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The new ILO standards on the protection of workers' claims in the event of the insolvency of the employer

In June 1992, the International Labour Conference, the general assembly and supreme body of the International Labour Organisation, adopted Convention No. 173 and Recommendation No. 180 concerning the protection of workers' claims in the event of the insolvency of their employer. The adoption of these two new instruments has been the result of long and thorough preparatory work undertaken by the ILO and constitutes the ILO's response to one of the major challenges faced by labour law today, created by the increasing number of bankruptcies and insolvencies resulting from the present world-wide recession.

The purpose of the present article is to bring out the main features of these new international standards. Rather than giving a descriptive detailed account of the contents of the new instruments, the article attempts to highlight the main problems which had to be overcome in formulating the new standards and to concentrate on some of the more controversial issues involved. In a way, the preparation of ILO instruments is always an exercise in comparative labour law.

Procedural aspects

In accordance with the ILO Constitution, the item was discussed under the double-discussion procedure. For the first discussion in 1991, the Office had published in 1990 a report which described the

legal position in the various countries, analysed the problems involved and discussed the possible orientation of international standars on the subject. A questionnaire, annexed to the report, indicated the possible form and contents of future international instruments on the matter to which governments were invited to reply.[1] The replies of governments and, where available, employer's and workers' organisations, were reproduced in a second report[2] which also contained proposed conclusions for possible international standards which the Office had drawn up on the basis of the governments' replies. These conclusions formed the basis for the discussions of the International Labour Conference in 1991 which adopted a report, summarising these discussions and proposing a series of draft conclusions.[3] These conclusions were then transformed by the Office into a draft convention and a draft recommendation which were again submitted to governments for comments.[4] The government replies were published by the Office[5] which, in a separate document, published again a redrafted Convention and Recommendation, taking these governments' view into account.[6] These proposed instruments were then discussed by the International Conference in 1992 which adopted a report summarising these discussions.[7] The end result, Convention No. 173 and Recommendation No. 180, were adopted at the same session of the Conference in 1992.

These references are given here for the benefit of those readers who would wish to direct their research into detailed aspects of these various preparatory steps. As indicated above, the present article concentrates on what appear to be the most important and also controversial features of the new instruments, illustrating some of the difficulties arising in the course of the preparation of ILO instruments in general.

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1 International Labour Conference, 78th Session, Geneva 1991, Report V(1) (ILO, Geneva, 1990).
2 International Labour Conference, 78th Session, Geneva 1991, Report V(2) (ILO, Geneva, 1991).
3 International Labour Conference, 78th Session, Geneva 1991, Provisional Record No. 20.
4 International Labour Conference, 79th Session, Geneva 1992, Report IV(1).
5 International Labour Conference, 78th Session, Geneva 1992, Report IV(2A).
6 International Labour Conference, 79th Session, Geneva 1992, Report IV(2B).
7 International Labour Conference, 79th Session, Geneva 1992, Provisional Record No. 25.

Major problems and previous ILO activities

The central problem before the ILO Conference was to formulate international standards and principles for the type and degree of protection that workers' claims to the employer should enjoy in the case in which the latter becomes bankrupt or otherwise insolvent. The Conference discussions showed that there is at the moment widespread agreement throughout the world that workers' claims in such a situation require special protection in one way or another. This principle is reflected in the legislation of a great number of countries. What was controversial during the Conference discussions was how far such protection should go and what form it should take. The subject therefore raised a number of complex issues which were in fact on the borderline between insolvency law and labour law. Consequently, the topic is more legal in nature than many other questions which have been before the ILO Conference with a view to the adoption of international instruments. This was clearly reflected during the Conference discussions.

The subject has a long history in the ILO. Over 40 years ago, the ILO Conference adopted the Protection of Wages Convention, 1949 (No. 95) which provides inter alia 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 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." This means, as the Convention goes on to state, that "wages constituting a privileged debt shall be paid in full before ordinary creditors may establish any claim to a share of the assets". Furthermore, national laws and regulations must determine the relative priority of wages constituting a privileged debt or other privileged debts. In the same spirit, the Workmen's Compensation (Accidents) Convention, 1925 (No. 17) had laid down the principle that the payment of compensation to workers who suffer personal injury due to industrial accidents, must be ensured "in all circumstances, in the event of the insolvency of the employer or insurer".

During the past 40 years which have elapsed since the adoption of Convention No. 95, important changes have occured in the legislation of a great number of countries, consisting in essence in two developments. Firstly, in many countries, legislation ensuring

privilege to workers' claims in the case of the employer's insolvency has been considerably improved, chiefly by enlarging the coverage of the workers concerned, by extending the notion of "wages" protected, by conferring a higher rank of priority of workers' privileged claims over other types of privileged claims, such as those of the State as regards taxes, and even, in a number of countries, by protecting the workers' claims by so-called "super-privileges" over other claims, including those secured by mortgages or liens. Secondly, a number of countries, particularly in Western Europe, have established special guarantee funds or institutions which guarantee workers' claims independently from and irrespective of the amount of assets available to the enterprise which has become the object of an insolvency procedure.

