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The protection of workers' claims in the event of the insolvency of their employer

From civil law to social security

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A particularly unhappy consequence of business failure – no rare occurrence in the present-day world – is the inability of insolvent enterprises to pay the wages due to their employees. The problem is one that has preoccupied lawmakers for many years, and has not escaped the ILO's attention. There is an international labour standard – Article 11 of the Protection of Wages Convention, 1949 (No. 95) – relating to the matter, and since 1985 the Governing Body of the ILO has regularly discussed the possibility of adopting new standards on the subject with a view to supplementing and improving the existing protection.[1]

I. Bases of protection for workers' claims in the event of the employer's insolvency

The principle that a worker's remuneration is sacrosanct – a fundamental principle of labour law – can be seriously threatened by the insolvency of the employer, a situation in which the wage earner risks losing not only his job but also part of the wages due to him. Although a firm's other external creditors may find themselves in a situation similar to that of the workers, who are its internal creditors, it is widely accepted that the latter – for understandable reasons – deserve special protection. In the first place, the wage has certain characteristics comparable to alimony, since in most cases a worker depends on his wage to support himself and his family. Secondly, the protection which can be given to wage entitlements to some extent corrects the adverse imbalance which affects the worker as a result of the employer's obligation to pay the wage only after the worker has carried out his obligation to perform his work *(postnumeratio)*; the implication of the payment of wages only once the work has been done is that the worker makes an advance of his services to the employer, while the latter does not offer the worker any

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corresponding legal guarantees of payment, by contrast with the case of other creditors, such as suppliers, who can claim payment in cash for the goods they supply, or with that of financial institutions, which can demand guarantees *in rem* or security by third parties as a condition for granting credit. Thirdly, unlike other "money" creditors, who generally have many debtors (so that non-payment by one will at the most cause them to lose only a single credit amongst the hundreds or thousands in their loans portfolio), the worker, being a "service" creditor, has only one debtor, his employer, on whom he depends both for his wage and for employment. Thus the worker finds himself in a particularly disadvantageous and precarious position in the event of the insolvency of the employing undertaking. Lastly, while the possibility of the employer's insolvency is part of his business risk, it would appear unjust, should the insolvency occur, for the worker to suffer the consequences of that risk as regards his claims for services rendered, especially since this would mean admitting that he should bear the consequences of the failure of his employer's management even though he played no part in that management.

For these reasons, most national legislations have established special methods for protecting service-related claims in the event of the employer's insolvency. Although a variety of such methods might be used, only two are in fact widely applied at the present day. One consists in treating service-related claims, in whole or in part, as preferential, so that, in the event of the employer's insolvency, payments to the worker are given priority over the claims of other creditors. This is a very old method since its legal basis is recognised in civil law, whence it was taken over into labour legislation.

The second method is of much more recent origin, dating from the late 1960s, just before the latest economic recession which, as we know only too well, resulted in the closure of numerous businesses, many job losses, and widespread non-payment of debts, including service-related debts. Under this method the payment of the worker's service-related claims is guaranteed by a third party, an institution, which takes over the insolvent employer's liabilities if the worker does not succeed in recovering from the employer's assets what is due to him. The guaranteeing institution, usually known as the "wage guarantee fund", does not come within the scope of the code of obligations nor within the scope of the individual contract of employment; it is akin to social security, from which it has borrowed some of its salient features.

The first part of this article examines the main characteristics of the preferential protection of wages. The second part discusses the shortcomings of this method and other considerations that have led many countries to set up wage guarantee funds. The third and final part of the article discusses such funds.

II. Preferential protection of workers' claims

The institution of preferential treatment is closely related to the proceedings introduced to deal with insolvency situations, i.e. situations in which a debtor suspends payment of his debts. Although the definition of suspension of payments varies from one national legislation to another, practically all provide that there is suspension of payments if a debtor's available assets are not sufficient to meet payments when they fall due. Insolvency proceedings generally have certain common characteristics:

(a) their object is to restore an enterprise's financial soundness, or failing this, to wind it up by means of an order for the transfer or sale of its assets;

(b) they place all creditors of the common debtor on an equal footing *(par conditio creditorum)*, treating them collectively as a "pool" in which their claims and rights are merged. The purpose of insolvency proceedings, which are essentially *collective proceedings*, is to avoid individual enforcement actions, which involve the risk that one or more creditors may obtain personal advantages to the detriment of the rest.

