Employee priorities in insolvency proceedings and wage guarantees: a critical assessment

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In many countries, insolvency regimes alter the distribution of debtors' assets among creditors, by way of creditor priorities, rules on claw-back actions and on set-off rights. This distributive function of insolvency rules is particularly clear having regard creditor priorities. Many jurisdictions, indeed, in order to protect specific classes of creditors, curb pre-insolvency entitlements deriving from private bargains between a debtor and her creditors. The political decision on whether prioritising certain claims or fully respecting pre-insolvency entitlements reflects the hierarchy of interests that has prevailed in a specific country and the regulatory strategies adopted by policy-makers. Employee priorities are telling examples of these distributive rules. Many jurisdictions, indeed, prioritise employees' claims for unpaid wages and security payments over claims of other creditors. Employees, however, could also be protected by way of security mechanisms, with the consequence that the impact of employee priorities depends on their interplay with such social security schemes. Employee priorities, in particular, could either equilibrating weaknesses of social security schemes or reinforcing their impact. This work will assess this interplay in a sample of three E.U. Member States: France, U.K. and Germany. These States, according to the traditional 'varieties of capitalism' approach, are classified as either 'liberal market economies' (U.K.) or 'coordinated market economies' (Germany and France). Along this distinction, we expect that the U.K. does not accept insolvency priorities and that Germany and France are open to adopt rules that curb free market entitlements. The current institutional settings ant their historical development only partially reflect this expectation.

I. SETTING THE SCENE: INSOLVENCY PRIORITIES AND WELFARE STATE

In all developed countries, firms' insolvencies trigger a special set of norms and proceedings (commonly labelled 'insolvency law'), which aim at maximising the value of debtors' assets and at dealing with creditors' collective actions problems. Despite these common elements, features and goals of insolvency regimes diverge from State to State. In particular, each jurisdiction follows own policies on creditors' ranking in debtors' estates distribution, and in most insolvency regimes secured creditors enjoy the right to be paid prior to other creditors. This priority, which is necessary in developed economies based upon debt financing, certainly advantages sophisticated creditors and banks, who have the market power to request guarantees from their debtors. Many jurisdictions, however, alter pre-insolvency entitlements by prioritising claims of specific classes of unsecured creditors over other creditors' claims. In many jurisdictions, in particular, employee claims for unpaid wages and unpaid

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social contributions are prioritised over other creditors' claims (in some cases even over secured creditors), in order to protect the class of stakeholders that suffers most from a company's default. Additionally, many countries provide for specific social security schemes for protecting workers of insolvent undertakings from the risk of not receiving unpaid wages. These social security schemes are normally insurance-based, not tax-based, and in most cases they are financed by employers' contributions.

Several researches have classified employee priorities of most countries around the world.[1] What has not been considered so far is the fact that insolvency priorities and social security schemes are to be analysed as elements of a comprehensive system for protecting employees. Employee priorities and social security mechanisms could be combined in different ways: some countries grant employees a priority together with a social security scheme, while other countries protect employees only through insolvency priority or only through a social security scheme. Therefore, in order to understand how priority mechanisms operate, and to compare employees' priorities in different countries, it is necessary considering their interplay with social security mechanisms that pursue similar goals. In other words, employee priorities can not be understood without considering the whole social security environment these priorities are embedded in, and in particular other social security schemes aimed at protecting the same claims. Interestingly, this perspective disputes the separation between 'private law', dealing only with inter-private conflicts, as opposed to 'public law', dealing with state powers or top-down regulations and redistributions mechanisms. Although creditors' priorities are 'private law' instruments, they also serve a social function, which could be also fulfilled by typical 'public law' strategies, such as social security schemes.

This paper will analyse the interplay between employee priorities and social security schemes in three EU Member States (France, U.K. and Germany), which are classified as different 'types' of market economies. While the U.K. is the model for 'liberal market economies', Germany and France are classified as 'coordinated market economies'. It goes without saying that the level of employee protection depend on the whole welfare state and social security mechanisms, not only on the interplay between employees' ranking among other creditors and security schemes aimed at granting payment of due wages and contributions; furthermore, the impact of these two institutional settings also depend on contingent macroeconomic factors, such as the level of unemployment, growth tendencies or interest rate policies. Nevertheless, since these institutional settings (employee ranking and security schemes) aim at attaining the same specific goal at a 'micro-level' (paying due wages to employees) their interplay is sufficiently stringent and specific to be analysed as such. It will be shown that the interplay between employee priority and social security and its development in the last decades does not entirely reflect the classification of these countries as either 'liberal' or 'coordinated' market economies, and its explanation is still puzzling.

II. VARIETIES OF CAPITALISM AND EMPLOYEES' PROTECTION

The common tenet of all theories stemming from the 'varieties of capitalism' approach is that different countries show distinct institutional equilibriums, which shape in a unique way a specific form of 'market economy'. National political economies are analytically segmented into five 'institutional spheres': industrial relations, vocational training, corporate governance, inter-firm relations and workers – management relations.[2] Each country finds an own equilibrium among these institutional spheres, and different national equilibriums are clustered along the division between two ideal-types of

[1] See: Wang Huaiyu, 'An international comparison of insolvency laws', OECD 5th forum on Asian Insolvency Reform, 27-28 April 2006, http://www.oecd.org/china/38182541.pdf.; Janis Sarra, *Employee and pension claims during company insolvency: a comparative study of 62 jurisdictions* (Toronto, Carswell, 2008).

