INSOL INTERNATIONAL

EMPLOYEE ENTITLEMENTS

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International Association of Restructuring, Insolvency & Bankruptcy Professionals

Employee Entitlements

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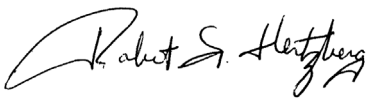
For employees of a financially distressed company, there is seldom a more emotionally wrenching issue than the treatment of their wage and benefit claims in a restructuring process. Employees, who are the life blood of the enterprise, too often find that they are treated as expendable and their pension or retirement savings may have evaporated. Stories about the loss of employee benefits and resulting hardships abound in the newspapers throughout the world. The legacy costs associated with employee wages, benefits and pension claims can be enormous and are often among the most intractable issues confronted in a restructuring proceeding.

International insolvency practitioners will frequently need to address the diverse ways in which employee claims are handled in various jurisdictions. This reference book provides that information in a consolidated format which will be a welcomed and valuable addition to any insolvency practitioner's library.

This book covers twenty-four countries, including France, Russia and Malaysia. It makes for interesting reading in its own right, and will be enormously helpful to the practitioner working with this subject, as well governments considering implementing or amending legislation affecting the treatment of employee claims.

Employee entitlements is a fascinating subject which will continue to impact international restructurings for years to come. We hope that you will find this work useful as you address these issues in your practice.



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Contents

Argentina

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is no definition contained in the Insolvency Law[1] of an employee for the purposes of said law. This law refers to employees as a "*trabajador*" (worker). The Work Contract Law-[2] *"Régimen de Contrato de Trabajo"* defines the employment relation as "work" ("*trabajo*")[3] "*For the purposes of this law, work is any legal activity that is performed for the benefit of he/she who has the power to direct it, for a remuneration*"

2. What are the employee entitlements and to what extent (if any) are they given priority treatment during the formal insolvency proceedings?

"Special priority" employee claims: Employees have a "special priority"[4] in liquidations. Arrears of interest for 2 years after default in payment of recognized items shall also be allowed.[5] As will be examined. There is a "general priority" for employees' claims, which are to be paid out of the liquidation of the general assets of the debtor.[6] Thirdly, all employees' claims not awarded a "special" or a "general" priority are considered unsecured claims.

"Special priority" employee claims are as follows:

Arrears of wages: Six months prior to the declaration of bankruptcy, whether or not immediately before such declaration; consecutive or not.

Redundancy Pay: In case the work contract[7] is terminated by a non-justified decision of the employer, the worker shall be entitled to a severance compensation equivalent to one month's salary per each year of service or period exceeding 3 months. The basis for remuneration shall be the best salary earned in the last year or shorter period of time. Such basis shall not exceed

1 24.522 Insolvency Law (1995)
2 Law 20.744
3 Art. 4
4 Art. 241, par. 2) of Insolvency Law 24.522
5 Art. 242, par. 1, LCQ 24.522
6 2.2. Art. 246 LCQ 24.522
7 Art. 245 WCL

the amount resultant of thrice the monthly median of all salaries contained in the trade-union agreements applicable to each worker, excluding seniority. The compensation shall not be below one month's salary. The limit of 3 times the monthly median as related to the trade-union agreements was declared unconstitutional by decision of the Supreme Court of Argentina[8] as unfair, wherein the limit is set now on a third of the best monthly normal and habitual remuneration of each individual worker.

When the termination of the work contract is due to a diminution in the activity of the enterprise not attributable to the employer, the severance pay shall be reduced by half.[9] The amount to be paid in case of bankruptcy of the employer[10] shall be determined in accordance with the estimation made by the Labour Law judge of the conduct of the employer in the managing of the business. If the estimation is that bankruptcy was caused by ill management, then severance pay shall be provided for at 100%[11]. If that estimation concludes that bankruptcy was determined by causes other than management, severance pay shall be 50%[12].

Until December 10, 2003,[13] termination of a work contract by a non justified decision of the employer would entitle the worker to obtain double severance pay. This emergency period has been extended until 31.12.04[14]. There is opinion that the "double compensation" is applicable also to "indirect" severance of the contract (the employee terminates the work contract for illegal conduct of the employer), payment in lieu of notice and vacation pay.

Compensation for death of employee: Compensation for the death of an employee is payable to next-of-kin[15].

Additional (bonus) yearly salary pay: The worker[16] is entitled to be paid an additional 1/12 of the total salaries paid during a calendar year, payable in two instalments, one on the 30th June and the other on the 31st December. Whenever the work contract is terminated, the worker is entitled to a

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8 CSJN, Sept. 14, 2004, "Vizzotti c/ AMSA", "El Derecho", Oct. 13, 2004, nr.52.998.
9 Art.247 WCT
10 Art. 251 WCL
11 Art. 245 WCL
12 Art. 247 WCL
13 Emergency Law 25.561 (Art.16)
14 (Decree of Urgency nro.823/04, B.O. 28.06.04
15 Art. 248, WCT 20.744
16 Art. 121 WCT

compensation equivalent to 1/12 of the total salaries paid in the last semester.[17] This claim is assimilated to wages.

Last salary shall be payable "*in totum*": When the termination[18] of the contract is notified to the worker without the prescribed due notice, and in a date that is not in coincidence with the last day of the month, the salary of the month shall be paid "*in totum*".

Holiday pay**:** Workers[19] are entitled to a continued vacation period of: (a) 14 days when seniority in the employment is less than 5 years; (b) 21 days when seniority is over 5 years but less than 10; (c) 28 days when seniority is over 10 years but under 20; (d) 35 days when seniority exceeds 20 years. Art. 155 WCL provides for the pay during vacation equivalent to 1/25 part of the monthly pay, also indicating the proportion when payment is made with other frequencies (daily, hourly, commissions, percentages, etc.). When[20] the work contract is terminated, the worker shall be entitled to a holiday-pay compensation equivalent to the salaries proportional to the fraction of the year of termination. This claim is assimilated to wages.

Payment in Lieu of Notice**:** The employer[21] shall give the worker notice of the termination of the work contract for 15 days during the trial-period of three months,[22] one month if the seniority in the employment is under five years, and two months if more than five years. The employee[23] that has not been given such notice shall be entitled to compensation equivalent to his/her salaries during the stated notice period. Salaries shall include all increases for the employee's category during the notice period, and the proportion of the one-month end-of-year bonus. This claim is assimilated to wages.

Unfair Discriminatory Dismissal Claim: Notwithstanding, the general provisions[24] prohibiting all discriminatory acts- are applicable, with claims for damages grounded on these matters under liability for tort

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17 Art. 123 WCT
18 Art. 233 of WCL 20.744 (as modified by law nr. 25.877/04)
19 Art. 150 WCL
20 Art. 156 WCL
21 Art. 231 WCL 20.744 (as modified by law nr. 25.877 of 19.3.2004)
22 Art. 92 bis of law nr. 20.744 as modified by law 25.877
23 Art. 233 WCL 20.744
24 Law nr. 23.592 (1988)

Compensation for work-related accidents: The Law[25] prescribes mandatory insurance for most employers in specific labour-risk insurance corporations ("*Aseguradoras de Riesgos del Trabajo*", or ARTs). The law devised a system wherein the employers, when protected by a valid insurance policy, would be immune to claims from workers for work-related accidents, with the sole exception of intentional damage. To this effect, limits were set by law with respect to compensation for these claims[26] in order for the employer to be covered by adequate insurance, and the resulting compensation was to be paid in annuities[27]. The Supreme Court of Argentina has declared such limits as unconstitutional, ruling that compensations shall be "integral" as related to damage caused[28]. The Supreme Court has also ruled that the imposition of such annuities is unconstitutional and that payment of compensation has to be made in one lump sum[29]. As a result of these rulings, the law concerning work-related accidents has been deeply modified, making higher and less predictable the cost of these hazards for the employer. These claims shall have the priority as examined "supra". In case these non-insured or self-insured employers are deemed to have insufficient assets to meet these claims, a special judicial summary procedure[30] is provided for by the law to establish this situation, and the law provides for a fund to pay for these claims[31]. Claims for work-related accidents of workers not registered with the labour authorities made the bulk of litigation in this area, although the situation may vary substantially after the rulings of the Supreme Court. The situation after these rulings is that insurance companies shall be liable up to the amounts fixed under the law, but the employer shall be liable for the amounts exceeding such limit, up to the sums determined by the labour judges in each particular case[32].

Unemployment Insurance (Redundancy compensation funds): Workers made redundant because of the liquidation insolvency of their employer are covered under a National Employment Fund[33] ("*Fondo Nacional de Empleo*"), to which employers contribute 1.5% of the payroll. To be a beneficiary, the worker shall

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25 Law nr. 24.557 (Ley de Riesgos del Trabajo", as modified by Executive Decree nr. 1278/00, LRT).

26 Art. 39, par. 1, Law 24.557

27 Art. 14.2.b, Law 24.557

28 CSJN, "Aquino c/ Cargo Servicios Industriales", Sept. 21, 2004; "La Ley", Sept. 27, 2004, reversing previous decisions (e.g. in re "Gorosito c/ Riva", Feb. 1, 2002, "La Ley" 2002-A, 936).

29 CSJN, October 26, 2004, "Milone c/ Asociart", "La Capital", Oct. 27, 2004, p. 10.

30 Art. 29 LRT

31 Arts. 33/34, LRT, Decrees nr. 585/96, 491/97 and 334/96.

32 There has been a critical response to the rulings of the Supreme Court, as raising costs of production ("La Nación", Economía y Negocios, September 26, 2004, p.1). The Administration has announced that it has the intention to propose a bill to raise mandatory insurance ("La Capital", Rosario, November 4, 2004).

33 Art. 114 par. e of Law 24.013

have performed services in a formal work contract for at least twelve months in the last three years. The entitlement is half of the best salary collected in the semester prior to redundancy, with a minimum of Ar$ 150 and a maximum of Ar$ 300 (about u$s 100). The program covers most aspects of redundancy besides insolvency.

In addition there is a social security program called “Jefaf y Jefes de Hogar” (Heads of Household) that provides Ar$ 150 to all unemployed heads of family who are not receiving other redundancy plan benefits (regulated under National Executive Decrees nrs. 565/02, 1353/03).

2.2. “General priority” employee claims

Arrears of wages for six months, compensation for redundancy, compensation of death of the employee, last-month payment-in-totum, payment in lieu of notice, unfair discriminatory dismissal, work-related accidents, holiday pay, additional yearly salary pay, *fondo de desempleo* and any other derived from the work contract, not paid as a “special” priority (the assets under the lien proved insufficient to cover such claims) shall have a lien on the general assets of the debtor. Interest for two years after default in payment of salaries, the fees of the lawyers and other judicial costs (e.g. experts’ fees) of any judicial proceedings brought against the debtor by the worker.

Family Subsidies (“*Subsidios familiares*”) for six months

Social Security Agencies
All contributions owed to federal, provincial, or municipal social security agencies (whether related to medicine, family subsidies or redundancy-compensation funds) shall be recognised a “general” priority. No interest is allowed under this category.

3. **How does the priority given to employee entitlements in formal insolvency proceedings, compare to the priority given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?**

The order of the priority of payment of creditors and remuneration of office holders is as follows:

First: Creditors holding a hypothecary right on immovables ("*hipoteca*") or movables ("*prenda*"). There shall be a deduction for the Administrator-in-bankruptcy's fees for the administration and conservation of the secured assets, fixed in a proportion of the total amount obtained from the sale of those assets.

Second: Labour-law claims holding "special" priority status as indicated "supra". Taxes holding "special" priority status (those affecting specific assets of the debtor, e.g. land tax). There shall also be a deduction for the Administrator-in-bankruptcy's fees, fixed in a proportion of the total amount obtained from the sale of assets under the lien.

Third: Insolvency administrator's fees and fees of professionals or employees retained by the estate, damages caused by the Administrator in the discharge of his duties as such or by the use of the estate assets. All post-bankruptcy claims are to be included in this category (e.g. taxes accrued after the declaration of bankruptcy).

Fourth: Unpaid wages and wage-assimilated claims holding "general" priority status as indicated "supra".

Fifth: All other claims holding "general" priority status as indicated "supra". These claims shall have a lien only on 50% of the results of the liquidation of the estate of the debtor. Taxes on the debtor are to be included in this category (e.g. income tax, capital gains tax).

Sixth: Unsecured creditors.

Seventh: Shareholders of companies (provided there is a remnant, which is extremely rare). They are not to be considered creditors, and shall not be paid in bankruptcy. Their payment shall require the closing of liquidation insolvency proceedings due to payments to all creditors in full. After that, shareholders are entitled to distribute the remnant assets.

4. What if any personal liability do directors and/or others involved in management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation with employee entitlements?

Administrators of business companies are not responsible for wages or other entitlements owed to employees. Some court decisions have assigned responsibility to directors for wages in case the employees have not been duly registered with the labour authorities.[34] The law provides for the disregard of legal entity in case the company has been "*used as a recourse to violate the law or frustrate third party rights*".

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

In cases of employer insolvency,[35] wherein a system of warranties was devised to cover : (1) salaries for the eight weeks prior to insolvency or the termination of employment; (2) amounts owed for vacation leave or other leaves for work performed for six months; and (3) severance compensation. This agreement has not acquired enforcement in Argentina yet.

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[34] Art. 54 of the Argentine Companies Law nro. 19.550

[35] Law nro. 24.285 ratified agreement nr. 173 of the International Labour Conference on the Protection of Labour Debts

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

There is a sharp distinction whether the ongoing business is sold in the context of a formal liquidation insolvency proceeding or not.

The buyer of such a business has immunity.[36] To attain this immunity, the business enterprise must have been "continued" and a specific proceeding under judicial supervision for carrying on with the operations of the insolvent person.[37] The sale of the assets as an ongoing business must have been done in accordance with formal liquidation proceedings.[38] The acquirer shall not be considered successor to the labour contracts existent at the time of the transfer of the assets. Any amount owed to employees for services performed before or after the declaration of liquidation insolvency, due to work-related accidents, work-related diseases, or compensation payments of any kind - shall be payable only in the liquidation insolvency proceedings. The buyer of the ongoing business shall be exempt from such payments.

Outside of liquidation insolvency proceedings, the situation is drastically different. The Law[39] provides for successor liability of the acquirer of an establishment for all obligations derived of the labour contracts that bound the seller. The labour contracts shall be deemed to continue with the acquirer and the worker shall retain his/her entitlements including seniority. This rule[40] shall apply even in cases of leases or other temporary assignments of the establishment. There is joint liability[41] of the seller and buyer of the establishment, as well as that derived from any other legal or factual situation through which another person becomes the operator of the business. This solidarity does not apply in cases when the successor is the State (nationalisation of enterprises).

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36 Art. 199 of LCQ 24.522
37 Arts.189/195 LCQ
38 LCQ. (Arts. 203/205)
39 Art. 225 WCT 20.744
40 Art. 227 WCT 20.744
41 Art. 228 WCT 20.744

Australia

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is only a very broad definition[1] of employee in the *Corporations Act 2001* ("**Act**"). "Employee" is not comprehensively defined in Australian legislation in relation to situations of formal insolvency. For this reason, it is necessary to look to the definition of employee as determined by the courts.

Traditionally, the test for whether or not a person was an employee relied solely on the nature and degree of control exercised over the worker – a *contract of service* being one of employment and a *contract for services* excluding an employer-employee relationship[2]. The Australian High Court uses a 'multiple indicia' test[3]. Factors for examination include:

- Nature of the tasks undertaken;
- Freedom of action given;
- Provision of services apart from labour;
- Magnitude of the contract amount;
- Manner in which payment is to be made;
- Powers of dismissal;
- Circumstances under which payment of the reward may be withheld;
- Deduction of taxes from money paid;
- Granting of annual holidays; and
- Need to report one's comings and goings.

The High Court has emphasised that it is the totality of the relationship between the parties which needs to be considered in determining whether a person is an employee or an independent contractor.[4]

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1 S.596AA(4)

2 Organisation test formulated by Denning LJ in Stevenson, Jordan and Harrison Ltd v McDonald and Evans [1952] 1 TLR 101 (NB: Australian courts have never accepted this as the only test, rather as one in a sequence of separate, related tests)

3 Multiple indicia test leading case: Stevens v Brodribb Sawmilling Co Pty Ltd (1986) 160 CLR 16

4 Kirby J, Ermogenous v Greek Orthodox Community of South Australia [2002] HCA 8 para 81

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during formal insolvency?

The Act recognises a number of categories of employee entitlement and sets them out in their order of priority[5] as follows:

- wages and superannuation contributions[6],
- injury compensation[7]
- amounts due under an industrial instrument in respect of a leave of absence[8]
- retrenchment payments[9]

Employee entitlements have priority over unsecured liabilities as well as liabilities secured by a floating charge.

As noted above, the Act affords priority to contributions payable by the insolvent company to an approved superannuation fund on behalf of its employees.

In Australia, the *Superannuation Guarantee (Administration) Act 1992* requires 9% of an employee's gross wage to be deducted and remitted to an approved superannuation fund. The employee is not entitled to access those funds until retirement or in specified cases. Therefore the Act specifically recognises these contributions and affords them priority over unsecured, and in the case of a floating charge, secured creditors.

There is a limitation on the amount for which an employee who is or was also a director of the insolvent company, or a spouse or relative of the director, can rank as a priority creditor. The priority detailed[10] in the Act is limited to the amounts due to a director, a director's spouse or a director's relative (as defined in the Act) for:

(a) wages and superannuation to $2,000[11]

(b) leave of absence under an industrial instrument to $1,500[12] and

(c) retrenchment payments to not include that period when the employee was a director of the company (or when the employee's spouse or relative was a director)[13].

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5 Section 556(1)
6 Subsection e
7 Subsection f
8 Subsection g
9 Subsection h
10 Section 556 (1)
11 Section 556 (1A)
12 Section 556(1B)
13 Section 556(1C)

3. **How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?**

   Secured creditors

   The Act[14] provides priority to the employee entitlements over liabilities secured by a floating charge when assets are otherwise insufficient to meet those entitlements'. This however, is not the case with respect to fixed charges.

   Insolvency administrators, professionals retained by the estate & unsecured creditors

   The Act sets out the order in which certain debts and claims are to be paid in priority to all other unsecured debts and claims.

   Fees and expenses incurred by insolvency administrators during the administration and/or winding up process which are considered expenses incurred in realising and/or preserving the property of the insolvent company, as well as other expenses properly incurred and remuneration, all rank in priority to employee entitlements, which in turn rank in priority to unsecured claims.[15]

   Shareholders

   "A debt owed by a company to a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied"[16]*. Such liabilities therefore rank after all other creditors."*

4. **What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?**

   A new Part 5.8A was inserted into the Act which came into force on 30 June 2000. The new law protects the entitlements of employees from agreements and

[14] Section 561
[15] Section 556 (1)
[16] Section 563A

transactions entered into with the intention of defeating the recovery of entitlements. A person must not enter into an agreement or transaction with the intention of preventing the recovery of employee entitlements or significantly reducing the recovery of employee entitlements[17].

If a person contravenes this rule Part they will be liable to compensate for the loss[18]. The company's liquidator or the employee may directly recover the amount of the loss from the person responsible as a debt due to the company/employee.

Although directors in exercising their duties to the company should consider the interests of employees, there is no case law or legislation in Australia imposing an explicit obligation on directors to do so. However, if a director places the company in breach of any law by not giving consideration to the interests of employees, the director may be seen to not have acted with the required care and diligence from which both criminal and civil consequences flow.[19]

While the company is primarily responsible for unpaid taxes, liability can in certain circumstances be transferred personally to directors. For instance, in relation to tax deducted by the company from employees' wages on account of income tax, directors can be made personally liable for a penalty equal to the amount of any tax deductions not remitted to the Deputy Commissioner of Taxation. Pursuant to the *Income Tax Assessment Act 1936 (Cth)* the director can however, avoid this personal liability if, within 14 days of the requisite notice being given to him or her, the company pays the tax, enters into an agreement with the Deputy Commissioner to pay the tax, enters into voluntary administration or is wound up.[20]

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

The Commonwealth Government has established the General Employees

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17 Section 596AB
18 Section 596AC
19 H A J Ford, R P Austin, I M Ramsay, Ford's Principles of Corporations Law 10th Edition, Butterworths, 2001 at [8.120]
20 Section 22AOE(b)Income Tax Assessment Act

Entitlements and Redundancy Scheme ("**GEERS**") to provide for unpaid entitlements of employees who have been terminated because of the company's insolvency. The Department of Workplace Relations administers GEERS, which applies to terminations on or since 11 September 2001.

A claimant must apply within 12 months of termination for payment of any unpaid wages, annual leave, long-service leave, payment in lieu of notice and up to 8 weeks redundancy pay. All payments are subject to a defined salary cap and must be repaid from any recovery of funds from the realisation of assets or other proceedings in the insolvency process. ("*The scheme does not relieve employers or insolvency practitioners of their responsibility to meet employee entitlements to the extent that there are sufficient assets to do so.*"[21])

GEERS applies to terminations resulting from:

- the employer becoming insolvent or being placed under external administration; or
- a receiver being appointed and the company ceasing to carry on business because of its insolvency.

It does not apply to an employee who was a shareholding executive director (being a director who is concerned in, or who takes part in the management of the body), a relative of an executive director or, in the case of an unincorporated employer, a relative of the former employer.

If GEERS makes an advance to enable payment of employee entitlements, it will then attempt to recover any payments made out of funds becoming available from the insolvency process. GEERS is granted the same priority for these advances as the employee would have enjoyed in relation to payment of their entitlements[22].

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

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[21] Department of Employment and Workplace Relations, General Employee Entitlements and Redundancy Scheme Operational Arrangements, undated

[22] Section 560

In each state and territory of Australia, the relevant legislation and award provisions are designed to as far as possible protect employees' continuity of service where the business is transferred. Accordingly, where a business is sold as a going concern, the contract of sale will often provide for the purchaser to be allowed a deduction from the purchase price in respect of the outstanding employee entitlements (accompanied by a warranty by the purchaser to pay such entitlements as and when they fall due) .

There are three main entitlements that may transfer –

Long Service Leave
Legislation in all states provides that a worker's employment is deemed to continue for the purposes of long service leave even if there is a change of employer on the sale of a business as a going concern. The purchaser of the business is obliged to take on the actual and contingent obligation in respect of long service leave.

Annual Leave
A sale of business is an event which breaks the continuity of a worker's employment for the purposes of annual leave in all states and territories other than New South Wales and Queensland where there is legislation to protect continuity of service in this context. Therefore, a vendor may be obliged to pay accrued annual leave entitlements to a worker on the sale of a business (except in New South Wales and Queensland). It is common practice to assign this obligation to the purchaser with the written agreement of the transferring employees. Those employees who do not agree to transfer their annual leave entitlements must be paid out by the vendor.

Sick Leave
In New South Wales and Queensland, State legislation provides that where a business is transferred as a going concern, the continuity of service of a worker is not broken for the purposes of sick leave. This means that the purchaser is obliged to assume responsibility for accrued sick leave entitlements of workers in these jurisdictions. There is no equivalent legislation in other States. Some industrial awards provide for accrued sick leave entitlements to be assumed by the purchaser when a business is transferred.

Austria

1. How is an employee defined for the purpose of formal insolvency proceedings ?

An employee is not defined in a special way for the purpose of formal insolvency proceedings. The general definition of employee[1] according to Austrian General Civil Act (ABGB) is that an employee is a person who undertakes to render services to another person for a certain time and is used in relation to this situation. The employee has to perform his services in personal dependence on another person. The employer-employee relationship is determined by the following factors:

- There is no freedom of decision concerning place of work, labour time and action given for the employee;
- There is continual control exercised over the employee;
- Integration into the company's organisation;
- Obligation to comply the directives of the employer;
- Financial and economic dependence;
- Obligation for the employee to render all services personally;

All these factors need to be considered in their entirety to be able to distinguish the employer-employee relationship from contracts for services.

[1] § 1151

2. What are the employee entitlements, and to what extent (if any) are they given priority treatment during formal insolvency proceeding?

The opening of the formal insolvency proceeding has no influence on the employer-employee relationship if the employee has commenced the employment. There are no modifications of the contract nor will the relationship be terminated because of the insolvency. The insolvency practitioner takes on all the duties of the employer. During the formal insolvency proceeding both the insolvency administrator and the employee have the choice whether to continue the relationship or to terminate it prematurely[2]. If both decide to continue the employer-employee relationship after the opening of the formal insolvency proceeding, all employee claims accrued during the administration have to be paid totally by the insolvency practitioner. He has to make sure having enough money for paying all the claims arising during the insolvency proceeding. The employee is entitled to receive the stipulated wages.

Employee entitlements earned prior to the opening of the insolvency proceeding are paid pro-rata with other unsecured creditors in the insolvency proceedings. They have no priority over the claims of other creditors.

If the employee or insolvency administrator terminates the relationship, the employee is entitled to claim the following[3]:

- Arrears of the stipulated wages
- Accrued holiday compensation
- Compensation if the employee is given less notice than the legal period of notice
- Redundancy Pay

In the event of a termination, all these entitlements will be satisfied proportionally at the end of the formal proceeding: they are not given any priority treatment. The unpaid entitlements will then be satisfied by the IAF-Service GmbH established for guaranteeing the payment of employee claims in insolvencies.

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2 § 25 of the Austrian Bankruptcy Act (KO)
3 § 25 KO

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings, compare to the priority (if any) given to secured creditors, insolvency administrators, professional retained by the estate, unsecured creditors and shareholders?

All claims accrued at the date of the formal insolvency proceeding have to be paid by the insolvency administrator.[4] The Austrian bankruptcy Act does not provide priority to employee entitlements over other claims with the exception that if the assets are insufficient to meet all claims in full the law specifies the following priorities of payment[5]:

- costs of the formal insolvency proceeding (including the insolvency practitioner's remuneration, court fees, etc.);
- advance on costs paid by a third person and used for covering the costs of the insolvency proceeding;
- employee entitlements;
- other claims accrued during the administration.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The directors of a company are only liable for employment taxes if they deliberately neglect to pay their tax liability[6].