The real importance of preferential treatment becomes evident in cases where the undertaking against which insolvency proceedings are instituted is to be liquidated and where the goods constituting its assets are to be sold. According to the equality principle *(par conditio)* the proceeds of the sale of such goods (which almost always amount to less than the firm's liabilities) must be distributed among the various creditors in proportion to their claims. However, this rule is subject to many exceptions in the law of different countries. For varying reasons, some creditors enjoy priority or preferential treatment over others. Hence, their claims are not merged in the collective "pool", and payment of their claims may be demanded in full before the other creditors, with pooled claims, can obtain payment, or even part payment, of theirs. For example, claims secured by some right *in rem*, such as a mortgage or lien on specific property, rank ahead of the others; they are often segregated and not liable to pooling, for they can be met by individual action by the creditors holding the liens or mortgages. Other claims also enjoy preference by reason of the nature of the debt (for example, maintenance claims, funeral expenses, or expenses incurred in connection with terminal illness) or by reason of the status of the creditor (for example, claims by tax authorities or by a social security institution). In the light of the considerations that justify the protection of service-related claims the legislation of a large majority of countries also grants preference to such claims or at least to certain categories of them. Indeed, the Protection of Wages Convention, 1949 (No. 95), provides that, 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 or as regards part of such wages; the wages constituting a privileged

debt shall be paid in full before ordinary (non-privileged) creditors may establish any claim to a share of the assets.

Origins and development

The preferential protection of workers' claims was recognised by the law of many countries even before the basic principles of labour legislation began to be established. For example, it was provided for in the French Civil Code (Napoleonic Code) as long ago as the early nineteenth century, and in this respect the code was not making new law but simply taking over practices long established in French law. The influence of the Napoleonic Code on the civil law of the time is well known and explains why the law in many other countries followed its example and likewise laid down the principle of the preferential protection of service-related claims at least as far as certain classes of such claims were concerned. Under the Napoleonic Code only the wages of domestic servants qualified for preferential treatment, but by amending legislation enacted in 1836 it was extended to cover workers and employees, commercial travellers, theatrical performers and other categories of wage earners.

Once it had gained recognition in civil law, preferential treatment of service-related claims was gradually extended and strengthened as the various nations came to establish their labour legislation. Hence the many provisions relating to this treatment in various laws concerning individual employment contracts, and in particular in the sections dealing with the protection of wages. Whereas in the early stages the preference applied only to wages *stricto sensu*, it eventually came to cover various wage supplements as well. Moreover, the legislation was gradually amended by successive enactments that ranked service-related claims ahead of those of other (likewise preferential) creditors.

Extension of preferential treatment for service-related claims

The extension of preferential treatment for service-related claims to debts other than "wages" strictly defined was one of the first results of the acceptance into labour law of the concept of preferential treatment in civil causes. Nowadays the preference quite commonly applies not only to wages but also to other employment claims, such as paid leave, Christmas or year-end bonuses, compensation in lieu of notice or severance pay. Examples of provisions extending such preferential treatment occur in the legislation of Argentina, Belgium, France, Japan, Mexico, Switzerland, the United Kingdom, the United States and Venezuela.

The broader interpretation of "service-related claims" represents, of course, a major step forward, for usually, if a firm suspends payments, the debts owed in respect of wages proper are taken to be only those due for the most recent working period (generally the last fortnight in the case of

workers paid at a daily rate, or the last month in the case of employees paid by the month), whereas in many cases the firm also owes all the service-related payments customarily made at longer than fortnightly or monthly intervals, e.g. commissions (normally payable quarterly), paid leave allowances, the Christmas bonus or other similar bonuses (commonly paid once or twice a year) and, above all, severance pay, which is paid only on termination of the contract of employment and may represent a substantial sum. It follows that in most cases it is not the wages as such but these supplements that form the substance of the service-related debts. Accordingly, the extension of preferential treatment to these debts unquestionably has considerable practical implications.

Limits of the protection

Nevertheless, in most countries preferential treatment does not safeguard all the service-related claims but only a proportion of them. It may cover only the wages earned during a period preceding a reference date, or a specified sum of money, or else – as is more often the case – a combination of the two. These limitations are recognised by the Protection of Wages Convention, 1949 (No. 95), which provides that the modalities of its application are to be determined by national laws. For example, in India the wages entitled to preferential treatment are those due for the last two months preceding the reference date, in Canada and the United States those due for the last three months, in Trinidad and Tobago and the United Kingdom those due for the last four months, in Argentina, France, Portugal, Switzerland and Uruguay those due for the last six months, and in the Federal Republic of Germany and Mexico those due for the last 12 months. The reference date also varies from one country to another: it may be the date on which payments are suspended, or the date on which insolvency proceedings are instituted, or the date on which the court declares the firm bankrupt or orders it to be wound up, or else the date of termination or suspension of the employment relationship. Similarly, the maximum amount of money payable may vary, for it is usually subject to readjustment; in France and Spain, for example, the amount is determined by reference to the standard minimum wage, which tends to fluctuate with the cost-of-living index. In other countries it is fixed in nominal terms. In 1985, for example, the amount so fixed was $2,000 in the United States, £800 in the United Kingdom and 300,000 Belgian francs in Belgium. In some countries the cash amount payable in these circumstances has not been adjusted for many years, and as a consequence preferential treatment of service-related claims has lost a good deal of its practical value. In Canada, for example, the amount has not been changed since 1949 when it was fixed at C$500. Originally equivalent to three months' pay, by 1984 inflation had reduced its value to barely six or seven days' pay.