Resulting from these two developments, the basic question with which the International Labour Conference had to deal was how to formulate new international standards which reflect these recent developments and which, at the same time, would be acceptable to the majority of Conference delegates whose two-third majority is required for the adoption of Conventions and Recommendations. The problem before the Conference was to draft international standards which took into acount two possible approaches to the protection of workers' claims in the event of the employer's insolvency, namely either by affording them a privileged position compared with the claims of other creditors or by protecting them through some kind of guarantee institution.

All these developments and questions have been the subject of various preparatory studies undertaken by the Office and the findings of these studies were discussed by a meeting of experts on the matter, held in 1985. The end result of all these preparatory activities was the decision taken by the ILO Governing Body in 1989 to place the item on the agenda of the 1991 and 1992 Sessions of the International Labour Conference which, as indicated above, terminated its discussion of the subject by adopting Convention No. 173 and Recommendation No. 180.

Form of the international instruments

In preparing international labour standards, it is of decisive importance to determine at an early stage whether the instrument to be adopted should be a Convention or a Recommendation. Both types

of instruments are defined in detail by the Constitution of the ILO, the essential difference being that a Convention, when ratified by ILO member States, becomes a binding international treaty to which effect must be given by the ratifying countries, whereas a Recommendation contains merely suggestions which have no binding effect, except that member States must from time to time report to the ILO on the law and practice in their respective countries in respect of the subject matter of the Recommendation. In view of this difference, each International Labour Conference which debates international standards is confronted with the question of whether it would be better to decide first on the form of the proposed instrument or instruments and afterwards determine their respective contents, or whether it would be preferable to deal first with the substantive provisions and then to decide, in the light of these provisions, on whether the provisions concerned are more suitable for a Convention or for a Recommendation.

Anticipating this problem, the Office had, in respect of the subject discussed here, suggested from the very beginning, i.e. when drafting the first questionnaire, that there should be two instruments on the matter, a Convention supplemented by a Recommendation. In preparing this approach, the Office sought a tentative reply to two basic questions: first, how to translate the existence of two different forms of protecting workers' claims (privilege or guarantee institution) into international standards and second, how to select those substantive matters which should be included in the Convention and those which would be more suitable for the Recommendation.

These proposals which were – apart from points of detail – accepted and followed by the Conference consisted in the following approach. On the first question, the solution was to divide the Convention into two parts, the first one relating to the protection of workers' claims by means of a privilege, and the second one concerning the protection of such claims by a guarantee institution. The underlying idea, expressed explicitly in the Convention itself, is that it is left to each ratifying country to decide on whether it accepts only the first or only the second or both parts of the Convention. Moreover, countries are free to decide, whenever they opt for the formula of a "guarantee institution", to limit its application to certain categories of workers and to certain branches of economic activity.

On the second question, the solution consisted in limiting the

Convention to a few principles, leaving detail to the Recommendation.

With these general considerations in mind, the following paragraphs indicate briefly, with regard to the main substantive aspects, which standard is contained in the Convention and which has been included in the Recommendation. This approach appears to be more useful for readers interested in comparative labour law than a mere descriptive summarising of the contents of each one of the two instruments separately. As indicated before, we shall deal here only with those standards which seem to be of major importance. For details, readers are referred to the ILO documents cited above.

Substantive contents of the instruments

The term *"insolvency"* is defined in the same manner in both the Convention and Recommendation. It refers to situations in which, in accordance with national law and practice, proceedings have been opened relating to an employer's assets with a view to the collective reimbursement of its creditors. Both instruments leave it to ILO member States to extend the term "insolvency" to other situations in which workers' claims cannot be paid by reason of the financial situation of the employer. As an example of such a situation, the Convention cites explicitly the case where the amount of the employer's assets is recognized as being insufficient to justify the opening of insolvency proceedings. This example is also given in the Recommendation which adds three more cases, namely where the enterprise has closed down or ceased its activities or is voluntarily wound up; where, in the course of proceedings to recover a worker's claim, it is found that the employer has no assets or that these are insufficient to pay the debt in question; or where the employer has died and his or her assets have been placed in the hands of an administrator and the amounts due cannot be paid out of the estate. Both instruments leave it to national laws, regulations or practice to determine the extent to which an employer's assets are subject to the insolvency proceedings.

Because of its binding character, the Convention contains specific provisions on its *scope*. In principle, the Convention applies to all employees and to all branches of economic activity. It leaves it, however, to the competent authorities of each country after consulting employers' and workers' organisations, to exclude (from

both Parts) specific categories of workers, in particular public employees, by reason of the particular nature of their employment relationship, or if there are other types of guarantee affording them protection equivalent to that provided by the Convention.

