BANKRUPTCY LAW AS A BALANCING SYSTEM: LESSONS FROM A COMPARATIVE ANALYSIS OF THE INTERSECTION BETWEEN LABOR AND BANKRUPTCY LAWS

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ABSTRACT[▯]

The rehabilitation of distressed corporations often requires the reduction of labor costs. In order to regain economic stability, distressed firms need to terminate employees or modify their employment conditions. When employees are protected by statutes or by collective bargaining agreements, however, such measures are not always possible. The employer's freedom to manage its work force is limited, and it may fail to implement labor reforms necessary for the firm's recovery.

This Article deals with this conflict from a comparative perspective. It examines whether labor laws should remain unchanged, even when employment protections jeopardize the continued operation of the firm, or whether bankruptcy law should override the protections and facilitate corporate rehabilitation. To do so, this Article studies the bankruptcy policy of three European jurisdictions—the Netherlands, France and Germany, and compares it vis-à-vis the dominant approach to bankruptcy law in the United States—the procedural approach. We reveal that bankruptcy law in Europe serves as a balancing system to otherwise rigid labor laws. We analyze the rationale of this policy and explore its benefits and costs. The analysis provides lessons relevant also to the Unites States. It contributes to the ongoing debate between the traditional and procedural approaches, and it sheds light on the interpretation of section 1113 of the Bankruptcy Code.

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[▯] [Eds. note – Due to the prevalence of foreign language sources utilized in this Article, the *American Bankruptcy Institute Law Review* is not responsible for the accuracy of these sources.]

INTRODUCTION

One of the important causes of corporate insolvency is unsustainable labor costs.[1] Corporations reach expensive labor agreements in times of prosperity, only to realize, in times of downturn, that they are unable to afford the agreed costs. General Motors, American Airlines, and LTV Steel are but a few examples of firms that entered into financial distress partly due to problematic labor agreements, and they filed for bankruptcy in an attempt to decrease their employment costs and to rehabilitate.[2]

The intersection between bankruptcy and labor laws, however, raises difficulties. On the one hand, the rehabilitation of the business entity may require difficult employment measures to be taken. In order to regain economic stability, employment contracts need to be terminated and working conditions modified.[3] On the other hand, labor laws often limit such changes. The employees are protected by statutes or collective bargaining agreements, and generally the employer cannot unilaterally override these protections and terminate or modify employment contracts.[4] A question, therefore, arises—how do such employment protections need to be treated in bankruptcy? Should labor laws remain unchanged, even when these laws jeopardize the continued operation of the firm, or should bankruptcy law override "regular" labor protections and facilitate corporate rehabilitation, perhaps at the expense of some of the debtor's employees?

To answer this question, this Article examines the intersection between labor and bankruptcy laws from a comparative perspective. We first look at jurisdictions with generally high employment protections and then compare our findings with the prevailing bankruptcy approach in the United States—the procedural approach.

In the first part of this Article we examine an interesting, yet so far under-explored, phenomenon.[5] Jurisdictions with generally high employment protection levels use bankruptcy laws to decrease their level of employment protection when an employer is insolvent. After the bankruptcy filing, an employer can more easily

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[1] Robert E. McGarrah, *The Decline of U.S. Manufacturers: Causes and Remedies*, 30 BUSINESS HORIZONS 59, 59 (1987); Harry DeAngelo & Linda DeAngelo, *Union Negotiations and Corporate Policy: A Study of Labor Concessions in the Domestic Steel Industry During the 1980s*, 30 J. FIN. ECON. 3 (1991); Mark C. Mathiesen, *Bankruptcy of Airlines: Causes, Complaints, and Changes*, 61 J. AIR L. & COM. 1017, 1019 (1996).

[2] Terry G. Sanders, *The Runaway to Settlement: Rejection of Collective Bargaining Agreements in Airline Bankruptcies*, 72 BROOK. L. REV. 1401, 1404–05 (2007); DeAngelo & DeAngelo, *supra* note 1, at 21; *The Bankruptcy of General Motors: A Giant Falls*, ECONOMIST (June 4, 2009), http://www.economist.com/node/13782942; *see also* Chrystin Ondersma, *Employment Patterns in Relation to Bankruptcy*, 83 AM. BANKR. L.J. 237, 238 (2009).

[3] *See* Donald L. Martin, *The Economics of Employment Termination Rights*, 20 J.L. & ECON. 187, 188–89 (1977).

[4] *See id.* (discussing how the Netherlands prohibits parties from dissolving private nongovernmental employment relationships unilaterally).

[5] Roger Blanpain and Antoine Jacobs did look into this phenomenon, but they did not explain its rationales or discuss its effects. *See generally* EMPLOYEE RIGHTS IN BANKRUPTCY: A COMPARATIVE-LAW ASSESSMENT 23 (Roger Blanpain & Antonie T. J. M. Jacobs eds., 2002) [hereinafter BLAINPAIN & JACOBS].

dismiss employees, and the dismissed employees are more limited in challenging the validity of their terminations. These labor law modifications occur not only when the business is liquidated, but also, and more important for our purposes, when the business continues to operate as a going concern. During the reorganization process (or when the business is sold as a going concern), the regular employment rules change and the employer (debtor) enjoys greater employment flexibility. This phenomenon is demonstrated through three different European jurisdictions—the Netherlands, France and Germany. All three jurisdictions, although in varying degrees, modify their regular labor practices, in order to enable easier termination of employees when an employer is bankrupt.

This (European) inclination to alter labor law rights inside bankruptcy conflicts with the view that has become the "founding narrative" of bankruptcy law in the United States—the procedural (contractual) view of bankruptcy.[6] According to the procedural view, bankruptcy law ought to mirror non-bankruptcy legal entitlements. The legislator determines the creditors' rights in general (the law outside bankruptcy), and unless some bankruptcy policy requires otherwise, bankruptcy law implements these rights within a bankruptcy process.[7] The procedural approach was adopted by the United States Supreme Court in the case of *Butner v. United States*.[8] The court in *Butner* observed that a uniform treatment of the substantive law in and outside bankruptcy "*serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy*.'"[9] In Europe, on the other hand, at least with regard to labor issues, bankruptcy serves as a balancing system. Labor laws outside bankruptcy are highly inflexible, and bankruptcy laws somewhat soften the rigid rules when the employer becomes insolvent.[10] This difference enables us to examine the rationale and effects of bankruptcy specific changes in labor law vis-à-vis the arguments raised by the procedural approach.

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[6] *See* John D. Ayer, *The Role of Finance Theory in Shaping Bankruptcy Policy*, 3 AM. BANKR. INST. L. REV. 53, 66 (1995) ("Jackson's article [(which presented the theory for the first time)] has established itself as a kind of a 'founding narrative' of bankruptcy thought."); *see also* Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 442 (1992) ("This model is the standard justification for bankruptcy's general supplantation of private contact rights . . . ."); Robert E. Scott, *Through Bankruptcy with the Creditors' Bargain Heuristic*, 53 U. CHI. L. REV. 690, 692 (1986); Adam James Wiensch, *The Supreme Court, Textualism, and the Treatment of Pre-Bankruptcy Code Law*, 79 GEO. L.J. 1831, 1851 (1991).

[7] *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 20–27 (Beard Books 2001) (1986) (explaining purpose of the bankruptcy process).

[8] 440 U.S. 48 (1979).

[9] *Id.* at 55 (emphasis added); *see also* JACKSON, *supra* note 7, at 21 ("The problem of changing relative entitlements in bankruptcy not only underlies this book's normative view of bankruptcy law but also forms the basis of the bankruptcy system that has been enacted."). Note, though, that although to a lesser extent than in Europe, the U.S. Bankruptcy Code also makes some changes to the substantive labor laws. *See* 11 U.S.C. § 1113 (2012) (providing for rejection of collective bargaining agreements).

[10] *See* Harvey R. Miller, Michele J. Meises & Christopher Marcus, *The State of the Unions in Reorganization and Restructuring Cases*, 15 AM. BANKR. INST. L. REV. 465, 465 (2007) ("In circumstances of financial distress, the inflexibility of unions often precipitates a decision to seek relief under chapter 11 of the United States Bankruptcy Code to enhance an employer's bargaining leverage.").

The second part of this Article thus examines the ex-post effects of the modifications. We show that although bankruptcy specific changes in labor laws harm the individual dismissed employees, a reduction of employment protection level when an employer is insolvent can be beneficial to the employee group as a whole. Generally, when the employer is solvent, the employees (especially unionized employees) have an interest in a high level of employment protection. They enjoy the job security the protections give, while the costs of the protections are shifted (at least in part) to the employer or to the general public. When the employer becomes insolvent, however, a high level of protection can be detrimental to the employees.[11] The protections get in the way of structural reforms needed to keep the firm as a going concern, and they give creditors perverse incentives to prefer piecemeal liquidations over reorganizations.[12] The labor modifications, thus, reduce the level of employment protection in bankruptcy. This reduction harms the interests of some of the employees (those who are dismissed), but the rest of the employees have a higher chance to stay employed in a rehabilitated firm. Thus, assuming the majority of employees want to keep their employment, a bankruptcy specific labor law modification can serve to the employees' advantage.

But although the employees as a group may benefit from the reduction in employment protection, this Article shows, akin to the procedural approach, that the modifications have detrimental ex-ante effects. The bankruptcy specific changes produce forum shopping effects, and these can create job losses and reduce social welfare. First, due to the bankruptcy specific changes, in some cases bankruptcy is filed just in order to gain the labor law advantages ("bankruptcy abuse"). Distressed firms wish to terminate employees easily and cheaply, and they use bankruptcy proceedings to do so. Empirical evidence gathered in the Netherlands (where bankruptcy provides significant changes to labor laws) show that approximately four percent of the bankruptcies (in some studies eight percent) are filed in order to reduce labor costs.[13] Most trustees consider a "technical bankruptcy" as a legitimate way to solve their clients' economic difficulties, and this may create unnecessary bankruptcy filings (that also damage employees).[14] Second, the labor modifications create perverse incentives when debtors choose among different possible bankruptcy proceedings. Debtors tend to file for bankruptcy proceedings which

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[11] *See* Matthew L. Seror, *Analyzing the Inadequacies of Employee Protections in Bankruptcy*, 13 S. CAL. INTERDISC. L.J. 141, 160 (2003) ("Despite the well-intentioned actions of both Congress and the state legislatures, the protections provided to employees are often ineffective when administered in the context of a bankruptcy case. In other words, the protections . . . could potentially become worthless when invoked during the course of a bankruptcy proceeding.").

[12] *Id.* at 159 ("If the debtor can convince the court that the collective bargaining agreement is an impediment to reorganization, the majority of courts find that the equities balance in favor of rejection.").

[13] R. KNEGT ET AL., FRAUDE EN MISBRUIK BIJ FAILLISSEMENT: EEN ONDERZOEK NAAR HUN AARD EN OMVANG EN NAAR DE MOGELIJKHEDEN VAN BESTRIJDING 57 (2005), *available at* http://wodc.nl/onderzoeksdatabase/faillisementsfraude.aspx.

[14] ROGER KNEGT, FAILLISSEMENTEN EN SELECTIEF ONTSLAG, EEN ONDERZOEK NAAR 'ONEIGENLIJK GEBRUIK' VAN DE FAILLISSEMENTSWET 1–51 (1996); KNEGT ET AL., *supra* note 13.

allow for labor law modifications (easier terminations), even when there are alternative proceedings that are more efficient and can better suit the debtors' needs.

These observations can teach us valuable lessons, theoretical and practical, also with respect to bankruptcy law in the United States. From a theoretical perspective, the analysis contributes to the on-going debate between the traditional and procedural approaches to bankruptcy. It shows that although a reduction of employment protection level in insolvency can create benefits to employees, it also has adverse effects that jurisdictions need to consider. As the proceduralists argue, bankruptcy specific labor modifications create bankruptcy abuse and forum shopping effects, and these may undermine the purpose for which the modifications were designed. From a more practical perspective, the analysis has bearing on the interpretation of section 1113 of the Bankruptcy Code—the section that deals with the rejection of collective bargaining agreements in bankruptcy.[15] This Article advocates a narrow interpretation of section 1113 because as the European experience teaches us, the creation of bankruptcy specific privileges does not necessarily help debtors and employees in the long-run.

The rest of this Article then proceeds as follows: In the first part of this Article we lay down the factual background. We describe the labor laws in the Netherlands, France and Germany, and the changes applied to the general law within the bankruptcy process. In the second part of this Article we explain the rationale of the changes, and in the third part we describe the forum shopping effects. We conclude by examining the lessons learned from this comparative analysis to the domestic bankruptcy law.

I. MODIFICATION OF EMPLOYMENT PROTECTION LEVELS IN BANKRUPTCY LAW

The term "employment protection legislation" ("EPL") refers to a set of rules that limit employers when hiring, managing and firing employees.[16] These rules, which can be grounded in primary legislation, regulation, court rulings or collective bargaining agreements, cover various areas of the employment relationship, and determine the overall level of job security afforded to employees.[17] In order to evaluate the employment protection level in different countries, the Organisation for Economic Co-operation and Development (the "OECD") constructed an index comprised of various indicators.[18] The index calculates the employment protection

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[15] *See* 11 U.S.C. § 1113 (2012). There is a circuit split between the Second and Third Circuits about the conditions that justify the rejection of collective bargaining agreements. While the Third Circuit allows changes to collective bargaining agreements only when they are essential to prevent liquidations, the Second Circuit adopted a more flexible approach, and it allows modifications even when they "increase the likelihood" of a successful reorganization. *See* 7 COLLIER ON BANKRUPTCY, ¶ 1113.05[6] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009).