[2] Peter A. Hall & David Soskice, 'Introduction to varieties of capitalism', in (Hall & Soskice eds.) *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford University Press, 2001.

economies: 'liberal market economies' and 'coordinated market economies'. In the former, firms and other social actors coordinate their activities and reciprocal relations mostly by way of 'competitive market arrangements' and market transactions. By contrast, in coordinated market economies, firms and other social actors rely mostly upon non-market relationships and top-down regulation. In Germany (an model of coordinated market economies), for example, companies rely on long-term investments and require employers to enter into firm-specific engagement, which corresponds to a higher job stability and employment protection.[3]

The interplay and the combinations between different institutional settings is commonly characterised by reference to the concept of 'complementarity' between different institutions. In each national economy different institutional settings provide coherent incentives, reinforcing each other's efficiency and returns.[4] In this framework, institutions are considered 'complementary' to each other when the presence of one institution reinforces the efficiency and the returns of other institutions ('complementarity as reinforcement').[5] A consequence is also that different institutional settings, in order to work at best, should be coherent and should aim at attaining same goals, while contradictory incentives and non-coherent institutions risk being inefficient.[6] This approach has however triggered an intense debate. Other scholars, indeed, have suggested different definitions of 'complementarity' between institutional settings, according to which different institutions are 'complementary' when they 'mutually compensate for each other's deficiencies' and when the tendency of an institution is offset by other institutions or other social mechanisms ('complementarity as compensation').[7] Employee priorities and social security mechanisms aim at attaining the same goals and at satisfying the same social needs. Hence, the question arises as to whether, in a specific country, these mechanisms show some form of reciprocal complementarity, and whether this complementarity is a 'reinforcement' or a 'compensation'.

A legislator's decision on whether prioritising employees' claims is a telling example for a country's attitude towards free market and private bargains, having regard crucial economic relations such as labour contracts. These relations occur between employers and employees, who are in inherently unequal positions in the economic reality. Nevertheless, in the world of legal concepts, both parties are classified as 'legal subjects', with the consequence that the contract among them is a relation between formally equal and free parties, who exchange their commodities, workforce and money, in a 'free' market.[8] In other words, the formal equality of 'legal subjects' entering into a market transaction hides the reality of parties' inequality. The consequence is that social inequalities merely belong to the 'private' sphere and are, in this way, politically neutralised.[9] Employee priorities aim at re-balancing such intrinsically unequal transaction when the employer becomes insolvent, by disregarding the veil of parties' equality and the outcome of free market transactions. Therefore, one would expect that in 'liberal market economies', which are based upon free market and competition, no insolvency priorities exist. By contrast, 'coordinated market economies', which rely less on market transactions, are likely to

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[3] Hall & Soskice, supra note 2, 6.

[4] Hall & Soskice, supra note 2, 19 – 22; Peter A. Hall & Daniel W. Gingerich, 'Varieties of Capitalism and Institutional Complementarities in the Political Economy: An Empirical Analysis', 39 British Journal of Political (2009) 449

[5] Hall & Soskice, supra note 2, 7; Bruno Amable, *The Diversity of Modern Capitalism* (New York, NY, Oxford University Press, 2003).

[6] Peter A. Hall & Daniel W. Gingerich, 'Varieties of Capitalism and Institutional Complementarities in the Political Economy: An Empirical Analysis' (2009) 39 British Journal of Political Sciences, at 449.

[7] Colin Crouch, *Capitalist Diversity and Change*, Oxford, 2005, p. 50 and 'Welfare State Regimes and Industrial Relations Systems: The Questionable Role of Path Dependency Theory', in Ebbinghaus & Manow eds., *Comparing Welfare Capitalism*, (Routledge: 2014) at 105.

[8] The standard reference for this approach is: Karl Marx, *Das Kapital,* Volume 1 (London: 1863), ch. 4, section 3.

[9] Pietro Barcellona, *I soggetti e le norme* (Milan, 1984), 119 – 123.

be more open to creditors' protection by way of insolvency priorities. As we shall see hereunder, this classification does not entirely reflect reality, and reveals more complex, and puzzling, policy solutions and strategies.