According to some authors, the reason for this limitation is that legislation ought to protect only the proportion of the claim corresponding to maintenance or *subsistence*. It has been argued, furthermore, that the parties to insolvency proceedings include, in addition to the employees, other creditors for whom allowance should be made as well and who would suffer serious prejudice if the claims of the preferential creditors were not subject to some limitation. It should be noted, however, that in insolvency proceedings other kinds of preferential claims may be lodged that are not usually subject to limitations comparable to those applicable to service-related claims. A further point to note is that in some countries, e.g. Brazil, the Dominican Republic, Italy, Panama and Peru, the law does not set any limit to service-related claims qualifying for preferential treatment, though admittedly this situation is the exception rather than the rule.

Ranking of service-related claims for purposes of preferential treatment

The preferential treatment of service-related claims means that, as regards payment, employees rank ahead of the other creditors of the common debtor. Nevertheless, the parties to insolvency proceedings generally include, in addition to the employees, other creditors to whose claims, whether against the debtor's assets in general (general preference) or against some particular asset or group of assets of the debtor's (special preference), the law likewise accords a certain preference. Since the law makes provision for higher-ranking claims to be settled before lower-ranking ones, it is a matter of crucial importance to employees not only that their service-related claims should qualify for some kind of preferential treatment but also that their preferential claims should be ranked as high as possible. In this respect Convention No. 95 does not offer any guidance: while it says that "the relative priority of wages constituting a privileged debt and other privileged debts shall be determined by national laws", it does not specify a minimum ranking for service-related claims. The Napoleonic Code, it may be noted, in according a general preference to wages, ranked them in fourth place, after court expenses, funeral expenses and expenses of the debtor's terminal illness. This principle was later taken over by the civil law of many but not all other countries that followed the French Code: for example, in the Portuguese Civil Code service-related claims were ranked tenth, and in the Italian Code fourteenth.

Neither the Napoleonic Code nor the other civil codes went so far as to accord to workers a preference over creditors having a special preferential right enforceable against some particular property of the debtor's. Nor did they make any provision for service-related preferential claims to be pursued in opposition to those of creditors to whom the debtor had given security *in rem*, such as liens or mortgages. Moreover, in a considerable number of countries the preference given to service-related claims was reduced, being

subordinated in many instances by tax legislation to preferential claims by the State in respect of taxes or charges owed by the insolvent employer.

Whatever justification may be offered for such provisions, the fact remains that they seriously prejudice employees' claims, for in bankruptcy cases it commonly happens that many of the debtor's assets are subject to a lien or mortgage. Furthermore, experience shows that very frequently the biggest creditor is the State, with the consequence that little or nothing is usually left for distribution to the lower-ranking creditors after its claims have been settled.

This explains why labour legislation has gradually evolved in the direction of strengthening employees' preferential status vis-à-vis the State. One example is the Italian law of November 1969, as subsequently amended in July 1975, whereby service-related preferential claims – which until then had been ranked fourteenth – were given first rank. Similarly in the United States, where formerly tax authorities' claims ranked ahead of employees' claims, the order of priority was reversed by the Federal Bankruptcy Act of 1978. The Danish law reform of 1969 went even further, in that all preferences were abolished with the exception of workers' preferential claims. In many, perhaps most, countries service-related claims now receive preferential treatment over all other claims, although in some countries, e.g. India, Kenya, Nigeria, Pakistan, Singapore and the United Kingdom, they rank equally with claims by tax authorities, while in a few countries, e.g. Cameroon, the Dominican Republic, Egypt, Japan and Sweden, they are still subordinated to debts to the State.

Super-preference

Finally, there are legislative enactments that give employees' claims preference even over creditors holding security *in rem* in the form of mortgages, liens or floating charges – in other words, a "super-preference". The first country to take this step was Mexico, under its 1917 Political Constitution. Similar measures were adopted by a number of countries in Latin America, e.g. Brazil, Ecuador and Peru; in Europe, e.g. France and Spain; in Africa, e.g. Cameroon, Chad and Mali; and in Asia and the Pacific, e.g. the Philippines. However, this super-preference may have disruptive effects on the commercial credit system, for there is no doubt that the value of securities *in rem* offered by firms to financial institutions will fall when there are other creditors – the employees – whose claims in such cases would rank ahead of those of the institutions. This may explain why super-preference is confined to only a few countries. Besides, normally super-preference only applies to a proportion of the actual preferential claim; in other words, it is a "preference within a preference".[2] In Spain, for example, the portion of the service-related claims qualifying for super-preference cannot relate to more than the last 30 days of employment, while in France it relates only to the last 60 days of employment, plus certain benefits (those

payable in respect of untaken leave, and benefits payable in lieu of notice); and even then, such claims are safeguarded only within limits fixed in relation to a reference wage.