4 § 46 KO
5 § 47 KO
6 § 9 of the Austrian Tax Act

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what (if any) priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

The IAF-Service GmbH[7] has been set up to guarantee the payment of employee entitlements in insolvencies. For this purpose, a fund financed mainly by employers' contributions has been established.
The IAF-Service GmbH as administrator of this fund will only pay the applied entitlements, if the following requirements are met:

- opening of a formal insolvency proceeding;
- the employee has registered his claims at the Bankruptcy court;
- the employee has sent the completed application form to the IAF-Service GmbH within 6 months from the opening of the formal insolvency proceedings;
- the insolvency practitioner has admitted the registered employee entitlements; and
- the employee is not a managing director of a GmbH-Company, a member of the management board of a Stock Company or an executive – the IAF-Service GmbH will not apply to these people.

The IAF-Service GmbH pays arrears of wages, annual leave, overtime pay, holiday pay, payment in lieu of notice and redundancy pay. There are statutory and time limits in relation to these claims: employees may only claim arrears for the last 6 months of the continuing or terminated relationship. Entitlements dating further back are only secured if the employees have already asserted them at court and the legal proceeding is continuing.

If the IAF-Service GmbH pays the claims of an employee, these claims will be assigned automatically to the IAF-Service GmbH. The IAF-Service GmbH will then participate in the formal insolvency proceeding in place of the employee.

[7] Insolvenz-Ausfallsgeld-Fonds-Service GmbH (i.e. "Insolvency – loss of money – fund – service GmbH-Company")

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for the employee claims on the basis of successor liability or otherwise?

A. sale out of a formal insolvency proceeding:
If a business is sold as a going concern out of a formal insolvency proceeding, all employer-employee relationships are transferred to the acquirer without any modifications and take on all actual and contingent obligations[8]. The purchaser is obliged to continue paying the wages and other employee entitlements as stipulated. The acquirer is also liable jointly and severally with the vendor for all claims accrued before the event of sale and known at the time of the transfer[9]. The purchaser is also liable for any unpaid employment taxes accrued during the year before the transfer.[10]

B. sale in a formal insolvency proceeding:
As a basic principle, a sale of a going business in a formal insolvency proceeding relieves the purchaser from the liability for employee entitlements accrued in the past[11]. Furthermore the successor is not obliged to enter into any employment agreement but has the free choice whether to continue the employer-employee relationships or not[12].

[8] § 3 AVRAG, Austrian Employment Contract Act
[9] § 6 AVRAG and § 1409 ABGB
[10] § 14 BAO
[11] § 1409a ABGB
[12] § 3/2 AVRAG

Belgium

A distinction must be made between:

(i) bankruptcy, which is a liquidation procedure for companies who have ceased paying their debts and are unable to obtain credit. It involves the Commercial Court appointing a bankruptcy trustee to take control of the company, to collect and realise its assets and to distribute the proceeds among creditors in accordance with their legal ranking. Bankruptcy will essentially lead to the company's business being dismantled

(ii) judicial composition, which aims to give a company, having temporary payment difficulties, an opportunity to restructure by temporarily suspending the rights of its creditors'. The purpose of this proceeding is to safeguard the business, allowing it to continue its activities, including the employment of its workers, while it reorganises its debts. The Commercial Court which appoints a judicial commissioner to assist the company in managing its business and in drafting its restructuring plan.

The aim is to allow the company to survive as a legal entity and if this is not possible, the law permits a transfer of all or part of the company's business as a going concern.

There is also the voluntary and judicial winding-up of a company decided by the company's general assembly of shareholders and the Commercial Court respectively.

1. How is an employee defined for the purposes of formal insolvency proceedings?

Under Belgian law, there is no specific definition of an "employee" for the purpose of insolvency proceedings.

Belgian employment law defines an employee as a person who is paid for work done under the supervision of another person. The factor that determines the parties' professional relationship is therefore whether one party is subordinate to the other. In determining the professional relationship between the parties, the court will take into account:

(i) the type of contract the parties have entered into and its provisions; and

(ii) how the parties have actually performed the contract, i.e. whether performance is compatible with the terms of the contract.

In practice, labour courts decide whether a "link of subordination" exists by examining whether a sufficient number of indicators are present that point to the existence of such a "link".

The following are examples of such indicators (more than one must exist to establish a "link of subordination"):

(i) an employer gives detailed instructions to a worker, which the worker is obliged to follow;

(ii) an employer requires a worker to regularly draft reports, attend meetings where instructions are given, comply with a schedule and justify the use of time, justify absences, especially in the event of illness or to obtain permission before taking annual leave;

(iii) an employer offers to fully reimburse expenses, to pay a fixed or guaranteed remuneration, to provide a company car, to give holiday pay or to put an insurance policy in place.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

These preferential debts include unpaid wages or employee's compensation, social security contributions and rank as follows (compared with the main other preferential debts):

(i) judicial costs;

(ii) unpaid remuneration, up to a maximum of EUR 7,436.81 and payment in lieu of notice (without limitation of the amount);[1]

(ii) various social security contributions such as:

- holiday pay (past and current year);[2]
- workers' injury compensation;
- contributions in favour of the social security administration;
- claims of the Fund to indemnify workers dismissed on the occasion of the closing down of a company (see also under question 5);

(vi) tax claims.

The employees will be unsecured creditors of the bankrupt company in respect of all the other amounts which are due to them by the company.

In case of judicial composition proceedings, the company must continue to pay all its creditors, including its employees. If an employment contract was terminated before the start of the proceedings, the claims arising out of it will be considered as privileged for the purpose of the proceedings.

If a company is declared bankrupt after judicial composition proceedings are commenced, the company's employees could claim (this is a contested issue

[1] Article 19,3°bis
[2] Article 19, 4°

under Belgian law) that any remuneration or the payment in lieu of notice due to them are costs that rank ahead of the claims of all other creditors in the bankrupt estate. Such a claim would be based on the argument that these sums constitute a cost of a contract which was continued after the start of the judicial composition proceedings, with the judicial commissioner's co-operation, approval or assistance (see question 3).

In the case of winding-up of the company, the liquidator must pay all the company's creditors, including the employees. If the assets are insufficient to pay in full all creditors, their claims will be paid according to their rank.

The Belgian Supreme Court (*"Cour de cassation"*) also ruled that if the liquidator terminates an employment contract during the winding-up proceedings, the payment in lieu of notice will be considered as a cost and expense of the winding-up and will therefore rank ahead of all other claims.

3. How does the priority (if any) given to employee entitlements in formal insolvency proceedings compare with the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

The preferential debts, set out in the Act on Preferences and Mortgages of 16 December 1851, rank after the costs and expenses of the bankruptcy. The concerned creditors are referred to as having a general privilege, which does not attach to specific assets.

The costs and expenses of the bankruptcy rank ahead of the claims of all creditors and include:

(i) the bankruptcy trustee's remuneration and professional expenses, and

(ii) the costs of continuing any contracts (including employment contracts) for the benefit of the liquidation, after the start of the bankruptcy.

There are also the costs of the contracts which were continued after the start of judicial composition proceedings with the judicial commissioner's co-operation, approval or assistance; these costs also rank ahead of the claims of all creditors, but it remains unclear whether these costs rank ahead of certain secured creditors.

In principle, all assets owned by the bankrupt company form part of the bankrupt estate. However, certain creditors may have specific rights over some of the company's assets, mainly rights over assets that serve as a security for the separate certain creditors, namely the first-ranking mortgagee, the pledge-holder (including the floating charge-holder) and the creditors with a security right over a specific asset.

Unsecured creditors and finally shareholders rank last and will only be paid if the company is solvent, after all the other creditors.

The payment in lieu of notice to which an employee is entitled following termination of his employment contract by the liquidator during winding-up proceedings will be considered as a cost and expense of the winding-up and will therefore rank ahead of the claims of all creditors.

4. What if any personal liability do directors and others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

Company directors may be held liable for damages to the bankrupt estate (and thus indirectly to the employees) under four types of civil liability, namely for:

(i) breach of management duties: the bankruptcy trustee may bring a claim against the directors on the company's behalf if they failed to correctly perform their mandate to manage the company. The performance will be assessed according to the standard of a normal, prudent and diligent director;

(ii) in tort: at the request of the bankruptcy trustee, the court may hold directors liable in tort if the directors:

- breached a legal obligation (for example if they failed to withhold or to pay to the tax or social security authorities the amounts which an employer must retain from the wages of its employees); or

- have not acted as normal, prudent and diligent directors should.

In some cases the court may hold a director liable at the request of third parties; it is for instance argued that the tax authorities may request that a director be held liable if the company has failed to pay the amounts owed to the tax authorities.

Not paying or not timely paying the employees' salaries may give rise to criminal sanctions. The directors may be personally criminally liable for these infringements and therefore subject to a fine (between 130 EUR and 2500 EUR per employee involved) or imprisonment (8 days to max. 1month). These criminal sanctions are however exceptional. Criminal liability will not automatically lead to civil liability of the directors, but it may help the employees in substantiating their civil liability claim against the directors.

(iii) breach of the Company Code or the company's articles of association: at the request of the bankruptcy trustee, the court may hold a director liable for breaches such as, for example not presenting the annual accounts.

(iv) a serious fault which contributes to the company's bankruptcy: the Company Code provides for a specific kind of director's liability. If a company's liabilities in bankruptcy exceed its assets, the directors or former directors may be held liable for the company's liability up to the amount of the shortfall. If the bankruptcy trustee can prove that the directors have committed a manifestly serious mistake (for example, serious fraud, continuing a significant loss making activity or investments that significantly exceed the company's financial means) that has contributed to the bankruptcy.

5. Is there any form of statutory, industry or government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

The Act of 28 June 1966 created a Fund (with legal personality) to compensate workers dismissed when a company closes down ("the Fund").

The objective of the 'Fund' is to pay in place of the bankrupt employer or employer that fails to pay the amounts to which the employees are entitled in the event the company closes down or there is a change of employer. To be entitled to these payments, employees must fulfil certain conditions such as, having an employment contract of indefinite duration, having at least one year's service with the company and not having been dismissed for serious cause.

If the Fund pays employee entitlements, it will then attempt to recover them from the employer or the employer's bankrupt estate. As the Fund is subrogated to the employees' rights, it may rely on the same general privilege (and thus the same priority) as the employees under the Act on Preferences and Mortgages of 16 December 1851[3]. The Fund has a claim for the supplementary payment in lieu of notice that it has paid to the employees. The Fund will also have a general privilege as regards this claim, ranking after the employees' claims.

The Fund will thus pay the employees for example, any unpaid remuneration, holiday pay and payment in lieu of notice[4]. However, the remuneration taken into account is limited to EUR 1,859.20 a month, up to a total amount of EUR 22,310.42.

The Fund might also intervene in the event of a transfer of undertaking in the framework of judicial composition proceedings or winding-up of the company as the employer.

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[3] Articles 19, 3°*bis* and 14

[4] Article 19,4°*quinquies*

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The rights of employees on a transfer of an undertaking are set out in Collective Bargain Agreement n°32*bis* of 7 June 1985, as approved by the Royal Decree of 15 July 1985 and amended by the Collective Bargain Agreements n°32*ter*, *quater* and *quinquies* of 2 December 1986, 19 December 1989 and 13 March 2002 respectively ("the Collective Bargain Agreement").

A distinction must be made between Chapter II and Chapter III of the Collective Bargain Agreement:

(i) Chapter II of the Collective Bargain Agreement relates to the conventional transfer of an undertaking, with a change of employer as a consequence.

Such a transfer might occur out of formal insolvency proceedings (e.g. winding-up of the company). In that case, the new employer must take over all the rights and obligations of the existing employment contracts, except supplementary social security entitlements such as extra-legal pensions, etc. The former and the new employer are also jointly and severally liable for all for all claims existing at the time of the transfer and resulting from the employment contracts existing at that time.

However, such a transfer might also occur in the framework of judicial composition proceedings. In that event, the new employer will not be liable for the claims existing at the time of the transfer and resulting from the employment contracts existing at that time. However a new employer will be liable if the Fund does not compensate the employees. Further, the former employer, the new employer and the worker's representatives may negotiate modified working conditions in a bid to save jobs and ensure the company's survival.

(ii) Chapter III of the Collective Bargain Agreement relates to a transfer of an undertaking in the case of bankruptcy.

The following rules apply to workers who are employees at the date of the bankruptcy (or the renunciation to the company's assets) or which were dismissed within a one month period before that date and which were taken over at the moment of the transfer of the undertaking or within six months after the transfer:

- the new employer is not liable for the transferred employee's claims against the bankrupt employer; and

- the new employer may freely decide on the employees it wants to employ.

Brazil

1. How is an employee defined for the purpose of formal insolvency proceedings?

An employee is defined as, “any person who renders services habitually to an employer, under subordination, and receiving a salary”[1].

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

Under Brazilian Labor law, an employee is entitled to certain rights, in addition to any items which may have been agreed to in a written employment contract. Examples of employee entitlements in Brazil are:

- annual mandatory salary increase - at the percentage rate set forth in either the collective bargaining agreement executed between the respective employer and employee unions (whether or not the employee is affiliated to such unions), or the collective labor claim filed by the employee union against the employer union;
- Christmas Bonus - an additional payment equal to one month’s compensation;
- annual vacation - 30 days, plus a bonus of 1/3 of the employee’s monthly compensation.
- accrued severance fund (or FGTS) - an amount to be funded by the employer equaling 8% of the employee’s monthly compensation, deposited in a special bank account of the employee at the Federal Savings Bank (Caixa Econômica Federal);
- transportation voucher - employers are liable for the cost of transportation vouchers which exceed 6% of the employee’s monthly compensation;

[1] Article 3 of Decree-Law 5,452 of 1943 (Consolidation of Labor Laws - CLT).

- sick leave - employers are liable for 15 days sick leave, thereafter the leave is determined by the Social Security administration, which is responsible for the payment of the employee;
- 120-day maternity leave - employees are entitled to 120-day maternity leave;
- 5-day paternity leave - employees are entitled to 5-day paternity leave;
- 30% increase in pay for dangerous working conditions;
- 10%, 20% or 40% increase of the minimum wage for unhealthy working conditions;
- 25% increase in pay for a temporary transfer of the workplace;
- in the event of a dismissal without cause, payment of an accrued severance
- fund indemnity equaling 40% of the deposits made during the employment relationship;
- overtime pay at a minimum of at least 50% of the normal hourly rate;
- night shift hour reduction (every 52 minutes 30 seconds of work done between 22:00 and 05:00 is considered equal to a full 60 minutes of work);
- 20% additional pay for night shift workers;
- 6 hour shifts for some employee categories;
- minimum salaries when provided by law; and
- weekly paid rest period, usually on Sundays.

Benefits not provided by law, or those benefits contained in a collective bargaining agreement extended by the employer on a discretionary basis, such as discretionary bonuses, become a vested right to the employee when paid repeatedly and shall be treated as an entitlement. A true discretionary bonus (i.e. the payment of which is not required and is only paid occasionally) does not vest the employee with any right.

During formal insolvency proceedings, which are regulated by Decree-Law 7,661 of 1945 (Bankruptcy Law), employee entitlements have priority over all other claims, with the exception of claims for compensation arising from work-related accidents, which must be satisfied first.

Brazil is currently in the process of reforming its insolvency legislation, which is considerably outdated. The Bill of the New Bankruptcy Law was approved by the House of Representatives in October 2003 and by the Senate in July 2004. The Bill has now been sent back to the House of Representatives for final approval, which should occur before the end of 2004. The Bill provides for a limitation of the labor preference to a total of 150 "monthly salaries" (currently approximately US$ 13,000). This proposed limitation of the labor preference is one of the most controversial issues currently under discussion in the House of Representatives.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

The classification of creditors in bankruptcy, is as follows:

(i) claims for compensation arising from work-related accidents[2];

(ii) other labor and social security claims[3];

(iii) tax liabilities[4];

(iv) costs of administering the bankrupt estate, including professional fees[5];

(v) secured claims (claims in rem)[6];

(vi) personal claims enjoying special privilege[7];

(vii) personal claims enjoying general privilege[8];

(viii) unsecured claims[9].

Opinion ("súmula") no. 219 issued by the Federal Court of Appeals (*STJ*) has determined that claims resulting from services rendered to the bankrupt estate, including trustee's fees, must enjoy the same privilege enjoyed by labor claims.

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2 Section 1, Article 102 of Decree-Law 7,661/45 (Bankruptcy Law), as restated by Law 3,726/60 and Law 8,213/91 and Decree 2 ,172/97.

3 Article 102 of the Bankruptcy Law, as restated by Law 3,726/60; Article 449 of the Consolidation of Labor Laws .as restated by Law 6,449/77; Article 157 of Law 3,807/60, as restated by Decree-Law 66/66 and Law 6,830/80.

4 Article 5 of Law 6,830/80; Article 186, 187 and 188 of the National Tax Code (Law 5,172/66).

5 Section III, Paragraph 1, Article 124 of the Bankruptcy Law.

6 Section I, Article 102 of the Bankruptcy Law.

7 Section II and Paragraph 2 of Article 102 of the Bankruptcy Law.

8 Section III and Paragraph 3 of Article 102 of the Bankruptcy Law .

9 Section IV and Paragraph 4 of Article 102; of the Bankruptcy Law.

In practice, fees for the administration of the insolvency proceedings commonly take absolute priority over all claims since they are paid out of the bankruptcy estate throughout the proceedings and before the payment of any other obligations, even if such obligations should be privileged[10].

The New Brazilian Bankruptcy Law will place secured claims above tax claims in the order of preference. However, labor claims will continue to enjoy preference over both secured and tax claims, up to the limit mentioned above.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

Under Brazilian law, officers and directors are not personally liable for obligations incurred in the corporation's name by virtue of administrative acts performed in the normal course of business. However, corporate officers and directors are personally liable when, "(I) within the scope of their powers, they act recklessly, negligently, incompetently or fraudulently; or (II) they violate the law or act in an ultra vires manner, whether or not they do so in a negligent or fraudulent manner" [11].

Under section I above, if officers or directors are acting within the scope of their powers, they can only be held liable if it is proven that they have acted recklessly, negligently, incompetently or fraudulently. Under section II above, however, officers and directors will be held strictly liable for ultra vires acts. In principle, a company is not liable for the ultra vires acts of its officers and directors unless the damaged party was acting in good faith. On a finding of liability, the company, any of its shareholders, or an injured third party may bring an action against the responsible director in an attempt to recoup its losses[12].

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[10] Brazilian courts frequently grant advanced payments, or prompt reimbursement, to the trustee for expenses incurred in connection with the administration of the estate. In some cases, courts may provide the trustee with a salary as an advance of fees which he would be entitled to at the end of the proceedings.

[11] Articles 1,015, 1,016 and 1,017 of Law 10,406/2002 (Civil Code) and Article 158 of Law 6,404/76 (Corporation Law).

[12] Article 159 of the Corporation Law.

Although there is no special liability system for bankruptcies in Brazil, the general rules outlined above will apply. The sole provision relating to officer and director liability in the Bankruptcy Law deals exclusively with procedural issues, establishing that the personal liability of an officer or director of a bankrupt company shall be adjudicated by way of a separate action brought before the bankruptcy court which is administering the company's bankruptcy.

Breach of fiduciary duty to creditors or wrongful trading
There are additional rules providing for the joint and individual liability of corporate directors[13]. Liability deriving from illegal acts is distinguished from liability arising from a failure to carry out duties and obligations in connection with the regular functioning of the company, as follows:

- **Liability for illegal acts** - A director is not responsible for the illegal acts of other directors unless he conspires with them or is deemed negligent in regard to the discovery of their illegal acts or, having knowledge of wrongdoing, fails to attempt to impede it. Members of corporate bodies, such as the board of directors and those participating in joint decisions in accordance with the company's by-laws, have joint and several liability, unless they voted against the action.

- **Liability for damage resulting from a failure to carry out corporate duties and obligations** - Directors are jointly and severally liable for damages resulting from a failure to carry out their duties and obligations in connection with the regular functioning of the company, even if each director is not responsible for the performance of all duties. Thus, for example, the failure to produce and publish annual balance sheets, which may impair the normal functioning of the company, may result in the joint and several liability of the directors. However, in the case of public companies, directors will only be liable for damages resulting from a failure to perform their individual duties in accordance with the company by-laws.

In any event, a director who learns of the existence of a failure on the part of a current or former director to perform his corporate duties must communicate this fact to the shareholders at a general meeting in order to exonerate himself of liability for damages caused as a result of the director's failure to act.

[13] Paragraphs 1 through 5 of Article 158 of the Corporation Law.

The Brazilian Securities and Exchange Commission can impose administrative penalties, such as warnings, fines, and the suspension or disqualification of directors of public companies, by means of administrative hearings, which are appealable to the National Monetary Council. The Central Bank possesses similar authority over financial institutions to issue warnings and to impose fines, suspensions and disqualifications.

Liability in bankruptcy

There is no special liability system in the event of bankruptcy. The Bankruptcy Law states that when a company is declared bankrupt, the managers will not be deemed liable for obligations incurred in the corporation's name by virtue of administrative acts performed in the normal course of business, subject to certain exceptions[14].

There is a popular trend by Brazilian courts, in relation to outstanding labor and tax debts, to aggressively pursue any potentially liable party who may have "deep pockets", regardless of the principles of limiting the liability to companies and corporations. Therefore, in addition to parent and affiliate company liability, principal/shareholder assets are frequently attached in Brazil for the enforcement of such outstanding obligations.

Under Brazilian law, a legal entity usually cannot be held criminally liable, although the Bankruptcy Law provides for the criminal liability of such an entity's legal representatives (directors, officers, administrators, managers or liquidators)[15].

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

There is no statutory, industry or government funded "safety net" that guarantees the payment of employee entitlements in an insolvency context in Brazil.

[14] Article 6 of the Bankruptcy Law.
[15] Articles 186 to 190 of the Bankruptcy Law

6. **In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?**

   Under the present Bankruptcy Law, all labor debts are assumed by the purchaser of a distressed company, or a part thereof. Therefore, the buyer will be liable for labor debts that the seller is unable to satisfy. This poses a very real obstacle to the transfer of an insolvent company, or any division of it, as a going concern. To address this issue, the proposed New Bankruptcy Law permits the exclusion of labor liabilities (as well as other commercial and tax liabilities) so that the buyer of a bankrupt company, or any portion thereof, in a judicial sale of assets, would no longer assume such liabilities of the debtor, thus encouraging the sale of companies as going concerns.

Canada

1. How is an employee defined for the purposes of formal insolvency proceedings?

An "employee" is not expressly defined in Canadian insolvency legislation, though employees have certain express rights under such legislation. Where an insolvency matter turns on whether an individual is or is not an employee of a debtor, the courts typically draw upon both insolvency and employment-related legislation and case law.

The determination of the meaning of an "employee" (as with substantially all employment-related matters) is principally a matter of provincial, not federal, constitutional jurisdiction. However, the meaning of "employee" has also evolved in Canada under federal insolvency legislation and under federal (and provincial) tax legislation. For example, employees are afforded different tax treatment than independent contractors, thereby evoking a long line of tax-driven case law concerning the attributes of an employment relationship and the factors that characterize an employee. Canadian courts have accepted that there is no single test or conclusive factor or list of factors that universally determines whether an individual is an employee; rather, all the circumstances must be considered and each case decided on its merits.

Factors which are considered (but not determinative) include: whether employment is exclusive to one employer; the degree of control the employer exerts over the employee; whether the employee works regular fixed hours or intermittently; and whether the employee receives a fixed salary, defined remuneration or is compensated based on other variable factors such as profits.

Under the *Employment Standards Act* (Ontario) (the "ESA"), an "employee" is not defined exhaustively, but is defined to include:

(a) a person, including an officer of a corporation, who performs work for an employer for wages;

(b) a person who supplies services to an employer for wages;

(c) a person who receives training from a person who is an employer, as set out in subsection (2); or

(d) a person who is a homeworker,

and includes a person who was an employee. This definition of "employee", in turn, incorporates terms such as "wages", "employer" and "homeworker", each of which is broadly defined in the ESA.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

Bankruptcy (Bankruptcy and Insolvency Act (Canada)) (the "Act")

In a bankruptcy, and subject to the claims of secured creditors, an employee is entitled to a 4th ranking priority claim in respect of "*wages, salaries, commissions or compensation ... for services rendered during the six months immediately preceding the bankruptcy to the extent of two thousand dollars in each case, together with, in the case of a travelling salesman, disbursements properly incurred by that salesman in and about the bankrupt's business, to the extent of an additional one thousand dollars in each case, during the same period, and for the purposes of this paragraph, commissions payable when goods are shipped, delivered or paid for, if shipped, delivered or paid for within the six-month period, shall be deemed to have been earned therein".*[1]

In addition to secured claims, employee's preferential claims ranks subsequent to: (a) reasonable funeral and testamentary expenses of a deceased bankrupt; (b) administrative costs of the bankruptcy; and (c) a 5% levy (i.e. tax) on all distributions by the trustee to secured, preferred and unsecured creditors, payable to the government official – called the Superintendent of Bankruptcy – responsible for supervising and administering all bankruptcy matters.

[1] Section 136(1)(d) of the Act.

There has been considerable deliberation in Canadian case law as to the meaning of the words "wages, salaries, commissions or compensation" in s. 136(1)(d) of the Act. It has been established that these words include vacation pay pertaining to the six-month period in question, but do not include pension benefits, severance pay or termination pay.

Where a director or officer has a claim against a bankrupt for wages, salary, commission or compensation for work done or services rendered to the corporation in any capacity, such director or officer is precluded from benefiting from the preference granted under Section 136(1)(d) and such claim will be treated solely as a unsecured claim.[2]

If a wage-earner is not entitled to a preference, or has money still owing after receiving his or her preferential claim, he is entitled to rank as an ordinary unsecured creditor for the amount owing.