III. CREDITORS' EQUAL TREATMENT V. LOCAL PRIORITIES

One of the main goals of insolvency law is addressing collective action problems faced by creditors if their debtors become insolvent. First of all, in order to avoid that creditors individually seize their debtors' assets, a common feature of all insolvency regimes is the general stay of individual creditors' claims. Secondly, to avoid 'hold-out' problems, rules on restructuring proceedings require that plans should be approved by a majority of creditors and are binding for all creditors. Therefore, insolvency rules aim at facilitating the efficient liquidation of a debtor's assets or the most value-enhancing restructuring plan, to the advantage of all creditors.[10] It goes without saying that, in this conceptual framework, insolvency rules should be neutral regarding pre-insolvency creditors' entitlements and that the main principle of assets' distribution should be the *par condicio creditorum,* or *pari passu*, according to which secured creditors enjoy priority over unsecured creditors and all unsecured creditors rank equally.[11]

Nevertheless, the reality of insolvency regimes of many countries is quite different. In many jurisdictions, indeed, insolvency rules curb pre-insolvency entitlements in order to protect certain classes of unsecured creditors, which are prioritised over other creditors.[12] The common argument to justify these solutions is that priorities, which trump pre-insolvency private bargains between debtors and their creditors, protect specific classes of creditors according to local political values and preferences.[13] These insolvency rules reflect political options as to the equilibrium between classes of creditors, regardless of their reciprocal market power.[14] By creating a creditor priority, in other words, politics takes revenge over the market. National insolvency regimes, however, rarely prioritise unsecured creditors over secured creditors. What usually happens is that certain classes of unsecured creditors enjoy a priority over other unsecured creditors, which simply shifts the economic burden of a firm's insolvency from one class of unsecured creditors to another.[15] It goes without saying that these decisions generate tensions between prioritised creditors and other creditors. Therefore, priorities should be justified by strong political reasons, as they have a distributional impact over different stakeholders of the company.

Nearly every country prioritises employees' claims for unpaid wages and social security contributions. This significant *ex post* alteration of pre-insolvency entitlements is politically justified by the specific nature of the claim and by the specific position of employees in a company. Employees' investment, indeed, is often 'firm-specific' and undiversified.[16] When an employer enters into insolvent liquidation, employees lose the financial resources aimed at supporting themselves and their family, unless they are

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[10] Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge Ma, 1986) p. 21 – 25.

[11] Roy Goode, *Principles of corporate insolvency law* (London, 2011) p. 235 – 240.

[12] Josè M. Garrido, 'The distributional question in insolvency: comparative aspects' (1995) 4 International Insolvency Review, 27, 31.

[13] Priorities follow local values and policy options, but do not necessarily protect local creditors only, as foreign creditors also can make use of these priorities: John A. Pottow (2005 – 2006) 'Greed and pride in international bankruptcy: the problems of and proposed solutions to "local interests"', 104 Michigan Law Review, 1911.

[14] See Federico M. Mucciarelli, 'Not just efficiency: insolvency law in the EU and its political dimension' (2013) 14 European Business Organization Law Review, 175 – 200.

[15] See José M. Garrido, *Preferenza e proporzionalità nella tutela del credito* (Milan, 1998), 32 – 36.

[16] See Henry Hansmann, 'When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy' (1990) 99 Yale Law Journal, 1749, 1764 – 1765; Goode supra note 11.

able to find promptly another job or a generous welfare state is in place supporting their needs. Therefore, prioritising employees over other creditors could be politically justified upon straightforward 'fairness' arguments.[17] Furthermore, when a company becomes insolvent, limited liability protects shareholders' private assets[18], while employees risk losing what is necessary for them to make a living. Therefore, when the employer is a company, employee priorities mitigate the incentives' distortions created by limited liability. When a jurisdiction prioritises employees' claims, however, the question arises as to the relative position of labour claims *vis-à-vis* other creditors. Comparative researches conducted in this field reveal that only a minority of jurisdictions grant employees the right to be paid prior to any other creditors including secured creditors, at least within certain limits or time periods.[19] In the vast majority of states, by contrast, employees are to be paid prior to other unsecured creditors only, while secured creditors have priority over employees and other unsecured creditors. In some countries, however, employees cede priority only to fixed or immovable securities, while 'floating charge' securities are to be paid after employees. Eventually, it is worth stressing that very few countries do not grant employees any priorities.

IV. EMPLOYEE PRIORITY AND OTHER SOCIAL SECURITY STRATEGIES

The historical development of employees' priority reveals that this measure was originally a substitute for lacking social security mechanisms. In Continental Europe, employees' priority was probably firstly introduced by a reform of Tuscany insolvency law in 1713[20], but their most famous version was in article 2104 of the *Code Napoleon,* which codified previous French customary law that was originally aimed at protecting domestic workers.[21] At a time when there was no welfare state, employees' priority was justified as a form of workers' social protection when their employers has become insolvent. During the XX Century, the development of welfare state strategies allows protecting employees also through insurance or tax-based schemes.

At international level, the International Labour Organization (ILO), the World Bank and UNCITRAL have addressed, albeit in different times and with different political goals, the issue of employees' priorities. The ILO convention on protection of wages stated clearly: *In the event of the bankruptcy or judicial liquidation of an undertaking, the workers employed therein shall be treated as privileged creditors either as regards wages due to them for service rendered during such a period prior to the bankruptcy or judicial liquidation as may be prescribed by national laws or regulations, or as regards wages up to a prescribed amount as may be determined by national laws or regulations.*[22] It is, however, up to each State to establish the 'relative priority' of those claims in relation to other creditors, having regard to specific domestic circumstances and, obviously, to domestic welfare state. This convention was adopted in 1949, an era where progressive and 'Keynesian' ideas were functional to the post-world war II reconstruction and were therefore shared values at the international level.