Summary

The granting of highest preference to service-related claims and especially the granting of super-preferred status to them marked the culminating point of an evolution of the law that began in civil law and later continued in labour legislation. To what extent has the preferential protection of these claims really succeeded in ensuring that they are met in the event of the employer's insolvency? And if it has fallen short of this objective, what are the main reasons for its failure? These are the questions we shall take up in the next section.

III. Shortcomings of the preference system

However great the advances in law described above, practical experience and, in particular, the economic crisis of the 1970s, with its resulting business failures and non-payment of service-related claims, show that preferential protection is inadequate. It is even argued by some writers that it is also undesirable and anachronistic.

There are two reasons why it may prove inadequate. First, as mentioned above, preferential treatment applies not to the entirety of the service-related claim but only to part of it. Moreover, only in a few countries does the service-related claim receive absolute preference. In the majority the preference given to service-related claims cannot overthrow the higher ranking of the preferential claims of creditors holding liens or mortgages or of creditors with special prior rights to specified property. In many other countries – though not perhaps the majority – the tax authorities have an overriding prior claim. To show to what extent employees' interests may suffer in cases where their preferential claims are subordinated to those of the State suffice it to note that in the United States in the period 1976-77 (i.e. before the amendment of the bankruptcy law in 1978, which ranked service-related claims ahead of those of the State) employees were able to recover a mere 1.4 per cent of their total claims remaining unpaid by reason of bankruptcy.

The situation may of course be better in cases where service-related claims receive top preference, especially if they receive super-preference. In France, for example, according to 1972 figures, only 19 per cent of super-preferred service-related claims remained unsatisfied. Yet, as a rule, super-preference safeguards only a fraction of them, and even that fraction is subject to considerable limitations. For instance, while in France the super-preferred claims were, as noted, very largely satisfied in 1972, those

qualifying for ordinary preference remained unsatisfied as to 82 per cent, and non-preferential claims remained unsatisfied as to 94 per cent. Overall, only 39 per cent of employees' claims were met in bankruptcy cases. The position was even more unfavourable in Austria, where it is estimated that in the 1970s employees recovered, in bankruptcy cases, 17 per cent of their preferential claims and non-preferred creditors a mere 1 per cent.[3]

The second reason why the protection is inadequate is that the preference is of no effect in bankruptcies where there are no, or virtually no, realisable assets. The preferential status of a claim is, after all, a protection that remains within the scope of a bilateral relationship governed by private law, the relationship between creditor and debtor. On one side stands the creditor demanding settlement of a claim arising out of an obligation enforceable in law; on the other side stands the debtor who can discharge this obligation only within the limits of what he owns – and, by definition, what he owns is not enough, which is precisely why he is involved in insolvency proceedings. While, therefore, the adequacy of the protection of the service-related claim depends partly on the extent of the preference accorded to employees and partly on the ranking of this preference, in actual practice it depends even more on whether there are any assets left. The ranking of the preference and its extent can be determined by the law, but no rule of law can determine in advance what assets – if any – will be available. In short, while wage protection in the event of the employer's insolvency comes within the scope of private law, there is no possibility that private law can offer any guarantee of payment. This explains why the prevailing view is that the only adequate way to protect wages is to remove protection from the realm of private law and to bring it within the scope of social legislation.

However, as well as being insufficient to protect employees' rights, the preferential treatment accorded to them may be undesirable in cases where, as a consequence, the firm's own creditworthiness suffers. For if the preference accorded to service-related claims ranks ahead of, for example, the preference accorded to those of financial institutions, it is likely that the latter will be wary of granting loans. Consequently, it may become harder for an employer to obtain financial credit and any such credit will certainly be more expensive. It is to be feared that firms whose operations are most labour-intensive will suffer most from any possible tightening of credit, since loans made to them will carry higher risks than those to more capital-intensive firms.