In addition, subject to the claims of secured creditors, the Act provides a 9th ranking priority to claims resulting from injuries to employees of the bankrupt that are not covered by applicable workers' compensation legislation.[3] The priority exists only to the extent of monies received from persons or corporations (i.e. insurers) guaranteeing the bankrupt against damages resulting from the injuries. Prior-ranking claims include: (a) funeral and testamentary expenses; (b) administrative costs; (c) the levy payable to the Superintendent of Bankruptcy; (d) employee preferential claims; (e) certain municipal tax claims; (f) certain landlord claims for arrears and accelerated rent; and (g) the enforcement costs of a first execution creditor.

Restructuring

In a restructuring under the *Companies' Creditors Arrangement Act* (the "CCAA"), the claims of employees do not have an express statutory priority or preference. The status and treatment of these claims would be as set out in the restructuring plan.

However, in a restructuring proposal under the Act, no proposal in respect of an employer shall be approved by the Court unless such proposal provides for

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[2] Section 140 of the Act.
[3] Section 136(1)(i) of the Act.

payment to the employees and former employees, immediately after Court approval of the proposal, of amounts equal to the amounts that they would be qualified to receive under Section 136(1)(d) if the employer had became bankrupt instead of restructuring, as well as wages, salaries, commissions or compensation for services rendered after that date and before the Court approval of the proposal, together with, in the case of travelling salesmen, disbursements properly incurred by those salesmen in and about the bankrupt's business during the same period.[4] Further, the Court cannot approve the restructuring proposal unless it is satisfied that the employer can and will make the aforementioned payments due to employees as and when required.

Post-Insolvency

A recent Ontario Court of Appeal decision[5] has provided an important clarification with respect to employment-related claims that arise from and after the commencement of insolvency proceedings where a third-party insolvency professional is appointed (e.g. a trustee in bankruptcy, receiver, etc.). The Court of Appeal held that a collective agreement does not terminate for all purposes on bankruptcy and can bind a successor employer, including potentially a trustee or receiver that takes over the business of the debtor. In other words, where an appointed insolvency professional continues the employment of some or all of an insolvent company's employees from and after the commencement of insolvency proceedings and is determined to be a "successor employer" (which is a legal term of art in Canada) under applicable employment legislation, the insolvency professional may be liable for the employment obligations (including obligations under a collective agreement, if applicable). However, the insolvency professional and the employees (or union, if applicable) are free to agree otherwise. The Court of Appeal indicated that an insolvency professional is not liable for employment obligations that preceded its appointment.

[4] Section 60(1.3) of the Act.
[5] GMAC Commercial Credit Corporation of Canada v. T.C.T. Logistics Inc., [2004] O.J. No. 1353 (Ont. C.A.).

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

Secured Creditors

In virtually all instances, the claims of secured creditors rank in priority to the claims of employees. This is equally true in bankruptcies and restructurings.

One notable exception is that banks in Canada may have secured claims pursuant to a special security interest under the *Bank Act* (Canada), which provides that certain employees will have a claim for wages, salaries or other remuneration for the three months' immediately preceding the bankruptcy that is in priority to the bank's claim.[6]

Insolvency Administrators

Subject to the claims of secured creditors, the Act grants a 2nd ranking priority to the costs of the administration of the bankruptcy proceeding (i.e. the fees and disbursements of the trustee in bankruptcy, including its legal costs), which claims have priority ahead of the claims of employees (whether preferential or unsecured).[7] Other than secured claims, administrative claims ranks subsequent only to the reasonable funeral and testamentary costs of a deceased bankrupt.

Similarly, in restructurings under either the Act or the CCAA, the administrative costs of the insolvency proceeding would be paid in full in advance of any payments to employees in respect of their claims.

Unsecured Creditors

Certain claims of employees have, subject to the claims of secured creditors, a 4th ranking priority under the Act, which preferential claims have priority over the claims of unsecured creditors.[8]

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[6] Section 427(7) of the Bank Act.
[7] Section 136(1)(b) of the Act.
[8] Section 136(1)(d) of the Act.

If a wage-earner is not entitled to a preference, or has money still remaining owing after receiving his or her preferential claim, the employee is entitled to rank as an ordinary unsecured creditor for the amount owing, and such claim would be paid *pari passu* with other unsecured creditors.

In a restructuring under the CCAA, the claims of employees (to the extent they are included in the restructuring and subject to compromise) would typically be treated as unsecured claims and paid *pari passu* with other unsecured creditors. As noted above, the Act provides that employee wage-related claims must be paid in full as part of a restructuring under that statute, the effect of which is to afford such claims better treatment than unsecured claims (which typically would be significantly compromised).[9]

Directors

Any claim for wages, salary, commission or compensation for work done or services rendered *by an officer or director* of the bankrupt company, however, will not rank as a preferred claim under Section 136(1)(d) of the *Bankruptcy and Insolvency Act* and will be treated solely as a unsecured claim.

In a restructuring under the CCAA, however, directors are often granted by court order a "super-priority" charge in respect of any claims against them (excluding claims relating to fraud or gross negligence), which court-ordered charge has priority over unsecured claims against the debtor (which would include employee claims). In restructurings under the Act, charges in favour of directors are quite rare, and all claims of directors are typically treated according to their nature – either secured or unsecured as the case may be, and typically the latter.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

[9] Section 60(1.3) of the Act.

While claims for outstanding wages are typically asserted first against the bankrupt company, a director of the bankrupt company may be held personally liable for outstanding "wages" under the *Employment Standards Act* (Ontario) (the "ESA"). The definition of "wages" in the ESA is very broad and includes "any payment required to be made by an employer to an employee under the ESA" and "any payment owed under an employment agreement". Under the ESA, "employment agreement" is defined as including a collective agreement, thus any monies owed to an employee under the terms of the collective agreement would also be covered.

The ESA places limits on a director's potential liability. The ESA expressly excludes director liability for termination and severance pay (i.e. as these amounts are not "wages") and it provides that the maximum amount of director liability for each employee is six months' wages, plus outstanding vacation pay accrued within the last 12 months. It also provides that a director's liability is limited to claims arising in the period for which he or she was a director.

Directors are also liable to ensure that certain statutory trust deductions from employee wages are remitted to the governmental taxing authorities. These trusts include income tax, pension plan contributions and employment insurance. Again, directors may be personally liable for failing to meet these remittance obligations (or failing to ensure that the debtor corporation makes these remittances).

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

There is generally no form of statutory "safety net" in Canada to guarantee or otherwise compensate employees who have suffered loss of employee entitlements as a result of their employer's insolvency.

There is, however, one notable exception. In Ontario, the Pension Benefits Guarantee Fund ("PBGF") was established in 1980 to protect basic pension benefits for pension plan members when a defined-benefit pension plan is wound up with insufficient assets. The PBGF is funded by annual levies charged to employers with defined benefit pension plans (excluding multi-employer plans). In general, the PBGF guarantees the first $1,000 per month of pension benefits. The PBGF does not guarantee non-pension benefits such as health or dental, or future indexation of pension benefits. The PBGF is administered by the Financial Services Commission of Ontario.

6. **In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?**

In Canada, jurisdiction with respect to employment matters in insolvency proceedings is quite complex. The federal government has sole jurisdiction with respect to insolvency matters, whereas jurisdiction in respect of employment matters is divided between the federal and provincial governments. The provinces are empowered to legislate with respect to most employment matters through their power over "property and civil rights".

Canadian courts have held that provincial labour legislation governs these matters. A purchaser of assets on a going concern basis is consistently held to be a "successor employer" under provincial legislation. Purchasers generally understand and accept that they will be successor employers in these circumstances as a matter of law and, accordingly, conduct significant due diligence with respect to employment-related claims of the vendor and, further, inevitably factor these obligations into the purchase price paid by them.

In businesses where employees are members of a union, the acquirer becomes bound by the existing bargaining rights of the union by operation of law, including any collective agreement, regardless of whether it actually hires the former union employees. It cannot avoid the union by merely refusing to hire the former union employees.

The People's Republic of China (the P.R.C.)

1. How is an employee defined for the purposes of formal insolvency proceedings?

The term "employee" is not defined in any law of the P.R.C. Many laws of China were enacted prior to the market economy policies introduced and therefore the laws have still not been amended to reflect the recent policy changes. Therefore the term "employee" only exists in informal documents and is yet to be accepted in official documents.

In the current corporation law[1], relevant laws on enterprise and the bankruptcy law, "staff and workers" is a phrase similar to the term "employee" in its implication.[2] It stipulates that "*a company shall protect the lawful rights and interests of its staff and workers, reinforce labor protection and attain safe production. The company shall take various means to reinforce occupational education and on the job training among its staff and workers so as to improve their level of competence*."[3] The Enterprise Bankruptcy Law (EBL)[4] regulates that "*the state shall take every appropriate means to arrange re-employment for the staff and workers of bankrupt enterprises and guarantee their basic living needs prior to re-employment*." The State Council is authorized to stipulate regulations concerning specific ways by which this is to be achieved. One can find from these provisions that the Chinese "staff and workers" is basically similar to "employee" in other countries. The difference between them rests in that the term "employee" reflects a relationship between wage and labor, while the phrase "staff and workers " embodies a sense of master in socialist enterprises.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during formal insolvency proceeding?

The Law sets out the distribution order of bankrupt assets. There are two substantive rights of employees,[5] i.e. claims to wages and labor insurance

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1 Article 15 of the Corporation Law of the P.R.C
2 China corporate law was promulgated in 1993
3 The Enterprise Bankruptcy Law of the P.R.C.(Trial Implementation) was promulgated in December 1986
4 Article 4 in Chapter one of the Enterprise Bankruptcy Law of the P.R.C. (Trial Implementation)
5 37 of Enterprise Bankruptcy Law of the P.R.C. (Trial Implementation), promulgated in December 1986

expenses. The "Conciliation and Consolidation"[6] terms of the Law also determines procedural rights for the staff and workers that "*consolidation scheme of the enterprise shall be discussed by the representative meeting of its staff and workers. The state of the consolidation shall be reported to the representative meeting of the staff and workers and opinions of the meeting shall be sought."*

The new Enterprise Bankruptcy Law (Draft) submitted in June 2004 to the Standing Committee of the N.P.C. for consideration has extended the protection of employee rights. According to the Draft, the rights of the staff and workers are prescribed in the "*Declaration of Creditor's Rights*"[7] that "*the staff and workers and labor union of the creditors' enterprise may send their representatives to attend creditors' meetings*". "The number of creditors'[8] representatives may not exceed nine persons among them one should be a representative of labor credits".[9] When all the groups approve the reorganization plan, it shall be deemed adopted. The Law[10] has also extended[11] the substantive rights of the staff and workers to, in addition to wages owed and outstanding social insurance fees, other fees due as provided by state laws and administrative regulations owed by the bankrupt enterprise.

In China, labor creditor are preferential and rank after secured creditor but receive priority before unsecured creditors in the order of liquidation. After[12] a prior deduction of bankruptcy fees and expenses is made, repayment shall be made in the following order:

1) wages and labor insurance fees;

2) taxes; and

3) unsecured creditors.

Where the assets are insufficient to meet all the claims in the same ranking, repayment shall be made on a pro-rata basis. The liquidation order provided for, in the new EBL (Draft) of 2004 is identical with the above order.

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6 Clause 2, Article 20 in Chapter 4
7 Clause 2, Article 54, Section 1 "General Provisions" in Chapter 5
8 Clause 2, Article 62, Section 2 "Creditors' Committee" in Chapter 5
9 Section 3, Chapter 7 Article 81, in Article 85
10 Section 4 "Appraisal and Distribution" of Chapter 9 "Bankruptcy Liquidation"
11 Article 137
12 Article 37 of the EBL (Trial Implementation),

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

Secured Creditors

The EBL[13] stipulates that "*assets that are guaranteed are not part of the bankrupt property; where value of the guarantee exceeds the amount of its secured claims the exceeded portion will become part of the bankrupt property*." According to this provision, a secured creditor has an exclusive right to his secured property within the amount of his secured claims. Secured creditors are not paid through the bankrupt procedure. Thus, claims of secured creditors rank in priority to the preference enjoyed by employees. The Law on priority under the new Enterprise Bankruptcy Law (Draft) of 2004 is identical to the current Bankruptcy Law.

Secured claims are given much protection by Chinese laws, but the Guarantee Law and Bankruptcy Law both do not recognise floating charges.

Insolvency administrators, professionals retained by the estate & unsecured creditors

The EBL[14] stipulates that "The following fees and expenses incurred for bankruptcy should be paid in priority by the bankrupt property. These payments include:

1) *fees and expenses incurred in the administration, realization and distribution of the bankrupt property, including remuneration of professionals retained;*

2) *lawsuit costs of the bankruptcy;*

3) *other fees and expenses paid for the common interest of creditors in the bankruptcy procedure.*

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13 Clause 4, Article 28 of the Enterprise Bankruptcy Law (Trial Implementation)
14 Article 34

The Article also stipulates that "*when the bankrupt property is not enough to pay for the fees and expenses for bankruptcy, the People's Court should declare determination of the bankruptcy procedure*". One may find in this Article that fees for insolvency administrators and professionals retained by the owners of the property and unsecured creditors are all included in item 1) above. They rank in priority to employee entitlements that are unsecured.

Shareholders

A Shareholders rights are that of a proprietor rather than entitlements of a creditor. Rights of a shareholder therefore do not fall into the category of distribution of a bankrupt property. Only when there is still residual property after the distribution of bankrupt property may a payment be made to a shareholder.

As to a debt owed by a company from its normal business activities to a shareholder, there is no relevant provision. As a result, its payment abides by the general distribution rule.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

After a company or enterprise is liquidated, liability to pay outstanding debts is terminated immediately. Directors are no longer responsible for paying the unpaid employee entitlements or taxes. Employee entitlements, would have to be paid only under the Insurance Law and the social security system.

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

The Chinese government has established two systems namely,

(i) the unemployment insurance, and

(ii) the minimum living security.
Unemployment insurance provides relief from unemployment caused by insolvency to ensure the basic living needs of the staff and workers and minimum living security ensures a minimum living standard for the staff and workers. Neither system however, enables an employee to have his/her labor claims satisfied in whole.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

"*When companies are merged,*[15] *claims and debts of the parties should be taken over by the merged company or the newly established company*." In view of this provision, the assignee is obliged by clear expression of law to take on responsibility for labor entitlements of employees of the merged companies. This provision covers company mergers under normal conditions.

In practice, regardless of whether the merged company is bankrupt or not, the acquiree or the merger is obliged to, in accordance with the relevant regulation of the State Council and relevant rules of the local government, assume all claims and debts of the mergee, including labor entitlements of employees.

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[15] Clause 4, Article 184 of the Chinese Corporation Law

Czech Republic

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is no comprehensive, precise definition in the Czech Labour Code[1] of the term "employee". The Labour Code states that, while working for a wage, an employee in an employment relationship shall performan the employer's tasks in accordance with the employer's instructions. According to this regulation, an employee is a person in an employment relationship.

The Czech "*Act on Protection of Employees against the Employer's Insolvency*"[2] (the"Act") states[3] that for the purposes of this Act, the employee shall be defined as an individual with whom the employer has concluded a labour relationship or an agreement on labour activity and whose labour relationship or agreement on labour activity exists at the moment of submission of an application for adjudication of bankruptcy over his employer, or as an individual whose labour relationship or agreement on labour activity have ended during the last six months before submission of the application for adjudication of bankruptcy.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

According to the Act,[4] an employer shall, within the scope and upon conditions stipulated by the Act, be entitled to payment of due wage claims not paid by his employer[5] who has become insolvent.[6]

The Act also stipulates that, a maximum of 3 months wage claims may be made in the period of six months preceding the month when the application for adjudication of bankruptcy was filed (hereinafter the "decisive period"). The period of three months shall be computed back from the first day of the

1 Act No. 65/1965
2 Act of the Czech Republic No. 118/2000 Sb. on protection of Employees against the Employer's Insolvency as amended
3 § 3 lit
4 § 1
5 § 8 of the Labour Code.
6 § 5 para. 1

month when application for adjudication of bankruptcy was filed. The employee may assert his wage claims vis-á-vis the same employer only once in a three year period.

The total wage claims paid to one employee including the supplementary payment[7] shall not exceed 1.5 times of the so-called "decisive sum" for one months wages. The decisive sum is determined by a decree of the Ministry of Labour and Social Affairs with effect from May 1 for 12 calendar months; and is calculated from the average wage in the national economy in the preceding calendar year. The labour office applies the decisive sum in force on the day of submission of the application for adjudication of bankruptcy.[8]

The labour office[9] decides on the amount of wages claims within 7 days, providing the claims are proved by the employee within 3 months from the adjudication of bankruptcy; otherwise, they shall become time-barred.

The Czech Bankruptcy Act[10] sets out the priority of claims.

The following employee's claims[11] have a right to priority payment

a) wage (salary) claims of employees;
b) remunerations for work performed outside an employment relationship;
c) claims for leave and public holidays;
d) claims of employees arising from the transfer of the liability to the bankrupt on a contractual basis;
e) severance payments for termination of the employment;
f) so-called "material security" granted to employers under special provisions;
g) claims for compensation on invalid termination of the employment by the employer;
h) compensation of travel, moving or other expenses;
i) compensations of employees for their tools, equipment and items necessary for work;

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7 § 9 para. 6
8 § 5 para. 2 Employees Protection Act
9 According to § 9 para. 6 Employees Protection Act,
10 Act of the Czech Republic No. 328/1991 Sb. on bankruptcy and composition section 54
11 § 31 para. 3 Bankruptcy Act

j) compensation for loss of earnings arising from full or partial disability (unless compensated otherwise) and claims for compensation and the maintenance of survivors in connection with a work injury, incapacity or death..

The claims under 3 a) and b) are considered work claims if they arose during the three years before the declaration of bankruptcy and/or after the declaration of bankruptcy; claims under 3 c) to j) shall be considered work claims if they arose after the declaration of bankruptcy or in the month when the bankruptcy was declared.[12]

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

Before composition, claims to exclusion of a thing from the estate[13] claims against the estate[14] claims to separate satisfaction (§ 28 – i.e. mortgages) and work claims[15] may be satisfied at any time during the bankruptcy proceedings. However, only to 70% of the amount received can be used to settle their claims and the rest of the proceeds going to the unsecured claims.

4. What if any personal liabilities do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owned in relation to employee entitlements?

There is no case law or legislation in the Czech Republic imposing an obligation on directors to pay employee entitlements. While in theory, it would be possible for an unpaid employee to execute his claim for damages against a managing director, this ends as soon as bankruptcy is declared.

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[12] § 31 para. 4
[13] § 31 para. 4
[14] § 31 para. 4
[15] § 31 para. 4

Failing to pay social security contributions and wages has in the last few years been criminalized. In many cases, however, agreement with the relevant authorities has been possible with overdue payments being made without additional sanctions.

5. Is there any form of statutory, industry of government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what (if any) priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

There is no special "safety net" scheme that guarantees employee entitlements in the event of insolvency. Employees[16] however may ask any labour office for satisfaction of unpaid wage claims within 3 months and the labour office publishes the information. Should the court reject the application for declaration of bankruptcy during this time period, cease these proceedings or cancel the bankruptcy, the wage claims may be asserted against the employer until the court has finally decided thereon.[17]

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability otherwise?

When a business is sold in the Czech Republic (be it the entire business or a part of business as defined in the Commercial Code), the claims of employees are usually investigated specially and reflected in the purchase price.

Upon sale of goods or an enterprise in bankruptcy (for instance in an auction) the claims of the employees remains with the administrator of the estate: the employees have no claim against the purchaser of the business.

[16] § 4 para. 1 Employees Protection Act,
[17] § 4 para. 1 Employees Protection Act,

Denmark

1. How is an employee defined for the purposes of formal insolvency proceedings?

No Danish law defines an employee. The concept is developed through case law and in theory.

Of essence are the following criteria:

- Is the employee subject to orders from an employer?
- Does the employer withhold tax when paying remuneration to the employee?
- Does the employee have only one employer?
- Is the employee paid on a regular basis (e.g. monthly or weekly)
- Is the employee granted annual holidays?

If a positive reply can be given to the above-mentioned questions, a person will be considered an employee with respect to the Danish Bankruptcy Act.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

Employees have different entitlements depending on whether the employer is in suspension of payments or in bankruptcy:

Suspension of payments

A person who is employed with the debtor's business and who receives remuneration in arrears at periodic intervals may require that the debtor provide adequate security for the remuneration falling due from time to time after the notice of suspension of payments.[1] If security is not provided without undue delay (usually within 3-4 days), the employee may terminate the contract of employment and claim damages.

Bankruptcy

"*The estate should as soon as possible decide whether to adopt employment contracts made with persons, employed with the debtor's business enterprise…*" [2]

From the adjudication order, the estate is granted two weeks to decide and inform the employees if the estate will adopt the employment contracts. If the estate chooses to adopt some or all the employment contracts, the remuneration (from adjudication order) will be a pre-preferential claim in the estate.

If the estate decides not to adopt employment contracts and informs the employees within two weeks, the remuneration will be a preferential claim in the estate.

If the estate fails to decide and inform the employees within two weeks, the remuneration will be a pre-preferential claim in the estate in the period from adjudication order until the employees are notified.

The following claims are preferential and will be covered according to the order of distribution of assets mentioned below:

- Salary and allowances
- Compensation (notice period)
- Unpaid pension contribution
- Holiday allowances

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1 Section 16b of the Danish Bankruptcy Act
2 Section 63 of the Danish Bankruptcy Act

- Redundancy payment
- Unfair dismissal claim
- Reasonable legal costs incurred before the bankruptcy

The following claims are not preferential and will be treated as unsecured creditors.):

- Mileage allowances
- Subsistence allowances
- Entertainment costs
- Claims from more than six month before the bankruptcy.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

The assets of the estate will be distributed in the following order:[3]

1. Secured claims e.g. assets with retention of title.[4]

2. Prior to any other debts costs and expenses regarding commencement of bankruptcy, the administration of the estate, i.e. costs incurred in the course of bankruptcy proceedings (including salaries on adopted employment contracts), debts incurred by the estate during its administration, shall be paid in equal proportions.[5]

3. Thereafter reasonable costs and expenses incurred in an attempt to provide a total arrangement of the debtor's financial affairs by a reorganization, dissolution process, composition or similar schemes, other debts (including salaries) incurred by the debtor after the date of notice with the consent of the supervisor appointed by the bankruptcy court (suspension of payments), reasonable costs and expenses incurred in a commencement of liquidation of a public limited liability company or private company and the court fee shall be paid in equal proportions.[6]

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3 Sections 82, 93 - 98 of the Danish Bankruptcy Act
4 Section 82
5 Section 93
6 Section 94

4. Thereafter claims for wages/salaries and other consideration for work performed in the debtor's service, which has fallen due within the period from six months prior to the date of notice and until making of the winding up order shall be paid in equal proportions (preferential claims).[7]

5. Thereafter any suppliers' claims for duties on goods which are dutiable under the certain statutes and which have been supplied to the debtor, in duty paid condition, for resale within a time limit of 12 months before the date of notice.[8]

6. Thereafter unsecured creditors shall be paid in equal proportions any further claims, other than those referred to below.[9]

7. After all other categories of claims, the following claims shall be paid in the following order (1) claims for interest accrued after adjudication (not being interest accrued on the claims referred to under 2 and 3 above), (2) claims for fines, penalties and appraisal value on seizure, claims for payment of additional tax in consequence of wrongful tax return or non submission of such return, and (3) claims for agreed penalties to the extent that such penalties exceed the actual loss suffered, and (4) claims under gratuitous promises (deferred claims).

Any excess will be distributed to the shareholders according to rules governing solvent liquidation of companies.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The management of the company can be held liable for unpaid claims if the management has committed the company to obligations knowing that the company will not be able to pay claims relating to the obligations. This issue is sometimes brought up regarding unpaid withheld tax on salaries if the

7 Section 95
8 Section 96
9 Section 97

management knew that the company would not be able to pay withheld taxes, when the net salaries were paid to the employees.

5. Is there any form of statutory, industry or government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

The Employees' Guarantee Fund is an independent institution founded by law in 1972. The Employees' Guarantee Fund revenue comes from employer's contributions.

It covers claims up to DKK 110.000 plus holiday allowances in the case of bankruptcy. The employee must file an application within four weeks from the bankruptcy.

The Employees' Guarantee Fund does not cover claims from the management of the business or persons related to the management.

The Employees' Guarantee Fund is subrogate as a preferential claim against the estate.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise

The acquirer takes on all the transferor's rights and obligations in respect of the employees taken over, including salary, holiday and public holiday pay, expenses payable to the ATP (the Danish Labour Market Supplementary Pension Scheme), bonus, profit share, gratuity and value of overtime where time has not been taken in lieu.[10]

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[10] Section 2 of the Danish Act on the Legal Position of Employees on the Transfer of Undertakings (Lov om lønmodtageres retsstilling ved virksomhedsoverdragelse)

According to current practice developed in theory and by The Employees' Guarantee Fund special rules apply if the transfer of business is done from a bankruptcy estate and the transfer was not planned before the bankruptcy. In this case, the acquirer might avoid claims relating to the period before the bankruptcy.

France

1. How is an employee defined for the purposes of formal insolvency proceedings?

The term "employee" is not defined in laws concerning either insolvency or labour According to traditional labour laws, however an employee is defined as a person who

- conducts a professional activity;
- receives remuneration for work; or
- is under a bond of subordination.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceedings?

Employees' claim are entitled to a general preference, over personal and real estate, guaranteeing the payment of their last six months of wages[1]. The wages correspond to the main income received in exchange for their professional activity. Allowances are incorporated into the wages and consist of:

- paid leave,
- improper termination of contract,
- certain dismissal allowances.

However, this preferential claim does not extend either to the employee profit sharing or to variable bonuses paid to staff.

The employee's level of priority is not very advantageous. When determining an employee's rights, the personal estate, security-holders and the Treasury all have priority over the employees and rank at the same level as the social security bodies.