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[17] Lynn LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80 Va L. Review 1887.

[18] See: Lucian A. Bebchuk & Jesse M. Fried, 'The uneasy case for the priority of secured claims in bankruptcy' (1996) 105 Yale L. J. 857, 899; John Armour, Gerhard Hertig & Hideki Kanda, 'Transactions with creditors, in Kraakman, Armour, Davies, Enriques, Hansmann, Hertig, Hopt, Kanda eds., *The anatomy of corporate law* (Oxford, 2009) 2nd edition, 116 – 117; Stephanie Blankenburg, Dan Plesch & Frank Wilkinson, 'Limited liability and the modern corporation in theory and in practice' (2010) 34 Cambridge Journal of Economics, 821, 831.

[19] Huaiyu, supra note 1.

[20] Garrido, supra note 15, 22, fn 51.

[21] Garrido, *supra* note 15, 35.

[22] Article 11, Protection of Wages Convention, 1949 (No. 95) – adopted 1st July 1949, entered into force 24th September 1952.

In 2001, by contrast, in a completely different cultural and economic climate, the *Principles and Guidelines for Effective Insolvency and Creditor Rights System* of the World Bank addressed employees' priorities by giving much more weight to business' and banks' interests and to the need to protect the system of secured lending. The *Principles,* in particular, clearly stressed that '[a]*ny priority placed ahead of the secured party represents a substantial cost, which is generally transferred back to borrowers in the form of higher interest rates and transaction costs. Often the public policy represented by the priority (say, benefiting workers) receives a minor and occasional benefit at a substantial cost to the entire commercial system. Such priorities should be eliminated, reduced, and, where public policy concerns are compelling, addressed by other legal reforms that do not compromise the system for secured lending'*.[23] What emerges from the World Bank's *Principles* of 2001 is that, if politicians are pressed by 'compelling political concerns' to protect workers, they should preferably adopt other strategies rather than altering pre-existing entitlements deriving from private bargains between a debtor and his or her creditors. This strategy clearly advantages sophisticated creditors, such as banks or big corporations, which have sufficient market power to require securities from their debtors. Nevertheless, the suggestion of protecting employees by way of social security schemes, rather than through priorities, does not necessarily disadvantage employees. In this respect, it is interesting noticing what the UNCITRAL legislative guides to cross border insolvencies, issued in 2004, stressed: '*[s]ome priorities are based on social concerns that may be addressed more readily by law other than the insolvency law, such as social welfare legislation, than by designing an insolvency law to achieve social objectives that are only indirectly related to questions of debt and insolvency. Providing a priority in the insolvency law may at best afford an incomplete and inadequate remedy for the social problem, while at the same time rendering insolvency proceedings less effective*'[24]. Social security schemes, indeed, if their scope is sufficiently broad, may grant employees the possibility of recovering the whole amount of due wages and contributions. By contrast, employees' priorities, by placing this burden onto other creditors' shoulders, do not grant the same certainty when the employer's assets are not sufficient.

Furthermore, these mechanisms are strictly intertwined. Once a social security scheme pays due wages and contributions, it can subrogate employees' rights. Therefore, social security schemes' claims in a debtor's estate rank equally to workers' claims. Employees' priorities, therefore, grants the schemes and their contributors a chance of recovering the amount paid. This reinforces the viability of social security schemes, but, ironically, it also places the ultimate burden onto other unsecured creditors' shoulders. We shall see hereunder, that this interplay is crucial to understand the political economy of employee priorities.

In the European Union, a preference for social security mechanisms over priorities can be read between the lines of the Directive on Employees' Protection[25], according to which Member States should put in place mechanisms that guarantee the payment of employees' outstanding claims relating to their employment, by establishing a 'guarantee institution' for securing 'payment of employees' outstanding claims resulting from contracts of employment or employment relationships'.[26] Member States, indeed, can exclude certain employees' claims from social guarantee's protection *'by virtue of the existence of other forms of guarantee if it established that these offer […] a degree of protection equivalent to that resulting from this directive*'[27]. What is extremely interesting is that the Directive requires a factual comparison on

[23] World Bank Principles, paragraph 58. See also paragraph 147: "*There is an observable tendency to increase the categories of debts enjoying such priority, for example by giving this status to each new form of tax or duty or each additional employee entitlement. Indeed, in countries with a strong tradition of worker protection there is sometimes an acute tension between the provision of safeguards for employees against the consequences of their employers' insolvency and the need of the bankruptcy trustee to keep the business viable and, if possible, restore it to profitability, which may involve a sharp reduction in the workforce.*"

[24] UNCITRAL legislative guide, paragraph 68.

[25] Council Directive 80/987/EEC on the approximation of the laws of Member States relating to the protection of employees in the event of the insolvency of their employer. This directive was amended several times and eventually codified by Directive 2008/94 of the European Parliament and the Council.

[26] Directive on Employees' Protection, Article 1(1).