[16] *See* Andrea Barone, *Employment Protection Legislation: A Critical Review of the Literature*, iv (2001), *available at* http://jpkc.ojc.zj.cn/ldfx/UploadFiles/2010928214832623.pdf.

[17] *See id.* (describing EPL as a set of regulations that restrict a firm's "freedom to adjust the labour input").

[18] *See* Giuseppe Nicoletti, Stefano Scarpetta & Olivier Boylaud, *Summary Indicators of Product Market Regulation with an Extension to Employment Protection Legislation* 7 (1999) (explaining purpose of

level on a scale of zero to six (the higher the measure, the stricter the employment protections) and assesses the stringency of the various labor markets.[19]

Our research looks into three countries with relatively high employment protection levels—the Netherlands, Germany, and France.[20] Interestingly, the level of employment protection in all three countries decreases when an employer files for bankruptcy—a fact that the OECD (or any other research) does not explore in its reports. Within a bankruptcy process, even when the business continues to operate as a going concern, some of the protections employees enjoy disappear and the employer (the administrator) benefits from a greater range of flexibility. In this part we examine the nature of this change. We describe the employment protections outside bankruptcy and then point out the modifications that take place as a result of a bankruptcy process.

A. The Netherlands

1. The General Dutch Dismissals Law

The general presumption in Dutch law is that employers do not have the freedom to dismiss employees.[21] An employer who wishes to terminate an employment contract (for an indefinite period of time) must first seek outside approval, and terminations executed without such approval are null and void.[22] The

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indicators). The OECD index is comprised of three sub-categories that measure different aspects of employment protection: the individual dismissal of workers with regular contracts, additional costs for collective dismissals, and the regulation of temporary contracts. Danielle Venn, *Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators*, OECD SOCIAL, EMPLOYMENT AND MIGRATION WORKING PAPERS at 8 (2009), *available at* http://www.oecd.org/els/emp/43116624.pdf. For our purposes the indicators concerning the regulation of temporary contracts are less relevant, as we focus our analysis on the employer's ability to dismiss employees in general (not only temporary workers).

[19] The United States, which has the lowest protection level out of the OECD member countries, receives a score of 0.8 in the OECD index, while Turkey, which has the highest level of protection, receives a score of 3.5. *See* Venn, *supra* note 18, at 19.

[20] *See id.* (showing graphically high employment protection levels of the three countries). Note that although the Netherlands has an average overall employment protection level, the individual workers protection level is very high, and in 1999 it was second only to Portugal. *See* Barone, *supra* note 16, at v.

[21] *See Doing Business in the Netherlands*, ECOVIS LODDER & CO INT'L B.V., *available at* http://www.ecovis.com/fileadmin/countries/netherlands/Doing_business_in_the_Netherlands.pdf (stating provisions of Dutch labor law regarding termination are mandatory and cannot be contracted out of employment agreement).

[22] This requirement is waived when the terminations are done in one of the following circumstances: by mutual consent, during an employment trial period of maximum two months, or at the expiration of a fixed term employment contract or in summary dismissals. *See* 11 Antonie T. J. M. Jacobs, INTERNATIONAL ENCYCLOPEDIA FOR LABOUR LAW AND INDUSTRIAL RELATIONS 100–11 (R. Blanpain ed., ELL – Suppl. 276 (2004)) [hereinafter JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS]. Summary dismissals are terminations for urgent reasons. Such dismissals are possible if the employer can show that the employee has behaved in such manner that the employer cannot be expected to allow the employment contract to continue. The law sets forth a number of examples of urgent situations, like theft, misleading or false statements made while applying for a job, gross negligence in the performance of duties and more.

permission to dismiss employees should be obtained either from the Public Employment Agency ("*UWV Werkbedrijf*," or the "UWV") or from the district court.[23]

The UWV is an administrative agency engaged in job placement and re-integration.[24] When an employer wishes to dismiss an employee, he applies to the UWV in writing and substantiates the reasons for the dismissal.[25] The reasons should be either personal or economic. When the reasons are personal, the employer needs to show the employee functioned poorly and that the employer cannot be expected to continue with the employment. When the reasons are economic, the employer needs to substantiate his poor financial situation, and explain how the termination will improve the economic hardship.[26] After receiving the employer's application, the employee has a chance to respond and rebut the employer's arguments. The UWV assesses whether terminations are reasonable, while taking into account the interests of both parties.[27]

An alternative way to approve the dismissals is a request to a Dutch district court.[28] According to the Dutch Civil Code, the court may dissolve an employment contract based on "important reasons."[29] The reasons should show a change in circumstances, which are of such nature that the contract of employment needs to be terminated immediately or after a short notice.[30] In practice, however, judges almost

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[23] *See id.*

[24] For further details about the UWV Werkbedijf and its functions, *see* About UWV, http://www.uwv.nl/OverUWV/index.aspx (last visited Apr. 20, 2015).

[25] The Extraordinary Decree on Labor Relations 1945 (The "Buitengewoon Besluit Arbeidsverhoudingen") - (BBA) art. 6 (1945) (Neth.).

[26] Robert Knegt, *Regulating Dismissal from Employment: Administrative and Judicial Procedures in the Netherlands*, 11 L. & POL'Y 175, 177 (1989) (stating economic reasons are one justification for dismissing an employee).

[27] *See id.* (discussing the process by which employer can initiate action to terminate an employee). The decision of the UWV is irrevocable, and is not subject to an appeal. However, if the UWV's permission has been granted, the employee, within six months, can initiate a court proceeding claiming unreasonable dismissals. *See* BURGERLIJK WETBOEK [BW] 7:681 (Neth.), *available at* http://www.dutchcivillaw.com/civilcodebook077.htm (listing grounds on which dismissed employee may sue employer if termination was "obviously unreasonable"). Dismissals will be deemed evidently unreasonable when a false or pretended reason for termination has been provided by the employer, or if the financial consequences of the termination for the employee are too heavy in comparison to the interest of the employer. In case the court finds the terminations unreasonable, it may award damages to the employee, or with the employer's consent, reinstate the worker to his former position. JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 103.

[28] Knegt, *supra* note 26, at 178 (stating that an employer can request an order from a lower court terminating an employment contract on the grounds of "a change in circumstances").

[29] BW 7:685(1).

[30] *Id.* 7:685(2); Knegt, *supra* note 26, at 183 (stating that "important reasons" has been given a broad interpretation by courts and includes, for instance, economic necessity, and lack of trust or a "troubled relationship").

always grant a request to rescind an employment contract,[31] but as opposed to the UWV,[32] they also award damages to the employees.[33]

When the employer terminates the employment contract through the UWV, a pre-termination notice period is required.[34] The duration of the pre-termination notice depends on the duration of the employment relationship, and may last up to four months.[35] During this period the employer pays the employee his full salary.

In the event an employer intends to terminate the employment of twenty or more employees within a period of three months, the dismissals are qualified as collective redundancy and additional rules are applicable.[36] First, prior notification and detailed information of the proposed lay-offs must be given to the UWV and the trade unions.[37] The UWV cannot give its permission to the terminations until a period of at least one month has lapsed from the notification.[38] During this waiting period, the employer must consult the works council (if in place) and the trade unions, and explore different avenues to mitigate the consequences of the dismissals, such as retention or redeployment of some of the employees.[39] Second, in the event of collective redundancy the employer must apply a "balancing system" in deciding which employees are to be dismissed. The balancing system obliges the employer to divide the employees into age groups, and the percentage of employees in each of the age groups must remain the same before and after the redundancies.[40] Third, although no formal statutory requirement is in place, a social plan is usually negotiated between the employer and the trade unions or works council.[41] A social

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[31] Only about four percent of the cases are refused. JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 105–06.

[32] Under Dutch law there is no general statutory obligation to pay compensation for the dismissals (severance pay). Therefore, the UWV does not award damages to the employee, and it cannot condition its dismissal permission on such payment. *See* Knegt, *supra* note 26, at 178.

[33] The damages are calculated using an agreed formula, taking into account the employee's age and seniority. The amounts, however, may vary from case to case. Baker & McKenzie, *The Global Employer: Focus on Termination, Employment Discrimination, and Workplace Harassment Laws* 346 (2012), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1068&context=lawfirms [hereinafter Baker & McKenzie Report] (stating damages in these circumstances are calculated based on the employee's age, years of service, pay at time of termination, and special circumstances).

[34] *Id.* at 344.

[35] For the exact formula see *id.*at 344.

[36] *See id.* at 348 (explaining rules for collective redundancies).

[37] *Id.* at 349.

[38] *See id.* ("There is a minimum waiting period for giving notice of one month starting as of the notification to the UWV.").

[39] JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 111.

[40] Dismissals Decree (*Ontslagbesluit*) art. 4:2 (1999) (Neth.), *available at* http://wetten.overheid.nl/BWBR0010062/geldigheidsdatum_28-04-2014.

[41] In the Netherlands, as in most of continental Europe, the employees can be represented by several layers of employees' organizations. The trade unions aim to organize all employees that work in the same economic sector, such as public service, transportation, builders, etc. The works councils, on the other hand, represent employees that work within one establishment for the same employer. The division of tasks between the trade unions and the works councils change between country to country, and sometimes within industry to industry. In the Netherlands, social plans are most often negotiated with the relevant trade unions, but in absence of a collective bargaining agreement it can also be negotiated with the works council or even with an assembly of workers of an enterprise. *See* Jelle Visser, *The Netherlands: From Paternalism to*

plan is an agreement (some say a collective bargaining agreement) that elaborates the terms and conditions of the redundancies. The aim of the social plan is to minimize the number of forced dismissals, and to ease their financial consequences.[42]

2. Bankruptcy Modifications

Insolvency proceedings alter this termination process.[43] Some of the above mentioned limitations disappear or soften up in bankruptcy, and administrators can terminate employees more easily and cheaply.

First, within bankruptcy, administrators are not subject to the general prohibition of dismissal.[44] They do not have to seek the UWV's or the district court's permission, and the trustee can terminate the employment contract by giving notice to the employee.[45] Like with many other actions that concern the bankruptcy estate, administrators do need to obtain permission from the bankruptcy supervisory judge, but this does not pose a significant obstacle.[46] Unlike outside bankruptcy, there are no statutory guidelines that the bankruptcy court needs to examine in order to give its permission, and often the employees do not participate or respond to the administrator's dismissals request.[47] In practice, dismissal requests from bankruptcy judges are almost never refused.[48]

In addition, administrators rarely pay compensation to the dismissed employees in bankruptcy. Outside bankruptcy, although there is no statutory requirement for severance pay, compensation will be paid when there is a contractual obligation to do so or if it is awarded by the district court.[49] In bankruptcy, however, such payment is easily circumvented. First, compensation for dismissals agreed to by the

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Representation, *in* WORKS COUNCILS: CONSULTATION, REPRESENTATION, AND COOPERATION IN INDUSTRIAL RELATIONS 79, 83–85, 88, 91 (1995).

[42] *See* JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 112–13. Since there are no formal statutory requirements for the social plan, there is a great diversity among their conditions, but some common grounds do exist. Usually, the plans deal with the issues of compensation to the dismissed employees, the order of dismissals and employee redeployment (either inside or outside the enterprise).

[43] The Netherlands offers two types of insolvency processes: suspension of payments (*surseance van betaling*) and bankruptcy (*faillissments*). In this Part we focus on bankruptcy, but further in this Article we elaborate also on the suspension of payments procedure, and explain the differences between them.

[44] BLANPAIN & JACOBS, *supra* note 5, at 24.

[45] *See Faillissementswet* [FW] art. 40(1) (Neth.), *available at* http://www.dutchcivillaw.com/bankruptcyact.htm (stating liquidator in bankruptcy proceedings may terminate an employee by giving employee notice); *id.* art. 68(2) (stating curator does not need magistrate permission under section 40).

[46] In theory, administrators can ask to rescind the contract from the civil court, pursuant to section 7:685 of the Dutch Civil Code, but this route is almost never taken by administrators. Administrators do not want to undergo this burdensome procedure, and risk the imposition of compensation for the dismissals. *See* BLANPAIN & JACOBS, *supra* note 5, at 25.

[47] Memorandum from Loyens & Loeff N.V. [hereinafter L&L Opinion]. *See* JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 114. The employee does have the right to appeal the decision of the supervisory judge within five days after the employee became aware of the authorization.

[48] *See id.* at 114.

[49] *See supra* note 32 and accompanying text.

parties (whether in an individual employment contract or a collective bargaining agreement) is not classified as a claim against the estate. Administrators have no obligation to pay the agreed redundancy payment, unless the dismissals were carried out prior to the filing.[50] Second, since the only approval required for the termination is from the bankruptcy court, the compensation awarded to employees by the district court is also denied. The trustee does not request the district court's permission to rescind the contract, and the court does not award damages to the employees.[51] Third, the pre-termination notice significantly shortens—from a period of up to four months outside bankruptcy, to a maximum of six weeks inside a bankruptcy process.[52] This renders the terminations cheaper.

The procedure for collective dismissals is also rendered easier. As opposed to outside bankruptcy, the trustee does not need to report the intention to execute collective dismissals to the UWV and does not need to wait a month after such notification to initiate the terminations.[53] The prescribed consultation with the trade unions is also not applicable, as there is no statutory obligation to agree on a social plan.[54] This allows the trustee to execute a reorganization plan without sufficient consideration to the employees' needs, and in effect to extract value from them as part of the plan.