[1] Articles 2101 and 2104 of the civil code

The situation is better concerning rights over the real estate, since the preferential employee claim precedes the claims of mortgage-holders.[2] However, a negative aspect of the employee's preferential claim is that often the sale of real estate is slow and requires lengthy legal actions, while the employee needs immediate payments. In order to strengthen the rights of the employees, the Statutory Decree of August 8 1935[3], created top priority for employees ('super preferential claims') which covers outstanding payments for the last sixty working days. These sums are not completely covered, the employee receiving only twice the sum retained as the limit for social security subscriptions (Article D 143.1 of the Labour Code). Furthermore, this system no longer guarantees dismissal allowances. This top priority is very powerful since the employees whose claims arose during the supervision period have priority over the creditors given priority by the Commercial Code[4].

The only accepted limit to this priority is that in accordance with the commercial code[5] employee claims do not come before those of security-holders with retention of title.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

According to the system of distribution, the order of priority is as follows:

a) the fee of the insolvency practitioner;
b) employees ('super preferential' claims);
c) costs of administering the insolvency proceedings;
d) mortgage-holders (secured creditors)
e) beneficiaries of the provisions of of the commercial code[6]
f) the Treasury (general secured creditor);
g) the security-holders (special secured creditors);
h) the social security body (general secured creditor);
i) the unsecured creditors

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[2] Article 2105 of the civil code
[3] Article L 1430-10 of the Labour Code
[4] Ex-Article 40, now L621-32
[5] Article L 622-21
[6] Article L621-32

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The 'natural person' director is not held liable for the sums due to employees. Nevertheless, if mismanagement is proved and action is taken against directors in order to oblige them to pay all creditors of the company, the employees' claims will be included among them.

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

When there are insufficient assets, or when the sale of assets is expected to take a long time, the employees will not have to suffer because of this situation. Indeed, the law of December 1973, incorporated in Article L143-11 and the following Labour Code created a system of compulsory insurance ('AGS') to protect employees against the possible risk of non-payment of wages. As mentioned above, according to this system the payments that will be made to individual employees will not go above an amount limited by decree.

Following the unemployment insurance scheme, this system covers the employees of tradesmen, craftsmen, farmers and of legal persons.

The insurance system covers all of the unpaid wages on the day of commencement of proceedings. But the guarantee is limited for wages owed subsequently, because such payments are normally guaranteed[7].

The insurance funds are paid for by special contributions recovered by the unemployment compensation paying body ('ASSEDIC') from employers. However, even if the employer did not make his contributions, the employees are still guaranteed these benefits.

[7] Article L621-32 (commercial code).

It should be also noted that the Law of May 4 2004 states that compensation agreements concluded 18 months prior to the commencement of proceedings are no longer eligible to be covered by the insurance system (AGS).

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

In the event of a sale of a business that is in financial difficulty, the acquirer is not deemed liable for anything else than his own debts. In fact, only debts incurred after the date of the acquisition can be chargeable to the business. All former debts, including wages owed, are only to be paid within a discharge plan applied by the trustee.

In addition, there is the economic dismissal proceeding which is covered by common labour law that apply to reorganisation and liquidation proceedings, but some amendments concerning timescales and notice have been introduced. One or more employees may be made redundant during the supervision period but this kind of dismissal must have at least three features: be urgent, inevitable and indispensable, to be effective.

However strict regulations have been devised for this procedure. The trustee will have to consult with the employees' committee first, or if none exists, with the employees' representative. He must also inform the labour inspector about the dismissal of one or more of the employees. Finally, in order to proceed to the dismissal he must have confirmation from the judge.

Germany

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is no statutory definition of an employee under German law. In principle, an employee is a person who performs dependent work for the benefit of another person on the basis of a civil law contract. An employee is personally dependent on the employer if the employer has the right to give instructions as to the place, time and content of the work to be performed. An additional characteristic is that employees are generally integrated into the business organisation of the employer. This understanding also applies for the purposes of formal insolvency proceedings.

Against this background, freelancers, independent contractors and directors are not considered employees under German law.

2. What entitlements of employees are afforded priority for the purposes of formal insolvency proceedings? In particular, what is the treatment of superannuation or pension contributions payable by the company with respect to its employees?

Claims already existing at the opening of formal insolvency proceedings ("pre-proceeding") are unsecured.[1] By contrast, obligations incurred by the insolvency administrator (after the opening of formal insolvency proceedings[2]), or by a temporary insolvency administrator (if already entitled to exclusively act on behalf of the debtor[3],) are preferential.

As a consequence, whether wages, holiday pay, bonuses or comparable entitlements and pensions rank ahead of unsecured claims depends on whether they are pre-proceeding.

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1 Section 38 of the German Insolvency Act
2 Section 55 (1) of the Act
3 Section 55 (2) of the Act

As far as claims for compensation (*Nachteilsausgleichsansprüche*) and claims resulting from a collective severance plan (*Sozialplanansprüche*) are concerned, the distinction is as follows:

Pursuant to the German Works Constitution Act (*Betriebsverfassungsgesetz*) an employee may be entitled to a claim for compensation if the employer of a business for which a Works Council has been established does not comply with certain statutory obligations in connection with operational changes (e.g., a downsizing or closure of the business). If in such a case, the operational change is implemented by an insolvency administrator after the opening of formal insolvency proceedings, the claim for compensation is preferential.

If a collective severance plan is agreed after the opening of formal insolvency proceedings, claims resulting from such plan qualify as preferential claims[4].

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

The costs and expenses of both temporary and final insolvency administrators are preferential claims.[5] To the extent that employee entitlements qualify as preferential claims, they rank equally with administrators costs and expenses.

Among the group of unsecured creditors, employees are not afforded priority over other unsecured creditors for the non – preferential element, if any, of their claims.

Directors do not fall within the scope of the generally accepted definition of employees. If they do qualify as employees, however, whether their entitlements are preferential or unsecured depends on whether they are pre-proceeding or post-proceeding.

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[4] Section 123 of the Act)

[5] Section 54 of the Act

4. What, if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements [or taxes or other duties owed in relation to employee entitlements]?

Social security contributions

The German social security system distinguishes between the following four types of insurance:

- social security pension scheme (*gesetzliche Rentenversicherung*);
- unemployment insurance (*Arbeitslosenversicherung*);
- statutory health insurance (*gesetzliche Krankenversicherung*); and
- statutory nursing care insurance (*gesetzliche Pflegeversicherung*).

Contributions to these four mandatory insurances are shared equally between employer and employee. Employee contributions are withheld from wages and paid directly to the respective social security institution by the employer.

Non-compliance with such payment duty results in personal liability for tort[6] on the part of the director and also constitutes a criminal offence regardless whether or not respective wages are actually paid out to the employee[7]. With respect to the criminal liability however, the German Supreme Court makes an exception for non-compliance during the three-weeks period in which the management has to file for insolvency.

Taxes on Wages

Albeit that the employee is the debtor in respect of taxes on wages, the employer is obliged to withhold such contributions from the employee's wages and pay them to the fiscal authorities. This obligation lies with the director of the company.[8] Non-compliance results in personal liability on the part of the director[9] and constitutes a criminal offence.[10]

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6 Section 823 of the German Civil Code
7 Section 266a of the German Criminal Code
8 Section 34 of the German Tax Code
9 Section 69 of the German Tax Code
10 Sections 370, 378 and 380 of the German Tax Code

Remuneration

The insolvency administrator becomes personally liable for employee entitlements to the extent they have been created post-proceeding and it was foreseeable that the assets would not cover these additional costs.[11]

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what, if any, priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

Insolvency Compensation

Employees (and under certain circumstances, directors) have a claim against the Federal Employment Agency for so-called insolvency compensation (*Insolvenzgeld*), which is outstanding remuneration for a pre-petition period of three months preceding the opening or dismissal of formal insolvency proceedings.[12] The Federal Employment Agency, against payment of insolvency remuneration to the employee, assumes the claims of the employees against the employer, which qualifies as an unsecured claim.

Pension Claims

Employees (and under certain circumstances, directors) with pension entitlements including vested pension expectancies, upon the opening of formal insolvency proceedings, assume a claim against a pension security institution that was founded for that purpose: the *Pensions-Sicherungs-Verein*.[13] Pension beneficiaries or holders of a vested pension expectancy may also claim against the *Pensions-Sicherungs-Verein* (i) where, in order to avert insolvency, a debt restructuring has been agreed with the consent of the *Pensions-Sicherungs-Verein*, (ii) if the opening of formal insolvency proceedings is dismissed for lack of assets, (iii) and or, subject to additional requirements, in the event of a discontinuation of the business activities of the insolvent employer with no prospects for the opening of formal insolvency proceedings.

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[11] Section 61 of the German Insolvency Act

[12] Section183 of the German Social Code III

[13] The German Act for the Improvement of Company Pension Plans

The *Pensions-Sicherungs-Verein*, on payment to pension beneficiaries, assumes a respective claim against the employer, which qualifies either as a preferential or as an unsecured claim.

Credits in case of Partial Retirement (*Wertguthaben bei Altersteilzeit*)

Employees of a certain age might be able to convert their employment into partial retirement, which is commonly done by way of the so-called "block-model". This means that initially the employee continues to work full-time but against reduced compensation and will later on be released until retirement against reduced compensation.

Where such block-model arrangements have been entered into, the employer has to duly protect accrued partial - retirement remuneration credits of employees against insolvency as well as the social contributions to be paid in respect of such remuneration credits.[14]

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The acquirer of a business or a part of a business enters into the rights and obligations arising from the employment relationships in existence at the time of the transfer of that business or part of that business.[15] An acquirer therefore would, for example, be liable for obligations arising from an occupational pension scheme in existence at the time of the transfer.

In principle, the German Civil Code also applies in a case of a business transfer or a transfer of a part of a business in connection with insolvency proceedings out of insolvency.[16] However, modifications apply in terms of the liability of the acquirer if the transfer takes place after the opening of formal insolvency proceedings. In such cases, the acquirer's liability is restricted to employee claims and entitlements created after the opening of formal insolvency proceedings. Thus, for example, the acquirer is only liable for occupational pension claims that have come into existence after the opening

[14] Section 8a of the German Partial Retirement Act
[15] Section 613a of the German Civil Code
[16] Section 613a

of formal insolvency proceedings, provided however, that those obligations affect employment relationships in existence at the time of the transfer. The *Pensions-Sicherungs-Verein* might assume liability with respect to occupational pension entitlements for which the acquirer is not liable.[17]

However, there is no restriction of liability of the acquirer with respect to employee claims and entitlements that could not be filed with the insolvency administrator (e.g. holiday claims). Moreover, in some cases, of the German Commercial Code[18] provides that the purchaser acquirer assumes all liabilities of the vendor if he continues the business under its previous firm name. However, there is no liability under the German Commercial Code if assets (as opposed to the business) are purchased from an insolvency administrator after the opening of formal insolvency proceedings.

[17] cf. 5.2
[18] Section 25

Hong Kong

1. How is an employee defined for the purposes of formal insolvency proceedings?

The term "employee" is defined in the Employment Ordinance ("EO") [1] as engaged under a contract of employment. To determine those workers to whom the Ordinance applies reference must be made to the common law.

The EO covers all employees, whether temporary or part-time, with the following exceptions:

(a) a person who is a member of the family of the proprietor of the business in which he is employed and who dwells in the same dwelling as the proprietor;

(b) an employee as defined in the Contracts for Employment Outside Hong Kong Ordinance[2];

(c) a person who is serving under a crew agreement within the meaning of the Merchants Shipping (Seafarers) Ordinance[3], or on board a ship which is not registered in Hong Kong; and

(d) Contracts of apprenticeship registered under the Apprenticeship Ordinance[4] except to the extent provided in that Ordinance.

Employees employed under a continuous contract; whether temporary or part-time, are entitled to all the statutory benefits under the EO subject to satisfaction of the conditions stipulated therein. An employee who works continuously for the same employer for four weeks or more, with at least 18 hours in each week, is regarded as working under a continuous contract.

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1 Cap 57 "EO"
2 Cap.78
3 Cap. 478
4 Cap 47

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

Employers have a basic legal obligation to pay the wages or salaries agreed with an employee subject to provision that the employee carries out the work and services agreed with the employer. In Hong Kong, salaries and wages are not fixed by law and are negotiated between the employer and the employee, except for certain minor classes of employees.

A summary of employee claims on termination of a contract of employment in case of receivership or liquidation of their employer under the provisions of the EO and the Companies Ordinance ("CO") is as follows:

Wages
All remuneration, earnings, allowances (including travel allowances, commissions and overtime), tips and service charges however designated or calculated, capable of being expressed in terms of money, payable to an employee in respect of work done or to be done under his contract of employment.

Payment in lieu of notice
Where there is a proper employment contract and the contract has

a. No specific provision, payment in lieu of notice should not be less than 1 month.

b. Specific provision, payment in lieu of notice should cover the agreed period but not less than 7 days[5].

Where there is no proper employment contract, payment in lieu of notice should be the equivalent of one month's salary.

Either party to a contract of employment may at any time terminate the contract without notice by agreeing to pay to the other party a sum equal to the amount of wages which would have accrued to the employee in the period of notice (per above).

[5] S.6 and 7 of EO

Severance pay
Only employees who have been employed for at least 24 months are entitled to severance payment[6]. Generally, the maximum payment shall not exceed the total amount of wages earned during the last 12 months or HK$180,000, whichever is less.

Accrued holiday pay
Employees employed under a continuous contract for a period of 3 months immediately preceding a statutory holiday as defined in the EO[7] shall be entitled to holiday pay equivalent to the wages which the employees would have earned if he had worked on the holiday.[8]

Annual leave pay
In many cases, annual leave pay is provided for in the employment contracts. For cases where the same is not provided for in the employment contract and

a. the employee has been employed for 12 months,[9] or

b. the employee has been employed for less than 12 months but more than 3 months, the annual leave pay is proportional to the entitlement.[10]

Employees have preferential claims in respect of a portion of the total amount outstanding to them when an employer becomes insolvent. The CO specifies which debts are preferential (including employee claims) and the priority of payment in the event of formal insolvency proceedings against a corporate employer.

The following schedule summarises some of the employee claims that rank for priority.[11] All of these debts rank equally among themselves and must be paid in full unless the assets are insufficient to meet them, in which case they abate in equal proportion amongst themselves.

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6 S. 31B(1) of EO
7 S.39(1)
8 S.40 and S.41D of EO
9 S.41AA of EO
10 S.41D of EO
11 S.265 of the CO

Categories of claims	Limits of preferential claims with first priority (HK$)*
Arrears of wages	8,000
Severance pay	8,000
Long Service Leave	8,000
Compensation due under the Employees' Compensation Ordinance	No limit
Wages in lieu of notice	2,000
Accrued holiday remuneration	No limit
Unpaid contributions due by the employer to the Mandatory Provident Fund ("MPF")	50,000 plus 50% of the amount that exceeds 50,000
Salaries deducted by the company for making contributions to MPF not paid into the scheme	No limit

** All amounts in excess of the above limits share the same priority as ordinary unsecured creditors.*

Where any payment is made on account of wages, severance payment, long service payment, wages in lieu of notice, or accrued holiday remuneration out of money advanced by some person for that purpose, that person has a right of priority in a winding-up equivalent to the priority which the employees would have had if they had not been paid by such advance. Included in this group is the Protection of Wages on Insolvency Fund (see. below).

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

In insolvency proceedings generally, the available assets are distributed amongst the various types of claims in the following order:-

- Costs and expenses of the insolvency proceedings, including the remuneration of the insolvency practitioner;
- Creditors secured by a fixed charge;
- Preferential creditors – including certain debts due to employees as outlined above;
- Creditors secured by a floating charge;
- Unsecured creditors in general; and
- Shareholders.

Where there are insufficient funds to pay any class of claims in full, payments are made on a pro-rata basis.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The directors and/or others involved in the management of the company have no personal liability with respect to unpaid employee entitlements or taxes or other duties owed unless their employment contracts state that they are employed by the directors and not the company.

5. Is there any form of statutory, industry or government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

Since 1985, pursuant to the Protection of Wages on Insolvency Ordinance ("PWIO"), employees owed wages, severance pay or wages in lieu of notice by an insolvent employer may apply to the Protection of Wages on Insolvency Fund Board ("the PWIF") for payment. The PWIF is funded by a special levy on business registration fees. The payments are made on an ex-gratia basis and are subject to certain limits. The PWIF has no statutory obligation to make payments in the case of a voluntary liquidation or a receivership. However, it will often make such payments on an ex-gratia basis.
The circumstances under which payment will be made by the PWIF include the following

i. in the case of an employer who is not a company,[12] a bankruptcy petition has been presented against him; or he has committed an act of bankruptcy within the meaning of section 3 of the Bankruptcy Ordinance[13] but a petition cannot be presented against him;[14]

ii in the case of any employer which is a company, a winding-up petition has been presented against that employer;[16] or

iii the Commissioner may make an ex-gratia payment if in his opinion:-[17]

a. the employer employs less than 20 employees; and

b. sufficient evidence exists to support the presentation of a petition in that case on the ground," if the employer is a company, that it is unable to pay its debts; or if the employer is a person other than a company; that he has committed an act of bankruptcy; and.

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12 S.16 (1)(a) of PWIO
13 Cap. 6, section 3
14 Section 6 (1)(a)
15 6 (1)(a)
16 S.16(1)(b) of PWIO
17 S18 of PWIO

c. it is unrecoverable or uneconomic to present a petition.

The following table summarises the limits of ex-gratia payments made by the PWIF:

Categories of claims	Wages protection fund limits (HK$)
Arrears of salary	36,000
Payment in lieu of notice	22,500 or 1 month's pay whichever is the less
Severance pay	HK$50,000 + 50% of amount exceeding HK$50,000

Any employees whose employer has become insolvent and who are owed wages, wages in lieu of notice or severance payments are eligible to submit an application to the PWIF. Directors of insolvent companies will generally not be entitled to claim from the PWIF.

In seeking payment from the PWIF, the applicants must sign a statutory declaration to confirm the accuracy of their claims. The PWIF will verify the claims against personnel and wages records before the ex-gratia payments are approved.

The PWIO provides that the rights and remedies of the employee, to the extent of the amount of payment made by the PWIF, will be subrogated to the PWIF. The claims of the PWIF are afforded preferential status in a winding up ahead of other employee claims[18].

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The contract of service of an employee is deemed to terminate upon the making of the winding up order (in the case of a Court- initiated liquidation)

[18] CO S.265

or the appointment of a liquidator (in the case of a voluntary liquidation). The appointment of a receiver or provisional liquidator does not serve to terminate a contract of employment.

However, the general rule that the assignment of the benefit of a contract is possible without the consent of the other party does not apply to employment contracts, which are personal contracts and are not assignable.

When a business is sold with the intention that the employees will transfer with the business, there is legally a termination of the employment with the seller, and a new hiring by the purchaser. The EO makes special provisions to protect entitlements to severance and long service payments, which are both subject to minimum length of service requirements.

If the intention of the parties is to transfer obligations from the seller to the purchaser, certain conditions have to be met. These include-

- giving notice or payment in lieu of notice;
- making an offer of employment to the employee with terms which are either “not different” from the previous terms and conditions, including provisions as to the capacity and place in which the new employee would be employed, and “no less favourable” to the employee;
- an offer of re-employment to take effect on or before the termination of the previous employment; in practice, both are usually timed to occur on the date of transfer;
- an acceptance of the offer by the employee.

If the purchaser subsequently dismisses an employee transferred in this way, he will be liable to pay severance payment or long service payment based on the entire length of service with both employers.

If an employee unreasonably refuses an offer of new employment made in accordance with the above conditions, neither the seller nor the purchaser will have any liability for severance payments.

India

1. How is an employee defined for the purposes of formal insolvency proceedings?

For the purpose of entitlements in liquidation proceedings, the Companies Act, 1956 (**Companies Act**) defines only the workmen and not the employee. The Industrial Disputes Act, 1947 (14 of 1947)[1] defines the "*Workman*" as "*any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied, and for the purposes of any proceeding under the said Act in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched in connection with, or as consequence of, that dispute, or whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person who is subject to the Air Force Act, 1950 (45 of 1950), or the Army Act, 1950 (46 of 1950), or the Navy Act, 1957 (62 of 1957); or who is employed in the police service or as an officer or other employee of a prison; or who is employed mainly in a managerial or administrative capacity; or who, being employed in a supervisory capacity, draws wages exceeding one thousand six hundred rupees per mensem or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature".*

Though not defined, all persons under employment of the company except the workmen can be referred as employees.

The law of restructuring of companies, namely, Sick Industrial Companies (Special Provisions) Act, 1985 (**SICA**) does not define the employee or workmen. However,[2] words and expressions used and not defined have the same meaning as assigned to them in the Companies Act.

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[1] Section 529 (3) (b) of the Companies Act, 1956

[2] Section 3(2) of SICA

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

The Companies Act[3] provides a more favourable treatment of the workmen over the employees and also allows a broader range of entitlements for the purpose of preferential payments during the liquidation of a company.

Entitlement of Employees for preferential payments is as follows[4]:

- All wages or salary of any employee in respect of service rendered and due for a period not exceeding 4 months in the 12 months immediately preceeding the date of winding up order subject to maximum of Rs 20,000 per employee.[5]

- All accrued holiday remuneration payable to an employee in case of death or termination of his employment immediately preceding the winding up order.[6]

- All employers contributions under the Employees State Insurance Act, 1948 or any other law in the twelve months preceding the date of winding up order.[7]

- All amounts payable under the Workmen Compensation Act, 1923 (WCA) which arose on account of the death or disablement of any employee.[8]

- All sums due to any employee from any provident, pension, gratuity or any other fund for the welfare of the employees maintained by company.[9]

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[3] Section 529
[4] Section 530 (1)) of the Companies act, 1956
[5] Section 530 (1) (b) of the Companies Act, 1956.
[6] Section 530 (1) (c) of the Companies Act, 1956.
[7] Section 530 (1) (d) of the Companies Act, 1956.
[8] Section 530 (1) (e) of the Companies act, 1956.
[9] Section 530 (1) (f) of the Companies Act, 1956.

Entitlement of Workmen considered for preferential payments is as follows:

The Companies Act[10] defines the permissible workmen dues, which will be considered for preferential payment over and above unsecured creditors, revenue, taxes and cesses on pari-passu basis with secured creditors as follows:

- All wages or salary whether payable by way of time, piece work, commission or hype rid of anyone as per the Industrial Disputes Act, 1947. It means a wide range of entitlements of the workmen is covered including compensation of retrenchment etc. There is no financial or time limit fixed for consideration of salary of workmen for the purpose of preferential payments unlike in the case of employees.

- All accrued holiday remuneration payable in case of death or termination as due on the date of winding up order.

- All amounts payable under the WCA Workmen Compensation Act, 1923 payable on account of any compensation liability in respect of the death or disablement of any workman.

- All sums due to any employee from provident, pension, gratuity or any other fund for the welfare of the workmen maintained by company.

SICA does not contain any specific provision for treatment of employees or workmen's dues though their cases are heard by the Board for Industrial and Financial Reconstruction (BIFR) which sanctions the scheme subject to satisfying itself about the reasonability of the treatment provided to the dues of workmen in particular.

[10] Section 529 (3) (b)

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

Overriding preferential payments

The Companies Act, 1956[11] ranks[12] the dues of workmen as pari passu with secured creditors. The claims of workmen and secured creditors override all other claims against the company in liquidation. The liabilities to workmen and secured creditors shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

The "workmen's dues", in relation to a company, means the aggregate of the following sums due from the company to its workmen:

- All wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act;

- All accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect, of, the winding up order or resolution;

- Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has, at the commencement of the winding up, under a contract with insurers rights capable of being transferred to and vested in the workman[13], all amounts due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company;

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[11] Section 529A
[12] Inserted by the Companies (Amendment) Act, 1985
[13] Section 14 WCA 1923 (Section 8 of 1923)

All sums due to any workman from a provident, pension gratuity or any other fund for the welfare of the workmen, maintained by the company;

"Workmen's portion", in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues; and the amounts of the debts due to the secured creditors.

Preferential payments

The following debts are paid in priority[14] to all other debts and (a) rank equally among themselves paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions; and (b) so far as the assets of the company available for payment of general creditors are insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge:

- All revenues, taxes, cesses and rates due from the company to the Central or a State Government or to a local authority at the date of appointment of a provisional liquidator or date of order of winding up whichever is earlier and having become due and payable within the twelve months next before that date.

- All wages or salary (including wages payable for time or piece work and salary earned wholly or in part by way of commission) of any employee, in respect of services rendered to the company and due for a period not exceeding four months within the twelve months next before the relevant date subject to the limit of rupees twenty thousand provided by the Ministry of Finance, Department of Company Affairs.[15] Any remuneration in respect of a period of holiday or of absence from work through sickness or other good cause shall be deemed to be wages in respect of services rendered to the company during that period.

[14] Section 529A,
[15] Section 530(2) of the Companies act, 1956.

- All accrued holiday remuneration becoming payable to any employee, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order or resolution. The expression " accrued holiday remuneration " includes, in relation to any person, all sums which, by virtue either of his contract of employment or of any enactment (including any order made or direction given under any enactment), are payable on account of the remuneration which would, in the ordinary course, have become payable to him in respect of a period of holiday, had his employment with the company continued until he became entitled to be allowed the holiday.

- Where any payment has been made to any employee of a company, (i) on account of wages or salary; or (ii) to him, or in the case of his death, to any other person in his right, on account of accrued holiday remuneration, out of money advanced by some person for that purpose, the person by whom the money was advanced shall, in a winding up, have a right of priority in respect of the money so advanced and paid, up to the amount by which the sum in respect of which the employee or other person in his right, would have been entitled to priority in the winding up has been diminished by reason of the payment having been made.

- Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, all amounts due, in respect of contributions payable during the twelve months next before the relevant date, by the company as the employer of any persons, under the Employees' State Insurance Act, 1948[16] (34 of 1948), or any other law for the time being in force.

- Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has, at the commencement of the winding up, under such a contract with insurers,[17] as is mentioned in Section 14 of the Workmen's Compensation Act, 1923 (8 of 1923), rights capable of being transferred to and vested in the workman, all amounts due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company. Where any such compensation is a weekly payment, the amount due in

[16] Section (34 of 1948)

[17] Section 14 of the Workmen's Compensation Act, 1923 (8 of 1923)

respect thereof shall be taken to be the amount of the lump sum for which the weekly payment could, if redeemable, be redeemed if the employer made an application for that purpose under the said Act.

- All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company.

- The expenses of any investigation into affairs of the company[18] in so far as they are payable by the company.

SICA does not contain any provision providing preference to employee's entitlements in a rehabilitation scheme though BIFR does satisfy itself on the reasonable treatment of their dues before sanctioning the scheme.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The Companies Act, 1956 does not specifically provide a liability for directors and others involved in management of the company. However, various other laws deal with such provisions. Some of these laws are:

- *Industrial Disputes Act,*
- *Industries (Development and Regulation) Act, 1951.*
- *The Employees Provident Funds and Misc. Provisions Act, 1952*
- *Employees State Insurance Act, 1948*
- *Employers Liability Act, 1938*
- *The Minimum Wages Act, 1948*
- *The Payment of Bonus Act, 1965*
- *The Payment of Gratuity Act, 1972*
- *The Payment of Wages Act, 1936*
- *Workmen's Compensation Act, 1923*

[18] Section 235 or 237 of the Companies Act

- *Employees' State Insurance (General) Regulations, 1950*

Under these statutes, liabilities including penal are provided for.

5. Is there any form of statutory, industry or government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

There is no government scheme guaranteeing payment of employee entitlements in liquidation or rehabilitation proceedings. However, under the Companies (Second Amendment) Act, 2002 enacted recently though still to be notified, a Rehabilitation Fund is proposed to be set up out of a cess to be charged from corporate entities. The Fund would be utilized, amongst others, for making interim payments of workmen's dues pending revival or rehabilitation of the sick industrial company and payment of workmen's dues under Section 529.[19]

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

This is treated as essentially a matter between the parties. In cases of merger, acquisition or amalgamation or sale as going concern other than in rehabilitation or liquidation, a tripartite agreement between the acquirer, acquiree and the employees' association/union is arrived at providing for settlement of employees' claims. If employees are dissatisfied with their treatment, they can challenge the acquisition in court and the courts approve such schemes subject to satisfaction on the reasonability of the treatment provided to employees' dues. In cases of acquisition in liquidation or rehabilitation proceedings, the court or BIFR, respectively ensure that a reasonable treatment is provided by acquirer to employees entitlements.

[19] Section 441 C of the Companies (Second Amendment) Act, 2002

Ireland

1. How is an employee defined for the purposes of formal insolvency proceedings?

In this chapter the employee entitlements referred to arise on liquidation and receivership of companies, and on bankruptcy of individuals. The following has no application to the rescue procedure known as examinership.

An "employee" is defined in slightly different terms for the purposes of various legislation. However the entitlements set out below will be available to employees who:

(i) are in employment which is insurable for all benefits under the Social Welfare Acts (in general this means employees who pay full social insurance contributions);

(ii) are between 16 and 66 years of age or, if over 66 years, in employment which, but for their age, would be insurable for all benefits under the Social Welfare Acts;

An 'employee' is also defined[1] as "*a person who has entered into or works under (or, in the case of a contract which has been terminated, worked under) a contract with an employer, whether the contract is for manual labour, clerical work or otherwise, is express or implied, oral or in writing, and whether it is a contract of service or apprenticeship or otherwise".*[2]

2. What are the employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

In respect of companies[3], and in respect of individuals[4], certain debts are granted preferential status. They must be paid out of the realised assets after the costs, charges, and expenses of the procedure have been paid but prior

[1] Section 1 of the Protection of Employees (Employers' Insolvency) Act, 1984
[2] Separate provisions govern workers whose services are provided by an employment agency.
[3] Section 285 of the Companies Act, 1963 (as amended by subsequent legislation)
[4] Section 81 of the Bankruptcy Act 1988 (as amended)

to the claims of any creditors secured by a floating charge (if any) and unsecured creditors. (Creditors secured by fixed charges do not come within the system of priorities as they have a right to realise their security outside the procedure.) The following employee entitlements rank as preferential claims in a liquidation, receivership or bankruptcy of the employer.

Arrears of Wages
An employee is entitled to claim for full wages or salary due in respect of the 4 months prior to the commencement of the procedure, subject to a maximum claim of €3,174.[5] Wages due in excess of the limit rank as an unsecured claim.

Holiday Pay
Employees have statutory rights to rest, working hours and holidays.[6] Any payment due in place of accrued holidays ranks as a preferential claim.[7] There is a minimum entitlement to 20 days annual leave plus 9 public holidays, and there is no cap on the weekly rate of pay that may be claimed. Contractual holiday entitlements in excess of the statutory minimum also rank as a preferential claim.

Minimum Notice
The following periods of notice of termination of employment apply: [8]

Length of Service	Period of Notice
13 weeks to 2 years	1 week
2 to 5 years	2 weeks
5 to 10 years	4 weeks
10 to 15 years	6 weeks
More than 15 years	8 weeks

If an employee is not required to work during his notice period, he is entitled to payment in lieu of notice. Unlike redundancy, there is no cap on the weekly rate of pay that may be claimed. Amounts payable in respect of minimum

[5] Companies Act, 1963 section 285 (2)(b) and (c). Bankruptcy Act 1988, section 81(1)(b) and (c)
[6] The Organisation of Working Time Act 1997
[7] Companies Act, 1963 section 285 (2)(d). Bankruptcy Act 1988, section 81(1)(d)
[8] The Minimum Notice and Terms of Employment Acts, 1973 to 2001

notice entitlements rank as preferential debts in a liquidation, receivership or bankruptcy.[9]

If a contract of employment provides for a notice period in excess of the statutory entitlements, such terms are binding, but any excess over the statutory entitlement will rank as an unsecured claim.

Redundancy

The Redundancy Payments Acts,[10] set out the manner in which continuous and qualifying service and normal weekly remuneration are to be calculated. A lump sum redundancy payment for a qualifying employee is calculated, subject to a statutory weekly ceiling of €507.90, as follows:

(i) two weeks' pay for every qualifying year of service;

(ii) in addition, one week's pay;

The employee's right to claim statutory redundancy from the employer ranks as a preferential claim in a liquidation, receivership or bankruptcy. [11]

An employee is also entitled to 2 weeks notice in writing of the proposed redundancy.[12] The statutory notice under the minimum notice legislation and the statutory notice under the redundancy legislation of 2 weeks may run concurrently.

If an individual's contract of employment entitles him to redundancy in excess of the statutory redundancy payment, then the additional payment will rank as an unsecured claim in the liquidation, receivership or bankruptcy.

Unfair Dismissal

Compensation payable[13] as a result of an unfair dismissal ranks as a preferential claim in a liquidation, receivership or bankruptcy.[14]

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9 Minimum Notice and Terms of Employment Act 1973, section 13
10 1967 to 2003
11 Redundancy Payments Act 1967 as amended, section 42
12 Redundancy Payments Act 1967 as amended, section 17
13 Unfair Dismissals Acts, 1977 to 2001
14 Unfair Dismissals Act 1977, section 12

Equality Award
An award of compensation for breach of rights under the Employment Equality Act 1998 ranks as a preferential claim in a liquidation, receivership or bankruptcy.[15]

Minimum Pay Arrears
Any arrears of pay due pursuant to the National Minimum Wage Act rank as a preferential claim in a liquidation, receivership or bankruptcy.[16]

Maternity Leave
Compensation payable for breach of rights under the Maternity Protection Act ranks as a preferential claim in a liquidation, receivership or bankruptcy.[17]

Parental Leave
Compensation payable for breach of rights under the Parental Leave Act ranks as a preferential claim in a liquidation, receivership or bankruptcy. [18]

Adoptive Leave
Compensation payable for breach of rights under the Adoptive Leave Act, ranks as a preferential claim in a liquidation, receivership or bankruptcy.[19]

Carer's Leave
Compensation payable for breach of rights under the Carer's Leave Act, ranks as a preferential claim in a liquidation, receivership or bankruptcy.[20]

Sickness Benefits
All sums due to an employee under any sickness benefit scheme rank as a preferential claim in a liquidation, receivership or bankruptcy. [21]

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[15] Employment Equality Act 1998, section 103
[16] National Minimum Wage Act 2000, section 49
[17] Maternity Protection Act 1994, section 36
[18] Parental Leave Act 1998, section 24
[19] Adoptive Leave Act, 1995, section 38
[20] Carer's Leave Act, 2001, section 25
[21] Companies Act 1963, section 285(2)(h).) (Bankruptcy Act 1988, section 81(1)(e)

Pensions
Any payment due by an employer to a pension scheme either in respect of its own contributions or in respect of contributions deducted from an employee ranks as a preferential claim in a liquidation, receivership or bankruptcy.[22]

Damages in respect of an Accident
All amounts due in respect of damages and costs to an employee in connection with an accident in the course of employment, which occurred prior to the commencement of the procedure, insofar as they have not been effectively covered by insurance, rank as a preferential debt in a liquidation or receivership but not in a bankruptcy.[23]

3. How does the priority (if any) given to employee entitlements in formal insolvency proceedings, compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

A creditor secured by a fixed charge does not come within the system of priorities set out below, as such a creditor has the right to realise the security outside the insolvency procedure.

In a liquidation, the priority in which claims are paid is as follows:

(i) remuneration, costs and expenses of an examiner
(ii) costs and expenses of a liquidation
(iii) remuneration of a liquidator
(iv) the "super-preferential claim", for social insurance contributions deducted from employee wages but not paid to the Social Insurance Fund
(v) preferential debts ranking pari passu with each other
(vi) floating charges
(vii) unsecured debts ranking pari passu with each other
(viii) deferred debts ranking according to the agreement for deferral

[22] Companies Act 1963, section 285(2)(i). (Bankruptcy Act 1988, section 81(1)(f)
[23] Companies Act 1963, section 285 (2)(g)

(ix) shareholder rights as provided in the articles of association

In a receivership, the priority in which claims are paid is as follows:

(i) remuneration, costs and expenses of an examiner
(ii) remuneration, costs and expenses of the receiver
(iii) the "super-preferential claim", for social insurance contributions deducted from employee wages but not paid to the Social Insurance Fund
(vi) preferential debts ranking pari passu with each other
(v) floating charges

In a bankruptcy, the priority in which claims are paid is as follows:

(i) remuneration, costs and expenses of the trustee
(ii) the "super-preferential claim", for social insurance contributions deducted from employee wages but not paid to the Social Insurance Fund
(iii) preferential debts ranking pari passu with each other
(iv) unsecured creditors ranking pari passu with each other

4. What, if any, personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The directors/managers of a company do not have any specific liability to employees or to any other party with respect to unpaid employee entitlements, taxes or other employee related liabilities.

Various provisions exist which may render directors and others liable for all the debts of a company, including employee related liabilities, for example the Companies Act 1990[24] provides for the personal liability of directors for failure

[24] Section 204

to keep proper books of account and the Companies Act 1963[25] provides for personal liability of directors for fraudulent and reckless trading.

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

The Department of Enterprise Trade and Employment administers a fund called the Social Insurance Fund (the **"Fund")** under the Protection of Employees (Employers' Insolvency) Acts 1984 to 2004.

Each employee who qualifies under the acts can claim against the Fund. Most categories of preferential entitlement can be claimed from the Fund but the amount payable, in respect of any of the debts calculated by reference to remuneration, is capped at €507.90 in respect of any one week.

In addition the Fund will pay arrears of contributions due to a pension scheme which were deducted by an employer from employee wages or which were due as the employer's contributions within twelve months prior to the commencement of the liquidation, receivership or bankruptcy. Alternatively the Fund will pay an actuarially calculated shortfall, if the amount is less than the arrears of contributions. It is to be noted that damages and costs in respect of an accident are not payable out of the Fund.

The Minister for Enterprise Trade and Employment is subrogated to the rights of the employee as a preferential creditor in relation to any payments made from the Fund. Not all sums payable out of the Fund are calculated on the same basis as the employees' preferential claims. (See for example the Fund's weekly limit on wages and the overall limit of €3,174.35 on preferential wages.) Where the Fund pays less than the full amount of the employee's preferential claim, the employee may claim the balance as a preferential claim.

[25] Section 297A

A separate but similar scheme operates to provide employees with their redundancy entitlements. Under the Redundancy Payments Acts, 1967 to 2003 the employee may claim the statutory redundancy sum from the Fund. The Fund then claims back 40% of the amount paid out as a preferential claim against the employer.[26]

6. In the event of a sale by an insolvent debtor, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The Transfer of Undertakings Directive (77/187/EEC) (the **"Directive")** became part of Irish domestic legislation in 1980. The amended Directive 2001/23/EC of 12 March 2001 was implemented in Ireland by the European Communities (Protection of Employees on Transfer of Undertakings) Regulations 2003 (SI 131/2003) (the **"Regulations").**

The purpose of the Regulations is to safeguard employees' rights in the event of a transfer of an undertaking, business or part of a business, by providing that on a relevant transfer of a business all the rights and obligations under employment contracts are automatically transferred. However, the Regulation does not apply if the transfer occurs after the employer company has been put into liquidation by order of the court or after the employer has been declared bankrupt. There is no such exception in the case of voluntary liquidation or receivership.

[26] Redundancy Payments Act 1967 as amended, sections 32 and 42

Italy

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is no specific definition for the term "Employee" in the Italian insolvency legislation. There is, however, a general definition which states[1] "*An employee is a person who binds himself, for a remuneration, to cooperate in the enterprise by contributing his intellectual or manual work, in the employment and under the management of the enterpriser".*

Bankruptcy[2] is not a cause of automatic termination of the employment relationship and the Trustee has to notify his intentions to dismiss the employee by notice as provided by the law.

2. What are the employee entitlements, and what extent (if any) are they given priority treatment during the formal insolvency proceeding?

Italian legislation protects employee entitlements as follows:

- Remuneration as determined in national collective contracts;
- Severance pay;
- Old age indemnity;
- Sickness compensation;
- Allowance for notice requirements;
- Pay for holidays not enjoyed;
- Redundancy payments.

In case of insolvency proceedings[3], employees claims are given a high priority compared to other categories of creditors. There is a general priority over debtor's movables for claims for employee's matured wages[4], retirement indemnity credits and damages for ineffectual, invalid or annullable dismissal[5].

1 Article 2094 Civil Code
2 Article 2119 Civil Code
3 Article 2751 bis Civil Code
4 Article 2751-bis n.1 the Civil Code
5 Art. 18 of Law 300/70 and art. 2 Law of 108/90

3. **How does the priority (if any) given employee entitlements in formal insolvency proceedings, compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?**

A general privilege (priority) over movable property is granted to claims relating to the following:[6]

- remuneration due in any form to employees and all allowances due by reason of termination of employment, as well as damages consequent upon an employer's failure to pay compulsory social security and insurance contributions and compensation for ineffective, void or voidable discharge;

- remuneration of professionals or any other person performing intellectual work due for the last two years of services;

- commissions deriving from an agency relationship due for the last year of services and the allowances due for the termination of such relationship;

- claims of an artisan enterprise or co-operative companies for production and work, for the compensation for services rendered and the sale of manufactured products;

- claims for direct taxes due to the State, for value added tax and for taxes due to local public bodies.[7]

- claims for contributions for compulsory insurance for disability, old-age and survivors.[8]

6 Article 2751 bis Civil Code
7 Art. 2752 Civil Code
8 Artt. 2753-2754 Civil Code

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements o taxes or other duties owed in relation to employee entitlements?

Italian Law does not impose a personal liability on directors in relation of unpaid employee entitlements or taxes.

The Civil Code[9] provides for general liability of directors who do not perform obligations fixed by the law or by the company by-laws, using the ordinary diligence required by the nature of the matter and by their specific skills. This liability is only vis a vis the company but could be, in case of insolvency, enforced by the Trustee or by the Receiver of the proceeding.[10]

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

"*Fondo di garanzia Inps*"[11] has been established to substitute for the employer in case of insolvency for the purpose of paying the retirement indemnity.

The Inps fund extends the competence[12] also pays the last three wages during the last twelve months of employment before the declaration of insolvency.

There is a specific kind of extraordinary temporary unemployment compensation (CIGS)[13] for employees working for insolvent employers.
To qualify for compensation from the CIGS the following criteria must be satisfied:

- more than 15 employees if the undertaking is an industrial company and more than 200 if it is a commercial company,

9 Article 2392 Civil Code
10 Article 2394 bis Civil Code.
11 Article 2 of Law no. 297/82
12 Articles 1 and 2 of d.lgs. 80/1992
13 Article 3 of law 223/91

- the company has been declared insolvent and an insolvency proceeding has been started,
- the employee has worked with the insolvent employer for at least twelve months.

The maximum duration of the CIGS is twelve months (or 36 months in 5 years) but this may be extended for a further six months.

These dates can be deviated if the productivity of the undertaking is started at least 24 months before the admission to CIGS and the activity is continued until 12 months before the starting of the insolvency proceeding.

The CIGS provides 80% of the hourly remuneration of the employee.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The Civil Code[14] governs the transfer procedures of business concern in insolvency proceedings.

The second paragraph[15] states that "*the transferor and the transferee are liable in solido for all claims that the employee had at the time of the transfer. By the procedures set forth[16], the employee may consent to the release of the transferor from the obligations deriving from the labor relationship."*

The Law provides the lessee of the business the right of pre-emption in order to purchase the business.

The legislation also states that in case of non-termination of the business activity, only by an agreement between trade unions and the purchaser (or

[14] Articles 47 of Law 428/90 and Article 2112 Civil Code
[15] Article 2112 Civil Code
[16] Articles 410 and 411 of the Code of Civil Procedure

lessee), the same acquirer can employ only a part of the employees of the insolvent company (or ongoing business). Pursuant to this agreement the new employer should not be liable for claims on the basis of successor liability.

Failing this agreement, the purchaser (or lessee) should be liable jointly with the Trustee for employee's credits and claims.[17]

[17] Article 2112, second par Civil Code

Japan

1. How is an employee defined for the purposes of formal insolvency proceedings?

The term "employee" is not defined in the Japanese insolvency laws. An "*employee*" is defined as[1] "an individual who both works for a business or a place of business and is paid wages," regardless of the type of vocation. "Wages"[2] are defined as all payments from employer to employee for compensation for his or her work, including, but not limited to, salary, benefits, bonuses, etc.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

There are five types of formal insolvency laws in Japan. The treatment of employee entitlements varies slightly under each.

General priority claims, which are a type of unsecured claim, have priority over other unsecured claims.[3] These general priority claims, which are so designated under other, non-insolvency laws, include "wages".[4] Under the Civil Code, wages are given priority over other employee entitlements. The Bankruptcy Law was just reformed and the reformed new law will be effective from 2005. An employees claim for wages for three months prior to the commencement of the insolvency proceedings shall be considered estate claims, a type of administrative claim, which shall be paid before unsecured claims.[5] With regard to a claim of retirement allowance for an employee who retires before the insolvency proceedings are closed, a claim in the amount of three months' wage before retirement (or three months' wages before the commencement of the insolvency proceedings, whichever is greater), shall be considered estate claims. The court can allow the bankruptcy trustee to pay all or part of these claims before it approves the distribution plan, in the

1 Section 9 of the Labour Standard Law
2 Section 11 of the Labour Standard Law
3 Section 39 of the Bankruptcy Law
4 Section 308 of the Civil Code.
5 Section 149 of the reformed Bankruptcy Law

event the creditor (employee or retired employee) will suffer hardship without the timely distribution of the claim, and provided this distribution does not impair the interest of other same or higher priority creditors.[6]

Another type of liquidation law is the Special Liquidation Law under the Commercial Code. The difference between this Code and the Bankruptcy Law is that while a trustee is appointed under the Bankruptcy Law, a liquidator is usually appointed voluntarily by the debtor under the Special Liquidation Law. A liquidation plan should take into account priority claims, including wage claims. Wage claim receive favorable treatment under liquidation plans under the Code.[7] In some cases, the court approves the regular payment of wages outside the liquidation plan.

There are three types of reorganization laws in Japan. Corporate Reorganization Law differs from the Civil Rehabilitation Law in that all the creditors are bound under the former, and a trustee is always appointed. The Corporate Reorganization Law treats wage claims for the six-month period prior to the commencement of the insolvency proceedings and the return of deposit money (given as security for the proper conduct of employees) as claims of common benefit, a type of administrative claim, which can be paid at any time before the distribution of unsecured claims and outside the reorganization plan.[8] If the employee quits the debtor before the confirmation of the plan, the equivalent of six months' wages before retirement, or one-third of the amount of the total retirement allowance, whichever is larger, shall constitute common benefit claims. This is also true for returning deposit money that is credited by the employee against the debtor company. If the debtor fires the employee, the full amount of the retirement allowance shall constitute the common benefit claim.

Under the Civil Rehabilitation Law, which binds just unsecured creditors and is a debtor-in-possession type procedure it provides[9] for general priority claims, which are paid at any time outside the procedure. Wage claims before the commencement of insolvency proceedings are considered general priority claims. Wage claims after commencement of insolvency proceedings are

[6] Section 101 of the reformed Bankruptcy Law
[7] Section 448 of the Code
[8] Section 130
[9] Section 122

considered common benefit claims, which are also paid at any time outside the procedure.[10]

There is also another rehabilitation procedure under the Commercial Code, the Corporate Arrangement Law. Because this law requires unanimous approval of the plan, there have been only a few proceedings under this law.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

Under the Bankruptcy Law, priority is given to employee entitlements within unsecured claims. That means that the priority is lower than that of secured claims (since secured claimants are not bound by the Bankruptcy law) and administrative claims, including the fees for trustees and other professionals, but higher than for the claims for general unsecured claims and shareholder claims.

Under the reformed Bankruptcy Law, estate claims, including employee entitlements, are given priority over unsecured creditor claims and shareholder claims. Estate claims also include fees for trustees and professionals. If the estate is insufficient to pay the total amount of the estate claims, claims shall be paid out of the existing estate in proportion to the amount of each claim without regard for priorities prescribed by other laws. The status of secured claims is unaffected.

Under the Special Liquidation Law, secured creditors can execute their rights at their own discretion. Administrative claims by liquidators and professionals obtain a first priority, then employee entitlements, and, lastly, claims by unsecured creditors under the liquidation plan.

Under the Corporate Reorganization Law, employee entitlements are considered claims for common benefits, which also include the claims of

[10] Section 119

trustees and professionals. These claims should be paid at any time before both the secured and unsecured claims are paid. If the estate proves to be insufficient to pay out all the claims for common benefit, the payment for each claim shall be made in proportion to the amount of the claim without regard for priorities. Shareholders' claims are the lowest priority.

Under the Civil Rehabilitation Law, employee entitlements are considered general priority claims, which are paid at any time outside the rehabilitation plan. Claims by the D.I.P. and retained professionals are claims for common benefit. Whether general priority claims or claims for common benefit have priority is determined according to the Civil Code and/or the Civil Execution Code, not by the CRL itself. Employee entitlements have priority over unsecured claims, but not secured claims, because the CRL binds just the unsecured claims.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

Directors and officers are generally not subject to personal liability with respect to unpaid employee entitlements or taxes. These, however do not include any employee entitlements. Directors are usually obliged to personally guarantee bank loans to the company.

5. **Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?**

   The Japan Labor Health and Welfare Organization (JLHWO) has established a procedure for payment of unpaid wages on behalf of the debtor company. If the debtor company files an insolvency proceeding or the chief of the Labor Standard Inspection Office finds that the debtor is inside the zone of insolvency, a retired employee who leaves the debtor between six months before the filing (or approval from the chief of the Office) and two years after the filing date (or approval date) can obtain part of the unpaid wages from the JLHWO. The unpaid wages include both six months' salary before leaving and retirement allowance. The amount paid is 80% of the total amount of the unpaid wages, except that the maximum amount of payment from JLHWO varies according to the age of the employee. If the JLHWO pays an employee in lieu of the debtor doing so, it obtains the claims of the employee, with the same priority.

6. **In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?**

   The seller can transfer an employee claim to the buyer, which may result in the deduction of this amount from the price of business. If the interested party wants to transfer a labour contract between the seller and an employee, the consents of the seller, buyer, and the individual employee are required. A collective bargaining agreement can be transferred to the buyer as long as the seller, buyer, and the labour union agree to it. These principles apply in the ordinary course of business, and continue to apply even if the debtor files under the insolvency laws.

Malaysia

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is no specific definition of an employee for the purpose of insolvency proceedings in Malaysia. Generally speaking, an employee is one who has entered into a contract for service as opposed to a contract for services with the employer. The question whether a contract is one of service or one for services is a mixed question of law and fact and a number of factors will be considered to determine whether an employer-employee relationship exists, including *inter alia* the contractual provisions, the degree of control exercised by the employer, the obligation of the employer to provide work, provision of tools and payment of statutory contributions.

2. What are the employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

An employee[1] is entitled to preference over unsecured debts in a winding up for the following payments:-

Wages or salary – these include amounts earned wholly or in part by way of commission and any amount payable by way of allowance or reimbursement under any contract of employment, of any employee not exceeding RM1,500 or such other amount as may be prescribed from time to time in respect of services rendered by him to the company within a period of four (4) months before the commencement of the winding up.

It should be noted that under the Employment Act 1955 ('EA'), 'wages'[2] means basic wages and all other payments in cash payable to an employee for work done in respect of his contract of service but does not include:-

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1 Section 292(1) of the Companies Act 1965 ('CA')

2 Section 2(1) of the EA & Indo Malaysia Engineering Co Bhd v Muniandy Rengasamy & Ors [1990] 3 MLJ 301 SC

i. the value of any house accommodation or the supply of any food, fuel, light or water or medical attendance, or of any approved amenity or approved service;

ii. any contribution paid by the employer on his own account to any pension fund, provident fund, superannuation scheme, retrenchment, termination, lay-off or retirement scheme, thrift scheme or any other fund or scheme established for the benefit or welfare of the employee;

iii. any travelling allowance or the value of any travelling concession;

iv. any sum payable to the employee to defray special expenses entailed on him by the nature of his employment;

v. any gratuity payable on discharge or retirement; or

vi. any annual bonus or any part of any annual bonus.