[27] Directive on Employees' Protection, Article 1(2).

whether a certain institutional setting is as effective in protecting employee as the guarantee foreseen by the directive. The U.K. regime is a telling example for alternative protections in specific cases. The U.K. National Insurance Fund, indeed, protects employees' claims for due wages with the exception of seamen' claims, which are only covered by maritime lien. This is a security created by operation of law over a ship and her cargo[28], granting seamen a priority over other creditors. The question arises as to whether these two strategies (social security v. priority) produce equivalent effects for employees. In this regard, the European Commission stressed that this lien 'may not always offer a degree of protection equivalent to that of the U.K. National Insurance Fund'.[29] Implicitly, the Commission argues that employee priorities are not as effective as social security schemes, and that Member States can not replace the guarantee foreseen by the Directive on Employees' Protection with insolvency priorities.

V. A COMPARATIVE ANALYSIS OF FRANCE, U.K. AND GERMANY

EU Member States can differently combine employees' ranking among other creditors and social security schemes according to own political agenda and with the aim of pursuing own social and economic goals. As we have stressed in the introductory section, employee priorities and social security schemes should be analysed as a single strategy for protecting employees when their employer becomes insolvent. These different combinations mirror domestic social structures and are to be assessed as elements of a specific country's political economy. In this section, I will compare and contrast the regimes of employees' priority and social protections in three Member States of the European Union: France, U.K and Germany. These countries balance employees' priorities and social securities in different manners. These three countries, however, have a common element: they have implemented the Directive on Employees' Protection. The existence of a common element (a social security scheme) allows to compare and to contrast these States' strategies regarding employee priorities.

1. France

In France, labour protection is particularly effective. If an employer enters into an insolvency proceeding, all claims deriving from labour contracts are protected by both a general privilege and a super-priority that trumps secured creditors' claims.[30] Interestingly, both mechanisms were put in place in the same year (1973).

The super-priority has a broad scope, as it protects any employees' claims towards their employers and any indemnities compensating them for a job loss. A super-priority also protects any claims for paid leaves[31]. Theses superpriorities, however, are capped at a monthly amount of at least twice the amount used to calculate social and pension contributions. Since the monthly amount for calculating social pensions in 2015 is €3,170,[32] the value of employees' super-priority in 2015 is at least €6,340. A government regulation can increase and update this amount.[33] Employees' claims exceeding the

[28] International Convention on Maritime Liens and Mortgages, 1993, articles 4 and 5.

[29] Report from the Commission to the European Parliament and the Council on the implementation and application of certain provisions of Directive 2008/94/EC on the protection of employees in the event of the insolvency of their employer, 28.2.2011, COM (2011) 84 Final, 3.

[30] Article L 625-7 Code de commerce

[31] Article L143-11 Code de travail.

[32] Ministre des affaires sociales, de la santé et des droits des femmes - ministre de l'agriculture, de l'agroalimentaire et de la forêt - secrétaire d'Etat chargé du budget: Arrêté du 26 novembre 2014 portant fixation du plafond de la sécurité sociale pour 2015.

[33] Article L143-10 Code de travail.

monthly amount of the super-priority enjoy a forth-rank 'general privilege' on movable assets[34] and a second-rank 'privilege' on immovable assets[35] of their insolvent debtor. It is worth reminding that in France, like in other South European countries[36], creditors' priorities have proliferated over the last decades and, in some cases, they have probably reached a 'saturation point' beyond which preference creditors are scarcely protected or not protected at all.[37] By granting a 'super priority', therefore, the French legislator tried to effectively protect employees, by taking into account that 'normal' priorities would not be effective and would not grant workers a real possibility to recover their claims.

Besides these priorities, employees are also protected by an insurance mechanism based upon employers' contributions.[38] In particular, all employers have to insure the payment of all due salaries, including pension and insurance payments, when they become insolvent. This insurance mechanism is implemented through a special entity, created for that specific purpose by the national employer organisations, in agreement with the labour minister[39]. The insurance fond protects any contracts of employment, including part-time contracts, fixed-term and temporary contracts. The insurance fond guarantees any due payment without any time limitation, up to a maximum amount that is updated every year (in 2015 such amount is €76,080). When this insurance indemnifies employees, it is subrogated in the same rights of protected employees and enjoys super-priority *vis-à-vis* other creditors. The priority, therefore, is a crucial element of this complex mechanism for protecting employees, as it allows the insurance fond (and indirectly its contributors: the employers as a class) to recover what they have paid for protecting employees' claims. The ultimate burden of this mechanism is hence placed upon other unsecured creditors' shoulders.

2. *United Kingdom*

In the United Kingdom creditor priorities are almost unknown, and insolvency rules respect pre-insolvency entitlements and private free-market bargains between a debtor and their creditors. The few exceptions to this general principle are not comparable with the complex web of privileges of Latin countries. In this regard, it is worth reminding that in 2002 the Crown preference for unpaid taxes was also abolished.[40] This picture is coherent with the common classification of U.K. as a 'liberal market economy', relying on free market mechanisms for allocating social resources and for striking the balance among social actors.

Employees' claims for due wages are however prioritised over other unsecured creditors, while fixed secured creditors and insolvency practitioners' fees enjoy priority over employees. This protection covers any employees' due wages, including holiday remuneration and related rights[41], for a period of four months prior to the starting day of the insolvency proceeding.[42] This priority is however capped at

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[34] Article 2331 Civil code.

