THE BANKRUPTCY CRITERIA AND PRIORITY OF CLAIMS: AN INTERNATIONAL COMPARISON OF INSOLVENCY LAWS

by
Wang Huaiyu*

Comparatively speaking, the criteria used for deeming an enterprise bankrupt and the priority of labour creditors are two core problems in insolvency law. The former is the precondition for the execution of insolvency law. The latter influences the execution of insolvency law; it establishes creditors' rights and interests, and develops an effective economic order. The Chinese Insolvency Law is about to be revised. The new one will be geared to international standards in accordance with conditions extant in China. This text summarises pertinent regulations in 42 different countries.

1) On bankruptcy criteria

Bankruptcy criteria describe the conditions under which an enterprise can turn to bankruptcy procedures. When certain conditions are met, an enterprise can apply for voluntary bankruptcy, or it can be forced into a bankruptcy procedure under a creditor's application. We have roughly classified the regulations of 42 countries with respect to bankruptcy conditions. They are as follows:

a) The inability to pay off debts

i) The inability to pay off expired debts is a bankruptcy condition in: Australia; Canada; Chile; Estonia; France; Germany; Hong Kong, China; Hungary; Indonesia; Italy (except for companies that can rapidly improve their economic condition); New Zealand; Scotland; Singapore; Slovakia; the US; Venezuela; and Viet Nam.

ii) Some limits or specific conditions are added to the inability to pay off debts as a basic bankruptcy condition. For example, Belgium, Bermuda, Colombia, England and Wales (the inability to offset its debts with its assets is one of the causes of the inability to pay off its debts), Malaysia, Romania, Russia, South Africa, Switzerland, and Thailand, (debts greater than 5% of gross debts).

iii) The permanent inability to pay off debts. Not many countries have this as a condition for bankruptcy. Finland is an example.

b) The inability to pay off its expired debts <u>or</u> the inability to offset its debts with assets. An enterprise can turn to a bankruptcy procedure provided it meets one of the situations. For example, Austria, the Czech Republic, Israel, Japan, Latvia,

* Enterprise Research Institute, Development Research Centre of the State Council.

Mexico (the debtor's assets cannot offset more than 80% of its debt), Poland and other countries.

c) The inability to pay off the expired debts and also the inability to offset its debts with its assets. For example, Norway and Spain.

d) No specific bankruptcy condition is specified; the creditor can prove that the enterprise is bankrupt in any way. This kind of bankruptcy is not strictly limited. It leaves judges wide room to decide whether a company qualifies for bankruptcy. This kind of regulation exists in Sweden.

   Some countries use the period of sustained losses, business stops or the attempt of management to flee the country etc. as conditions for bankruptcy. In Viet Nam, employees with three consecutive months' of unpaid wages can apply for the bankruptcy of their employer.

As a whole, most countries make the inability to pay off debts the basic condition for bankruptcy.

2) The relationship between employee, creditor, and secured creditor rights

A debtor-secured creditor relationship usually exists between banks and enterprises. It is very important for enterprises to maintain their banking relationships as a source of financing. But, employees are necessary to actually run an enterprise. So when an enterprise falls into bankruptcy, the question of how to deal with the interests of its two most important creditors becomes important. The following describes international approaches:

a) Give the employees absolute priority protection, *i.e.* employee rights come prior to secured creditors' rights. Countries with such regulations are Brazil (this section is being modified in a new law), Chile, Columbia, Indonesia (specified in the New Labour Law in 2003), and Mexico.

b) Provide absolute priority to employee creditors with certain restrictions. For example, employee creditors meeting certain requirements have priority over secured creditors within a certain period. Countries using this approach are the Czech Republic (Secured creditor's can only can be repaid preferentially from 70% of the value of the security, the remaining 30% is to be added to the bankrupt's assets. Employees are paid preferentially with 30% of the bankrupt's assets. Unpaid employees and secured creditors are repaid as common creditors from the remaining 70%), Russia (employee creditors come prior to fixed security after it expires), Spain (within the last 30 days).

c) Secured creditor's come prior to employee creditors while employee creditors come prior to floating security creditors. Examples are Australia; Bermuda; England; Hong Kong, China; Israel; Romania; Scotland; Singapore; Slovakia; and Wales.

d) All secured creditors' rights are prior to employee creditors' rights while employee creditor rights are prior to common creditors' rights. See Austria, Canada, Hungary, Japan, Malaysia, Norway, South Africa, Sweden, Switzerland, Thailand, Venezuela, Viet Nam, the US, and so on.

   Among the above, generally speaking, there are certain restrictions on employee creditors' rights in items c) and d), including restrictions on time and amount.

e) Employee creditors do not enjoy any priority. They are repaid together with common creditors. Estonia, Germany and other countries have such regulations.