However the Supreme Court in the case of Indo Malaysia Engineering Co Bhd v Muniandy Rengasamy & Ors held that for there to be any successful claim by the employee, they must necessarily be categorized either as wages, salary, vacation leave superannuation or provident fund payment[3]. The court held that pro rata bonus, termination benefits and the indemnity in lieu of notice do not come within the definition of wages. This is because pro rata bonus is paid under the collective agreement and are not wages or salary in respect of services and bonus is usually paid at the end of the year and is not due yet. As for termination benefits, they become due only after the termination of the employment of the employee and are therefore not wages for the purpose of the CA[4]. An indemnity in lieu of notice is not for work done or payment for services rendered and hence is not within the purview of the CA.

Workmen Compensation - these are amounts due in respect of worker's compensation under any written law relating to worker's compensation accrued before the commencement of the winding up.

Remuneration for vacation leave **-** these are remuneration payable to any employee in respect of vacation leave, or in the case of his death to any other person in his right, accrued before the commencement of the winding up.

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3 under s.292(1) of the CA

4 s.292 of the CA

Contributions - these are contributions payable during the twelve (12) months next before the commencement of the winding up by the company as the employer of any person under any written law relating to employees superannuation or provident funds or under any scheme of superannuation or retirement benefit which is an approved scheme under the federal law relating to income tax.

These entitlements (in the order set out above) receive priority over unsecured claims and the preferential payments for wages or salary, remuneration for vacation leave and payment of contributions receive priority over a floating charge where the assets of the company are otherwise insufficient to meet those entitlements.

3. How does priority (if any) given employee entitlements in formal insolvency proceedings, compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

Secured Creditors
Employee entitlements will only receive priority over a floating charge where the assets of the company are otherwise insufficient to meet those entitlements mentioned above and not a fixed charge.

Insolvency Administrators, Professionals retained by the estate, unsecured creditors
The CA[5] provides for the priority of certain payments in priority to unsecured creditors. Under the provision, the costs and expenses of the winding up, remuneration of liquidators and the cost of any audit account carried out pursuant to the winding up receive priority over all unsecured creditors, including payments to employees.

Shareholders
Shareholders are entitled to any residue after all the secured debts and unsecured debts have been paid. Generally, residual assets are to be divided

[5] Section 292

among the shareholders in proportion to the nominal value of the shares held by them[6].

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

Taxes

Based on Rule 10 (1) of the Income Tax (Deduction From Remuneration) Rules 1994 ('ITDRR 1994'), employers who deduct a portion of the employees remuneration on account of income tax, must remit the said portion to the Inland Revenue Board before the 10th day of each month. Failure to do so will enable the Inland Revenue Board to initiate legal proceedings against the Company[7]. In circumstances where legal proceedings have been initiated against the Company, and if the Company is unable to remit the necessary amounts or has become insolvent, the Inland Revenue Board is empowered to take execution proceedings against the directors[8] personally.

Employment Provident Fund ('EPF')

Where EPF contributions remain unpaid by a Company, the directors of such Company, including any persons who were directors of such Company during such period in which contributions were liable to be paid, shall together with the Company, be jointly and severally liable for the contributions due and payable to EPF[9].

5. Is there any form of statutory, industry or government funded 'safety net' that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

There is no special scheme by the government to guarantee the payment of employee entitlements.

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6 Section 264 of the Companies Act 1965
7 Rule 17 of the ITDRR 1994
8 Section 75A(1) of the Income Tax Act 1967 (NB: This amendment came into force in 2002)
9 Section 46 of the Employees Provident Fund Act 1991

6. In the event of a sale by an Insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The Employment Act 1955 ('EA') is applicable to any person whose wages do not exceed RM1,500 per month and to those employees (*irrespective of their salary*) engaged in manual labour, operation and maintenance of vehicles and those supervising employees engaged in manual labour.

Based on the EA[10], where there is a change of ownership of the business for the purpose for which the employee is employed, the employee *shall be entitled to*, and the employer *shall give* to the employee, written notice of termination based on the length of service of the respective employee, as the change of ownership of a business amounts to a termination[11]. Failure to give the notices of termination will cause the employer to be liable under the EA[12] to pay an indemnity in *lieu* of notice.

Upon termination, the amount of termination benefits which an employer is required to pay an employee cannot be less than:

a. ten days' wages for every year of employment under a continuous contract of service with the employer, if he has been employed by that employer for a period of less than two years; or

b. fifteen days' wages for every year of the employment under a continuous contract of service with the employer, if he has been employed by that employer for two years of more but less than five years; or

c. twenty days' wages for every year of employment under a continuous contract of service with the employer, if he has been employed by that employer for five years or more

and *pro rata* as respects an incomplete year, calculated to the nearest month[13].

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10 Section 12(3) of the Employment Act 1955
11 Radtha d/o Raju & 358 Ors v Dunlop Estates Bhd [1996] 1 CLJ 755
12 Section 13 of the Employment Act 1955
13 Regulation 6, 1980 Regulations

Pursuant to the Employment (Termination and Layoff Benefits) Regulations 1980 where a change occurs in the ownership of a business for the purposes of which an employee is employed, or of a part of the business, the employee is not entitled to termination benefits:

a. if, within seven days of the change of ownership, the new owner offers to continue to employ him on terms and conditions not less favourable than before, and the employee unreasonableley refuses the offer; but

b. if the new owner does not do so, the employee's contract is deemed to have been terminated, and the new owner and his previous employer are jointly and severally liable to pay him termination benefits[14].

c. where a new owner makes such an offer and the offer is acceptable by the employee, the change of owners would not be construed as a break in the continuity of the period of the employee's entitlement.

Despite there being an offer for continuous employment by the new owner, termination notice must nevertheless still be given.

In the case of non-EA employees, the EA and the Regulations are not applicable but regard must be had to the Industrial Relations Act, 1967 ('IRA'). The IRA does not have specific provisions for termination benefits nor changes in ownership of business. Termination of an employee's contract of service is generally only allowed where there is *'just cause or excuse'*. Any transfer of employees to the new employer would require the consent of the employees to be transferred as a change in the employer would amount to a variation of the employment contract. It is advisable for the employees to be offered *continuous employment* wherein the new employment contract should take into account the employee's years of service with its previous employer (i.e. the new terms of employment cannot be less favorable than the previous terms.).

[14] Regulation 8, 1980 Regulations

The Netherlands

1. How is an employee defined for the purposes of formal insolvency proceedings?

With respect to the definition of "employee", the Bankruptcy Act,[1] refers to the "employment agreement" as defined in the Civil Code. To meet this definition, a master/servant relationship is essential. An employment contract need not be in writing. In the Bankruptcy Act commercial agency contracts are dealt with equally to employment contracts.

For purposes of social security legislation, including the scope of the "safety net" (see below, sub 5) which is part of the Unemployment Act, the definition of an "employee" is somewhat wider than set forth in the Civil Code; it comprises, under certain circumstances, some "socially comparable" categories, like home workers, artists and musicians, sportsmen, and, indeed, commercial agents; as long as the individuals involved are not independent contractors.

It is important to consider the position of a statutory managing director of a company, who is a shareholder. According to the Civil Code he may also be considered as an employee, but here the social security laws (including the safety net chapter) are more restrictive: the director is excluded from the definition, among other things, if he is at least a 50% shareholder.

There is a remaining grey zone in the area of subcontracting, e.g. consultancy and interim-management. Whether the individuals involved are deemed to be employees or independent contractors depends on many factual circumstances. The social security authorities (abbr. in Dutch: **UWV**, a public body) may issue a "Statement Labour Relationship" (VAR) that currently has an advisory status as to the aspect of independency of the contractor, but will tentatively get a legally binding status as of 2005.

[1] Article 40 and 239

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

The bankruptcy trustee (*curator)* or the administrator (*bewindvoerder*) appointed in the suspension of payments, may dismiss personnel (the administrator may do this only in co-operation with the management), observing, generally speaking, a maximum notice period of six weeks, irrespective of the contractual notice period or the statutory minimum period according to the Civil Code (in this section two we deal just with employees according to the definition of the Civil Code).

Employee entitlements may be defined as the aggregate of the financial consideration for the labour performed, inclusive but not limited to: basic pay, holiday allowance, bonuses of all kinds, commission, overtime payments, pension contributions; plus the amounts owed by the employer to the employee in respect of the termination of the employment agreement, like "irregular dismissal" claims (payment in lieu of notice), "obvious unfair dismissal" claims, and contractual "golden parachute" claims.

Post insolvency claims qualify as "debts of the estate" (*boedelschuld*) and are dealt with equally to "general costs of the estate".[2] They have, as such, a higher ranking than all pre-insolvency claims, whether or not these are preferential (with the exception of claims secured by pledge or mortgage).

The Dutch Supreme Court has ruled that, as to employees that are dismissed by the *curator*, the same qualification as *boedelschuld* applies to payments for unused holidays (even regarding holidays accrued prior to the insolvency), and to back service obligations of the employer relating to final pension schemes of such employees.

If however such dismissal triggers a contractual (golden) parachute clause, that was existing prior to the insolvency, the Supreme Court has ruled that the claim arising thereof can neither be qualified as a pre-insolvency claim, nor (as such

[2] As defined in article 182 Bankruptcy Act

and without further judicial test) as a *boedelschuld.* In practice, therefore, such clauses are non enforceable, once the company has gone bankrupt.

Employment entitlements consist of pre-insolvency claims, which are considered preferential[3] provided, however, that such entitlements do not date back further than 1st January of the year preceding the year in which the insolvency formally begun. An exception to this priority regards the employer's part of the pension contribution, which is a non preferential *pari passu* claim of the pension body against the estate.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

Creditors having secured their rights by mortgage or pledge may execute their security rights and be paid from the proceeds as if there were no insolvency without being obliged to share in the general costs of the estate. Thus, these creditors rank in priority to anybody else (apart from some very specific preferential rights of the tax authorities), but their priority is limited to recoupment on the specific assets involved. It is noteworthy that in respect of tax claims (like payroll tax, V.A.T) and claims for arrears of social security premiums, the tax authorities enjoy a general preference of a high ranking, in priority to employee's entitlements, usually called Super Preference.

Limiting this review to the most common preferences under Dutch law, the order of payment could be set out as follows:

(i) general costs of the estate, including but not limited to: expenses incurred by the *curator*/administrator in the due course of his work, as well as his remuneration; equally: *boedelschuld:* post insolvency employee's entitlements, post insolvency rent of premises (max. 3 months); all these

[3] Article 3:288 Civil Code

amounts to be increased by taxes and social premiums related thereto, if any.

If the assets of the estate are not sufficient to cover all these costs, the estate becomes “negative”, and a further sub order has to be made not covered here.

(ii) taxes and social security premiums (super preferential);

(iii) employees entitlements (preferential);

(iv) unsecured creditors;

(v) subordinated creditors and, finally, shareholders.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

In the case of bankruptcy of a company, directors have no liability to the employees. In a few cases however, courts have assessed such liability, founding this on abuse of insolvency proceedings, where the company had shown that its (almost) sole intention was to get rid of employees at no cost.

In this context: a new article [4] rules that, if a court’s bankruptcy order is nullified afterwards (e.g. on the ground of abuse), dismissals of personnel that were granted by the *curator* in the meantime, are made undone automatically. Such nullification could be seen as a gateway to director’s liability.

If a company is not able to timely pay its payroll taxes or social security premiums, it has to inform the authorities involved in due time, failure to do so causes director’s liability by operation of law to the UWV.

[4] 13a in the Bankruptcy Act (prompted by EC Directive 98/50)

5. Is there any form of statutory, industry or government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?

Such a scheme does exist and is laid down in chapter IV of the Unemployment Act, and is (informally) called: ***loongarantieregeling*** (wages guarantee scheme). It is an implementation of EC Directive 90/987. For employees of a bankrupt company it is most often the only law that counts, because the scheme has a comfortable coverage. Added to the fact that, as said earlier, unpaid holiday accruals and pension backservice obligations are qualified as *boedelschuld*, employees usually do not sustain a loss as to outstanding claims at the time of their dismissal (apart from broken careers and the inability of getting severance payments on top of statutory unemployment benefits). The scheme applies both in bankruptcy and suspension of payments scenarios.

The *loongarantieregeling* is operated by UWV. A condition precedent is a formal dismissal, given by the *curator*/administrator (normally within one week of the date of insolvency). Certain forms have to be completed by both employee and *curator*/administrator, and usually first payments are made within four to six weeks.

The scheme provides for the following payments:

(i) arrears of wages for a maximum of 13 weeks, to be counted back from the day the dismissal was granted;

(ii) wages for the notice period, with a maximum of 6 weeks;

(iii) outstanding holidays, holiday allowance and pension premiums, for a maximum of one year, to be counted back from the last day of the notice period.

How are “wages” defined, in this respect? In the first place the basic pay, furthermore: not only bonuses, commissions, overtime (all related to the said arrear period of 13 weeks), but, on the basis of case law, also expenses validly incurred by the employee in the due course of business, many kinds of contractual fringe benefits, like student grants, the counter value of free private use of a company car, traffic fines if these usually were reimbursed by the employer, costs of relocation that took place in the above reference period, court fees that the employer was ordered to pay to the employee in a law suit; and the like. So, the definition is wide, and the guaranteeing of the said amounts, even as to the basic pay, is not capped.

However, there are limits; obvious unfair dismissal claims are deemed to fall beyond the scope of the *loongarantieregeling*, as such a claim purports to cover potential loss of earnings in the future, and thus it cannot be attributed to the above reference periods of 13 or 6 weeks.

Payment could be refused in case of wrongful acting vis-à-vis UWV; e.g. management has deliberately chosen not to pay their own salaries the last 3 months before the insolvency (expecting to benefit from the scheme), but to pay creditors or the bank.

By making payments to employees, the UWV gets recourse claims against the bankrupt estate with the same ranking as the original employee claims. So, in this respect the UWV claim has no Super Preference.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The Netherlands have long since implemented the EC Directive(s) on the safeguarding of employee’s rights in the event of transfer of undertakings.[5]

[5] Sections 7:662 - 7:666 Civil Code

The sale by a company of all its assets as an ongoing business could be qualified, if that business keeps its identity, as a "transfer of an undertaking" as defined in the Civil Code. If this is the case, it has two consequences: (i) the employees involved are transferred as well, by operation of law, on the same terms and conditions they were working on before, and the acquirer becomes liable for all outstanding employee claims; (ii) the transferor remains jointly and severally liable for employee claims, together with the acquirer, during a limited period of time. Before 1 July 2002, terms and conditions in respect of pension commitments, effective with the transferor, were exempted from the transfer; as of the said date this has changed to some extent.

This concept is fully applicable in a *surséance van betaling* whilst it is does not apply in a bankruptcy.

Hence, for an acquirer, who wants to "pick and chose" personnel from the insolvent business, it is much more attractive to buy the assets out of a bankruptcy instead of a *surséance.* In addition, from the perspective of the *curator*/administrator who would prefer to make employees redundant before selling the assets: the degree of employee protection against dismissals is much higher in a *surséance* than in bankruptcy as during a *surséance*, a so called dismissal permit is required prior to giving notice of termination to an individual; the "last in first out" principle has to be observed; and individuals may successfully claim severance pay on top of State unemployment benefits.

The combination of these matters have caused that, by the end of the day, suspension of payments, that has been set up for surviving of undertakings, has proved to be a counter productive instrument for reorganising a business. This explains, *inter alia*, why more than 90% of the *surséances* in the Netherlands end up in a bankruptcy.

New Zealand

1. How is an employee defined for the purposes of formal insolvency proceedings?

Until recently, the principle piece of legislation relating to formal insolvencies, the *Companies Act 1993,* **("Act")** did not provide a definition of "employee" but the newly enacted *Companies Amendment Act 2004* **("CAA")**, endeavours to remedy that omission.[1] According to that Act [2] *"(ab) 'employee' means any person of any age employed by an employer to do any work for hire or reward under a contract of service (including a homeworker as defined in section 5 of the Employment Relations Act 2000)* ; *but does not include a person who is, or was at any time during the 12 months before the commencement of the liquidation, a director of the company in liquidation, or a nominee or relative of, or a trustee for, a director of the company".*

Whilst this definition has yet to be tested in practise, the legislative intent is clear in that directors, their relatives, nominees and trustees, are specifically excluded from the employee definition and therefore from the preferential position conferred on employees generally. This is in stark contrast to the pre-existing common law which had not imposed any restriction on claims made by directors who were also employees of the company.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during formal insolvency?

The Act [3] compels the liquidator to pay out of the assets of the company, the expenses, fees and claims in the order specified.[4] Each claim type in each class ranks equally however if there are insufficient realisations to meet all claims in full they abate in equal proportion.

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1 The 7th Schedule of the Act dictates the priorities in:-
a liquidation by virtue of section 312 of the Act
a receivership by virtue of 30(2)(b) of the Receiverships Act 1993 ("RA"); and
a statutory management pursuant to section 55 of the Corporations (Investigation and Management) Act 1989 "CIMA".

2 Clause 12 of Schedule 7

3 Section 312

4 Schedule 7 of the Act.

The various categories of preferential employee entitlements [5] include salary and wages (including commission), holiday pay and compensation. As of 29 May 2004, the CAA increased the maximum gross preferential entitlement from $6,000 to $15,000 in respect of the total sum to which priority is given.[6]

Salary and Wages: All outstanding salary and wages of an employee in respect of services rendered to the company during the 4 months prior to the commencement of the liquidation.[7] On occasion the Courts have allowed a broad interpretation of what constitutes "salary and wages" resulting in priority being conferred on claims for commission, living expense allowances, and piecework. The Courts however have held that payments in lieu of notice on termination of employment, do not constitute wages or salary.

Holiday Pay: Holiday pay accrued but not paid to the employee on the termination of employment or by reason of the commencement of the liquidation is preferential. There is no limit prescribed in regard to the time over which holiday pay entitlements accrue.

Redundancy Payments: As of 29 May 2004 when the CAA came into force, the priority categories have been extended to also include "*any compensation for redundancy owed to an employee that accrues before or as a result of the commencement of the liquidation*". In effect employees may now claim preferential entitlement for redundancy where there was a pre-existing agreement between an employer and employee which provided for redundancy compensation to be paid on termination of employment.

Personal Grievance Orders made under Employment Relations Act:
In addition, the CAA[8] accords priority to any reimbursement or payment in a personal grievance claim, ordered under the provisions of the Employment Relations Act in respect of wages or other remuneration lost during the 4 months prior to the commencement of the liquidation.

Employee entitlements are to be paid out in the order prescribed in the 7th Schedule CA. By virtue of Clause 9, where the company assets are insufficient to satisfy the claims of general creditors, employee entitlements

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[5] Clause 2 of Schedule 7
[6] 2(a), (b), (ba), (bb), (d) or (e) of the 7th Schedule
[7] Schedule 7 Cl.2(a) CA
[8] Schedule 7 Cl 2 (bb)

(Clause 2) have priority over claims of a security interest holder where that security interest:-

- is over all or any part of the company's accounts receivables and inventory (ie stock and debtors)
- is not a purchase money security interest
- does not arise from the transfer of an account receivable for which new value is provided by the transferee for the acquisition of that account receivable (ie where the debtors' ledger has been factored).

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

Secured Creditors

Since the enactment in 2002 of the *Personal Property Securities Act 1999* **("PPSA")** the distinction between fixed and floating charge assets is no longer relevant as all interests which amount to security interests are registrable and can be registered to give effective priority between security interest holders.

The PPSA introduced the purchase money security interest or "PMSI", which includes a person who gives value to allow goods to be acquired by a debtor, a security interest in goods taken by a seller (such as holders of retention of title security interests) and lessors. The 7th Schedule[9] provides that PMSI holders have priority over preferential creditors. The PPSA endeavours to preserve preferential creditor priorities over those assets which previously fell into the floating charge category (stock-in-trade, work in progress, book debts and other monetary sums) by excluding from the priority a charge over a company's accounts receivable and inventory.

In essence Section 30 of the RA coupled with the amendment to Schedule 7 of the Act regulates the priority of all creditors.

[9] Clause 9(b)(i)

Insolvency Administrators / Professionals retained by the estate

The properly incurred fees and expenses of the liquidator in carrying out the duties and exercising the powers, together with the liquidator's remuneration, rank ahead of employee entitlements by virtue of Clause 1 of the 7th Schedule. The expenses include the costs of professionals retained by the estate.

The insolvency administrator's priority currently extends also to the costs of the petitioning creditor in applying to the Court for an order to have the company placed into liquidation.

Under the draft Insolvency Law Reform Bill this priority level is likely to be further expanded to include:-

- The actual out-of-pocket expenses necessarily incurred by a liquidation committee;
- Reimbursement of costs incurred by a creditor in protecting or preserving company assets for the benefit of all creditors and payment to the creditor of the value those preserved assets realised up to the value of that creditor's unsecured debt.

Unsecured Creditors

Provided that there are sufficient realisations to settle all claims accorded priority under the 7th Schedule of the Act, any residual funds are to be distributed pari passu as specified in section 313 of the Act.

Shareholders

Finally in the event of surplus assets being available, any payments to shareholders are regarded as a distribution of capital and the liquidator is obliged to distribute such surplus in accordance with the company's constitution.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The New Zealand legislation has no specific provision imposing personal liability on a director / manager of a company with respect to unpaid employee entitlements, taxes or other duties owed in relation to employee entitlements.

A director must not agree, cause or allow the business of the company to be carried on in such a manner likely to "create a substantial risk of serious loss to the company's creditors."[10] A director of a company must not agree to the company incurring an obligation,[11] which could include obligations to employees, unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so. Should a liquidator consider such matters have occurred, application to the Court can be made[12] seeking an order that the director be made personally liable for the debts of the company and ordered to repay or restore property or pay such compensation as the Court determines.

Whilst[13] this does not in itself create a cause of action, it does provide a means of seeking redress from the directors and those involved with the management of the company for the outstanding debts of the company, including employee entitlements, taxes or other duties owed in relation to employee entitlements.

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

New Zealand has no statutory, industry or government funded "safety net" that guarantees payment of employee entitlements in an insolvency context. In those situations where employee entitlements are not met, the employee must seek social security support from the State.

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10 Section 135 of the Act
11 Section 136 of the Act
12 Section 301
13 Section 301

We would direct attention to Section 316 of the Act which established the Liquidation Surplus Account. It is from this account that the Official Assignee may authorise the payments of costs incurred by a creditor of a company in respect of proceedings initiated after the commencement of a liquidation. Whilst the Liquidation Surplus Account does not constitute a "safety net" in respect of outstanding employee entitlements, it has been used successfully to fund actions as a result of which employee priority entitlements have been settled. In Re New Zealand Stevedoring Co Ltd (In receivership and liquidation), the liquidator used the Liquidation Surplus Account funding to successfully recover from the receivers the sum of $1,831,731 as priority debts due to employees.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

Whilst New Zealand is regarded as being a leader in social protection policies, it is only recently that the New Zealand legislature has recognised and introduced legislation (*The Employment Relations Law Reform Bill)* to ensure some degree of protection for employees on the sale of a business of their employer. This protection, however, is not afforded to employees where the employer is the subject of some form of insolvency proceeding.

In the vast majority of cases, employees' employment is terminated either on or shortly after the appointment of an insolvency administrator, be they a receiver, liquidator, statutory manager or the Official Assignee. Termination of employees' employment will occur even in those circumstances where trading of the insolvent entity is continuing, the rationale being to crystalise all outstanding entitlements and to effectively provide a "clean slate" to any prospective purchaser.

Russia

1. How is an employee defined for the purposes of formal insolvency proceedings?

There is no specific definition of an "employee" for formal insolvency (bankruptcy) proceedings. The general definition of an employee is set forth in the Article 20 of the Labor Code of the Russian Federation (the "RF"), according to which an employee is an individual who has entered into labor relations with an employer. Such labor relations are based on an agreement between the employee and the employer regarding the performance by the employee of his/her labor functions (performing a certain job, having certain qualifications or holding a certain position), on the condition of the employee's compliance with internal rules and provided that the employer ensures acceptable working conditions and complies with labor legislation and any collective bargaining or other agreements.[1]

2. What employee entitlements exist, and to what extent (if any) are they given priority treatment during formal insolvency proceedings?

Generally, an employee's claim to an insolvent debtor may comprise amounts for unpaid salary, severance pay (if an employee is dismissed), compensation for unused vacation, and similar allowances provided for by law. However, employees' particular rights to recover these entitlements depend on the type of procedure regulating the insolvency process. Under the RF Bankruptcy Law of October 26, 2002 (the "Bankruptcy Law"). Almost all bankruptcy cases begin with a "supervisory procedure," after which one of four insolvency procedures may be applied to the debtor: financial recovery, external management, receivership, or settlement agreement.[2]

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1 Article 15 of the RF Labor Code

2 RF Bankruptcy Law of October 26, 2002 (the "Bankruptcy Law"

The supervisory procedure is an obligatory first stage in nearly every bankruptcy case.[3] Under the supervisory procedure, the main goals are to discover all of the debtor's creditors and to hold the first creditors' meeting, at which the creditors decide which of the next four procedures should be applied to the debtor. Once this procedure is complete, the court must resolve the bankruptcy case (*i.e.* apply a specific bankruptcy procedure to a debtor) within seven months, as required by the Bankruptcy Law.

As a general rule, once a supervisory procedure has been initiated, a stay is placed on satisfaction of all monetary claims accrued prior to that date (including those arising out of employment relations). Employees are entitled to be included in the arbitration manager's register of claims, but not to seek the debtor's satisfaction of these claims. In order to be included in the register, employee claims must be presented to the court by the arbitration manager and approved.

However, if an employee has obtained a court decision which entered into legal force prior to the date the supervisory procedure was initiated and which is in the process of being executed, these execution procedures (unlike others) will not be suspended and will actually be carried out against the debtor.

No restrictions apply to payment of wages for work conducted after the supervisory procedure has been initiated. These payments should be made in their regular manner.