[35] Article 2375 Code civil (former 2104).

[36] Garrido supra note 12, 39 – 40.

[37] Garrido supra note 12, 36.

[38] This insurance mechanism was also created in 1973: Loi 73/1194, as amended. See now Article L143-11-1 Code de travail.

[39] Article L143-11-4 Code de travail (Association pour la Gestion du régime d'assurance des créances des Salaires).

[40] Enterprise Act 2002 S. 251.

[41] Insolvency Act 1986, Schedule 6, Category 5. Such priority, however, dates back to the Preferential Payments in Bankruptcy Amendment Act 1897, S. 2.

[42] Four different 'relevant dates' can trigger this priority, according to the specific procedure: the date on which the company entered administration, the date on which a voluntary arrangement takes effect, the date of the appointment of a provisional liquidator or the date of the winding-up order: Insolvency Act 1986, s. 387.

maximum amount of £800. This amount has remained unchanged since 1986[43] and, at the moment (in 2015), it is a quite low threshold. Residual claims above this threshold are only protected within the amount of the 'prescribed part' of debtors' estate, which should be made available for unsecured creditors.[44] Hence, we can conclude saying that, although an employee priority still exists in the U.K., it only marginally alters pre-insolvency free market bargains.

In 1986, however, the same nominal value of £800 had a much higher purchasing power than today. Calculating the relative value of past amount of a currency to actual ones is accurate only over short periods, since it depends on the inflation rate and on the bundle of goods that a certain amount of money is aimed at purchasing. We can use a standard calculator of currency relative value, to have a rough order of magnitude of the purchase power of a nominal value of £800 in 1986.[45] This calculator reveals that in 2014 the relative value of 1986's £800 ranges from £1,882 to £3,494 and that the historic standard of leaving (which is probably the most relevant value) is about £2,000. All U.K. governments since 1986 (that is to say: tory, labour and coalition governments), therefore, have implicitly decided not altering this nominal amount and, as a consequence, to lower the real value of the employee priority up to a quite low amount.

On the other hand, the U.K. has implemented the Directive on Employees' Protection by way of the Employment Rights Act 1996, which codified previous legislation.[46] If an employer becomes insolvent, the National Security Fund must pay debts owed by the employer to the employees, including (if there was no unfair dismissal and the employer has given proper notice): arrears for a maximum of eight weeks at a rate of £464 a week; unused holiday pay, with a maximum of six weeks ad up to a weekly limit of £464; a statutory redundancy payment. The National Security Fund is subrogated to the rights of employees and, therefore, it enjoys the same preferential status within the limit of £800[47]. Interestingly, both employers and employees, not only the former, contribute to the National Security Fund. The Insolvency Service protects any employment contracts, excluding merchant seamen (who, as we have seen above, are supposed to be sufficiently protected by maritime liens).[48] Furthermore, this protection does not cover masters or members of the crew of fishing vessels when their payment is a share of profits or gross earnings of the vessel.[49]

3. *Germany*

Germany has a reputation for strong social security mechanisms and worker protection and is considered as the typical example of coordinated market economies. Having this in mind, one would expect that German employees enjoy both a priority for claims related to due wages and a strong social security. Nevertheless, the German Insolvency Act 1994, which entered into force in 1999[50], abolished

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[43] Insolvency Proceedings (Monetary Limits) Order 1986, SI 1986/1996, art. 4.

[44] Insolvency Act 1986, S. 176 .

[45] I use the calculator created by Lawrence H. Officer (University of Illinois at Chicago) and Samuel H. Williamson (Miami University): http://www.measuringworth.com/ukcompare/relativevalue.php.

[46] Employment Rights Act 1996, S. 166 – 169.

[47] Employment Rights Act 1996, S. 167(3)(a)

[48] Employment Rights Act 1996, S. 199(4) and S. 199(5).

[49] Employment Rights Act 1996, S. 192(2).

[50] *Insolvenzordnung* (InsO), 5.10.1994, BGBl. I 2866, as amended.

all creditor priorities, including employee claims for due wages, with the sole exceptions of a limited list of statutory liens.[51]

The lack of employee priority is compensated by a social fund collectively financed by German employers on insurance base[52]. This social fund covers outstanding employees' claims related to a period of three months prior to the decision to open an insolvency proceeding, including wages, holiday pay, bonuses and pension contributions (*Insolvenzgeld*). This fund protects any employees having outstanding pay claims, including part-time employees, employees with a fixed-term or temporary contracts, regardless of whether they are also protected by statutory unemployment insurance coverage. In 2004, the maximum amount of *Insolvenzgeld* was capped at the level of the monthly unemployment insurance payment.[53] After a payment, the social fund subrogates employees' position vis-à-vis the employer and, therefore, it does not enjoy any priorities and is reimbursed together with other unsecured creditors. Therefore, the fund can only partially recover from the debtor's estate what it paid to employees and the burden of reimbursement is primarily on the fund's contributors.