But perhaps the most important bankruptcy change concerns a transfer of business situation—a situation where the business is sold to a third party. Outside bankruptcy, pursuant to EU Directive 2001/23/EC,[55] all the rights and obligations arising from the employment relationship are automatically transferred to the new owner of the business.[56] Employment agreements cannot be terminated because of the transfer, and redundancies that are carried out despite this prohibition are considered null and void.[57] This, however, does not apply in bankruptcy.[58] When the business transfer is conducted as part of a bankruptcy process, the buyer is free

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[50] *See* BLANPAIN & JACOBS, *supra* note 5, at 38; L&L Opinion, *supra* note 47.

[51] In theory an employee can ask the court for compensation on the grounds of unreasonable dismissal by the administrators, but in practice, due to the employer's financial condition, courts rarely deny the economic grounds of the dismissals. *See* JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 114. If, despite the difficulties, the court declares the dismissals as unreasonable, then the compensation is ranked as an administrative expense, and is paid before all unsecured and preferred creditors.

[52] *See* FW art. 40(1) ("[E]mployment agreement may be terminated in any event with six weeks' notice.").

[53] *See* JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 114, 170.

[54] *See* L&L Opinion, *supra* note 47, at § 5.2.4; Mr. drs. R.M. Ronald Beltzer & R. Knegt, *Faillissementen en het afvloeien van personeel; over misbruik van het faillissementsrecht*, 26 JUSTITIËLE VERKENNINGEN 44 (2000), *available at* http://dare.uva.nl/document/39281.

[55] COMM'N OF THE EUR. CMTY. Council Directive 23, art. 3, § 3.1 (Mar. 12, 2001) [hereinafter Acquired Rights Directive] ("The rights and obligations arising for the transferor from an employment contract or employment relationship existing on the date of the transfer are, by reason of such transfer, transferred to the transferee.").

[56] *Id.*

[57] *See* BW art. 7:662–7:665. Termination of an employment agreement can, however, lawfully take place for economic, technical, or organizational (ETO) reasons, as long as they are not in connection to the transfer. *See* L&L Opinion, *supra* note 47, at § 4.11.

[58] *See* BW art. 7:666 (providing "Articles 7:662 up to and including 7:665 . . . do not apply to the transition of an enterprise if the employer is bankrupt and the enterprise belongs to the bankrupt estate").

to terminate the seller's employees as part of the transaction. He is able to choose which of the former employees he wants to hire and he is not obligated to give the rehired employees their former employment conditions.[59] This naturally renders bankruptcy business sales very attractive and, as we shall see, may even cause strategic bankruptcy filing and bankruptcy abuse.[60]

B. The French System

1. The General French Dismissals Law

Like in the Netherlands, termination of an employment contract in France requires a valid justification and must follow a certain procedure.[61] The employer's failure to comply with these requirements renders the terminations unlawful, and may result in the reinstatement of the dismissed employees or in the payment of damages.[62]

The justification to the terminations can be either personal or economic.[63] Personal reasons are reasons connected to the employee's conduct, for example, poor performance, absence without excuse, unprofessional behavior, etc.[64] Economic reasons are reasons connected to the employer, notably caused by technological modifications or economic difficulties.[65] Whether personal or economic, however, in order for the dismissal to be lawful, the reasons must be considered "real and serious" ("*cause reelle et serieuse*").[66] The phrase "real" means that the causes for dismissal must be found in external and verifiable facts.[67] The court needs to be convinced that the circumstances alleged by the employer are in

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[59] *See id.*

[60] It is a normal practice in the Netherlands that administrators, as opposed to solvent businesses, terminate employment agreements as part of the business sale, so that buyers get the business free of employment obligations. The buyers can then choose which of the former employees they want to rehire, and they are under no obligation to offer the rehired employees the same working conditions as the former business owner did before. *See* BLANPAIN & JACOBS, *supra* note 5, at 51.

[61] Thomas Le Barbanchon & Franck Malherbet, *An Anatomy of the French Labour Market: Country Case Study on Labour Market Segmentation*, *in* INTERNATIONAL LABOUR OFFICE 11 (Geneva 2013) ("Most European continental countries have some stringent procedural requirements for dismissals. In France, as a general principle, dismissals must be justified by a serious or genuine cause[.]").

[62] *See* Baker & McKenzie Report, *supra* note 33, at 162–63.

[63] CODE DU TRAVAIL [C. TRAV.] art. §§ L1232, 1233 (Fr.), *available at* http://www.legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006072050&dateTexte=20100326.

[64] *See* Baker & McKenzie Report, *supra* note 33, at 163.

[65] *Id.* at 165 ("Pursuant to Article L. 1233-3 of the French Labor Code, a dismissal can only be considered 'economic' if it is based on a reason unrelated to the employee, resulting from a reduction or change in the workforce or a substantial modification of the employment agreement due, in particular, to economic difficulties or technical changes.").

[66] *See* C. TRAV. art. §§ L1232, 1233, *available at* http://www.legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006072050&dateTexte=20100326.

[67] *See* Baker & McKenzie Report, *supra* note 33, at 164 (noting the French Labor Code does not provide definition of "real and serious cause," and that concept has been defined by French case law).

fact the true reason for the dismissals, and not some other ulterior motive.[68] The phrase "serious" means that the gravity of the causes is such that it will be impossible, without damage to the enterprise, to continue the employment.[69] The burden of proof of the real and serious reasons lies with the employer.[70] In case the employer does not meet this burden, the employee is entitled to damages of at least six months gross wages (sometimes more)—even if the employee does not suffer any harm.[71]

The procedures through which the dismissals take place vary according to the type of dismissals (personal or economic) and to the number of employees dismissed. All dismissals begin with a pre-termination hearing,[72] followed by a pre-termination notice that also states the justification for the dismissals.[73] The minimum duration of the notice is one month, but it can be extended if the parties mutually agree (through an individual or collective agreement).[74] When the dismissals are for economic reasons, additional procedures are required, depending on the number of employees terminated.[75] First, the employer needs to inform and consult with the works council (*comité d'entreprise*).[76] The number of consultations with the works council and the procedure in which they take place depend on both the scope of the terminations and on the firm's size.[77] Second, the employer must inform the labor agency of the dismissals.[78] The employer should specify to the agency on all provisions taken to avoid the dismissals or limit their number, and to

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[68] M. DESPAX & J. ROJOT, INT'L ENCYCLOPEDIA FOR LABOUR LAW AND INDUS. RELATIONS 160 (R. Blanpain ed., 1977) [hereinafter DESPAX & J. ROJOT, ENCYCLOPEDIA FOR LABOUR LAW—FR.).

[69] *Id.* at 161; *see also* Baker & McKenzie Report, *supra* note 33, at 164 ("[S]erious means that it must be of some significance, making it impossible for the employer to continue the employment relationship.").

[70] DESPAX & J. ROJOT, ENCYCLOPEDIA FOR LABOUR LAW—FR., *supra* note 68, at 162–63. Unlike in the Netherlands, the employer does not need to obtain authorization prior to the dismissals, but when an employee feels he was unjustly terminated, he may seek to the court's assistance.

[71] *Id.* at 166; *see also* Baker & McKenzie Report, *supra* note 33, at 179 ("Any dismissal made by an employer without a real and serious cause, or without complying with the procedural steps mentioned above, triggers the payment of damages to the employee.").

[72] *See* C. TRAV. art. L1232-2, 1233-11; *see also* Karen Paull, *Employment Termination Reform: What Should a Statute Require Before Terminations—Lessons From the French, British and German Experiences*, 14 HASTINGS INT'L & COMP. L. REV. 619, 657 (1991) (discussing the process of and purpose behind termination hearings).

[73] *See* C. TRAV. art. L1232-6, 1233-15.

[74] *See* Carole A. Scott, *Money Talks: The Influence of Economic Power on the Employment Laws and Policies in the United States and France*, 7 SAN DIEGO INT'L L.J. 341, 383 (2006) (discussing the notice requirement for employees who had worked for between six months and two years).

[75] The exact procedures vary according to the number of employees discharged and the size of the firm. The statute differentiates between dismissals of two to nine employees and dismissals of ten or more employees. It also differentiates between firms with fewer than fifty employees and firms with at least fifty employees. These differentiations, however, are not relevant to our discussion, because we describe the procedure from a bird's eye. For a more detailed description of the procedure. *See* Baker & McKenzie Report, *supra* note 33, 162–63.

[76] *See* C. TRAV. art. 1233-8 to 1233-10. The information provided to the council includes the reasons for terminations, the number of employees to be dismissed, the job categories and the impact of the dismissals on the enterprise. *Id.* art. 1233-10.

[77] DESPAX & J. ROJOT, ENCYCLOPEDIA FOR LABOUR LAW—FR., *supra* note 68, at 172–73.

[78] *See* Paull, *supra* note 72, at 636.

facilitate the outside re-employment of the dismissed employees.[79] Third, the employer must meet the selection criteria for the dismissed employees. The selection criteria is determined after consultation with the works council, and it must take into account various considerations specified in the statute, like seniority, family considerations, or special difficulties in finding another job.[80]

If ten or more employees are dismissed for economic reasons from firms with at least fifty employees, then the employer must also prepare a social plan ("*plan de sauvegarde de l'emploi*").[81] This plan includes all economic and financial information on the employer, as well as a description of the measures taken to minimize the social impact of the dismissals, or to avoid them.[82] The plan contains *inter alia*: agreements concerning occupational retraining, measures concerning reemployment of employees with the same or another company, and reduction or alteration of working hours.[83] The plan is reached in consultation with the works council, usually in the course of the general consultation process for collective redundancies described above.[84]

2. Bankruptcy Modifications

Inside a bankruptcy process these protections are modified. The need for justification weakens, and the procedural requirements soften up. Most of the modifications take place in a judicial reorganization procedure ("*redressement judiciaire*"), and so we focus our discussion on this procedure.[85]

The termination of employment contracts can be carried out during various stages of the reorganization procedure.[86] At the beginning of the process and before a plan of reorganization is submitted (the observation period), terminations take place only if they are urgent, inevitable and indispensable.[87] The administrator needs to prove that the layoffs are imperative to the continuation of the debtor's business, and that without immediate steps, the business may collapse.[88] The

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[79] *See* Baker & McKenzie Report, *supra* note 33, at 171–72, 177–78.

[80] *See* C. TRAV. art. 1233-5; *see also* Scott, *supra* note 74, at 384.

[81] *See* C. TRAV. art. L1233-61. Shortcomings in the consultation procedure with the works council, in the employer's reemployment efforts, or in the proposed social plan, can result in the invalidity of the terminations. *See* Scott, *supra* note 74, at 383–84.

[82] *See* Scott, *supra* note 74, at 368–69 (explaining the measures an employer must take).

[83] *See* C. TRAV. art. L1233-61.

[84] DESPAX & J. ROJOT, ENCYCLOPEDIA FOR LABOUR LAW—FR., *supra* note 68, at 261–63.

[85] French law offers various insolvency proceedings, and among them the "*redressement judiciaire*" is the chief judicial reorganization proceeding. For a more elaborate description of the different proceedings, *see infra* note 251.

[86] 2-22 COLLIER INTERNATIONAL BUSINESS INSOLVENCY GUIDE P 22.05 at ¶ 22.05[4][b] (describing judicial bankruptcy proceedings in France and stating "[n]o special rule applies to employee dismissal").

[87] Barbara K. Morgan, *Should the Sovereign Be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy*, 74 AM. BANKR. L.J. 461, 494 (2000) (discussing requirement of "a six-month observation period (*période d'observation*) to determine whether or not a rescue plan is feasible.").

[88] Jean Marie Becquet, *La Decision Du Juge De La Procedure Collective Concernant La Rupture Des Contrats De Travail*, 5 REVUE DES PROCEDURE COLLECTIVE 237 (2001); PATRICK MORVAN,

terminations are rendered easier, however, when they are part of the reorganization plan. According to section 631-19 of the French Commercial Code, a plan of reorganization should specify the dismissals to be made within one month following the plan's approval.[89] If the plan is approved, then within that month the dismissals are made by a simple notification of the administrator, subject to the rights related to the pre-termination notice.[90] As opposed to the law outside bankruptcy, the notification to the employees does not need to state the justification of the terminations.[91] It is sufficient for the layoff letter to reference to the decision authorizing the reorganization plan, without stating a *cause reelle et serieuse*.[92] The plan itself does not justify the termination of the individual employees.[93] It looks at the firm's economic situation in general, and details the number of employees in the different professional categories to be terminated and the criteria for choosing the employees.[94] Nevertheless, after the plan is approved, a real and serious cause is presumed to exist for each of the dismissed employees, and they are not permitted to argue the financial grounds (as opposed to the procedural aspects) of their dismissals.[95]

The procedural obligations, and in particular the obligation to consult with the works council, are applicable during a bankruptcy procedure, but they are also somewhat modified to facilitate easier terminations. First, section 1233-58 of the French Labor Code contains special rules with regard to the consultation process in case of judicial reorganization or liquidation.[96] These rules aim to speed up the conclusion of the social plan, and they require fewer meetings between the parties.[97] Second, section 1233-60 reduces the procedural requirements with regard to the labor agency.[98] The scope of information that the administrator needs to provide to the agency decreases, and the time period the agency has to examine the

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RESTRUCTURATIONS EN DROIT SOCIAL 687–88 (2d ed. 2010); Patrick Bailly, *Les Licenciements et Les Procedures Collectives*, GAZETTE DU PALAIS 3626, 3628 (November-December, 2008).

[89] CODE DE COMMERCE [C. COM.] art. L631-19 (Fr.).