The financial recovery procedure uses external resources, usually in the form of financing from the founder or third parties, to restructure and repay debts under the supervision of an administrative manager and creditors' committee. Financial recovery is a new procedure under the Bankruptcy Law and has not yet been tested in practice. The financial recovery procedure may not last more than two years.

The rules for bringing employee claims during financial recovery proceedings are largely the same as those for the supervisory procedure. However, under the financial recovery procedure, employee claims must be satisfied in an expedited manner. While regular monetary claims must be satisfied one

[3] Exceptions are very specific in nature and are not addressed here.
[4] Exceptions are very specific in nature and are not addressed here.

month before the end of the financial recovery procedure (which, as noted above, may last up to two years), employee claims included in the financial recovery plan must be satisfied within six months after its approval, in accordance with the plan.

The external management procedure provides a variety of methods for restoring a debtor's creditworthiness, including, *inter alia,* altering the company's business profile, terminating unprofitable product lines, liquidating accounts receivable, selling some of the debtor's property, assigning the debtor's claims to third parties, settling the debtor's obligations, or selling the debtor's business. According to court statistics, in the majority of cases, external management has resulted in declaring a debtor bankrupt and opening receivership proceedings. External management (alone or together with financial recovery) may not last more than two years.

As a general rule, a moratorium is introduced as of the date the external management procedure is initiated with respect to payment of creditors' claims which accrued prior to that date. However, this moratorium is not applicable to employee claims, which are due and payable by the debtor upon initiation of the external management procedure. Work conducted by employees while the external management procedure is underway should be compensated in the regular usual manner.

The receivership procedure is initiated with the purposes of organizing a sale of the debtor's property, settling as many outstanding creditor's claims as possible, and liquidating the debtor.

In such a case, all claims brought against the debtor shall be deemed due and shall be satisfied in the priority and order set forth in the Bankruptcy Law. According to this order, employee claims are included in the group of claims having second priority.

A settlement agreement can be proposed at any stage of a bankruptcy case, provided that the debts to first and second priority creditors have been repaid. Without complying with this condition, a settlement agreement would not be approved by the court and therefore, would not become legally effective.

3. How does the priority (if any) given to employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

When a debtor is declared bankrupt, the bankruptcy estate becomes subject to distribution (or sale with distribution of the proceeds of sale) among the creditors and other participants in the bankruptcy case. The Bankruptcy Law sets forth: (i) the list of payments to be made out of the bankruptcy estate ahead of settlement of the claims of bankruptcy creditors; and (ii) the order in which bankruptcy creditors' claims shall be settled.

(i) The following liabilities shall be settled from the bankruptcy estate ahead of settlements to bankruptcy creditors:

- debtor's judicial expenses, including expenses related to the publication of bankruptcy announcements;
- expenses related to and including the payment of fees to the arbitration manager and registry holder;
- current utility and operational expenses necessary for the debtor to carry out its activities;
- creditors' claims arising after the arbitration court accepted the application declaring the debtor bankrupt, as well as creditors' claims on monetary obligations emerging during the bankruptcy proceedings;
- indebtedness on salary payments emerging after the arbitration court accepted the application declaring the debtor bankrupt and accrued during the bankruptcy proceedings. A manager in bankruptcy must make all withholdings (alimony, income tax, trade union and insurance payments, *etc.*) and payments provided for by law with regard to salaries payable to employees continuing their work during bankruptcy proceedings and to those hired during the course of bankruptcy proceedings; and
- other expenses related to the bankruptcy proceedings.

(ii) Bankruptcy creditors' claims shall be satisfied in the following order:

- first, settlements under the claims of individuals to whom a debtor is liable for causing damage to life or health, or for compensation for moral damage;
- second, severance payments and salaries accrued before initiation of the bankruptcy procedure to employees who worked or continue to work under a labor contract, as well as compensation under author's contracts; and
- third, settlements with other creditors.

Creditors' claims under obligations secured by a pledge of the debtor's property shall be satisfied at the expense of the collateral ahead of other creditors, with the exception of obligations to first and second rank creditors (including employee claims) whose claims arose before the conclusion of the relevant pledge agreement.

Thus, employee claims (whether current or accrued prior to initiation of bankruptcy proceedings) clearly receive preferential treatment in the receivership procedure.

4. What personal liability (if any) do directors and/or others involved in the management of a company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The management of the company may bear: (1) administrative and criminal liability for non-payment of salaries, under certain circumstances; and (2) criminal liability for intentional failure to pay taxes or other duties owed in relation to employee entitlements.

(1) A violation[5] of labor law incurs an administrative penalty for officers[6] in an amount equal to five to fifty times the minimum wage (which is approximately

[5] Article 5.27 of the RF Code of Administrative Offenses

[6] Under Article 22 of the RF Labour Code, all employers are obliged to pay employee salaries in full.

US$ 4). Repeat of an offense by a person who has already been punished under the administrative procedure for the same violation may incur his/her disqualification for a term of one to three years.

Intentional non-payment of salaries, pensions, allowances and other payments provided for by law is punishable under the Criminal Code.[7] If committed by the head of an enterprise, institution or organization (irrespective of its form of ownership) out of a lucrative impulse or personal interest, such non-payment is punishable by: a penalty of up to 80,000 Rubles; a penalty in the amount of the convicted person's salary or other income over a period of up to six months; a ban on occupying certain positions or engaging in certain types of activities for up to five years; or imprisonment for up to two years.

However, in practice it is rather difficult to establish the motives of the person who could be liable for the offense. Therefore, actual convictions in such criminal cases are extremely rare.

(2) An organization paying salaries is responsible: (i) as a tax agent, for withholding taxes and certain other duties for non-budget funds; and (ii) as a taxpayer, for payment of taxes imposed on salaries as a whole. For intentional failure to perform either of these obligations, the head of the company (or chief accountant, as the case may be) may be criminally liable.

5. Is there any form of statutory, industry or government-funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and when, if at all, may payment under this safety net be triggered during the course of formal insolvency proceedings?

There is no statutory, industry or governmental fund to guarantee payment of employee entitlements in an insolvency context. However, an RF employment fund exists which, *inter alia*, is responsible for payments to people who have become unemployed (which is a common side-effect of insolvency procedures).

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[7] Article 145.1

6. In the event of a sale by an insolvent company of all of its assets as an ongoing business (whether within or outside of a formal proceeding), would the buyer be liable for employee claims on the basis of successor liability or otherwise?

Under the Bankruptcy Law, an "enterprise" is defined as a proprietary complex whose purpose is to conduct an ongoing business. Sale of the debtor's "enterprise" as an ongoing business may be part of the external management procedure or the receivership procedure, subject to the following rules.

A debtor's monetary obligations and mandatory payments shall not be attributed to the debtor's enterprise upon its sale, with the exception of obligations arising after acceptance of the debtor's application seeking a declaration of bankruptcy, which may be assigned to the buyer of the enterprise under the procedure and on the terms and conditions provided for by the Bankruptcy Law.

All labor contracts effective as of the date of sale shall continue to be in force and effect and the rights and duties of the employer shall pass on to the buyer. Consequently, the buyer will become the employer of the debtor's employees and will be liable for all of the employer's current obligations (including payment of current salaries). The buyer will also be entitled, *inter alia*, to terminate labor contracts with the debtor's former employees on the general terms and conditions set forth in the RF Labor Code (including the obligation to provide severance pay).

Employee claims which constitute bankruptcy claims shall be satisfied by the arbitration manager out of the money derived from the sale of the enterprise, in accordance with their prioritization (discussed in Section 3 hereof).

One specific case should also be addressed here, relating to the sale of city-forming enterprises. For purposes of the Bankruptcy Law, a city-forming enterprise is a legal entity employing at least twenty-five percent of the corresponding locality's inhabitants, or any enterprise employing over 5,000 people.

For the sale of a city-forming enterprise, governmental authorities may impose an additional obligation with respect to employees on the buyer. The local authority, the relevant federal executive authority involved in the bankruptcy case, or another executive authority of a constituent entity of the RF may petition the court holding the bankruptcy case to require inclusion in the purchase-sale agreement of a provision preserving jobs for no less than fifty percent of the employees of the city-forming enterprise as of the date of its sale, for a definite period up to three years from the moment of the agreement's entry into force.

If the buyer of the city-forming enterprise fails to fulfill this condition, the purchase and sale agreement may be terminated by the arbitration court upon an application by the governmental authority which petitioned to initiate the sale under these conditions. However, if the governmental authorities do not file such a petition, the city-forming enterprise shall be sold under the general procedure outlined above.

South Africa

1. How is an employee defined for the purposes of formal insolvency proceedings?

The IA Insolvency Act 24 of 1936[1] (hereafter the "IA"SA) does not contain a general definition of "employee" although the terms "contract of service" and "employee" are used within the IA.[2] This term is quite comprehensively described in both labour and tax law, and it is submitted that during formal insolvency proceedings the labour law terms of reference should apply. Both the Labour Relations Act (hereafter the "LRA")[3] and the Basic Conditions of Employment Act (hereafter the "BCEA")[4] contain the following definition:

"employee" means-

(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and
(b) any other person who in any other manner assists in carrying on or conducting the business of an employer."

This is a rather nondescript definition and both pieces of labour legislation contain the further presumptions regarding who will be deemed to be employees and whom not.[5]

Until the contrary is proved, a person who works for, or renders services to, any other person is presumed, regardless of the form of the contract, to be an employee, if any one or more of the following factors are present:

(a) the manner in which the person works is subject to the control or direction of another person;

(b) the person's hours of work are subject to the control or direction of another person;

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1 Insolvency Act 24 of 193624 of 1936.

2 However, for purposes of section 98A of the IA dealing with preferential claims (priorities) of employees, the term "employee": is defined in section 98A(5). See the discussion in parparagraph 2 below.

3 66 of 1995. Section 213 of the LRA.

4 75 of 1997. Section 1 of the BCEA.

5 Section 200A of the LRA and section 83A of the BCEA.

(c) in the case of a person who works for an organisation, the person forms part of that organisation;

(d) the person has worked for that other person for an average of at least 40 hours per month over the last three months;

(e) the person is economically dependant on the other person for whom he or she works or renders services;

(f) the person is provided with tools of trade or work equipment by the other person; or

(g) the person only works for or renders services to one person.

However, this presumption only applies to persons earning less than R115,572 per annum. For those persons earning in excess of the said amount, and those who wish to rebut the mentioned presumption, the following *indicia* formulated by the courts will be utilised to determine if a person is an employee: the existence of a relationship of authority; does the person in question form part of the employer's organisation; is the person being taxed as an employee; is the person being paid for the rendering of services (productive capacity) or the end result (such as the completion of a building project).[6]

2. What are the employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

At present, the South African insolvency law provides for a limited preference (priority) for certain claims of employees against the estate of the insolvent employer by providing them with a priority against the free residue of the estate.[7]

An employee who was employed by the insolvent is entitled to a preference for:[8]

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[6] SR van Jaarsveld and BPS van Eck *Principles of Labour Law* (2002) Butterworths 58-61; and the Labour Appeal Court Case *Liberty Life Association of Africa Ltd v Niselo*w 1996 *ILJ* 673 (LAC).

[7] See discussion in parparagraph 3 below regarding the free residue. The amounts of the preferential portions may be altered from time to time.

[8] Section 98A(1)(a) of the IA.

(i) Any salary or wages,[9] for a period not exceeding three months, to a maximum of R12,000.

(ii) Holiday pay accrued in the year of insolvency or the previous year, whether or not payment thereof is due at the date of sequestration or winding-up to a maximum of R4,000.

(iii) Any payment due in respect of any other form of paid absence for a period not exceeding three months prior to the date of sequestration or winding-up of the estate to a maximum of R4,000.

(iv) Any severance or retrenchment pay due to the employee in terms of any law, agreement, contract, wage-regulating measure, or as result of termination of section 38 of the IA to a maximum of R12,000.

The claim in paragraph (i) enjoys preference above the claims in paragraphs (ii) to (iv) which rank equally and abate in equal proportions if necessary.[10] An employee is entitled to these payments even though he or she has not proved his or her claim,[11] in terms of section 44, but the trustee may require an affidavit in support of the claim.[12]

An employee for the purposes of this section[13] means any person, excluding an independent contractor, who works for another person who:

(i) receives, or is entitled to receive, any salary or wages; or

(ii) in any manner assists in carrying on or in conducting the business of an employer.[14]

The Minister of Justice[15] may after prescribed consultation exclude employees from the preference by reason of the particular nature of the employment relationship between the employer and the employees, or because a guarantee affords employees protection equivalent to the

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9 The definition of salary or wages includes all cash earnings received by the employee from the employer – see section 98A(5)(B) of the IA. It seems that benefits other than in cash are not regarded as salary or wages.

10 Section 98A(4) of the IA.

11 Section 44 of the IA.

12 Section 98A(3) of the IA.· This concession regarding the proof of claims applies to the preferential portion of the claims only and an employee must still formally prove a claim to qualify for a dividend on a concurrent claim in so far as his or her claim is not preferent.

13 Section 98A (s) (a) of the IA.

14 See section 98A(5)(a) of the IA. It is to be noted that this is the same definition as contained in the LRA and BCEA but that it only applies to section 98A of the IA as discussed in parparagraph 1.

15 Section 98A(6) of the IA.

protection in this section. Thus far only company directors employed by the insolvent company and members of insolvent close corporations have been excluded for this purpose.[16]

The IA[17] further provides for a preference for any contributions which were payable by the insolvent employer. This includes contributions which were payable in respect of any of his or her employees, and which were, immediately prior to the sequestration of the estate or the winding-up, due by the insolvent employer, to any pension, provident, medical aid, sick pay, holiday, unemployment[18] or training scheme or fund, or to any similar scheme or fund. The preferential portion of claims in this regard is limited R12, 000.[19]

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings, compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

The general principle is that secured creditors must first be paid out of the proceeds of their respective securities after certain prescribed costs have been paid out of the proceeds.[20]

The free residue, being the surplus income derived from the proceeds of an asset serving as real security and the proceeds from unsecured assets, are used to pay the creditors with (statutory) preferential claims (priorities), and then to pay the concurrent (unsecured and unpreferred) creditors. Preferential claims are those which are thus preferred by operation of law and which are paid first within the prescribed order of preference provided for in the IA. This order is *usually* as follows:

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16 *Government Gazette* No 21519 dated 1 September 2000: Government Notice R 865.

17 Section 98A(1)(b) of the IA.

18 Section 98A(5)(c) of the IA excludes from this definition unemployment insurance. See also for a discussion of unemployment insurance parparagraph 5 below.

19 Section 98A(2) of the IA.

20 The IA acknowledges the following types of real security: A special mortgage bond over immovable property, as well as certain special notarial bonds over movable property; the lessor's tacit hypothec over the *invecta et illata* of the lessee, and the tacit hypothec of a credit grantor in terms of an instalment-sale in terms of section 84(1) of the IA; a pledge; and a lien.

(a) Sequestration or winding-up costs and general costs of administration. (This would, for instance, include the remuneration of the insolvency administrator as well as the fees of certain professionals retained by the estate.)[21]

(b) Certain sheriff charges incurred for execution of property before sequestration or winding up.[22]

(c) Preferential claims[23] in favour of employees regarding salaries and other claims and *thereafter* preferences[24] regarding contributions which were payable by the insolvent employer.

(d) A number of other statutory claims that rank *pari passu* and abate in equal proportion,[25]

(e) Income tax due by the insolvent in terms of section 101 of the IA.

(f) Claims secured by a general bond[26] and certain special notarial bonds registered before 1993 outside the province of Kwa-Zulu Natal.[27]

(g) If any balance remains, it is used to pay the concurrent creditors in proportion to their claims. Thereafter interest on such claims, if such claims are settled in full, from the date of sequestration to the date of payment in proportion to the amount of each such claim.[28] It must be noted that employees may claim the balance of their claims, i.e. the non-preferential portion as concurrent claims under this heading.

(h) Any surplus assets available after the payment of the costs incurred in the winding up and the various claims of the creditors must be distributed amongst the shareholders according to their rights and interests in the company.[29]

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21 See section 97(2) and (3) of the IA.
22 See section 98(1) and (2) of the IA.
23 Section 98A(1)(a) of the IA.
24 Section 98A(1)(b) of the IA.
25 Section 99 of the IA.
26 Section 102 of the IA.
27 See sections 1(2) and 1(4) of the Security by Means of Movable Property Act 57 of 1993.
28 See section 103 of the IA.
29 Section 342(1) of the Companies Act 61 of 1973.

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The directors have no pertinent statutory personal liability to the employees in this regard. Their contracts of employment may create such liability. However, directors may be held personally liable for reckless or fraudulent trading.[30] It is thus theoretically possible for an employee to rely on the Companies Act[31] when the prescribed requirements are met in this regard.

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

Apart from the preferences discussed above, South Africa has no national or provincial government fund to assist employees after insolvency with payment of arrears of salary, leave pay, severance pay or unfair dismissal claims. However, once an employee's contract of employment is suspended or terminated[32], he or she is entitled to benefits in terms of the Unemployment Insurance Act[33] (the "UIA").

The UIA provides for unemployment benefits ranging between 30% and 58.64% of previous earnings.[34] The higher a contributor's remuneration while still employed, the closer to 30% of previous earnings will be paid out.

A contributor's entitlement to benefits accrues at a rate of one day's benefits for every six days of employment as a contributor, to a maximum of 238 days (or 34 weeks or 8 1/2 months) in the preceding four years.[35] In order to calculate the benefits payable to an employee the rate of remuneration of an employee has to be determined. Included in the term "remuneration" is any amount of income which is payable to an employee by way of salary, leave

30 Section 424 of the Companies Act. 61 of 1973
31 Section 424 of the Companies Act.
32 Section 38 of the IA.
33 Unemployment Insurance Act 63 of 2001.
34 Section 12 and Schedule 3 of the UIA.
35 Section 13(3) and Schedule 2 of the UIA.

pay, wage, overtime pay, bonus, commission or pension, whether paid in cash or otherwise, in respect of services rendered. It does, however, not include any pension or retiring allowances.[36]

An unemployed contributor is entitled to unemployment benefits only if:[37]

- the contributor's contract of employment has been terminated by the employer, or a fixed term contract has come to an end or the contract has been suspended in terms of the provisions of the IA;
- application is made in accordance with the provisions of the UIA;
- the contributor is registered as a work-seeker in terms of the provisions of the Skills Development Act 97 of 1998;[38] and
- the contributor is capable and available for work.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

Where the business is transferred in an insolvency dispensation, section 197A of the LRA is to be applied to the contracts of employment. The general rule is thus that where a business (or part thereof) is transferred as a going concern and where the employer is insolvent or in the circumstances of a scheme of arrangement or compromise to avoid winding-up or sequestration for reasons of insolvency, the new employer will automatically be substituted in the place of the old employer in all contracts of employment which were in existence immediately prior to the old employer's provisional winding-up or sequestration.[39]

The LRA[40] makes it clear that the transfer of employment would not interrupt the employee's continuity of employment. The contract of employment continues with the new employer as if with the old employer - except that all the rights and obligations between the old employer and each employee at the time of the transfer remain rights and obligations between the old employer and each

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36 Section 1 of the UIA.

37 Section 16(1) of the UIA.

38 97 of 1998.

39 See sections 197A(1) and (2)(a) of the LRA. This general rule will not apply if the parties agreed otherwise in terms of section 197(6).

40 Section 197A

employee and anything done before the transfer by the old employer in respect of each employee is considered to have been done by the old employer.[41] In principle this means that the claims discussed in parparagraph 2 above will be against the estate of the old insolvent employer.

[41] See section 197A(2)(c) of the LRA.

Sweden

1. How is an employee defined for the purposes of formal insolvency proceedings?

An employee is not separately defined in the Swedish insolvency legislation, the concept of an "employee" is the same as in the employment situation.

The Swedish Employment legislation lacks a certain definition of the concept of an "employee". At the appraisal of whether a person shall be seen as an employee the courts make an overall assessment of the relevant circumstances in each case. Factors to be taken into account to decide whether a relation shall be characterised as an employee or an assignment relationship have evolved from the case law, the preparatory works and the literature.

Some basic requirements for a relationship to be characterised as an employment relationship is that *work is carried out due to a contractual obligation*, the purpose of the contract is that *work shall be carried out for another person* and the employed person shall *personally* carry out the work. Some other factors that are taken into account when assessing a worker's relation to the employer are are as follows:

- that the worker has been available for work during the time when the working tasks have occurred;
- that the tasks have varied;
- that the relationship between the worker and the employer has been of a continuous and regular character;
- that the worker has received tools to exercise the tasks;
- that the tasks, the place and time for exercising them have been under the control of the employer;

- that some of the remuneration for the worker has consisted of a guaranteed salary; and
- that the worker generally is economically and socially equal to an "employee".

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during formal insolvency proceeding?

The more important employment entitlements that can be claimed in an insolvency situation are salary, holiday pay and pension.

A partner in a trading company or a limited partnership company is not seen as an employee. A shareholder or managing director in a limited liability company is seen as an employee of the company if they carry out work on behalf of the company. A director of the company is not normally seen as an employee but can, depending on the circumstances, be seen as partly employed if besides the directorship he worked for the company.

Persons that are normally seen as employees can however be disqualified from preferential rights for their claims through a substantial ownership in the bankrupt company, which is regarded as being approximately thirty per cent of the shares in the company.

Claims for salary due to an employment with the bankrupt company comprise claims related to the period before the date of the bankruptcy decision and one month thereafter. The employee's claim for salary is only preferred if it has been earned during the last eight months of the employee's time of employment with the bankrupt company. The claims shall not have been earned before three months before the date of filing for bankruptcy.
A claim for notice payment is as a maximum preferred in accordance with the notice period stated in the Employment Protection Act (Sw. *Lagen om anställningsskydd*), a maximum of six months.

A requirement for preferential rights is that the employee is available to the insolvency administrator for work during the period of notice. If the employee does not work for the insolvency administrator, the employee has a duty to notify the employment service. If the employee receives a new employment he also has a duty to notify this to the insolvency administrator since this new income is deductible from the preferential claim.

Claims for holiday pay are only preferred for the current holiday year and the one before. Claims for pension are only preferred for a period from six months before the date of filing for bankruptcy to six months after the filing.

The priority for employee entitlements are maximised to ten basic amounts (Sw. *prisbasbelopp*), currently approximately SEK 393,000.

3. How does priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

Professionals retained by the estate to allow the insolvency administrator to carry out his duties receive payment first of all from the estate's assets. Second in rank is the administrator who will receive his remuneration before any creditors, including employees, receive any dividends from the estate.

Thereafter the first creditors of the company receive payment. First in rank are the secured creditors who have priority in the assets in which they have security and have thus priority before the employees' claims.

Some unsecured claims that have priority before the employees' claims are creditors for the filing for bankruptcy, the auditor/accountant that have claims for reviewing and keeping the books for the last six months before the date of the filing for bankruptcy and creditors with security consisting of a floating charge. A floating charge does however according to new rules since 1 January 2004, only constitute a preferential right in 55 percent of the estate's assets.

Shareholders receive payment last of all, i.e. when all creditors have been paid in full.

4. **What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?**

   There is no liability for directors or other persons in the company's management for payment of the employee entitlements.

   Regarding unpaid taxes in relation to employee entitlements, while generally the company is primarily responsible, nonetheless the directors or others involved in the management of the company might be personally liable for the payment of all unpaid taxes owed in relation to employee entitlements that have fallen due before the filing for bankruptcy.

5. **Is there any form of statutory, industry or government funded "safety net" that services to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payment it may make?**

   In Sweden there is a government funded "safety net" called the Government Wage Guarantee Fund (Sw. *Lönegarantin*) that will under certain circumstances guarantee that a bankrupt company's employees receive payments for salary, holiday pay and pension up to a certain amount. The County administrative board (*Sw*. *Länsstyrelsen*) administers the Government Wage Guarantee Fund.

   The insolvency administrator shall assess unpaid employment entitlements on the day of bankruptcy and claims that arise during the period of notice. The insolvency administrator notifies the County administrative board of his

decision and the County administrative board handles payment to the employees. If an employee is dissatisfied with the insolvency administrator's decision he can file a complaint to the district court.

Only preferential employee claims can be paid by the Government Wage Guarantee Fund. However, with regard to the payment during the notice period an employee can receive payment for up to six months (even though the time after one month from the date of the bankruptcy decision is not preferred).

The maximum payment that an employee can receive from the Government Wage Guarantee Fund is four basic amounts, which currently amounts to approximately SEK 157,200.

The Government Wage Guarantee Fund requires that the employee is available for work during the period of notice. If the employee does not work for the insolvency administrator, the employee has a duty to notify the employment service to continue to receive payments from the Government Wage Guarantee Fund. If the employee obtains a new employment he also has a duty to notify this to the insolvency administrator or the County administrative board since this new income is deductible from the payment from the Government Wage Guarantee Fund.

The County administrative board has a right to receive dividends in the bankruptcy and takes over the priority of the employees up to the amount that it has made payments.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

The Transfer of Undertakings (Protection of Employment) Regulation 1981 has an important impact on the sale of companies or businesses (in whole or part) in order to ensure that employees' rights and entitlements are not prejudiced during the sale process. There are currently no reliefs for

insolvency processes. This is a very complex area of law which may well impact on employee dismissals even before the transfer and legal advice should always be sought.

United Kingdom

1. How is an employee defined for the purposes of formal insolvency proceedings?

Section 230 (1) of the Employment Rights Act 1996 (ERA) defines an 'employee' as "*an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment*".

The ERA[1] defines 'contract of employment' as a "*contract of service or apprenticeship, whether expressed or implied, and (if it is express) whether oral or in writing*".

2. What are the employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

An employee is entitled to claim the following during insolvency proceedings: The relevant date for the following is the date of passing a resolution to wind up the company in a liquidation, the date an administration order is made in an administration, the date of appointment for a receiver in an administrative receivership, the date that a company voluntary arrangement is approved and in the case of a compulsory winding up of a company, the date that the order is made.