Lastly, the preferential protection of service-related claims could, at least in a number of countries, be regarded as anachronistic. It is based on the assumption that the bankrupt firm is bound to be liquidated and its assets sold. However, liquidation, which for many years was the normal outcome of insolvency proceedings – and this was the prevailing view in 1949 when the Protection of Wages Convention was adopted – is now no longer the main objective in many insolvency proceedings; rather, the modern law of

bankruptcy is tending to aim at the preservation or rehabilitation of the firm in question. The view often taken nowadays is that the disappearance of a company which is in difficulties creates more problems than are solved by bankruptcy, since its failure may well place other companies in a difficult situation as well, lead to job losses and even involve the elimination of socially and economically useful productive units. For this reason, more and more countries have established procedures for rescuing and rehabilitating firms in difficulties, a process which one author has described as a "transition from a legal to an economic and social approach to collective procedures".[4] It is reflected in some recent reforms of the insolvency law in Italy (1978), Austria (1982), Greece (1983), and, more particularly, France (1985), where the relevant law is no longer entitled "bankruptcy law" – this term being reserved for cases where the personal responsibility of the management of the enterprise is involved – but bears the title "law concerning the judicial restoration and liquidation of undertakings in difficulties".[5]

It can therefore be argued that preferential treatment, the application of which presupposes the liquidation of the firm, is out of tune with the times. If this is the only way for employees to obtain payment of what is due to them, they may find themselves obliged to accept the disappearance of the undertaking and, by the same token, the loss of their own employment. What is even worse, it can happen that in one and the same case of business failure the interests of some employees, who prefer to obtain satisfaction of their claims at the expense of the undertaking going out of business, clash with the interests of others for whom the continued existence of the undertaking is the sole alternative to unemployment.

IV. Wage guarantee funds

In the light of the disadvantages described above, the limitations of preferential treatment in insolvency proceedings have become obvious. Of all the disadvantages the decisive one was, very probably, the increase in the number of bankruptcies with virtually no realisable assets, which demonstrated just how ineffective legal protection based on the individual contract of employment was. As the increase in the number of employees losing their claims arising out of bankruptcies[6] began to assume disquieting proportions, it became obvious that it was necessary to devise genuinely effective systems of protection.

The possibility of such protection already existed using machinery based on the principles governing social security, which had achieved full maturity by the 1960s. There were institutions capable of granting to employees benefits in lieu of the claims outstanding against insolvent employers, for in most cases these institutions were already providing social benefits to meet various contingencies. Thus, from 1967 on, there began to be established what were known as "wage guarantee funds", the operation of which was governed by principles borrowed from social security: mandatory participa-

tion, solidarity, financing by wage-related contributions, non-proportionality between contributions and benefits, and administration by financially and administratively independent non-profit-making institutions. In many countries, though not all, the administration of these funds was vested with the social security agency responsible for unemployment insurance.

Wage guarantee funds originated in Europe: the first was established in Belgium (1967); subsequently, similar funds were established in the Netherlands (1968), Sweden (1970), Denmark (1972), Finland, Norway and France (1973), the Federal Republic of Germany (1974), the United Kingdom (1975), Spain (1976), Austria (1977), Greece (1981), Switzerland (1982), Ireland (1984) and Portugal (1985). Outside Europe, funds have been established in Israel, Japan, two provinces of Canada (Quebec and Manitoba) and one of the states of the United States (Oregon). By an Act promulgated in late 1986, a guarantee fund for service-related claims was also established in Argentina; at the time this article was being written this Argentine fund was still in the organising stage.[7] It should also be noted that in October 1980 the Council of the European Communities adopted a directive "on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer".[8]

Prerequisites for the operation of wage guarantee funds

Guarantee funds operate on the principle of subsidiary guarantee, that is, they are not principally liable for the settlement of service-related debts. It is, however, current practice for them to make advances in satisfaction of claims and later endeavour to recover the sums due from the principal debtor by subrogating themselves in the employee's rights.

Accordingly, two conditions have to be fulfilled for employees to be eligible for wage guarantee benefit: first, their claims must be of a kind protected by the guarantee; second, the reason why they have not been satisfied must be the employer's insolvency. As will be explained below, the definition of "protected service-related claims" does not necessarily coincide with the definition of the unsettled service-related claim. Nor does it always coincide with the definition of the service-related claim that qualifies for preferential treatment. Moreover, the "state of insolvency" referred to in the wage-guarantee schemes often does not mean the same thing as the term "insolvency" as used in bankruptcy law.

So far as protected service-related claims are concerned, two trends are discernible – one seeing the guarantee as limited to covering the fraction of the claim that might be held to correspond to maintenance or subsistence, the other aiming to extend the guarantee to a substantial proportion of the debt to the employee. Between these two approaches there are, of course, many intermediate solutions. The main argument for limiting the scope of the wage guarantee has probably been the need to ensure the financial viability of the

scheme, although quite possibly another factor has been concern to avoid abuses. For example, the Directive of the Council of the European Communities provides that "in order to avoid the payment of sums going beyond the social objective of this Directive, Member States may set a ceiling to the liability for employees' outstanding claims". It should be noted in this context that in some countries wage guarantee funds accept responsibility not only for the debts (to employees) of insolvent employers but in addition, subject to certain conditions, the debts of employers who are not insolvent.[9]