[90] *See* Andrew Tetley & Marcel Bayle, *Insolvency Law in France*, WORLD INSOLVENCY SYSTEMS 195, 270–71 (Otto Eduardo Fonseca Lobo ed., 2009); Becquet, *supra* note 88, at 239.

[91] 2-22 COLLIER INTERNATIONAL BUSINESS INSOLVENCY GUIDE, *supra* note 86, at ¶ 22.05[2][b].

[92] Bailly, *supra* note 88, at 3629. The plan does need to detail the firm's economic condition, the expected level of employment in the reorganized firm and the prospects of successful rehabilitation. *See* French Commercial Code art. L631-19(I), which adopts section 626-2 of the Code.

[93] The plan is not even allowed to mention the terminated employees by name. *See* MORVAN, *supra* note 88, at 702.

[94] *Id.* at 696–97.

[95] *See* Bailly, *supra* note 88, at 3629. Morvan harshly criticizes this bankruptcy rule. He argues that the bankruptcy court's approval of the reorganization plan should not replace the labor court's authority. According to Morvan, the bankruptcy court looks at that firm's general economic situation, whereas the labor court should examine the existence of a real and serious economic reason for each of the terminated employees. *See* MORVAN, *supra* note 88, at 696–97.

[96] C. TRAV. art. L. 1233-58.

[97] For example, in cases where more than ten employees are to be dismissed, there has to be only one meeting with the works council instead of two.

[98] C. TRAV. art L. 1233-60.

information shortens.[99] Third, the consequences of providing an insufficient social plan change. If outside bankruptcy an insufficient social plan results in the invalidation of terminations, section 1235-10 of the French Labor Code states that this does not apply during bankruptcy procedures.[100] During bankruptcy the terminations are valid, and the discharged employees are only entitled to damages.[101] This rule may have particular importance when the business is transferred in bankruptcy.[102]

In addition, similar to the Netherlands, the bankruptcy process renders dismissals carried out as part of a transfer of business possible. Outside bankruptcy, when an employer's business is transferred—i.e., sold or merges with another firm—the law imposes the continuation of the labor agreements. Dismissals carried out in connection with the business transfer are invalid, and all the labor obligations of the former employer pass to the new owner.[103] This rule is waived when the business sale is conducted as part of a bankruptcy.[104] Within bankruptcy, if the court approves a "transfer plan,"[105] then all the employees not rehired by the buyer pursuant to the plan are dismissed through an ordinary notification of the administrator or liquidator.[106] In addition, as opposed to the regular rule, the new employer does not take on the employment debts incurred by the transferring party before the takeover.[107] Thus, for example, the buyer is not required to pay for paid vacations acquired prior to the transfer date or to pay for indemnificatory debt resulting from layoffs performed before the transfer.[108]

Note, though, that despite these modifications, French law does give significant weight to the position of the works council[109] and the interests of the majority of employees. The Commercial Code emphasizes that the court can approve a reorganization or transfer plan only after the administrator has consulted with the works council (albeit in the revised and shortened form prescribed in 1233-58),[110] and it clearly states that the main purpose of the reorganization procedure is to save

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[99] *Cf.* C. TRAV. art L. 1233-46 to 1233-60, 1233-54; *see* MORVAN, *supra* note 88, at 696–97.

[100] *See* C. TRAV. art. L. 1235-10.

[101] *See* Samuel Estreicher and Jeffrey M. Hirsch, *Comparative Wrongful Dismissal Law: Reassessing American Exceptionalism*, NEW YORK U. L. & ECON. WORKING PAPERS, Paper 342, 34 (2013) (stating employees are eligible for severance payments in addition to any unjust dismissal remedies).

[102] Bailly, *supra* note 88, at 3630.

[103] *See* C. TRAV. art. L. 1224-1 & 1224-2; *see also* DESPAX & ROJOT, *supra* note 68, at 175–77.

[104] *See* Bailly, *supra* note 88, at 2630–32.

[105] A transfer plan is the plan according to which the business transfer is taking place. All potential buyers submit their transfer plans to the administrator, in which they detail, *inter alia*, the level and prospects for employment and the guarantees given to the business's continued performance. *See* C. COM. art. L642-2. The administrator examines the different plans, and the court then approves the chosen plan pursuant to the rules detailed in article 642-5.

[106] *See id.* art. 642-5. The court can approve the buying offer (the transfer plan) only after the preparation of a social plan for the dismissed employees and after a consultation with the work council or the employee delegates. *Id.*

[107] *See* Bailly, *supra* note 88, at 2631–32.

[108] *Id.*

[109] Or in the absence of a works council, the employees' delegates.

[110] *See* C. COM. art. L631-19.

the business and its employees (and only then to settle the business' liabilities).[111] In addition, if during the bankruptcy the administrator receives several offers to purchase the firm, the court is directed to choose the buyer which allows the most prolonged maintenance of employment—not the buyer who offers the highest price for the business.[112] Thus, the collective interests of the employees are elevated above those of the creditors, and the Code aims to keep as many workers employed as possible.[113]

This attitude, seemingly inconsistent with the bankruptcy modification described earlier, will be examined in the second part of this Article.

C. Germany

1. The German General Dismissals Law

In Germany, employees are protected against unjustifiable termination by the Protection Against Unfair Dismissal Act, known as the "*Kündigungsschutzgesetz*" ("KSchG").[114] The Act, which applies to employees employed for more than six months in firms with more than five employees, requires dismissals to be socially justified, which means they must be based on one of three possible reasons: misconduct, personal capabilities, or operational causes.[115] If the dismissals are the result of operational causes, the employer has to meet additional pre-conditions to justify the terminations.[116] The employer must show that the employee's specific job was removed, that there is no possibility to employ the employee in an alternative place in the firm, and that he selected the dismissed employees according to special rules ("*social selection*").[117] Although the employer does not have to seek third party authorization prior to the dismissals, an employee may

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[111] *See id.* art. L631-1 ("The purpose of the reorganization procedure is to allow the continuation of the business's operations, the maintenance of employment and the settlement of its liabilities."); *see also* Bailly, *supra* note 88, at 3626.

[112] *See* C. COM. art. L642-5.

[113] *See id.*

[114] Michael Kittner & Thomas C. Kohler, *Conditioning Expectations: The Protection of the Employment Bond in German and American Law*, 21 COMP. LAB. L. & POL'Y J. 263, 303 (2000) (stating "any routine termination required justification by the employer in order to be valid, based on the conduct of the employee, the inability of the employee to fulfill the requirements of the job or business requirements").

[115] Achim Seifert & Elke Funken-Hötzel, *Wrongful Dismissals in the Federal Republic of Germany*, 25 COMP. LAB. L. & POL'Y J. 487, 497–98 (2004). Conduct related dismissals are justified by the behavior of the employee, for example, failure to perform tasks or breach of fiduciary duties. Person related dismissals are based on the personal capabilities of the employee, and are often connected to health issues or an inability to perform the job. Operational related dismissals are connected to changes in the firm that preclude the continued employment. These changes can be internal, such as plant closure, change of technology, or introduction of new production measures, or external, such as drop of orders or lack of raw materials. *See id.*

[116] *See id.* at 498–99 (explaining such requirements, such as examining "whether the employee in question can be transferred to another workplace in the same establishment or in another establishment of the employer," and to "carry out so-called 'social selection'").

[117] *Id.*; Baker & McKenzie Report, *supra* note 33, at 197 (stating "'social selection' means selecting for redundancy the employee who would be the least severely affected by the termination").

challenge the termination in court in case he feels the employer is unjustified.[118] The court then examines whether the employer's interests outweigh those of the employee, and the employer bears the burden of proof for the existence of a social justification.[119] If the employer does not meet this burden, the dismissals are declared invalid and the employer is obligated to continue the employment relationship.[120]

In terms of procedure, terminations in Germany begin with a pre-termination notice to the employee. The notice should be in writing, and must contain clear and unambiguous declaration of the dismissals.[121] The duration of the pre-termination notice period increases with seniority. The initial notice period is four weeks, but it can increase to a maximum of seven months.[122] The notice period may be shortened or extended contractually.[123] In establishments with works council, the protection against dismissals is supplemented with the requirement to consult with the works council prior to the terminations.[124] The council may consent to the termination, raise doubts, or object to it based on certain grounds listed in the statute.[125] An objection by the works council does not invalidate the terminations, but it does give the employee the right to remain employed until legal proceedings on the termination are completed.[126]

In addition, when employment downsizing occurs as part of plant modifications, then further measures should be taken. "Plant modification" is a term defined in section 111 of the Works Constitution Act (the "BetrVG").[127] It applies to firms that have more than twenty employees, and relates to changes that entail substantial prejudice to the workers, such as a closedown of the plant or

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[118] Seifert & Funken-Hötzel, *supra* note 115, at 500 ("[T]he 'social selection' can be attacked by every dismissed employee.").

[119] Kittner & Kohler, *supra* note 114, at 305, 307–08.

[120] Seifert & Funken-Hötzel, *supra* note 115, at 501 ("[T]he employee who has been dismissed without social justification is entitled to be reinstated to his or her former job according to the working conditions agreed upon in the employment contract."). In practice, however, such proceedings usually end up in compromise, according to which the employer pays compensation to the employee, and the employee surrenders his right to be reemployed. *Id.* ("However, it seems that the right to be reinstated during the Labor Court procedure does not play an important role in practice.").

[121] BÜRGERLICHES GESETZBUCH (BGB) § 623 (Ger.) ("Termination of employment by notice of termination or separation agreement requires written form to be effective; electronic form is excluded.").

[122] The exact notice periods are as follows: Before two years, four weeks until the fifteenth or the end of the month, whatever is closer. After two years, an employee is entitled to the following notice periods until the end of a calendar month: after two years and before five years—one month notice period; after five years—two months; after eight years—three months; after ten years—four months; after twelve years—five months; after fifteen years—six months; and after twenty years—seven months. *Id.* § 622.

[123] *See id.* (explaining when notice period may be shortened or extended).

[124] BETRIEBSVERFASSUNGSGESETZ [hereinafter German Works Constitution Act] § 102 (Ger.) ("The works council shall be consulted before every dismissal."); Baker & McKenzie Report, *supra* note 33, at 196 ("If a Works Council exists, it must be given the opportunity to comment on the intended termination of an employee prior to serving the notice of termination.").

[125] *See* Kittner & Kohler, *supra* note 114, at 316–17 (discussing work council's evaluation process of intended termination).

[126] *Id.* at 305, 316–20.

[127] German Works Constitution Act § 111.

significant parts of it, merger or splitting up of plants, introduction of new work methods, and so on.[128] When plant modifications include the terminations of employees, the employer must meet additional obligations, namely an attempt for a reconciliation of interests and a social compensation plan.[129]

A reconciliation of interests is an agreement between the employer and the works council as to the way the proposed plant modifications are to be implemented. The agreement describes how the operational change is to take place and what will be its effects on the employees.[130] Although the conclusion of reconciliation agreement is not a compulsory condition for the terminations, the employer must go through various stages of negotiations with the works council in an attempt to reach one.[131]

As part of the negotiations, the employer should also agree with the works council on a social compensation plan.[132] The social compensation plan specifies the compensation and reduction of the economic disadvantages suffered by the employees as a result of the modifications.[133] If the parties are unable to reach an agreement, the conciliation board is authorized to decide the content of the social plan itself.[134]

2. Bankruptcy Modifications

Although to a lesser extent than in France or the Netherlands, bankruptcy law in Germany also modifies some of the employees' protections.[135] One of the important modifications concerns the validity of contractual limitations to the employer's dismissal rights. Section 113 of the German Insolvency Code (the "InsO") allows

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[128] *Id.*; Heiner Heseler & Ulrich Mückenberger, *The Management of Redundancies in Europe: The Case of Germany*, 13 LABOUR 183, 220 (1999) (listing "business alteration" definitions found in section 111 of the Works Council Constitution Act).

[129] German Works Constitution Act § 112; Baker & McKenzie Report, *supra* note 33, at 200 (discussing employer obligations when terminating employees as a result of plant modification).

[130] *See* Heseler & Mückenberger, *supra* note 128, at 221 ("The aim of the consultation it to achieve an agreement between the works council and the employer.").

[131] First, the parties must negotiate independently and if they fail to reach an agreement, they should attempt reconciliation with the Board of the Federal Labor Agency. Then, if the outcome is negative, the matter is brought to the conciliation board. The conciliation board will either bring about an agreement between the parties or declare a breakdown in the negotiations. Only after this procedure takes place can an employer implement plant modifications without risk of claims by the works council. *See* Gerhard Picot, *Closure of Plants and Other Operational Companies in West Germany*, 16 INT'L BUS. LAW. 59, 60 (1988); *see also* Heseler & Mückenberger, *supra* note 128, at 221.

[132] German Works Constitution Act § 112 ("The foregoing shall also apply to an agreement on full or part compensation for any financial prejudice sustained by staff as a result of the proposed alterations (social compensation plan).").

[133] *See* Picot, *supra* note 131, at 61 (discussing work council's power to force an agreement for compensation or mitigation of economic disadvantages suffered by employees through company changes).

[134] *See* Kittner & Kohler, *supra* note 114, at 318–19; Heseler & Mückenberger, *supra* note 128, at 221; Picot, *supra* note 131, at 61 ("If there is no mutual agreement, the Conciliation Committee . . . can make a binding decision for the Social Plan.").