Arrears of Wages: Wages refer to basic pay, bonuses, commission, overtime or guaranteed payments at the date of the insolvency. The employee can claim for a maximum of 8 weeks, of which the first £800 (if it is within 4 months prior to the date of insolvency) is afforded preferential status. The 8 weeks need not be consecutive or relate specifically to the 8 weeks immediately prior to the date of insolvency.

Holiday Pay: Employees may claim for holiday accrued during the 12 months immediately prior to the date of insolvency. The claims are limited to 6 weeks and are calculated on a pro-rata basis. Provided it is company policy, they are

[1] Section 230 (2)

also entitled to include holiday carried over from the previous year. This is all preferential.

Redundancy Pay: An employer[2] has to pay a redundancy payment to any employee who has worked for the company for more than 2 years. The amount is dependant on length of service, age of the employee and the weekly wage earned. This claim is an unsecured claim against the company and is not afforded priority.

Payment in Lieu of Notice: The ERA[3] states that all employees who have worked for the company for one month or more is entitled to one weeks notice for each full year that they have worked for the company up to a maximum of 12 weeks, unless their contract of employment states differently. This claim is unsecured and as such has no priority.

Protective Award: Is made in respect of claims brought against the company by trade unions, where an appropriate consultation period has not been made in accordance with Section 188 of the Trade Union & Labour Relations (Consolidation) Act 1992. It states that employers must consult with trade unions at the earliest opportunity regarding redundancies, the regulations being as follows;

a) where 100 or more employees are to be made redundant, a consultation period of 90 days is required.

b) where 10 or more employees are to be made redundant a consultation period of 30 days is required.

When an award is made it can order the employer to pay remuneration for a period of up to 90 days. This is categorised as arrears of wages and as such the first £800 of the combined arrears of wages claim and protective award will be classed as preferential and the remainder will be classed as unsecured.

Unfair Dismissal Claim: Complaints may be brought before an Employment Tribunal for racial/sexual discrimination, or if the employee considers that his redundancy was unfairly made because the particular role has not disappeared. From 1 February 2004 the limit has been increased to £55,000 which will rank as an unsecured claim.

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[2] Section 135 (1) of the ERA

[3] Section 86 (1)

Unpaid pension contributions: Unpaid contributions for occupational pension schemes for both the employees and employers can be a claim against the company. If the pension scheme was a final salary scheme then the scheme must have an independent trustee or an independent trustee must be appointed. The pension schemes are trusts and are therefore not assets of the company.

The claim is split between the employer's and employee's contributions. Any unpaid pension contributions not paid over to the pension provider in the 12 months prior to the date of appointment are classed as preferential and anything outstanding prior to the 12 month period is classed as unsecured.

The first 4 months of employee's pension contributions that have been deducted from their wages prior to the date of appointment but not paid over to the pension provider are classed as preferential and any other amount is classed as unsecured.

Payroll tax deductions: From 15 September 2003, the Enterprise Act 2002 abolished the Crown Departments' (including the Inland Revenue's) right to claim preferentially for unpaid taxes, Pay As You Earn tax (PAYE) and National Insurance Contributions (NIC), so their claims are unsecured and rank equally with other creditors.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings, compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors and shareholders?

The order of the priority of payment of creditors and remuneration of office holder is as follows:

First	Expenses incurred by the Insolvency Practitioner to allow him to carry out his duties including professionals fees
Second	Insolvency Practitioners' remuneration
Third	Creditors, secured with valid mortgage or debenture containing a fixed charge over assets.

Fourth	Preferential creditors, including the employees and Crown Departments of the Inland Revenue and Customs and Excise
Fifth	Debenture holders with a floating charge over assets, subject to a deduction of 10% within limits for the benefit of the unsecured creditors
Sixth	Unsecured creditors
Seventh	Shareholders (only paid if the company is solvent)

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements or taxes or other duties owed in relation to employee entitlements?

The directors have no personal liability to the employees unless their contract of employment states that they were employed by the director and not the company.

If the directors themselves were employed by the company under contracts of employment and the PAYE relating to their salaries has not been paid on insolvency, they may be personally liable to pay this to the Inland Revenue.

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

The Redundancy Payments Service (RPS) has been set up to provide help to former employees of insolvent companies who are owed wages, holiday pay, notice pay, redundancy pay, protective awards and unfair dismissal claims.

All of the above are limited to the statutory limits (from 1 February 2004 this is £270 per week or £54 per day), which is revised an on annual basis by the Secretary of State for Trade and Industry. The RPS will only pay a maximum of 8 weeks for arrears of wages (and protected awards).

The RPS will also pay the pension contributions for both employers and employees for the 12 month period leading up to the date of insolvency and they will apportion their claim accordingly as either preferential or unsecured.

Directors may claim but the RPS may reject their claims if they do not consider them to be employees. A number of factors are taken into consideration, for example:-

a) if the director was a majority shareholder

b) if the director had drawn any salary for a while

c) if the director did not attend the company every day

d) was a contract of employment ever issued?

e) were they entitled to holiday and sick pay?

Sub contractors may also claim if they are considered to be “an employee” of the company. The definition of a sub-contractor is determined by whether there is a master/servant relationship. As with directors, there are a number of criteria that the sub-contractors need to meet for the RPS to make a payment to them for arrears of wages etc. If the claim is rejected, the sub-contractors claim will rank as unsecured creditors.

The Redundancy Payments Service[4] is entitled to be paid the whole of its preferential claim, which is known as Super Preference before the employee can be paid the balance of their preferential claim. This has been abolished by the Enterprise Act 2002 with effect from 15 September 2003, in respect of cases after this date. Super Preference applies only to cases where the appointment was prior to this date.

[4] Section 189 of the Employment Rights Act 1996

6. **In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?**

   The Transfer of Undertakings (Protection of Employment) Regulations 1981 have an important impact on the sale of companies or businesses (in whole or part) in order to ensure that employees' rights and entitlements are not prejudiced during the sale process. There are currently no relief's for insolvency processes. This is a very complex area of law which may well impact on employee dismissals even before the transfer and legal advice should always be sought.

The United States of America

1. How is an employee defined for the purposes of formal insolvency proceedings?

Title 11 of the United States Code (the "Bankruptcy Code") does not define "employee" for purposes of a formal insolvency proceeding. The bankruptcy courts will look to the relevant state law or regulation to determine whether an individual qualifies as an employee of the debtor.

2. What are employee entitlements, and to what extent (if any) are they given priority treatment during the formal insolvency proceeding?

Pre-petition Wages. Unsecured claims for wages, salaries, or commissions, and vacation, severance, and sick leave pay, earned by an employee are eligible for priority treatment [1]. Sales commissions earned by an employee (or corporation with only one employee) acting as an independent contractor in the sale of goods or services for the debtor are also eligible for priority treatment, subject to certain requirements pertaining to the level of business with the debtor.

The priority for these claims is limited to $4,650 per employee and covers all wages, including salaries (whether hourly, weekly, or monthly), bonuses in the nature of compensation for work performed, and commissions, (any excess is a general unsecured claim) and is only available for wages, salaries, commissions, vacation pay, sick leave pay or severance earned within ninety days before the earlier of the date the debtor filed its bankruptcy petition or the date the debtor ceased operating its business. The alternative measuring dates protects against a debtor shutting down its business but delaying the filing of the bankruptcy case to avoid paying pre-petition accrued wage claims.

Debtors frequently file a motion at the beginning of the case requesting that the

[1] 11 U.S.C. § 507(a)(3).

court use its discretionary power to permit the debtor to pay pre-petition wage claims in the ordinary course of business to maintain the stability necessary for the transition to operating as a debtor in possession[2].

Post-petition Wages. Wages owed by the debtor for services provided after the company has filed for bankruptcy protection are entitled to the highest possible priority for an unsecured claim, known as administrative expense priority. The debtor is obligated to pay post-petition wages in full as they are incurred before payments can be made on account of any pre-petition unsecured claims.

Vacation Pay. The priority treatment of vacation pay and sick leave pay depends on the nature of the employment contract or collective bargaining agreement between the debtor and its employees. If the contractual relationship between the debtor and its employees provides that an employee accrues Paid Time Off based on the number of days worked during the year, the employee's priority claim for Paid Time Off is limited to the amount accrued during the ninety days before the earlier of the date the debtor filed its bankruptcy petition or the date the debtor ceased operating its business. Paid Time Off accrued prior to the ninety day period constitutes a general unsecured claim.

However, if the employment contract provides that a right to vacation pay vests on a certain day and the employee is dismissed prior to that vesting date, the employee likely does not have a claim for vacation pay at all. Or if the vesting date falls outside of the ninety day measuring period, all of the employee's vacation pay claim may be considered simply a general unsecured claim. Conversely, if the vesting date falls within the ninety day measuring period, the employee may have a priority claim for an entire year's worth of vacation pay simply by virtue of the timing of the vesting date. Most bankruptcy courts have generally held that vacation pay will be deemed to have been earned throughout the year and that, so long as the employee has a valid contractual claim for vacation pay, ninety days worth of vacation pay will be considered to have been accrued during the ninety day measuring period, regardless of the vesting schedule in the contract.

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[2] 11 U.S.C. § 105.

Pre-petition Severance Pay. Pre-petition severance benefits are entitled to priority to the extent they are earned within the ninety day measurement period and only up to the $4,650 total priority cap provided by the statute.[3] If the employee is terminated prior to the ninety day period, the employee's severance claim is not entitled to any priority. If the employee is terminated within the ninety day measurement period, then some of the severance benefits may be entitled to priority. The most common form of severance package is given as compensation for the loss of employment payable at the time of termination and the amount of severance pay is usually based on length of service. In this case, the severance benefits accrued in the ninety day period are entitled to priority. A few courts have held, however, that severance benefits are earned upon termination because no right to severance exists until an employee is involuntarily terminated. This is the minority view, however, and most courts will look at the severance benefits earned within the ninety day period and assign priority status on a pro rata basis, with the remaining amount constituting a general unsecured claim.

Another type of severance package provides benefits in lieu of notice of termination. This is payable if the company fails to give the employee the prescribed notice prior to termination. If this termination occurs within the ninety day period, the courts have held that the full amount of the severance, up to the $4,650 limitation, is entitled to priority treatment.

Post-petition Severance Pay. An employee terminated post-petition is entitled to administrative expense priority only to the extent that it is earned post-petition. Severance packages that are considered compensation in lieu of notice are deemed to have been earned at the time of the termination without requisite notice and to the entire amount is treated as an administrative expense if the termination occurs post-petition.

However, for severance benefits that are based on length of employment, there is a split of authority as to when and how those benefits are in fact "earned". Most courts grant administrative expense priority to severance claims only to the extent that the severance obligations are incurred based on services provided to the estate post-petition. For example, if an employee continues to

[3] 11 U.S.C. § 507(a)(3).

work for the debtor for three months after the bankruptcy filing, then the pro rata portion of the severance claim that can be attributed to the post-petition period would be afforded administrative expense priority. The remainder of the claim would be a priority claim to the extent it was attributable to the ninety day period before the bankruptcy filing with the remainder considered a general unsecured claim. The priority granted by section 507 is higher than other general unsecured claims but is lower in priority than administrative expense claims.

The Second Circuit courts hold that regardless of the type of severance at issue, the obligation is incurred upon the termination date and is an administrative expense claim entitled to the highest priority. This minority view is likely to be reviewed and brought in to line with the courts of other circuits.

Employee Benefit Plans. Contributions to an employee benefit plan are eligible for priority providing the contributions arise from services rendered within 180 days before the earlier of the date of filing for bankruptcy or the date the company ceased to do business, limited to $4,650 per employee[4]. This is reduced by the aggregate priority claims of employees and any amount paid on behalf of such employees to any other employee benefit plan. There is no statutory definition of "employee benefit plan," but it includes pension plans, health insurance plans and life insurance plans. The two types of employee benefit plans eligible for priority are self insured plans where employees are directly reimbursed for expenses covered by the employee benefit program and company-maintained insurance programs for the employees. The priority of employer contributions to both plans is subject to the timing and dollar amount limitations.

Pension Plans and the PBGC. Pensions plans are either a "defined benefit plan" or a "defined contribution plan". The priority status for contributions owed to defined contribution plans is relatively straightforward as these plans usually tie the employer contribution to the services rendered by the employee. Therefore, it is generally possible to allocate the contribution claim simply based on the services rendered by the employee during the 180 day measuring period.

A mandatory governmental insurance program created pursuant to Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA") protects workers participating in defined benefit pension plans sponsored by private

[4] 11 U.S.C. § 507(a)(4).

employers[5]. ERISA ensures that employees and their beneficiaries are not completely deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds had been accumulated in the plans and shifts responsibility for unfunded defined benefit pension plan liabilities to the Pension Benefit Guaranty Corporation ("PBGC"). When a company files for bankruptcy, it will likely be unable to simply terminate its existing pension and health plans and negotiate new plans more consistent with its current operations as it restructures. Pension plans covered by ERISA may only be terminated by an employer: (i) through a "standard termination" if the employer has sufficient assets to pay all benefit obligations; or (ii) if the assets are insufficient to pay all benefits (which will most likely be the case for a company in bankruptcy), the employer may terminate the plan by meeting the statutory standard for "financial distress"[6]. However, no termination, whether standard or through a showing of financial distress, is allowed if it would violate the terms of an existing collective bargaining agreement. Most such agreements with major unions do not allow such a termination. In such a scenario, the PBGC can force an involuntary termination of the plan regardless of the terms of the collective bargaining agreement[7] if it determines that either: (i) the plan has not met certain minimum funding requirements[8]; (ii) the plan will be unable to pay benefits when due and other events have occurred[9]; (iii) certain distributions were made under the plan to a participant who is also a substantial owner of the company (greater than 10% holder); or (iv) the possible long term loss to the PBGC with respect to the plan may be "reasonably" expected to increase "unreasonably" if the plan is not terminated.

When a plan covered under ERISA is terminated, the PBGC becomes trustee of the plan and takes control of the plan's assets and liabilities. The PBGC then uses the remaining assets to cover the benefit obligations under the plan and the PBGC adds its own funds to cover any remaining benefit obligations. The employer then becomes liable to the PBGC for any benefits it covers on behalf of the terminated plan, which generally gives rise to a substantial claim in the bankruptcy for the difference between the value of the plan assets at the time of termination and the value of the plan's vested obligations to its participants. The priority of such a claim is unclear - the PBGC argues that its claims are "actual and necessary costs" of preserving the estate and should be granted

5 Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA")
6 29 U.S.C. § section 1341(a)(3)).
7 ERISA § 4042.
8 29 U.S.C. section§ 1082.
9 29 U.S.C. section § 1343(b)(7).

administrative priority. The courts have not been sympathetic to that position but they usually grant priority to the extent that the costs were incurred within the 180-day time period[10]. The remainder of the PBGC claims are usually considered general unsecured claims.

3. How does the priority (if any) given employee entitlements in formal insolvency proceedings compare to the priority (if any) given to secured creditors, insolvency administrators, professionals retained by the estate, unsecured creditors, and shareholders?

The order of payment is as follows

1. Creditors holding valid and enforceable security interests against property of the estate hold the highest priority and are entitled to a recovery of their security or the reasonable equivalent value of their security.
2. Post-petition costs and expenses incurred by the estate that inure to the direct benefit of the estate are considered administrative expense claims and must be paid in full before any payment can be made on account of other unsecured claims. Administrative expense claims include professional fees, trustee fees, post-petition trade or vendor claims and employee claims categorised as administrative claims as above.
3. Priority unsecured claims including certain tax claims, wages, commissions, severance benefits, vacation pay, sick day pay, and employee benefits pursuant to sections 507(a)(3) and 507(a)(4) are paid next, and these claims must be paid in full before any distribution can be made to the general unsecured creditors or equity holders.
4. General unsecured creditors including claims for wages, commissions, severance benefits, vacation pay, sick day and employee benefits above the $4,650 limitation or outside of the respective 90 and 180-day measuring periods are then paid.
5. Equity holders after all other classes of creditors are paid in full.

[10] 11 U.S.C. § 507(a)(4)

4. What if any personal liability do directors and/or others involved in the management of the company have with respect to unpaid employee entitlements?

Wages and Employee Benefits.
As a general rule, officers and directors have no personal liability to the employees unless the employment contract states that the employee was employed directly by the officer or director and not by the company. However, there are some individual state statutes which look to whether the officer or director fits into the state's statutory definition of an "employer" when determining liability. For example, in Illinois, "Any officers of a corporation or agents of an employer who knowingly permit such employer to violate the provisions of this Act shall be deemed to be the employers of the employees of the corporation"[11]. In New York, the statute provides that if an employer is a corporation, under certain circumstances, the corporation's president, secretary, treasurer or officers exercising corresponding functions may each be held responsible for certain employee liabilities[12]. In Pennsylvania the statute defines "employer" as including "every person, firm, partnership, association, corporation, receiver or other officer of a court of this Commonwealth and any agent or officer of any of the above mentioned classes employing any person in this Commonwealth"[13]. As a general rule, these and similar statutes in other states have been interpreted to only apply to officers or directors that have either exercised significant control over the corporation or its finances, or "knowingly" permitted the corporation to purposely withhold benefits.

Withholding Taxes. The Internal Revenue Service ("IRS") requires employers to withhold from employees' pay checks money representing the employees' personal income tax and social security tax obligations. The employer holds these funds (referred to as "trust fund taxes") in trust for the United States and must deposit these funds in an approved bank at specified intervals, depending on the amount withheld. If an employer does not timely deposit these funds, the IRS may collect an equivalent sum from the officers or directors responsible for collecting the tax[14]. For an officer or director to be found "responsible," he must have significant control over the employer's finances or discretion over which bills or creditors get paid. However, being "responsible" will not by itself

11 820 ILCS 115/13 (2003)
12 NY CLS Labor § 198-c (2003).
13 43 P.S. § 260.2a (2003).
14 26 U.S.C. § 6672(a).

subject the officer or director to personal liability unless the officer or director wilfully failed to collect, account for, or pay over the withholding taxes to the IRS. This wilfulness standard is not particularly difficult to demonstrate. Courts have held directors and officers liable for trust fund taxes when the responsible officer or director knew that the withheld funds were being used for other corporate purposes, but expected that sufficient funds would be on hand on the due date for the payment to be made to the government.

Similar liability for withholding taxes is imposed on officers and directors under various state statutes and case law. For example, in New York, the statute imposes liability on "any person required to collect, truthfully account for and pay over the tax. . . who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof."[15]

5. Is there any form of statutory, industry or government funded "safety net" that serves to guarantee the payment of employee entitlements in an insolvency context? If so, how does such a scheme operate and what if any priority does it enjoy in formal insolvency proceedings in terms of payments it may make?

Worker Adjustment and Retraining Notification Act of 1988 (the "WARN Act.[16]") The WARN Act requires that employers provide employees 60 days notice or 60 days pay and benefits prior to either of: -

1. a plant closing which results, during any 30-day period, in the termination of 50 or more employees; or
2. a mass layoff that results in an employment loss at a single site of 33% of the employees and 50 employees or 500 employees regardless of the percentage of employees terminated.

[15] N.Y. TAX LAW § 685(g) (2004).
[16] Worker Adjustment and Retraining Notification Act of 1988.

Claims based on the WARN Act are treated in bankruptcy very similarly to the claims for severance based on compensation for lack of notice - if a termination occurs without the requisite notice, and it is within the ninety day measuring period, the entire WARN Act claim amount is eligible for priority treatment, subject to the $4,650 limitation[17]. If the termination occurs prior to the ninety day period, the WARN Act claim is treated as a general unsecured claim. If the termination occurs post-petition, the obligation is a post-petition obligation of the debtor and the entire claim is given administrative expense status.

Coal Act.[18] The Coal Act ensures the uninterrupted continuation of lifetime benefits to covered coal industry retirees[19] by extending liability to a broad base of contributors including the coal companies party to collective bargaining agreements with the United Mine Workers of America, and all of that company's related entities in the corporate structure and its successors in interest. Two of the financing mechanisms included in the Coal Act are the Combined Fund and the 1992 Plan. The former provides benefits to coal industry retirees and their dependents who were receiving, benefits from the old collectively bargained 1950 or 1975 Benefit Trusts as of July 20, 1992. The 1992 Plan provides benefits to persons who are not eligible for benefits from the Combined Fund but who, based on their satisfaction of age and service requirements as of February 1, 1993, could have retired and received benefits from those Trusts had those plans remained in existence. The 1992 Plan also provides benefits to those retirees who should be covered by individual employer plans ("IEPs") but whose employers fail to provide such benefits. This is funded through annual premiums which provide sufficient assets to fund benefits for beneficiaries whose last employer company no longer exists, and a monthly premium calculated based on the number of the entity's retirees who are receiving benefits from the 1992 Plan (rather than the entity's IEP). While the Coal Act requires a company to maintain its IEP and pay Combined Fund premiums so long as it remains "in business," the obligation to pay premiums to the 1992 Plan extends from as long as there is a liable entity remaining to pay them[20]. Filing for bankruptcy does not deem an entity no longer "in business" and a debtor will be required to maintain its IEP in bankruptcy. In addition, Combined Fund and 1992 Plan premiums are treated as taxes in bankruptcy

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17 under 507(a)(3), subject to the $4,650 limitation 11 U.S.C. 507(a)(3).
18 The Coal Industry Retiree Health Benefit Act of 1992, 26 U.S.C. §§ 9701 et seq.
19 The Coal Industry Retiree Health Benefit Act of 1992, 26 U.S.C. ss 9701 et seq
20 26 U.S.C. § 9711.

and are entitled to administrative expense priority if the debtor fails to pay these obligations as they fall due after filing for bankruptcy.

6. In the event of a sale by an insolvent company, whether in or out of a formal proceeding, of all of its assets as an ongoing business, would the acquirer be liable for employee claims on the basis of successor liability or otherwise?

A purchaser of only assets of a company generally acquires such assets free and clear of the seller's debts and liabilities unless such liabilities are specified in the asset purchase agreement or an exception to the principle of non-liability is applicable. When a corporate entity purchases assets and continues to operate the acquired business, the doctrine of successor liability may impute the liabilities of the acquired company onto the buyer. Courts have found successor liability to be appropriate under

- mere continuation, which applies in cases where there is a common identity of officers, director, and shareholders between the selling and buying entities;
- substantial continuation, which focuses on an entity's ownership and management structure, considering the continuity of the business itself, in determining whether successor liability is appropriate; and
- de facto merger under which a buyer is liable for the acquired company's liabilities when the asset sale results in essentially the same outcome as would have occurred had there been a merger, on the basis that in a true merger, the successor company would take on the liabilities of the merged entity.

In bankruptcy, buyers can protect themselves from successor liability as the bankruptcy courts can authorize the sale of property "free and clear of any interest in such property of an entity other than the estate."[21] The Bankruptcy Code does not define the kinds of interests in property that the statute was intended to encompass, but the Third and Fourth Circuits have held that employment-related successor liability claims fit within this expanded definition

[21] 11 U.S.C. § 363(f).

of "interests in property" and have held that a buyer may purchase a debtor's assets free and clear of such claims.

The rules regarding successor liability for unpaid pension obligations in asset sales are complex. In general, such successor liability for unpaid pension obligations may be imposed if the buyer

- expressly assumes part or all of the liabilities of a pension;
- purchases assets from an entity which sponsors or maintains a defined benefit pension plan subject to ERISA; or
- purchases assets from an entity which was a member of a controlled group which maintained a defined benefit pension plan subject to Title IV of ERISA.

The Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA") requires certain employers to provide continued health insurance coverage to former employees and their covered beneficiaries for a period of up to 18 months following termination of employment although employers may charge the employee for such coverage. On an asset sale, unless the buyer and seller agree otherwise, the seller retains the obligation to provide such continued health insurance to employees who terminate employment before or as a result of the asset sale. However, if the seller ceases to exist or to maintain a group health plan after the asset sale and if the buyer continues the business operations of the seller without substantial change, then the buyer is considered a "successor employer" for purposes of COBRA and may be obligated to extend COBRA coverage to seller's former employees. For purposes of COBRA, a buyer may become a successor employer even if the assets are purchased from a bankrupt company.

Under the WARN Act, certain employers are required to provide 60 days' notice (or pay in lieu of notice) to its workers in connection with certain plant closings and mass layoffs. Certain exceptions apply, including (a) a "faltering business", where the seller is actively seeking capital to continue the business and it is the seller's reasonable belief that obtaining such capital will continue

the business; and (b) "unforeseeable business circumstances." In certain cases, WARN Act liability for seller's employees may be imposed on the buyer in an asset sale if the seller's employees are laid off close to, or in conjunction with, the asset sale.

Courts have held that the buyer may be treated as a successor employer and may be held liable for prior employer discriminatory practices in cases where there is continuity of the business and where the seller has provided notice to the buyer of the potential discriminatory practice liability. (As set forth hereinabove, successor liability of the seller's employment discrimination practices may be avoided pursuant to a section 363 sale in bankruptcy.)
A buyer may also be liable under the Fair Labor Standards Act of 1938 for wages and overtime pay of a predecessor organization when it hires those employees if the buyer is considered to be the successor of the seller, adequate notice of the potential liability is provided to the purchaser and an insufficient remedy is available from the seller.

Under federal labour law, the buyer may inherit unfair labour practice liabilities of the seller in an asset deal and may be responsible to complete unfair labour remedies and comply with any National Labor Relations Board orders. Such liability is imposed upon the buyer if: (a) there is "substantial continuity" between the buyer and the seller in terms of operations and employees so that the buyer is considered a "successor employer" of the seller; and (b) the buyer has actual or constructive knowledge of unfair labour practices or of any NLRB proceeding against the seller. Substantial continuity is based on many factors including whether the employees are essentially performing their same jobs for the buyer and whether a majority of the employees was hired by the buyer.
A buyer is free to set initial employment terms, but if a majority of the seller's employees was unionized, then the buyer must negotiate with the union.
Though labour law does provide some exceptions for purchase of assets in bankruptcy, a buyer may inherit labour law liabilities in the purchase of an insolvent company's assets.

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