Account has been used to settle</td>
<td>No government backed program for employee entitlements, although the Liquidation Surplus Account has been used to settle</td>
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<td>Country</td>
<td>Personal Liability</td>
<td>Wages, Pensions, Vacation</td>
<td>Salaries and Wages, Vacations and Related Pay</td>
<td>Priority Hinges on Type of Procedure Applied</td>
<td>State Development Fund in the Making to Protect Further Employee Entitlements, but No Such Fund Currently Exists</td>
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<td>Norway</td>
<td>No</td>
<td>Yes, claims for wages (worth up to 6 months) or pensions maintain priority in debt, second rank, following the claims for the bankruptcy proceedings costs.</td>
<td>Wages worth up to 6 months (must be within 4 months of the bankruptcy filing), holiday remuneration up to 30 months’ worth (must have risen within the 24 months prior to the insolvency).</td>
<td>Wages, pensions, holiday remuneration.</td>
<td>Wage Guarantee Scheme administered by the government.</td>
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<td>OHADA</td>
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<td>Employers may be held personally liable.</td>
<td>Wages must be paid within 1 year.</td>
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<td>Philippines</td>
<td>Written notice to the workers and the Dept of Labor 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.</td>
<td>Preferential status; however, arguments in the interpretation of the law exist.</td>
<td>Salaries and wages, severance pay, vacation and related pay. Recovery and priority hinges on type of procedure applied.</td>
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<td>Russian Federation</td>
<td>Yes, insolvency terminates all employment contracts.</td>
<td>Limited preference against unencumbered (free) assets of the estate. No preference over secured.</td>
<td>First ranked are wages up to 3 months / R12,000; Next ranked (all paid pari passu) are holiday up to R4000, paid leave up to R4000, and severance up to R12,000</td>
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<td>No fund other than the general benefits of Unemployment Insurance Act.</td>
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<td>South Africa</td>
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<td>assets transferred or subject to Purchase Money Security Interest</td>
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<td>UK</td>
<td>No.</td>
<td>Preference payment</td>
<td>Ranked equally with Crown claims. Preference is after admin costs and fixed charge claims, but ranked ahead of floating charge claims and general unsecured creditors.</td>
<td>Maximum of 8 weeks, up to £800 for unpaid wages during 4 months prior to date of insolvency. Up to 6 weeks unpaid holiday pay accrued during 12 months prior to date of insolvency. preference payment of unpaid wages and accrued holiday/sick pay. If not possible, division of profits from its remaining assets among employees.</td>
<td>Redundancy Payment Service (RPS) gets a super-preference. RPS pays up to £270 weekly for up to 8 weeks. And up to 12 months for pension contributions.</td>
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<td>United States</td>
<td>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 the mass layoffs and/or close of the business. Post-petition wages have highest priority as administrative claims. Prepetition unpaid wages have preference over general unsecured.</td>
<td>Up to US$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.</td>
<td>Single and multi-employer pension plans are guaranteed by the Pension Benefit Guarantee Corporation (PBGC). PBGC takes over the single employer’s obligation to pay guarantee benefits up to the statutory maximum amount. PBGC then gains an unsecured claim against the debtor. With a multi-employer plan: if the entire plan becomes insolvent, PBGC pays the guaranteed benefits up to $6,000 per year per employee.</td>
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