[135] *See generally* Omer Kimhi & Arno Doebert, *Insolvenzrecht, Forum Shopping und das Butner-Prinzip–Gedanken zur ökonomischen Analyse des Arbeitsrechts der Insolvenzordnung*, 9 ZInsO 357 (2013).

the administrator to terminate an employee irrespective of employment protections agreed to in the employment contract.[136] This also applies to contractual exclusions to the right to terminate in collective bargaining agreements, and it overrides the general prohibition to terminate employees during a fixed term employment.[137] In addition, the InsO allows the administrator to unilaterally reject a works council agreement ("*Betriebsvereinbarung*," or the "WCA"), which is a type of collective bargaining agreement.[138] If the WCA provides for employment benefits that are incumbent on the estate, then the administrator is able to terminate the burdensome agreement with three months' notice.[139]

As opposed to the contractual protections, though, most of the statutory requisites for terminations still apply in insolvency. The provisions of the KSchG must be met, and the administrator should prove that the terminations are socially justified.[140] However, section 125 of the InsO limits the ability of the individual employee to contest the terminations. Pursuant to this section, if the administrator and the works council agree on a list of employees to be dismissed, the terminations are deemed to be socially justified.[141] Compelling operational reasons are presumed to exist, and to challenge the terminations the employees need to prove otherwise.[142] This makes challenging the terminations more difficult for the individual employee, and indeed trustees increasingly use this tool during restructuring.[143] Interestingly, though, the tool provided in section 125 was incorporated in 2004 to the general

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[136] INSOLVENZORDNUNG [INSO] § 113 (Ger.) ("A contract entitling the debtor to services may be terminated by the insolvency administrator and by the other party irrespective of any agreed duration of such contract or agreed exclusion of the right to routine termination.").

[137] *See* BERND KLOSE, *German Insolvency Statute*, WORLD INSOLVENCY SYSTEMS 341–42 (Otto Eduardo Fonseca Lobo ed., 2009).

[138] German labor laws allow collective bargaining agreements on two levels. Works councils can negotiate and conclude collective agreements with an employer for a single establishment (*Betriebsvereinbarung*), and the trade unions can negotiate and conclude collective agreements with employers' associations or single employers (*Tarifvertrag*). Section 120 of the German Insolvency Code applies to the works council agreements only, but these agreements often contain normative clauses regulating the works conditions for the employees who belong to the undertaking. *See* InSo § 120.

[139] This authority is especially significant when the business is sold to a third party. In a regular reorganization procedure, section 120 is not very important, because the working conditions prescribed by the works council agreement continue to take effect until they are replaced by a different WCA. Thus, the working conditions will remain the same until the employer negotiates a new agreement with the council. *See* German Works Constitution Act § 3 (discussing formation of new work council agreements). However, when the business is sold in a bankruptcy proceeding and section 120 applies, the buyer is not bound by the rejected agreement. According to section 613(a)(1) of the German Civil Code, an agreement with a mere after-effect is not binding by the buyer, and he can change the terms of the rejected agreement through individual agreements. *See* BGB § 613(a)(1); *see also* EBERHARD BRAUN, COMMENTARY ON THE GERMAN INSOLVENCY CODE 251 (2006).

[140] *See* BLANPAIN & JACOBS, *supra* note 5, at 26.

[141] InsO § 125.

[142] *See* BRAUN, *supra* note 139, at 259–61. In addition, the selection of the terminated employees (social selection) is examined only for gross errors.

[143] *See id.*; *see also* KLOSE, *supra* note 137, at 348 ("The possibility to conclude a balance of interests accord with attached list of names is being increasingly utilized by trustees in bankruptcy and works councils.").

labor law.[144] Thus, most of the facilitations provided by section 125 are now also available to employers through section 1(5) of the KSchG.[145]

In addition, the InsO simplifies the termination procedure. First, the pre-termination notice is shortened.[146] Inside bankruptcy proceedings, the maximum notice period is three months, compared to a maximum of seven months, which is the notice period outside bankruptcy.[147] Second, when the plan of reorganization constitutes a plant modification, the bankruptcy procedure simplifies the conclusion of a reconciliation of interests.[148] The administrator must still negotiate with the works council, but if an agreement has not been reached within three weeks, he has the option to ask the labor court to skip the rest of the burdensome negotiations procedure.[149] The labor court examines whether the disadvantages caused to the creditors from a full (and lengthy) conciliation procedure outweigh the social concerns to the employees, and if so, it can release the administrator from the conciliatory proceedings.[150] Third, with regard to the social compensation plan, the InsO limits the total amount the administrator can pay the employees.[151] According to section 123, the maximum amount the administrator can pay is two and a half months wages of the employees affected by the plan, and this amount cannot exceed a third of the total value of the estate.[152] If the compensation due exceeds these upper bounds, then each employee will get only his pro rata share.[153]

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[144] *See "Agenda 2010" and "Hartz" New Developments German Employment Law*, JONES DAY (2004), http://www.jonesday.com/files/Publication/45c8e58c-b24d-430c-b28c-811019cd85f4/Presentation/PublicationAttachment/edeca54a-b8f9-4854-b234-9ed9f682bed5/German_Labor_English.pdf (analyzing amendments to German employment law).

[145] The rules in § 1(5) of the Protection Against Unfair Dismissal Act [KSchG] and § 125 of the InsO are not exactly identical. On the differences, *see* Inken Gallner, ERFURTER KOMMENTAR ZUM ARBEITSRECHT § 125 RN.1 [ERFK-GALLNER] (Thomas Dietrich et al. eds., 13th ed. 2012).

[146] *See* InsO § 113 (describing maximum three month termination period).

[147] *See id.* ("If no shorter period has been agreed, the period of notice shall be three months to month's end.").

[148] *See id.* § 125.

[149] *See supra* note 131.

[150] *See* InsO §§ 121–122. If a conciliatory procedure does take place, the insolvency code expedites it. Whereas outside bankruptcy, both parties are entitled to demand a mediation procedure before the Federal Labor Agency prior to reaching the conciliation board, inside bankruptcy, a mediation procedure is not required unless both parties jointly agree to one. *See* BRAUN, *supra* note 139, at 252–55.

[151] *See* InsO § 123 ("A social plan established subsequent to opening of insolvency proceedings may provide for a total amount of up to two and one half month's wages . . . of the dismissed employees to recompense for or to attenuate their economic disadvantages under the envisaged plant modification.").

[152] *Id.* ("However, if no insolvency plan comes into being, no more than one third of the assets involved in the insolvency proceedings available for distribution among the creditors of the insolvency proceedings without such social plan may be used for the settlement of social plan claims.").

[153] This does not mean that all employees to be dismissed receive two and a half months wages. It only defines the upper limit of the total amount of the social compensation plan. How the amount is distributed is a matter of agreement between the administrator and the works council. Note that some employees may not be dismissed within the scope of the agreed upon plan modification, but may still suffer disadvantages for other reasons, and are thus covered by the scope of the social compensation plan. It is controversial whether the amount limit applies only to the dismissed employees or also to all the employees affected by the plan. *See* BRAUN, *supra* note 139, at 257–58.

Lastly, bankruptcy renders terminations conducted as part of a transfer of business easier. In general, employees' rights in situations of business transfers are regulated by section 613a of the German Civil Code ("*Bürgerliches Gesetzbuch*" or the "BGB").[154] This provision states that anyone who acquires a company must take on all of its employees, including their social rights, and that the acquirer is liable for all employment claims accrued until the transfer.[155] In bankruptcy, although section 613a continues to apply, its application is more limited.[156] Unlike the general rule, when a transfer of business takes place within bankruptcy, the buyer is not responsible for employment liabilities incurred prior to the filing.[157] The buyer is liable only for claims that arise after the opening of the insolvency proceedings, and he cannot be burdened with arrears or pension liabilities from the past.[158] The strict rule that voids terminations that occur in connection to the transfer of business also becomes more flexible.[159] If the buyer agrees with the works council on a reconciliation of interests with a list of employees to be fired (a procedure similar to the one set forth in section 125), then according to section 128 of the InsO, the terminations are valid (notwithstanding section 613a).[160] In addition, the Federal Labor Court determined that a notice of termination given by the administrator on the basis of a buyer's concept plan ("*Erwerberkonzept*") does not necessarily violate section 613a. The concept plan details how the buyer intends to restructure the acquired firm, and if a reconciliation of interests is concluded on the basis of such plan, then the terminations can be considered valid with the approval of the court.[161]

Indeed, Germany, like the other high EPL jurisdictions we have examined, decreases its employment protections in bankruptcy.[162] Especially in transfer of

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[154] BGB § 613a ("Rights and duties in the case of transfer of business").

[155] *See id.* ("If a business or part of a business passes to another owner by legal transaction, then the latter succeeds to the rights and duties under the employment relationships existing at the time of the transfer."); *see also* BERND WAAS, CORPORATE RESTRUCTURING AND THE ROLE OF LABOUR LAW 79, 88–89 (Roger Blanpain, Takashi Araki and Shinya Ouchi ed., 2003).

[156] *Id*. at 89–90.

[157] *See* InsO § 125.

[158] *See* BAG, Urt. v. 17.1.1980 – 3 AZR 160/79, ZIP 1980, 117 120 (Ger.); *BAG*, Urt. v. 30.10.2008 – 8 AZR 54/07, ZInsO 2009, 1119 (Ger.); BLANPAIN & JACOBS, *supra* note 5, at 46.

[159] *Compare* BGB § 613a(4) ("The termination of the employment relationship of an employee by the previous employer or by the new owner due to a transfer of a business or a part of a business is ineffective."), *with* InsO § 128(2) ("In the case of a transfer of plant, the presumption . . . shall also imply that termination of employment does not occur because of the transfer of plant.").

[160] *See* InsO § 128(2); *see also* BRAUN, *supra* note 139, at 263–66.

[161] *See* BAG, Urt. v. 20.3.2003 – 8 AZR 97/02, NJW 2003, 3506 (Ger.). The German Federal Labor Court explained that the purpose of section 613a is to prevent the acquirer from firing socially weaker employees (while keeping other stronger employees), but there is no point in forcing it to keep employees who, from an economic perspective, have no future position after the acquisition. This, however, requires a binding buyer's concept for rehabilitation and that the execution of this concept has already manifested itself to a certain degree at the time the termination is declared. A simple demand of the buyer to reduce the workforce before the transfer does not suffice.

[162] *Cf.* BLANPAIN & JACOBS, *supra* note 5, at 42 ("Employees' protection against dismissal is extremely limited in the context of bankruptcy . . . . General bans on dismissal for specified categories of grounds for dismissal and dismissal situations play a role, at most, when the receiver is pursuing a strategy of selective dismissals.").

business situations, these systems allow administrators more flexibility than employers regularly have, which allows for sales that will ultimately save the business.[163]

This seemingly technical analysis touches upon the foundations (or as Douglas Baird phrased it—"the axioms")[164] of bankruptcy law. It relates to the goals bankruptcy law should serve and to the connection between bankruptcy and other areas of law—the "law outside bankruptcy."[165] In the following parts, we examine how the different theoretical approaches to bankruptcy, and in particular the procedural approach—the prevailing view to bankruptcy in the United States[166]—correspond with this European policy.

II. BANKRUPTCY LAW AS A BALANCING SYSTEM

Bankruptcy scholarship can be divided into two competing camps: the traditionalists and the proceduralists. These two camps differ in the roles they believe bankruptcy law should play in the preservation of firms, and in the substantive law they think should be applied within a bankruptcy process.[167]

The traditional approach to bankruptcy emphasizes the rehabilitation of distressed firms.[168] According to this view, the liquidation of firms has ruinous spillover effects on employees, customers, and even on communities as a whole, and the law should aim to minimize these effects by preserving distressed firms as going concerns.[169] As part of the rehabilitation efforts, traditionalists are willing to modify the rights of the parties involved in a bankruptcy process from their non-bankruptcy baseline.[170] They endorse changes of the laws outside bankruptcy when such changes assist the rehabilitation process of a distressed debtor.[171]

The proceduralists, on the other hand, look at the bankruptcy process as a

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[163] *See* InsO § 126 (providing "the insolvency administrator may request a decision on the part of the labour court to the effect that termination of contracts covering certain employees designated in his request is conditioned by urgent operational requirements and justified under social aspects"); *see also id.* § 127 ("If the insolvency administrator gives notice to an employee . . . the legally binding decision in proceedings pursuant to Section 126 shall be binding on the parties.").

[164] *See* Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 575 (1998) [hereinafter Baird, *Bankruptcy's Uncontested Axioms*] (examining manner in which two sets of axioms have sculpted the bankruptcy world).

[165] *Id.* at 578.

[166] *See* references, *supra* note 6.

[167] *See id.* at 577–78 (describing differing approaches of proceduralists and traditionalists)

[168] *Id.* at 577 ("The traditionalists believe that bankruptcy law serves an important purpose in rehabilitating firms that, but for bankruptcy protection, would fail.").

[169] *See* Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM L. REV. 717, 773–74 (1991); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 367 (1993).

[170] *See* Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 872 (1982) (noting a secured creditor's non-bankruptcy entitlements are changed in bankruptcy).