With regard to the *definition of the workers' claims which are to be protected,* the Convention lists – for both cases, i.e. privilege and guarantee institution – four categories with certain variations applying to both cases. These are, first, workers' claims for wages relating to a prescribed period (minimum three months for the privilege case and eight weeks for the guarantee institution case); workers' claims for holiday pay due as a result of work performed during a given period (one year for privilege and six months for guarantee institution); workers' claims for amounts due in respect of other types of paid absence relating to a prescribed period (three months in case of privilege and eight weeks in case of guarantee institution); and severance pay due to workers upon termination of their employment. These minimum standards contained in the Convention are considerably extended and improved upon in the Recommendation which contains for both cases (privilege or guarantee fund) lists of claims substantially longer than those given in the Convention. These details cannot be enumerated in the present article.

Both instruments provide for *limitations of the amount of the protected claims* which are in both instruments the same for both cases (privilege or guarantee institution) but which differ between the Convention and the Recommendation. It is interesting to compare the language used in both instruments because it illustrates the idea that a Recommendation accompanying a Convention usually supplements, refines and extends the provisions of the Convention. In fact, the Convention states that national laws or regulations may limit the protected claims to a prescribed amount which must, however, not be below a socially acceptable level, adding that where such limitation has been established, the prescribed amount must be adjusted as necessary to maintain its value. The language of the Recommendation with regard to limitations is more specific in that it states that where the amount of the claim protected is limited, in order that this amount should not fall below a socially acceptable level, it should take into account variables such as a minimum wage, the part of the wage which is unattachable, the wage on which social security contributions are based or the average wage in industry.

Turning now to the first alternative, i.e. *protection of workers' claims by means of a privilege,* the Convention states the principle that workers' claims arising out of their employment must be paid out of the assets of the insolvent employer before non-privileged creditors can be paid their share. As mentioned above, this principle was already included in Convention No. 95.

There is only one more substantive provision on this matter in the Convention, namely that *workers' claims must be given a higher rank of privilege* than most other privileged claims, and in particular those of the State and the social security system. This provision is of great practical importance because the law and practice of different countries varies considerably with regard to the degree of priority given to privileged workers' claims as compared with the claims presented by other privileged creditors such as, for instance, claims guaranteed by a security (e.g. mortgage), claims of the State for arrears in taxes or claims of social security schemes for unpaid contributions. It will have been noted that a certain flexibility has been introduced in the text of the Convention by using the word "most" in connection with other privileged claims.

Still on the alternative of privilege, the Recommendation contains two additional provisions which are not in the Convention, and which concern, first, the payment of workers' claims which fall due after the insolvency proceedings have been opened, i.e. in the case in which the enterprise is authorised to continue its activities, and, second, the introduction of accelerated procedures for payment of workers' claims where the insolvency procedure cannot ensure rapid payment.

As regards the second alternative, the *protection of workers' claims by a guarantee institution,* both the Convention and the Recommendation contain only a very limited number of rather generally worded principles. First, the Convention merely states that countries accepting this Part must guarantee the payment of workers' claims through a guarantee institution. It is significant that neither the Convention nor the Recommendation define what the expression "guarantee institution" means. The Recommendation merely adds that the protection of workers' claims by a guarantee institution should have as wide a coverage as possible. Second, the Convention leaves it to member countries to adopt, after consulting employers' and workers' organisations, appropriate measures to prevent abuse. Third, the Convention leaves the organisation, management, operation and financing of wage guarantee institutions

to each country, stating explicitly that the protection of workers' claims may be provided by insurance companies as long as they offer sufficient guarantees. This provision leaves the door wide open to a great variety of such institutions, whether financed by employers alone, by employers and workers, by governments or government subsidies, whether assimilated to social security schemes or private insurance schemes or organised, managed, operated or financed in any other manner. Supplementing this general provision, the Recommendation lists a number of principles according to which guarantee institutions might operate. The use of the word "might" in the text of the Recommendation shows the desire of the Internatiol Labour Conference to maintain a high degree of flexibility which, it is hoped, should permit countries which have no or insufficient experience with guarantee institutions or with widely differring systems, to accept the international standards.

Concluding remarks

The contents of the new Convention and Recommendation show that the Conference produced, after lengthy and often difficult discussions and with the guiding help of the Office, texts which reflect the state of development in different countries, illustrated by the two alternative ways of protecting workers' claims in the event of the insolvency of their employer (privilege or guarantee institution). While the concept of "privileged claim" under an insolvency procedure is accepted in the law of most countries, although with varying degrees of protection, guarantee institutions are practically unknown in developing countries (with a few exceptions, primarily in Latin America). This problem is met by specifying that countries ratifying the Convention are free to accept or not to accept the Part on guarantee institutions.

In sum, the new instruments mark a clear improvement over the standards contained in Convention No. 95, adopted over 40 years ago. They reflect the evolution which has occurred since then in the law and practice of a great number of countries. At the same time, the Conference was careful to formulate the new standards in a language which would appear to be flexible enough to make them acceptable to numerous countries with different legal systems and having reached different levels of economic and social development.