As examples of the approaches referred to above one might mention that in the United Kingdom the guarantee institution's liability does not extend beyond eight weeks' pay, whereas in Austria the fund is liable for the entirety of the wages owed in respect of the period preceding the institution of insolvency proceedings (such period not to exceed the statutory three-year period of limitations). It is standard practice for guarantee funds to accept responsibility for certain supplementary payments, additional to wages, such as holiday pay, Christmas or year-end bonuses, severance pay, and even, in some countries, social security contributions payable by the employer. In some countries, e.g. the Federal Republic of Germany, the United States, Sweden and Finland, there is machinery – distinct from the wage guarantee funds – safeguarding payment to the employee of pension benefits under company-sponsored supplementary pension schemes. To give some idea of the magnitude of the benefits which guarantee funds may disburse to individual employees, it was estimated that in 1985 such disbursements could amount to a maximum of 900,000 Belgian francs in Belgium, 1,230,000 pesetas in Spain, 144,960 French francs in France,[10] 610,000 yen in Japan and 261,000 kronor in Sweden, although admittedly the average disbursement was a good deal less than the ceiling amounts mentioned: 233,671 Belgian francs,[11] 450,000 pesetas and 20,000 French francs.[12]

As regards the definition of "insolvency", very few systems lay down the condition that insolvency proceedings must necessarily have been instituted against the employer before employees become eligible for the benefit. In all cases, of course, the failure, bankruptcy or liquidation of a business raises a presumption of insolvency and sets the guarantee machinery in motion. However, in most countries the law specifies certain situations that give rise to a presumption of insolvency even though proceedings have not been formally instituted. In the Federal Republic of Germany, for example, the wage guarantee operates not only in cases where insolvency proceedings have been instituted against the employer but also where application has been made for the institution of such proceedings and the application has been dismissed by the court owing to lack of assets. In Belgium it is a prior condition of the operation of the guarantee that the enterprise must have completely or partly closed down, but it is not necessary that the bankruptcy court should have declared the suspension of payments. In Argentina the relevant prior condition is the "inability to pay", as evidenced by the fact that insolvency proceedings are pending in the civil commercial court and

also by a declaration by the labour tribunal in cases where the employee's claim cannot be satisfied by enforcement proceedings owing to the insufficiency of the debtor's assets. The principal exception is probably France, where the institution of insolvency proceedings is mandatory, and this rule is so strictly applied that the wage guarantee fund does not accept applications for benefits from employees but deals only with the receiver in bankruptcy.

Financing

As is the case with all social security institutions, the financing of the wage guarantee implies social solidarity. Accordingly, like other social security schemes, wage guarantee schemes are nearly always financed by a compulsory contribution, payable in most countries by the employers alone on the grounds that the risk of insolvency arises solely with the employer.

It is this feature that probably accounts for the conceptually more fundamental difference between preferential claim systems and wage guarantee funds. Whereas under the former each employer is answerable individually for his own insolvency – and consequently is answerable only to the extent of his own assets – the wage guarantee scheme establishes a principle of collective responsibility. According to this principle, what might be called the "community of entrepreneurs" assumes collectively the "business risk" of each of its members with respect to his employees' service-related claims. There are, of course, precedents for this procedure in social insurance, for many of its features are analogous to those of industrial accident insurance. This latter kind of insurance is also generally financed by contributions payable by the employer alone, on the grounds that the risk of accident should be borne exclusively by the employer.

In the case of the wage guarantee system the scope of solidarity is sometimes extended beyond that of the "community of private entrepreneurs". For example, the legislation of a large number of countries has extended the compulsory coverage of the system to state-owned enterprises. Many of these are not subject to the bankruptcy laws, and even though many others are so subject, it is inconceivable that the State should not discharge its liabilities in the event of an insufficiency of assets. In some countries the law has gone even further: for example, in Spain the principle has been laid down that the State pays the mandatory contribution in respect of the officials employed under contract in its own public administration.

What is more, in some countries the State itself contributes by means of subsidies to the financing of wage guarantee funds suffering a temporary, or even structural, shortfall. These subsidies are, of course, in line with the tendency to make, at least to some extent, the financing of social security measures a responsibility of the state budget; but they imply, in addition, an extension of the solidarity principle to society as a whole.

It may be noted, incidentally, that in some countries, e.g. Portugal, the wage guarantee is financed exclusively out of public resources; that in others, e.g. Finland and Japan, it is financed by contributions from both the employer and the State; and that the Netherlands is one of the few countries – perhaps the only one – where the wage guarantee fund is financed out of contributions from both employers and employees.