A retrospective analysis, however, reveals that before 1994 employees were highly protected.[54] In 1974, indeed, former insolvency rules of West Germany (*Konkursordnung*)[55] were amended to introduce employee super-priority, similarly to France. In particular, employees' claims for due wages of the last six months before their employers' insolvency were prioritised over other creditors, including secured creditors.[56] In the same year, the West German Parliament introduced the guarantee mechanism protecting employee's claims for due wages.[57] German employees' protection, therefore, followed the same path of France at just one-year distance, and between 1974 and 1999 German workers enjoyed an extremely strong protection, thanks to the combined operation of both a super-priority and a guarantee fund. In 1994, however, the Parliament of unified Germany, by reforming the insolvency law[58], repealed all insolvency priorities, including employees' priority for due wages. This granted the *pari passu* and creditors' equality in insolvency proceedings to their full extent.[59] Another consequence is that the liquidator can avoid any payments that were made short time before filing for insolvency[60]. The official motivations to the Insolvency Act maintain that any creditor priorities are ultimately based upon arbitrary political decisions and, therefore, are not logically justified.[61]

This issue was however intensively debated and the question arose as to whether this strategy would have harmed workers facing their employers' insolvency. In 1992, while debating the reform proposal, the main opposition party (SPD) agreed upon repealing other creditor priorities, with the sole exception

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[51] Andreas Piekenbrock, 'Insolvenzprivilegien im deutschen, ausländischen und europäischen Recht' (2009) *Zeitschrift für Zivilprozessrecht*, 63.

[52] *Sozialgesetzbuch III* 1997, §165.

[53] *Sozialgesetzbuch III* 1997, §167.

[54] See: Piekenbrock supra note 51, at 84.

[55] *Konkursordnung* (KO) Deutsches Reichsgesetzblatt Band 1877, Nr. 10 Seite 351 – 389

[56] *Konkursordnung* § 59(1) No 3-a, § 60(1), and §61(1) No 1-a, introduced by the act 17th July 1974, BGBl I, 1481, article 2 §1 No 1-b.

[57] *Konkursausfallgeld* AFG 1974

[58] Insolvenzordnung (InsO), entered into force on 1st January 1999

[59] The only exception is related to employees contract signed by the provisional administrator: *InsO* §55(2)

[60] *InsO* §130: employees' wages paid within three months prior to the opening of the insolvency proceeding are avoidable, if the employees were aware of the insolvency.

[61] German Parliament [*Deutscher Bundestag*], 12 legislative period, *Drucksache* 12/2443, 15.04.92, at 90.

of employee priorities.[62] Two years later, however, the SPD accepted the idea of repealing employee priorities also, arguing that '*in practice, in at least ¾ of cases such priorities are only on paper and in the residual ¼ of cases these priorities are effective only in few cases*', and that other social security strategies, such as the *Insolvenzausfallgeld, 'and other rules'* (maybe referring to the whole welfare state) provide for a better employee protection.[63] Similarly, the official motivations to the Insolvency Act argued that the *Insolvenzgeld* was a sufficient protection for workers. The problem, however, was – and still is – that the *Insolvenzgeld* only covers the payment of last three months of due wages, while the former superpriority protected due wages of the last six months before insolvency. Nevertheless, the official motivation to the Insolvency Act argued that this gap of three months is of scarce practical relevance, without further explaining why this is the case.[64] We can conclude arguing that in 1994 the German legislator intentionally created a discontinuity in insolvency law development with regard to creditors and employees' protection.

VI. CONCLUSIONS: EMPLOYEE PROTECTION AND SOCIAL COALITIONS

The comparative analysis undertaken in this work reveals significant divergences among France, U.K. and Germany. All these countries provide for a social security scheme that protects employees' claims for due wages and contributions, although within time and value limitations that vary from State to State. Their strategies, by contrast, diverge significantly regarding the option of protecting employees also by way of insolvency priorities; consequently, employee priorities and social securities are combined differently in different jurisdictions. Furthermore, their strategies have changed over the last thirty years. What is clear is that the 'variety of capitalism' approach reveals a quite limited heuristic capacity, at least with regard to the strategies for protecting employees against their employer' insolvency. It is useful summarise the results of the comparative analysis.

France cumulates an employee super-priority (within a quite high threshold) and a security scheme. The super-priority significantly alters pre-insolvency bargains and disregards the outcomes of free market transactions. Both the priority and the security scheme put the costs of employee protection first on the employers (who contribute to the social security scheme) and ultimately on other creditors' shoulders (through the security scheme's subrogation in employees' rights). This is a case of 'complementarity as reinforcement': two institutional settings (the social security and the priority system) aim at the same goal and mutually reinforce each other. France's policy has remained unaltered since its introduction in 1973.