[171] *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 792–93 (1987).

procedural tool.[172] Bankruptcy law, according to their view, should not favor rehabilitation over liquidation, and should not aim to protect the interests of non-claimants (like employees or communities).[173] The law's sole purpose is to facilitate a collective system, in order to increase the creditors' returns from the debtor.[174] Viewed as a procedural tool, bankruptcy law should also preserve the non-bankruptcy legal entitlements.[175] It should mirror the law outside bankruptcy, unless a change in the law is necessary as part of the move to a collective system.[176]

The proposition that bankruptcy law should keep the non-bankruptcy legal entitlements intact is justified by proceduralists with two main arguments. The first argument is negative in nature—bankruptcy filing simply does not provide a good enough reason to change the legal rights that are usually assigned to different parties (suppliers, workers, communities, etc.).[177] The goal of bankruptcy law is to maximize the size of the debtor's estate, but how the estate is allocated among the different creditors is a matter of substantive (non-bankruptcy) law.[178] Substantive law determines the creditors' rights to the debtor's assets (and the priorities among the creditors) in general, and it should do so also when the debtor is insolvent.[179] Take, for example, the level of employment protection. If labor policies outside bankruptcy rightly capture the relevant considerations of the labor market, then there is no reason to waive employment rights during a bankruptcy process. If, on the other hand, the general employment protection is too high, then why should the system decrease it only when the employer is bankrupt?[180] Granting employers

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[172] *See* Baird, *Bankruptcy's Uncontested Axioms*, *supra* note 164, at 576–77 (describing proceduralist "group's distinctive characteristic is its focus on procedure and its belief that a coherent bankruptcy law must recognize how it fits into both the rest of the legal system and a vibrant market economy").

[173] Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH & LEE L. REV. 931, 931 (2004) ("Procedure theory holds that it generally is wrong in bankruptcy to redistribute a debtor's wealth away from its rightsholders to benefit third-party interests, such as at-will employees and the general community.").

[174] *See* Jackson, *supra* note 170, at 861–62 (stating collective system reduces variances in recovery benefiting creditors); Mooney, *supra* note 173, at 948 (finding proceduralists respect non-bankruptcy entitlements in bankruptcy except when necessary to solve collective action problem facing creditors); Douglas G. Baird, *A World Without Bankruptcy*, 50 L. & CONTEMP. PROBS. 173, 192 (1987) ("The whole point of a bankruptcy proceeding is to change procedures so that creditors and others with rights to the firm's assets can act collectively.").

[175] *See* Mooney, *supra* note 173, at 937 ("Bankruptcy law should take substantive legal entitlements of rightsholders as it finds them, honoring both powers and limitations under nonbankruptcy law.").

[176] *See* JACKSON, *supra* note 7, at 21.

[177] *See* BARRY E. ADLER, DOUGLAS G. BAIRD & THOMAS H. JACKSON, BANKRUPTCY CASES PROBLEMS AND MATERIALS 28–29 (4th ed. 2007).

[178] *See* JACKSON, *supra* note 7, at 24; *see also* Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 823–24 (1987).

[179] *See* Thomas H. Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 AM. BANKR. L.J. 399, 416–17 (1986) (arguing decision to give substantive rights to group deserving of such rights should not be a bankruptcy-specific question).

[180] *See* JACKSON, *supra* note 7, at 112 ("The function of the labor law rule seems directed at *preferring* the protected group of union members by giving them a set of nonwaivable procedural rights effective both against the debtor and its other claimants . . . . If the analysis rightly captures the relevant considerations of non-bankruptcy law and policy, then bankruptcy law should mirror the rights established by labor law by enforcing them as they exist or by respecting their relative value.").

more flexibility in general may be able to prevent the bankruptcy situation in the first place.

The second, and perhaps more important, argument for the preservation of non-bankruptcy entitlement is that not only is a bankruptcy specific change in substantive rights not justified, it can also be damaging. Bankruptcy specific changes create bankruptcy abuse and forum-shopping effects,[181] and these effects decrease debtors' value and harm the social welfare. Douglas Baird explains the problem of forum shopping through the following example.[182] Imagine there are two cities, each with its own courthouse. The reason for building two courthouses is to allow the residents of each city to resolve their disputes close to where they reside—without having to spend unnecessary traveling costs. If, however, the two courthouses adjudicate cases according to a different set of substantive rules, then the purpose of having two courthouses will be defeated. Litigants will choose the court that applies the rules which maximize their chances of success, even when adjudication in that courthouse imposes unnecessary traveling costs on all parties. The same is true with regard to bankruptcy and non-bankruptcy forums. The goal of creating a bankruptcy specific collection system is to maximize the debtor's value when it becomes insolvent. If, however, substantive laws change as a result of the bankruptcy filing, then the debtor and creditors will choose the forum that implements the law most favorable to their individual claims. They may invoke bankruptcy in order to gain advantages from the substantive law modifications, even when the bankruptcy reduces the debtor's value for all other claimants. This creates economic inefficiency, and in a sense reintroduces the very problem bankruptcy is designed to solve.[183]

Due to these arguments, in the United States the procedural view has become the dominant approach to bankruptcy both normatively and positively.[184] In the famous case of *Butner v. United States*, the Supreme Court determined that unless some federal interest requires otherwise, there is no reason to alter the non-bankruptcy legal baseline.[185] The court explained that a uniform treatment of the substantive law inside and outside bankruptcy "*serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy*.'"[186]

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[181] Forum shopping is the "practice of choosing the most favorable jurisdiction or court in which a claim might be heard." BLACK'S LAW DICTIONARY 681 (8th ed. 2009).

[182] *See* Baird, *supra* note 178, at 824–28.

[183] *See* Baird, *Bankruptcy's Uncontested Axioms*, *supra* note 164, at 591; JACKSON, *supra* note 7, at 21; Jackson, *supra* note 178, at 403.

[184] *See* DOUGLAS BAIRD, ELEMENTS OF BANKRUPTCY 4–5 (5th ed. 2010); JACKSON, *supra* note 7, at 24 (stating bankruptcy law best approached by separating bankruptcy questions from nonbankruptcy questions).

[185] Butner v. United States, 440 U.S. 48, 55 (1979) ("Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").

[186] *Id*. (emphasis added); *see also* ADLER, BAIRD & JACKSON, *supra* note 177, at 30 ("Although Butner involved a narrow question of North Carolina real estate law . . . [the Butner] principle applies in almost every bankruptcy case."); JACKSON, *supra* note 7, at 21 ("The problem of changing relative entitlements in bankruptcy not only underlies this book's normative view of bankruptcy law but also forms the basis of the

As we have seen, however, the European systems examined in this Article adhere to a different, more traditional approach.[187] These systems choose to implement a high employment protection level outside bankruptcy, and then decrease the level of protection inside a bankruptcy process. They place significant obstacles (substantive and procedural) on an employer's ability to terminate employees in general, but then lower these obstacles when the employer files for bankruptcy.

This difference between the U.S. and European approaches gives us a chance to examine their relative pros and cons. How does a change in the non-bankruptcy legal baseline affect the bankruptcy process, and whether the forum-shopping arguments the proceduralists warn about are indeed significant. In examining these outcomes we distinguish between ex-post and ex-ante effects. The ex-post effects explain the rationale of the labor modifications and why such modifications are implemented more in Europe and less in the United States. The modifications balance the rigidities of the labor market, and thereby assist in corporate rehabilitations. Ex-ante, however, the modifications have the opposite effect. They create perverse incentives for the parties involved in the bankruptcy, and may cause inefficient use of bankruptcy procedure.

A. The Ex-Post Effects of Bankruptcy Specific Labor Modifications

In order to better understand the ex-post effects of labor modifications, we must first recognize that a high employment protection level does not always benefit employees.[188] Although generally the employees, and especially the unions, favor labor protections, when the business reaches insolvency the same protections may be detrimental to the employees as a group.

Outside bankruptcy employment protections benefit the employees. They extract rent from their employment (salary and benefits),[189] and the employment

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bankruptcy system that has been enacted. The Supreme Court made this point in a case that is as important for recognizing it as the actual issue decided is unimportant."). Note, though, that, although to a lesser extent than in Europe, the U.S. Bankruptcy Code also makes changes to the substantive labor laws. *See* BAIRD, *supra* note 184, at 126–27.

[187] Although both the German and the French systems viewed chapter 11 as the model for their bankruptcy legislation, at least with regard to employment issues, they chose not to adopt the U.S. *Butner* principle—the principle that mandates uniformity in substantive laws in and outside bankruptcy. *See supra* note 185.

[188] *See* John Armour & Simon Deakin, *Insolvency and Employment Protection: The Mixed Effects of the Acquired Rights Directive*, 22 INT'L REV. L. & ECON. 443 (2002). Armour & Deakin use the term "mixed effects" to describe the effects the Acquired Rights Directive has on employees.

[189] Gilles Saint-Paul developed a model that explains the existence of employment protections with political economic tools. He argues that unionized mostly unskilled employees (insiders) extract rent from their workplace. They receive relatively high wages and benefits, but will have difficulties finding a job with similar wages in case they are terminated. *See* Gilles Saint-Paul, *The Political Economy of Employment Protection*, 110 J. POL. ECON. 672, 673 (2002). Saint-Paul explains that in a perfectly competitive market the rent is equal to zero. In such a market any employee who seeks employment can immediately find one at the equilibrium wage, and thus there will be no utility difference between employed and unemployed persons. In the real world, however, the job markets are not perfectly competitive, and rents do exist. *See* Gilles Saint-

protections help them to keep their jobs and maintain their working conditions.[190] When the employer reaches insolvency, on the other hand, the same protections are liable to push the debtor into liquidation. The employer will be closed, and the employees will be out of work.[191] The reasons the protections may push the debtor towards liquidation are twofold.

First, in some cases reduced employment costs are essential to the continued operation of the firm.[192] The employer needs to cut labor costs in order to stay competitive, but the protections prevent him from taking the necessary measures.[193] They block the ability to execute operational changes, because they render layoffs more difficult and expensive to execute.[194] Without taking the necessary measures to cut employment expenditures, however, eventually the firm may be liquidated with even more employees laid off.[195] In other words, the protections aim to preserve employment, but when financial distress strikes, those same protections hinder labor reforms that are necessary for the firm's survival (which is beneficial to the majority of employees).

Second, not only may the protections inhibit essential structural reforms, they also give the creditors an incentive to prefer liquidations over reorganizations. Since some of the protections apply only when the business continues as a going concern—and not when the business is liquidated piecemeal, the creditors may have an interest in liquidating the business instead of reorganizing it. A good example concerns the employees' rights in a transfer of business context.[196] As we have seen, in Germany, France and the Netherlands, as well as in other European countries,[197]

Paul, *Assessing the Political Viability of Labour Market Reform: The Case of Employment Protection*, 81 FED. RES. BANK OF ST. LOUIS REV. 73, 73–74 (1999).

[190] The costs of the protections, however, are born, at least in part, by the employer and the general public. Due to the protections, the employer's production costs are higher and there is a reduction in the overall social welfare. *See* Hugo Hopenhayn & Richard Rogerson, *Job Turnover and Policy Evaluation: A General Equilibrium Analysis*, 101 J. POL. ECON. 915, 915–16 (1993); *see also* David H. Autor, William R. Kerr & Adriana D. Kugler, *Does Employment Protection Reduce Productivity? Evidence From US States*, 117 THE ECON. J. 189, 189 (2007); Robert C. Bird & John D. Knopf, *Do Wrongful-Discharge Laws Impair Firm Performance?*, 52 J. L. & ECON. 197, 198 (2009); Olivier Blanchard & Pedro Portugal, *What Hides Behind an Unemployment Rate: Comparing Portuguese and U.S. Labor Markets*, 91 AM. ECON. REV. 187, 187 (2001); Markus Poschke, *Employment Protection, Firm Selection, and Growth*, 56 J. MONETARY ECON. 1074, 1074–75 (2009). Since the employees enjoy the benefits of the protections in full, but they do not bear their entire costs, they have an interest to lobby for a high level of protections.

[191] *Cf.* Ondersma, *supra* note 2, at 248 (suggesting a chapter 11 proceeding that does not result in liquidation "is hardly . . . a job savior").

[192] *See* Wayne F. Cascio, *Strategies for Responsible Restructuring*, 16 ACAD. MGMT. EXECUTIVE 80, 81–82 (2002) (indicating downsizing is effective method to making money).

[193] *See id.* at 83 (discussing how Western European countries' labor laws make it difficult to terminate employees).

[194] *Id.* (stating labor laws in Western European countries make it difficult and expensive for companies to terminate workers).

[195] *See* Simon Macaire, *Moulinex: Chronicle of a Death Foretold?*, EUROFOUND (Nov. 2, 2001), http://www.eurofound.europa.eu/eiro/2001/10/feature/fr0110106f.htm.

[196] *See* Armour & Deakin, *supra* note 188, at 454.

[197] The domestic law of European countries in this matter is based on a European Directive – 2001/23/EC. *See* Council Directive 2001/23, art. 3(1), 2001 O.J. (L 082) 1 (EC) ("The transferor's rights and obligations

the general rule holds that the buyer of a firm is responsible for 100% of the employees' pre-sale claims.[198] If this rule was applied in a bankruptcy context, however, it would create perverse incentives for the creditors. When a bankrupt firm is sold as a going concern and the buyer is responsible for the employees' pre-sale claims, presumably the buyer deducts the payment to the employees from the purchase price. Since in bankruptcy the creditors (rather than the shareholders) receive the sale's proceeds, a reduction of the employees' pre-sale claims from the purchase price means that the creditors pay these claims. The price is reduced by the entire amount of the claims, and the creditors, therefore, pay the employment claims in full. When the business is liquidated piecemeal, on the other hand, the same rule does not apply. In this case, the employees have only a claim against the debtor's estate, and to the extent their claims are classified as unsecured, they will receive only a pro rata share of the debtor's assets (usually only a fraction of their claims).[199] Clearly creditors prefer to pay a fraction of the employment claims in liquidation rather than pay the claims in full when the debtor continues as a going concern—and this gives them an incentive to prefer liquidations.[200] The same rationale can also be applied to other employment protections, such as the justification requirements for the dismissals, the disallowance of terminations in a transfer of business context or certain procedural/consultation requirements. All these protections render the terminations expensive when the business continues as a going concern, and they are inapplicable when the debtor shuts down and its assets are sold separately.[201]

In other words, a high employment protection level can turn out to be a double edged sword. Although, in general, the protections help employees to maintain their conditions and employment, when the employer is insolvent they have the opposite effect. The protections incentivize creditors to prefer liquidations, and they decrease the chances that a distressed debtor will continue as a going concern.[202]

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arising from a contract of employment or from an employment relationship existing on the date of a transfer shall, by reason of such transfer, be transferred to the transferee.").