The amount of the contribution varies greatly from country to country and in all countries it has fluctuated from time to time, as a result of the fact that wage guarantee funds are financed by the assessment method, which means that their financing does not involve the establishment of long-term reserves but calls for the ad hoc balancing of receipts and disbursements. Experience shows that in most countries the amount of the contribution was initially relatively low, later increased when the economic recession became acute, and has begun to decline gradually in recent years. For example, in Austria the contribution was equivalent in 1978 to 0.1 per cent of the wage; it was increased to 0.8 per cent in 1983-84, reduced to 0.5 per cent in 1985, and stood at 0.2 per cent in 1986. In 1987 Argentina, the country which has most recently established a wage guarantee fund, fixed the initial rate of contribution at 0.5 per cent of remunerations subject to social security charges and contributions.

A last point to note is that national laws make provision in all cases for the subrogation of the guarantee funds in the rights of those entitled to fund benefits. Accordingly, the funds are entitled to appear as parties to insolvency proceedings for the purpose of recouping, from the assets of the insolvent undertaking, all or part of the sums paid out as advances to the employees. In practice, the recovery rate varies greatly from country to country, but in most cases it is low. While in France the guarantee institution recovers as much as one-third of its total advance payments – largely in consequence of the fact that some are protected by a super-preference[13] – in other countries the recovery rate is much lower; for example, in Belgium the sums recouped represent about 10 per cent of the advances, and in Sweden the proportion has ranged from 15 to 20 per cent in recent years. The proportion is probably even lower in Austria – where service-related claims in respect of the period preceding the suspension of payments by the employer do not enjoy any preferred status – and still lower in Spain, where it was estimated in 1985 that the guarantee institution recouped only about 1 per cent of the advances paid out to employees. It should be pointed out, however, that it is not the policy of the wage guarantee institutions to press their claims against the firms in question in cases where, if they did so, the result might be the winding-up of the firms and the loss of sources of employment. To follow a different course would mean, in effect, reverting to some extent to the position as it existed under the preferential treatment system which, as explained earlier, suffers the defect of favouring the liquidation rather than the rescue of the enterprise.

Conclusions

Let us recapitulate some of the more important ideas suggested by the above-mentioned developments in the legal protection of workers' claims in the event of the employer's insolvency.

It now seems to be recognised that the traditional system of protection based on preference, which originated in the civil law and was adopted by the ILO in its Protection of Wages Convention, 1949 (No. 95), is out of date and no longer meets the initial expectations. In the first place, preferential treatment gives no protection in cases where, as very often happens, bankruptcies leave no, or virtually no, realisable assets. Secondly, the concept of bankruptcy law with which it is associated is also outmoded. Modern insolvency proceedings are more concerned to restore the viability of firms in difficulties than to wind them up; preferential treatment of claims may be out of step with current thinking.

As a result, preferential treatment has in many countries become a less important means of protection while the role of wage guarantee institutions is growing. These replace the principle of contractual responsibilities by one of social solidarity, and as far as workers' claims are concerned, transfer the individual employer's risk of insolvency to a third party which is by definition solvent. All the necessary features are thus present for the inception of a new branch of social security to take its place beside those enumerated 35 years ago in the Social Security (Minimum Standards) Convention, 1952 (No. 102).

As was to be expected, these developments, like all those relating to social security, raise a number of queries; for instance, whether wage guarantee institutions such as have been set up in some countries will become the general rule. It became clear from the proceedings of the 1985 ILO Meeting of Experts on the Protection of Workers in the Event of the Insolvency of their Employer that there were wide divergences of opinion on this point, at least as wide as generally occur when a country contemplates setting up a new branch of social security or modifying an existing one. Here the crux of the matter is that the status of social security, and the ability to administer it, vary greatly from one country to another. Some authors contend that it is inadvisable to set up a new branch of social security before consolidating the existing ones; others urge that wages and wage protection are cornerstones of social policy. If wage protection is inadequate, and if workers' losses as a result of a spate of bankruptcies caused by a slump are very great, the social, and indeed the political, situation may become intolerable. At what stage can a State be considered capable of shouldering the responsibility of protecting workers' claims by setting up a wage guarantee institution? The answer to this question will require technical and financial study, but more will depend on the extent to which particular societies are sensitive to their workers' problems.

What might be called the "philosophical implications" of transferring coverage of business risks to social security have also to be considered. At

first sight, wage guarantee institutions appear to be incompatible with the ethos of free enterprise, which is based on the responsibility of individual entrepreneurs. The question is whether an insolvency insurance scheme to cover workers' claims would not weaken the sense of responsibility of workers and employers alike; or whether (as pointed out above), if the ill effects of unsuccessful management by an individual entrepreneur are to be borne by all entrepreneurs collectively (or by the whole of society if compensation is financed from public funds), this is not equivalent to recognising that there is such a thing as "collective guilt", a principle no less foreign to free enterprise.