 ASIAN INSOLVENCY SYSTEMS: CLOSING THE IMPLEMENTATION GAP - ISBN 978-92-64-03832-5 - © OECD 2007

We can see from the above that countries have different regulations on the priority of labour and secured creditors. The International Labour Organization put forward its Protecting Labour Creditor's Rights (Enterprise Bankruptcy) Convention in 1992. The convention came into effect in 1995. It stipulates that employee creditors' rights shall be protected preferentially, but the relationship between it and secured creditor's rights are to be determined by each country according to their own national circumstances. Nor does the EU Convention on Insolvency Proceedings, which came into effect on 31 May 2002, directly address the relationship between labour and secured creditors' rights. It leaves it to each country to decide. The relationship between these two kinds of creditor's rights is thus entirely determined by each country's domestic law. It has nothing to do with whether a country has a market economy or not.

Most countries do not equate labour creditor rights with common creditors' rights. Instead they always confer a certain priority. This is because of the importance of labour in market development. At the same time, labour is in a vulnerable position in the employment relationship, since it is unable to ask employers to provide guarantees for payment when signing employment contracts. This puts labour in an unfavourable situation compared with other creditors. In order to establish and perfect an efficient labour market and to defend principles of fairness and equitable treatment, most countries give labour creditors certain priority rights. But this kind of priority differs depending on the country. Some countries specify that labour comes before most other creditors (including secured creditors); some countries specify that labour creditors come before most other creditors (except secured creditors); and some countries put them on a level with common creditors. Regardless of the priority, labour creditor rights have certain restrictions on time and amount in most countries (refer to Table 3). Such restrictions can enhance labour's realisation of market risk and make talent move to better enterprises.

Although no single standard or approach applies to the priority of labour creditors, most countries give priority to secured creditors over labour creditors (refer to Table 2). This choice is related to the development of the capital market. With the development of a country's market, the need for capital will increase rapidly, so the guarantees provided to financial institutions are important to maintaining a sound system of credit.

On the whole, when dealing with the relationship between labour creditors and secured creditors, both fairness and efficiency are taken into account. Balancing the interests of each, and the constitution of supporting institutions depend upon the state of market development of the national market.

Annex

Table 1: Schedule of liquidation order under insolvency proceedings

Liquidation Order	1	2	3	4	Note
Country					
Australia	Dead securities	Clearing charges	Unpaid wages, pension and other employee creditor right	Floating security	
Austria	Secured creditors	Costs of insolvency proceedings	Employee wages and termination costs for service after the beginning of the insolvency proceeding	Others	Creditor's rights to real property after the beginning of insolvency proceeding will be superior to secured creditors' rights
Belgium	Costs of insolvency proceedings	Secured creditors	Others		No priority regulation for labour creditors
Bermuda	Dead securities	Labour creditors (including wages, pension and compensation payments)	Governmental creditors (such as taxes)	Floating security	
Brazil	Industrial injury and labour creditors, social security creditors	Tax	Maintenance and creditor's right of insolvent assets	Secured creditors	
Canada	Secured creditors	Costs of insolvency proceedings	Unpaid wages up to a certain amount	Others	
Chile	Costs of insolvency proceedings, labour creditors	Secured creditors	General creditors		
Colombia	Support creditors judicial cost and labour creditors, etc.	Freight charges and secured creditor's right	Others		

 ASIAN INSOLVENCY SYSTEMS: CLOSING THE IMPLEMENTATION GAP - ISBN 978-92-64-03832-5 -

Czech Republic	70% of secured assets to secured creditors	30% of secured assets are added to the bankrupt's assets, of which 30% is used to pay back labour creditors, and pension and alimony from three years before the insolvency	The remaining 70% of assets are used to pay back creditors, including labour creditors, who have not been completely paid off		
Estonia	Costs of insolvency proceedings	Secured creditors	General creditors		No mention of labour creditors
Finland	Dead securities	Floating security	Others		No priority regulation for labour creditors
France	Labour creditors	Costs of insolvency proceedings	Secured creditors	Unsecured creditors	
Germany	Secured creditors	Common creditors			
Hong Kong, China	Costs of insolvency proceedings	Dead securities	Labour creditors (wages and salaries of four months before the issuance, not to exceed CNY 8 000 (Chinese Yuan renminbi), due labour compensation in accordance with the "labour compensation ordinance", one month wage due to dismissal of employees or a salary of CNY 2 000 (when the monthly salary is less than CNY 2 000, holiday subsidies	Floating security	
Hungary	Clearing charges	Secured creditors	Labour, life annuity, alimony etc.	Compensation for injuries	No reference to wages
Indonesia	Tax and employee creditors	Secured creditors	Free of guarantee creditors		
Ireland		Labour creditors have priority. The order between labour and secured creditors is unclear. Labour, life annuity, and alimony.			
Israel	Dead securities	Clearing charges	Wages and taxes over a certain period and of a certain amount	Floating security	
Italy	Secured creditor are superior to labour creditors				