[198] *See* Acquired Rights Directive, art. 3.

[199] *See* Armour & Deakin, *supra* note 188, at 453–54.

[200] *Id*. at 454.

[201] *Id.* ("[W]here the firm is to be closed and the assets sold on a break-up basis, then an office-holder's failure to consult the employees about redundancies will have no, or almost no effect on creditors.").

[202] These mixed effects would not be so problematic if the employees (or their representatives) were able to waive the protections whenever they become a liability. The employees would then preserve the protections as long as they generate welfare to the employees' group, and give them up whenever they lead the employer to unnecessary liquidations. Unfortunately, however, such efficient waivers are not always possible. Some of the employment protections, in particular the individual protections discussed earlier, are statutory. The works council or the trade unions are unable to waive them in the name of each individual employee, and the individual employees, especially those harmed by the suggested reforms, may be unwilling to give up their rights independently. They will want to use the protections to argue their terminations unlawful, thereby delaying the reorganization or rendering it too expensive—to the detriment of the majority of employees. Second, when the employees are represented by several trade unions, then no union wishes to appear weak to its constituency. The representatives of each sector of employees have an interest to uphold a strong and uncompromising stand vis-à-vis the employer, and hope that the other sectors

The labor law modifications, which decrease the employment protection level in bankruptcy, soften these adverse effects ex-post—after the debtor filed for bankruptcy. The modifications render the termination of individual employees easier, and they mitigate the creditors' incentive to push for liquidation. This facilitates organizational reforms, and helps firms undergo a rehabilitation process that benefits the employees group as a whole. Thus, for example, in bankruptcy the discharged employees have fewer grounds to argue their terminations are unjust,[203] the approval of reorganization or transfer plans can be executed in a faster and cheaper manner,[204] the pre-termination notice shortens,[205] the compensation to the dismissed employees is reduced,[206] the categorical prohibition on dismissals connected to a transfer of business is lifted,[207] and the buyer of a distressed firm is not responsible for the employees' pre-petition claims.[208] All of these modifications impair the rights of dismissed individuals, in order to increase the chances of the firm's survival to the benefit of the group.

The French firm Moulinex provides a good example. Moulinex is a supplier of small electrical appliances and kitchen equipment. During the 1990s, the firm suffered from economic difficulties, and it needed to trim down its work force in order to stay competitive.[209] Moulinex's management repeatedly tried to initiate reforms and to close down some of its factories—but these attempts failed.[210] The employees, backed by the French government, thwarted the management's initiatives, because the suggested reforms included layoffs that the unions were unwilling to accept.[211] With no structural reform, however, Moulinex's economic situation continued to deteriorate, and in September 2001, faced with an imminent

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of employees will be willing to make the necessary concessions. This holdout problem may frustrate efficient waivers, and lead to the worst outcome from the employees' perspective—liquidation.

[203] In the Netherlands, the administrator no longer needs to receive a prior approval from the UWV or the district court, and the terminated employees can no longer demand damages for their terminations. In France, the administrator does not need to prove the existence of a real and serious cause for each individual employee, and the employees cannot contest the economic grounds for the terminations once a plan of reorganization is approved. In Germany, although the individual protections of the KSchG still apply, if the administrator agreed with the works council on a list of names to be terminated, there is a presumption the terminations are justified. Individual employees, therefore, are less likely to successfully contest the validity of the structural reforms. *See supra* Part I.

[204] The notice requirements to the various administrative agencies are made simpler, and the number of consultation/negotiation meetings with the works council is reduced.

[205] In Germany, the pre-termination notice is shortened from up to seven months to a maximum of three months. *See* InsO § 113. In the Netherlands, the notice requirement is shortened from up to four months to a maximum of six weeks. *See* FW § 40(1).

[206] In Germany, the maximum compensation allocated to employees in a social plan is capped. *See* InsO § 123. In the Netherlands, employees do not get compensation at all. *See supra* notes 49–51 and accompanying text.

[207] In Germany, this is not entirely accurate. Section 613a continues to apply, but there are exceptions to its applications. *See supra* Part I.C.2.

[208] *See supra* Part I.

[209] *See* Macaire, *supra* note 195 (explaining how Moulinex struggled financially in 1990s).

[210] *See* Cascio, *supra* note 192, at 83.

[211] *See id.*

threat of liquidation,[212] it filed for bankruptcy.[213] The bankruptcy filing helped the firm to avoid liquidation, because the bankruptcy judge was able to force terminations even on reluctant employees. Although 4,600 of Moulinex's employees were terminated,[214]—much more than the company's management suggested only a few months earlier (outside bankruptcy),[215]—at least the firm was able to continue as a going concern and some of its employees kept their positions.[216]

It is important to note, though, that in order to confirm that the structural reforms indeed serve to the benefit of the employees group, rather than the interests of other stakeholders at their expense, the collective voice of the employees must still be taken into account. If a bankruptcy judge can approve reorganizations that harm the interests of the majority of employees, or if the consent of the majority of employees is not required for the approval of the bankruptcy plan, then terminations (or other forms of infringements of employment rights) can be executed even when they are not essential to the reorganization. Although the debtor is able to continue its operation as a going concern without harming the workers, the debtor and creditors use the bankruptcy as a tool to reduce labor costs, and thereby to extract value from the employees. Even according to traditionalists, insolvency is not a pretext to extract value from one stakeholder to another, when such transfer is not required for the debtor's rehabilitation.

And indeed, despite the various bankruptcy specific modifications, the laws in France and Germany require that the collective voice of the employees will be heard also inside bankruptcy. In France, the court can approve reorganization or transfer plans only after hearing the works council's opinion, and it should accept the transfer plan that allows for the most prolonged maintenance of employment.[217]

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[212] Macaire, *supra* note 195.

[213] *See* John Tagliabue, *World Business Briefing, Europe: France: Moulinex Seeks Bankruptcy*, N.Y. TIMES (Sept. 8, 2001), http://www.nytimes.com/2001/09/08/business/world-business-briefing-europe-france-moulinex-seeks-bankruptcy.html; *see also* Carol Matlack, *Commentary: The High Cost of France's Aversion to Layoffs*, BUSINESSWEEK (Nov. 4, 2001), http://www.bloomberg.com/bw/stories/2001-11-04/commentary-the-high-cost-of-frances-aversion-to-layoffs.

[214] After less than two months in bankruptcy, the court approved a partial takeover of Moulinex by SEB, which included terminations of 4,600 employees. *See* Simon Macaire, *Partial Takeover of Moulinex by SEB*, EUROFOUND, (Nov. 13, 2001), http://www.eurofound.europa.eu/eiro/2001/11/inbrief/fr0111103n.htm.

[215] On April 25, 2001, prior to the bankruptcy filing, Moulinex's management suggested a restructuring plan, which included the termination of 4,000 jobs worldwide—including 1,500 in France. The unions rejected the proposal. On October 22, 2001, the court accepted the SEB proposal, which included the termination of 4,600 employees—including 3,700 in France. *See* Macaire, *supra* note 214.

[216] Two firms competed for Moulinex purchase—Fidei, a financial group specializing in buying out ailing companies, and SEB. The Fidei proposal allowed the retention of additional 1,000 employees, but the court decided to reject it. *See* Macaire, *supra* at note 195. The court determined that Fidei did not present sufficient guarantees for the firm's survival, and it preferred the SEB proposal which gave higher prospects for the firm's survival. Due to the unions' position, it is highly unlikely that the SEB purchase would take place without the bankruptcy court's intervention, and indeed SEB kept the Moulinex brand, and thousands of jobs were eventually saved. *See* Ross Tieman, *SEB Buy of Moulinex Approved – Again*, THE DEAL, Aug. 18, 2004.

[217] C. COM. art. L631-19 ("Where the plan provides for dismissals on economic grounds, the plan may be confirmed by the court only after having consulted the works council . . . ."); C. COM. art. L642-5 ("[T]he

The court's goal is to save the business and its employees, and only then to settle the business' liabilities towards the other creditors.[218] In Germany, even when the employer is bankrupt, the administrator and the works council must still reach a reconciliation of interests in order to implement plant modifications.[219] The administrator cannot take unilateral measures, and a social compensation plan must be negotiated.[220] The works council participation in the approval process is designed to make sure that even though individual employees may be harmed, the reforms serve the interests of the majority of employees.[221]

In the Netherlands, on the other hand, the position of the organized unions is not as strong. The works council and trade unions are kept out of the substantive decisions in bankruptcy,[222] and the court is not committed to the goal of employment preservation. As we shall see this enables other stakeholders (like the shareholders, managers or creditors) to take advantage of the bankruptcy process to harm employees.[223] They can use the bankruptcy to extract value from the employees, and as a result, forum shopping and bankruptcy abuse are stronger in the Netherlands as compared to other jurisdictions.

We can conclude, therefore, that bankruptcy modifications occur in countries with high employment protection levels, because the bankruptcy system is needed to balance the labor market rigidities. A high employment protection can prove problematic (even to the employees themselves) when economic distress strikes, and bankruptcy law softens the labor market rigidities. However, to make sure that other stakeholders do not take advantage of the bankruptcy to harm the employees, the employees' representation's voice must still be heard. The status of the works council should not be harmed, and to the extent the law empowers the works council outside bankruptcy its powers should not be diminished inside a bankruptcy process.[224]

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court will accept the offer which allow the most prolonged maintenance of employments attached to the assets assigned and the payment of the creditors, under the best conditions and which presents the best guarantees for its implementation.").

[218] C. COM. art. L631-1 ("The purpose of the reorganization procedure is to allow the continuation of the business's operations . . . ."); Bailly, *supra* note 88, at 3626.

[219] *See* InsO § 122.

[220] *See supra* notes 149–50 and accompanying text.

[221] German Works Constitution Act §§ 1, 2, 111, 112. Note that the works council, the body that represents the majority of employees in the firm, bears both the costs and the benefits of labor reforms that are executed as part of the reorganization. It bears the costs of the modifications, because employees are terminated or suffer wage losses. Such concessions are politically problematic for the council, and may lose power and support. On the other hand, in times of insolvency a high employment protection level can lead to the debtor's liquidation. Since liquidation is the employees' worst scenario, the majority of employees (and hence the works council) can benefit from changes that facilitate the continued operation of the firm. A works council, therefore, has an interest to resist the reduction of employment protections, until the point it believes that such protection level will result in liquidation.

[222] *See* Beltzer & Knegt, *supra* note 54.

[223] In the Netherlands the works council and trade unions are kept out of the substantive decisions in bankruptcy process. *See id.*

[224] The Article takes no stand on whether organized labor is socially beneficial or not, or on whether unions or works councils adequately perform their tasks. Our argument is more limited. We maintain that to

III. THE EX-ANTE CONSEQUENCES OF A CHANGE FROM THE LABOR LAWS BASELINE

So far we have seen that ex-post the bankruptcy, labor modifications can benefit the employees' group. However, this provides only a partial picture. As the procedural approach maintains, these ex-ante modifications can also create perverse incentives to the parties involved in the bankruptcy, and these incentives are detrimental to the employees.

The first problem the labor modifications present is bankruptcy abuse. This means that debtors use bankruptcy proceedings in order to enjoy the labor law privileges bankruptcy law affords, even when there is no real financial or economic necessity for the filing. Since the employer cannot easily dismiss employees outside bankruptcy, he files for bankruptcy and thereby bypasses the general labor law hurdles. The existence of bankruptcy abuse is damaging both to employees and to society as a whole. From the employees' perspective, they do not receive the protections they deserve. If outside bankruptcy dismissed employees are entitled to compensation, to a notice period, or to certain procedural benefits, the filing deprives them of these rights and forces them to accept less for their terminations. From a societal perspective the bankruptcy abuse is an unrequired cost. A bankruptcy process is very expensive (it involves lawyers, judges, economic consultants and more), and an unnecessary filing wastes resources with no social gains.[225] The bankruptcy decreases firms' value and raises credit prices.[226] Judicial systems, therefore, should aim to minimize bankruptcy abuses, and decrease parties' incentives to file for bankruptcy when there is no financial or economic need to do so.

The European systems, however, seem to do the opposite. Although few empirical studies have been conducted on bankruptcy abuse in Europe, from the few studies that have been conducted, especially in the Netherlands, it is clear that the phenomenon is not negligible. In research conducted in 1996, for example, Roger Knegt examined this problem by looking into 286 bankruptcy cases (including interviews with administrators and debtors).[227] He reports that in eight percent of the cases the need to reduce employment costs was indicated as an important motive for the bankruptcy filing.[228] In all these cases, the firm filed for liquidation bankruptcy (in order to enjoy the labor law privileges),[229] yet it was not liquidated but rather sold to a buyer that was linked to the firm's former management or shareholders. The firm continued as a new legal entity, but with

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the extent a jurisdiction believes that works councils unions should be empowered with certain rights and authorities outside bankruptcy, then the same rights and authorities should be preserved inside a bankruptcy.

[225] *See, e.g.*, Edward I. Altman, A Further Empirical Investigation of the Bankruptcy Cost Question, 39 J. FIN. 1067, 1067 (1984).