Such arguments are not to be lightly dismissed; but they hardly suffice to brand wage guarantee institutions as inconsistent with the principle of individual responsibility – they might equally well be used to stigmatise the collective guarantee given in many countries by banks or notaries, whereby an entire industry takes responsibility for losses arising from the bad or fraudulent management of one of its members. Just as a bank guarantee enhances credit rating, the protection given by wage guarantee institutions may be said to make individual entrepreneurs more creditworthy. There should be no reason for thinking that a wage guarantee fund is likely to diminish the individual entrepreneur's sense of personal responsibility any more than compulsory social insurance against employment accidents and occupational diseases diminishes an employer's responsibility for occupational safety and health, or family allowances diminish parents' responsibilities towards their children.

In any case, these "philosophical" problems do not appear to have led to any great objections from the entrepreneurs, who have theoretically most reason to make them. On the contrary, the employers' objections to wage guarantee systems have been based mainly on their high cost, on scepticism whether they could be efficiently administered or work well in practice, and on the difficulty of preventing fraud, or even on the argument that the time was not ripe for introducing a wage guarantee, because there were other branches of social security which should be consolidated first. Where there has been consensus that a wage guarantee was necessary and viable, the employers appear to have been in favour; and indeed, in various countries, France and Israel among them, wage guarantee funds have been set up by the employers themselves. When wage guarantee insurance was introduced in France in 1973 the then President of the National Council of French Employers (CNPF) stated: "In case of judicial liquidation or bankruptcy, workers losing their jobs must be guaranteed the earliest possible payment of their wages, compensation in lieu of notice, and the other allowances to which they are entitled. This is only fair. Employees should not have to bear the financial consequences of failed management."[14]

Notes

[1] At its sessions in June and November 1985, May and November 1986 and May 1987, the Governing Body considered proposals concerning the possible inclusion of this topic in the agenda of a future session of the International Labour Conference (see Governing Body documents GB.230/2/3, GB.231/2/2, GB.233/2/1, GB.234/2/1 and GB.236/2/1). In addition, the Governing Body considered the report of a Meeting of Experts on the Protection of Workers in the Event of the Insolvency of their Employer, which had been held in Geneva in March 1985 (Governing Body document GB.230/5/2). The ILO had prepared a comparative study of relevant law and practice for that meeting entitled *Protection of workers in the event of the insolvency of the employer* (Geneva, 1985; doc. MEPWI/1985/D.1).

[2] F. Derrida: "Le 'super-privilège' des salariés dans les procédures de règlement judiciaire et de liquidation des biens", in *Recueil Dalloz-Sirey* (Paris), 31 Jan. 1973, pp. 59-68.

[3] See *Social and Labour Bulletin* (Geneva, ILO), 1986, No. 1, pp. 95-96.

[4] R. Rodière: *Droit commercial. Effets de commerce. Contrats commerciaux. Faillites.* Précis Dalloz (Paris, 1978), p. 270.

[5] For an analysis of this law, especially as regards workers' rights in insolvency proceedings, see *Social and Labour Bulletin*, 1986, No. 2, pp. 245-249.

[6] See J. V. Gruat: "The problems of schemes for the protection of employees in case of enterprise bankruptcy (comparative study)", in International Social Security Association: *Unemployment protection schemes and employment policies*, Social Security Documentation, European Series, No. 5 (Geneva, 1981), pp. 160-178.

[7] See Mario E. Ackerman: "La ley num. 23472 de creación del Fondo de garantía de créditos laborales", in *Legislación del Trabajo* (Buenos Aires), Jan. 1987, No. 409, pp. 13-25.

[8] *Official Journal of the European Communities* (Luxembourg), No. L 283/23, 28 Oct. 1980.

[9] Thus in Spain, even when the employer is not insolvent, the wage guarantee fund pays 40 per cent of the compensation due to workers who are dismissed on economic or technological grounds or for reasons of *force majeure*, when the employer is an enterprise employing fewer than 25 workers.

[10] In 1985 the wage guarantee could be as much as 571,120 francs in exceptional cases.

[11] With a very big difference between average benefits for blue-collar workers (95,655 francs) and white-collar workers (421,410 francs).

[12] "Wage guarantee funds in Belgium, Spain and France: A comparison", in *Social and Labour Bulletin*, 1986, Nos. 3-4, pp. 481-485.

[13] In 1986 the guarantee institution recovered advances made to workers (through the intermediary of receivers in bankruptcy – *mandataires-liquidateurs*) to the extent of 70 per cent of claims qualifying for super-preference, 15 per cent of preference claims, and only 4.5 per cent of non-preferential claims.

[14] F. Ceyrac, President of the CNPF, quoted by Jean Cantenot: "La garantie du salaire par l'AGS", in *Droit social* (Paris), Feb. 1978, Special issue, p. S.103.