The U.K. regime also cumulates a priority and a social security scheme. The employee priority, however, is not as effective as their French counterparts: employees' claims are only prioritised over unsecured claims and floating charge securities, and this priority is capped at a low amount (£800). U.K. law, therefore, does not significantly alter pre-insolvency free market bargains between debtors and creditors, which is coherent with the common classification of the U.K. as 'liberal market economy'. Since this employee priority is quite modest today, the interplay between insolvency rules and social security scheme can be better classified as a type of 'complementarity as compensation', where an institutional setting compensate other institutions' weaknesses. Nevertheless, we have seen that the nominal value of the priority has not been altered since 1986 and that its todays' real value is probably less than half than it was originally. Therefore, in 1986 the employee priority was much more effective (although not as effective as the French or German regime at that time) and employees were better protected. By not

[62] See the arguments of Mr Pick MP, German Parliament [*Deutscher Bundestag*] 12 legislative period, 94 Sitzung, 3.6.1992, at 7774.

[63] Mr Pick MP, German Parliament [Deutscher Bundestag] 12 legislative period, 222. Sitzung. Bonn, 21.4.1994, at 19119

[64] German Parliament [Deutscher Bundestag], 12 legislative period, *Drucksache* 12/2443, 15.04.92, at 90: "*Für die Arbeitnehmer sind keine sozialen Härten zu erwarten, da für die Lohnausfälle der letzten drei Monate vor der Eröffnung des Insolvenzverfahrens Konkursausfallgeld gezahlt werden soll; ältere Rückstände sind selten von Bedeutung*".

altering this nominal value, U.K. governments of any colours – whether intentionally or not – decreased the real value of employee priority.

In Germany, eventually, employees do not enjoy any priority and are only protected by a social security scheme based upon employers' contributions. Curiously, the German model between 1974 and 1999 was very similar to today's French employees' protection regime, as it cumulated a super-priority and a guarantee fund. The policy goal of the post-1999 German insolvency regime is to canalise employees' protections into one sole strategy that socialises costs among the employers as a class. On the other hand, pre-insolvency entitlements are not altered and insolvency law does not redistribute value among unsecured creditors. Therefore, the interplay between insolvency rule and social security scheme is clearly a case or 'complementarity as compensation', where the social security scheme compensates the lack of employees' priorities. By contrast, before 1994 German institutions for protecting employees' claims for due wages were reinforcing each other.

This comparative analysis is briefly summarised in this chart:

Country	Employee priority	Social security	Complementarity
France	Yes (strong)	Yes (strong)	'Reinforcement'
U.K.	Yes (weak)	Yes	'Compensation'
Germany	No	Yes	'Compensation'

Both U.K. and Germany, therefore, have undertaken a similar path towards reducing employee priority: by not altering the nominal value of the priority threshold in the U.K. and by opting for a significant institutional discontinuity in Germany. These developments seem confirming the idea that institution-building is relatively independent from the existence of any forms of institutional complementarity.[65] The logic of the France regime, by contrast, has remained unaltered since 1973.

The institutional settings in these countries as to 1986 is summarised in this chart:

Country	Employee priority	Social security	Complementarity
France	Yes (strong)	Yes (strong)	'Reinforcement'
U.K.	Yes	Yes	*Unclear*
Germany	Yes (strong)	Yes	'Compensation'

To understand these developments, it is useful stressing that social systems are shaped by dynamic interactions and coalitions of social forces and stakeholders.[66] In particular, the interplay between employee priorities and social securities governs the interests of four classes of social actors: banks (which are normally secured creditors), employees, other unsecured creditors and employers. The security fund subrogates employees' rights and is protected by the same priority. Therefore, when a super-priority is in place, like in France since 1973 or in Germany before 1999, the security fund and its contributors are likely to recover a significant portion of the amount paid and other unsecured creditors carry the ultimate cost of employee protection. Since French and German security schemes are financed through employers' contributions, the institutional setting existing in France, and that existed in Germany until 1999, reflects a coalition between employees and employers. By contrast, in the post-

[65] Wolfgang Streeck 'Explorations into the origins of nonliberal capitalism in Germany and Japan' in Streeck & Yamamura eds., *The origin of nonliberal capitalism* (Ithaca, 2001) 1 – 38. See also Martin Höpner, 'What connect industrial relations and corporate governance? Explaining institutional complementarity' (2005) 3 Socio-Economic Review, 331, 346, arguing for an increasing 'shareholder orientation' of German capitalism since the '90s.

[66] Aguilera & Jackson 'The cross-national diversity of corporate governance: dimensions and determinants' (2003) 28 The Academy of Management Review, 459.

1994 German regime, pre insolvency entitlements (such as privately negotiated securities) are fully protected, and employees are only covered by a social security scheme. When the social security scheme subrogates employees' rights it will rank equal to other unsecured creditors and, therefore, it is likely to carry the ultimate cost of employee protection. This institutional setting protects secured creditors and employees and reflects a coalition between banks and employees.[67]

In the U.K., employee priority is capped at a quite low amount; hence employees are mostly protected by the intervention of the National Security Fund (whose intervention is also capped). The National Security Fund, however, is financed by contributions of both employers and employees, differently from French and German social security schemes, which are financed only by employers. Therefore, the U.K. system protects banks (secured creditors) and shares the residual burden between employers and employees. This institutional settings, in other words, reflects a much more complex coalition between social actors and reveals the weak position of labour, at least in comparison to France and Germany.

[67] Germany, in other words, revealed its profound nature of being a 'bank-based system': Ruth V. Aguilera & Gregory Jackson, supra note 66, 447.