Japan	Secured creditors	Taxes and the unpaid wages	Common benefit right		
Latvia	Costs of insolvency proceedings	Salaries, remuneration, annual compensation and dismissal pay etc. in the most recent three months of the 12 months before the insolvency	Payments for agricultural products	Taxation one year prior to the insolvency	
Malaysia	Secured creditors	Clearing charges	Wages or salaries not exceeding MYR 1 500 (Malaysian ringgits), compensation, holiday or death subsidies to workers, and pensions due or retirement plans 12 months before the insolvency	Federal taxes	
Mexico	Insolvency management expenses	Labour creditors	Tax	Secured creditors	
New Zealand	Wages of the bankruptcy trustee	Insolvency application expenses	Tax and social security expenses	Employee wages and pensions	Not very clear about the relationship between secured and labour creditors in accordance with the existing materials
Norway	Secured creditors	Labour creditors	Tax, etc.		
Poland	Secured creditors	Tax and social security	Costs for insolvency proceedings and labour creditors		
Romania	Secured creditors	Tax and social security	Wages within 6 months before the insolvency		
Russia	Personal injury and relative right of claim	Labour creditor and copyright	Others (including compulsory payments and secured creditors)		If the dead securities are set before the due date of the formal two creditor's rights, it shall be superior to the formal two
Scotland	Dead securities	Labour creditors up to a certain amount	Floating security	Clearing charges	

Singapore	Dead securities	Costs for insolvency proceedings	Back pay not exceeding SGD 7 500 (Singapore dollars)/person, dismissal payment, compensation due, pension and holiday subsidies not exceeding the same amount	Tax	
South Africa	Secured creditors	Clearing charges	Labour creditors (Salary, holiday subsidies, dismissal payments and others. The preferential scope is between ZAR 4 000 (rand) to ZAR 12 000.)	Taxes, etc.	
Spain	Taxes, wages 30 days before the insolvency	Secured creditors			
Sweden	Creditors after the insolvency	Priority of maritime liens	Secured creditors	Labour creditors	
Switzerland	Secured creditors	Labour creditors of 6 months before the insolvency			
Thailand	Secured creditors	Costs for insolvency proceedings	Labour creditors		
UK (England and Wales)	Dead securities	Costs of insolvency proceedings	Labour creditors (wages, salaries, medical and labour protection costs) not more than GBP 800 (United Kingdom pounds) in total	Floating security	
USA	Secured creditors	Costs of insolvency proceedings	Labour creditors (wages, salaries and commissions 90 days prior to the production stop or insolvency declaration, including holidays, illness, and welfare within 180 days not to exceed USD 4 295 (United States dollars) in total	Others	

Notes: The EU Convention on Insolvency Proceedings and the convention of the International Labour Organization make no explicit recommendations with respect to the priority of labour and secured creditors, leaving it to be specified in domestic law.

Most developed countries have established special foundations or insurance organisations to ensure employee creditors' rights. In case insolvency proceedings do not result in complete payment of creditors, these special organisations will usually be at hand to solve their problems.

This table is based mainly on the highlights of the revision of the Chinese Insolvency Law, specifically the priority given to labour and secured creditors. The table focuses on the order of these two creditor rights in a number of countries but does not completely reflect the relations between all the creditors.

Table 2: The relationship between labour and secured creditors in different countries

Nations where secured creditors come before labour creditors	Nations where labour creditors come between dead securities and floating security	Nations where labour creditors have complete superiority over secured creditors	Nations where labour creditors (with certain limitations) are superior to guaranteed creditors
Austria, Belgium, Canada, Estonia, Finland, Germany, Hungary, Japan, Malaysia, Norway, Poland, Romania, South Africa, Sweden, Switzerland, Thailand, USA (17)	Australia; Bermuda; Hong Kong, China; Israel; Scotland; Singapore; Slovakia; Romania; UK (9)	Brazil,* Chile, Colombia, Indonesia, Mexico (5)	Czech Republic, France, Russia, Spain (4)

* The new insolvency law of Brazil specifies that the prior labour creditor’s right takes the 150-month lowest wage as its limitation. For its long time limit, this right actually takes priority of the labour creditor’s right.

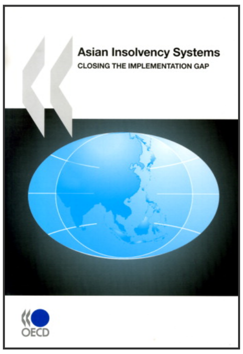
Table 3: Limitations to the priority of labour creditors

Limitations to the Priority of Labour Creditors	One Month	Three Months	Four Months	Six Months	One Year or More	Limit on the Fixed Amount
Country	Spain	Latin America USA*	Hong Kong, China*	Japan, Romania Switzerland,	Brazil, Czech Republic	Canada; Hong Kong, China; Israel;* Malaysia; Singapore; South Africa; UK, USA

* Nations with limitations on both time and amount of labour creditors’ rights.

ASIAN INSOLVENCY SYSTEMS: CLOSING THE IMPLEMENTATION GAP - ISBN 978-92-64-03832-5 - © OECD 2007

Table of Contents



From:

Asian Insolvency Systems: Closing the Implementation Gap

Access the complete publication at:

https://doi.org/10.1787/9789264038332-en

Please cite this chapter as:

Huaiyu, Wang (2007), "The bankruptcy criteria and priority of claims: an international comparison of insolvency laws", in OECD, *Asian Insolvency Systems: Closing the Implementation Gap*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264038332-20-en