[226] *Cf. id.* at 1080.

[227] *See* KNEGT ET AL., *supra* note 13.

[228] *Id.* at 109.

[229] For the different Dutch bankruptcy proceedings and the forum shopping between them. *See infra* notes 262–71.

similar or resembling ownership or leadership.[230] Knegt explains that, although formally prohibited, management and shareholders in these cases used the bankruptcy process in order to circumvent regular labor laws and reduce employment costs in ways unavailable outside of bankruptcy.[231] A more recent study conducted in 2005 confirms the existence of bankruptcy abuse, although on a smaller scale. This study, which focused on 868 bankruptcy cases, shows that approximately four percent of the bankruptcies were filed in order to cut employees' surplus.[232] In addition, most of the trustees interviewed for the study said that they are inclined to almost always consider a "technical bankruptcy" as a legitimate way out of financial difficulties.[233] The vast number of trustees that consider bankruptcy abuse as a solution to a firm's economic distress may indicate that the number of unnecessary filings is even greater than the numbers Knegt et al., report.

But bankruptcy abuse is only part of the problem. Even when the bankruptcy filing is economically justified, forum-shopping among different bankruptcy proceedings can create social damage. When a jurisdiction offers several types of bankruptcy procedures—some with labor law modifications and others without—firms tend to choose the bankruptcy procedure that maximizes their labor law privileges, rather than choose the more economically efficient procedure. To better explain this argument, we first examine the different bankruptcy procedures we refer to, and then show the difficulties bankruptcy labor modifications create.

Traditionally, unlike in the United States, European jurisdictions have mandated the appointment of trustees in a bankruptcy process. When a firm files for bankruptcy, the firm's management has to step down, and it is replaced by a court appointed official (an administrator or trustee).[234] The rationale of such an appointment is the perception that the management is responsible for the firm's economic deterioration. Management failed in its performance, and it has to be replaced in order to avoid further financial decline. In recent years, however, this perception has changed.[235] Research shows that a debtor-in-possession regime, a regime in which the management stays in place, has multiple advantages and the potential to increase the debtor's value and promote rehabilitation. First, the appointment of a debtor in possession preserves the management's familiarity and

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[230] KNEGT ET AL., *supra* note 13.

[231] *See* KNEGT, *supra* note 14, at 1–51; *see also* Beltzer & Knegt, *supra* note 54.

[232] Employee surplus was named as the reason for 3.8% of the filings and other long term contracts were named as the reason for 2.3% of the filings.

[233] KNEGT ET AL., *supra* note 13; *see also* A.P.K. Luttikhuis, Centraal Bureau voor de Statistiek, *Insolventierecht in cijfers en modellen: Werkgelegenheid en toezicht*, DEN HAAG: BOOM JURIDISCHE UITGEVERS (2006).

[234] *See, e.g.*, Alyssa S. Nishimoto, *Shifting Paradigms Within Corporate Bankruptcy Law: The History and Future of Chapter 11 and its Global Effects on Business Restructurings*, 5 CREIGHTON INT'L & COMP. L.J. 102, 107 (2013) (considering English bankruptcy process).

[235] *See* Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option For Distressed Businesses For the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 199–200 (2004); Nishimoto, *supra* note 234, at 102–03; *see also* Deborah Ball, *Europe Builds Own Chapter 11*, WALL ST. J. (Apr. 5, 2013, 6:20 PM), http://www.wsj.com/articles/SB10001424127887323296504578398612178796882.

experience with the business.[236] The incumbent management knows the clients, the employees and the business model, and its continued operation smoothens the entrance into bankruptcy and enables the debtor to operate better.[237] Second, replacing the management with a court appointed trustee delays the bankruptcy filing. The management has an interest in prolonging its control over the debtor, and it may postpone the filing for as long as possible.[238] Such delays reduce the debtor's value and decrease its chances for rehabilitation.[239] Firms enter bankruptcy beyond the point of salvation, and they are forced into liquidation—thereby terminating their entire workforce.[240] Empirical studies, therefore, suggest that a debtor-in-possession (self-administration) regime in bankruptcy is more efficient.[241]

In light of these insights, more and more European legislators added a self-administration option to their bankruptcy codes.[242] France and the Netherlands, for example, created special and separate proceedings that enable the debtor's management to stay in place, and to administer the bankruptcy process much like a debtor-in-possession.[243] These proceedings were designed to promote earlier filings,

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[236] *See* Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 136 (2005) (stating existing management's "knowledge, expertise, and familiarity [are] inherently valuable in large, complex, corporate restructurings").

[237] *See* Richard Posner, *Foreword* to CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES, at xi–xii (Jagdeep S. Bhandari & Lawrence A. Weiss, eds., 1996) (explaining the reasons for giving management the right to continue operation of the firm—"only management, and not a committee of creditors or a trustee . . . has the know-how to continue the firm in operation . . . .").

[238] Douglas G. Baird, *The Initiation Problem in Bankruptcy*, 11 INT'L REV. L. & ECON. 223, 232 (1991).

[239] *See* Miller & Waisman, *supra* note 236, at 155.

[240] During the delay the management may try to invest in dangerous projects, incur additional debt, or take other measures designed to avoid the bankruptcy, even when such measures are detrimental to the debtor's value or to the creditors. Research conducted by Adler, Capkun and Weiss, demonstrates this point using recent changes that give secured creditors more control over the debtor. They find that under a secured creditor bankruptcy regime filings were delayed, and that there was a clear deterioration in the financial health of the filing firms. *See* Barry E. Adler, Vedran Capkun & Lawrence A. Weiss, *Value Destruction in the New Era of Chapter 11*, 29 J.L. ECON. & ORGANIZATION 461, 463–64, 479 (2012). Gutierrez, Olmo, and Azofra reach similar results in their study. They show that the value of financially distressed firms under creditor-controlled jurisdictions is lower than their value under debtor-controlled jurisdictions. This decrease is partly explained by the delay in the filing. More firms enter bankruptcy beyond the point of salvation, and at this point liquidation is their only option. *See* Carlos Lopez Gutiérrez, Begoña Torre Olmo & Sergio Sanfilippo Azofra, *Firms' Performance Under Different Bankruptcy Systems: A Europe-USA Empirical Analysis*, 52 ACCT. & FIN. 849, 853–55, 865 (2012); *see also* Vaughn S. Armstrong & Leigh A. Riddick, *Bankruptcy Law Differences Across Countries*, *Managerial Incentives and Firm Value* (Jan. 2003), 19–20, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=420560.

[241] *See* Adler, Capkun & Weiss, *supra* note 240, at 464; Gutierrez, Olmo & Azofra, *supra* note 240.

[242] *See* Robert Weber, Note, *Can the* Sauvegarde *Reform Save French Bankruptcy Law?: A Comparative Look at Chapter 11 and French Bankruptcy Law from an Agency Cost Perspective*, 27 MICH J. INT'L L. 257, 297–98 (2005) (discussing proposed reforms in French bankruptcy law, which follow United States' chapter 11 procedures and allow for "management to retain control over the company" under *sauvegarde*, or safeguard, laws); Rim Ayadi-Ben Lakhal, Reorganization of Bankrupt Firms in France: Financial and Econometric Analysis 55–56 (May 12, 2011) (unpublished Ph.D. dissertation, University of Cergy-Pontoise), *available at* http://biblioweb.u-cergy.fr/theses/2011CERG0558.pdf; BRAUN, *supra* note 139, at 483.

[243] The German code also provides the option for self-administration. The InsO sections 270–285 allow the debtor, under certain pre-requisites, to maintain the right to manage and dispose of the assets involved in the bankruptcy, similar to the U.S. chapter 11's debtor in possession. In practice, however, the insolvency courts

and to increase the debtors' value during the bankruptcy process itself.[244] Fearing bankruptcy abuse, however, the legislators decided not to incorporate the bankruptcy labor law modifications (available in the traditional proceedings) into these new self-administration proceedings.[245] The legislators were probably concerned that if a trustee is not appointed, management will be more inclined to file for bankruptcy just to take advantage of the modifications. Since the filing is no longer associated with the management's loss of control, the danger of bankruptcy abuse is much more severe, and we can assume the legislators did not want to create a flood of unwarranted bankruptcies.

The legislators in France and the Netherlands thus created two bankruptcy options.[246] One option (the traditional option) modifies the law outside bankruptcy (in particular labor laws), but at the same time it mandates the appointment of a trustee. The trustee administers the firm's operations, and the shareholders and management lose their control over the firm.[247] The second option (the more recent bankruptcy proceedings) allows the incumbent management to stay in its place (albeit under the court's supervision), but implements the general labor law.[248] In this option debtors enjoy the advantages of a self-administration bankruptcy regime, but at the same time they have a smaller incentive for bankruptcy abuse because labor laws remain the same inside and outside bankruptcy.[249]

Examining the use of the two bankruptcy options, however, shows that the more recent bankruptcy proceedings (those which allow for the debtor's self-administration) are hardly used. Due to labor law issues, debtors prefer the traditional bankruptcy proceedings, and the hope for earlier filings and a more efficient bankruptcy process has not realized. This is the case in both France and the Netherlands.[250]

In France, the two relevant bankruptcy proceedings are the judicial reorganization ("*redressement judiciaire*") and the safeguard procedure ("*sauvegarde*").[251] *Redressement judiciaire* is the traditional bankruptcy

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rarely determine that debtors meet the required pre-requisites, and they demand the replacement of the management prior to the filing in order to allow self-administration. *See* Annerose Tashiro, *The German Self-Reorganisation Systems in Insolvency Proceedings*, 3 INT'L CORP. RESCUE 153, 155 (2006); BRAUN, *supra* note 139, at 483.

[244] *See* Weber, *supra* note 242, at 299.

[245] *See infra* notes 257–67 and accompanying text.

[246] In France there are additional bankruptcy options, but two are relevant for our analysis.

[247] In France the procedure is *Redressement Judiciaire*. In the Netherlands the procedure is *Faillissement*.

[248] In France the procedure is *Sauvegarde*. In the Netherlands the procedure is *Surseance San Betaling*.

[249] In Germany the labor modifications are implemented in all types of bankruptcy proceedings, and following the same logic—a trustee is almost always appointed. Although the code provides the option for self-administration, in practice this option plays an insignificant role as the courts rarely approve management to stay in control of the debtor.

[250] *Cf*. Kimhi & Doebert, *supra* note 135 (discussing Germany).

[251] For an overview of French proceedings see Tetley & Bayle, *supra* note 90, at 195–223; Lakhal, *supra* note 242, at 45–48. The most important proceedings are: conciliation, safeguard proceedings, judicial reorganization and liquidation. Conciliation is a dispute resolution procedure designed to prevent a formal insolvency. The aim of the conciliation is to reach an agreement between the debtor and the creditors, in order to defer payments or to reduce the amount of debt before an actual default occurs.

reorganization procedure. Within this proceeding a trustee is appointed, and the labor changes discussed earlier in this Article apply.[252] The safeguard procedure, on the other hand, is the more recent procedure (introduced in 2005). The safeguard procedure very much resembles *redressement judiciaire*, but it allows the management to stay in control of the debtor, and it introduces very few labor modifications.[253] Examining the data shows that, despite its advantages, the safeguard procedure is hardly used. In the years 2009-2011 there were about 1,000 safeguard filings per year, which constitute only two percent of all bankruptcy filings in France, and only seven percent of the *redressement judiciaire* filings.[254] The reasons for the paucity of safeguard proceedings are diverse, but employment protections seem to play an important role. Patrick Morvan explains:

> [L]egally, the sauvegarde is nothing else than an anticipated redressement judiciaire and nothing justifies that these two procedures submit the contract of employment to regimes so dissimilar. The constraints created by the labor law has the risk of encouraging the employers to prefer, in reverse to the intention of the legislator, the opening of a procedure of redressement judiciaire, much more of nature of facilitating the pronunciation of the dismissal. This reasoning, if it shall spread, will mark the failure of the reform.[255]

Much like the French bankruptcy law, Dutch law also offers two types of proceedings: suspension of payments ("*surseance van betaling*") and liquidation bankruptcy ("*faillissement*").[256] The suspension of payments procedure is a reorganization procedure (similar to the U.S. chapter 11).[257] The debtor's management and board of directors stay in place, and they, together with a supervisory judge, manage the business and negotiate a debt readjustment plan.[258] The *faillissement*, on the other hand, is supposed to serve as the liquidation procedure (similar to the U.S. chapter 7).[259] Within the *faillissement* procedure, the court appoints an administrator to replace the management, and the administrator is

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[252] *See generally* Lakhal, *supra* note 242, at 46–54; Weber, *supra* note 242, at 285. Naturally, if the debtor is sold piecemeal then a different bankruptcy procedure is used—liquidation.

[253] *See* Lakhal, *supra* note 242, at 55–58; Weber, *supra* note 242, at 297.

[254] Data from the website of the national council of registrars of commercial courts. *Opening of Insolvency Proceedings Judgments*, NAT'L COUNCIL REGISTRARS COURTS COM. (2011), http://www.cngtc.fr/obs-stat-jugement-ouverture-procedure-collective.php.

[255] *See* MORVAN, *supra* note 88, at 686 (noting employment protections encourage receivership).

[256] *See* Oscar Couwenberg & Stephan J. Lubben, *The Costs of Chapter 11 in Context: American and Dutch Business Bankruptcy*, 85 AM. BANKR. L.J. 63, 67 (2011).

[257] *See id.* (describing America's influence on foreign bankruptcy reorganization systems).

[258] *See* Peter J.M. Declercq, *Restructuring European Distressed Debt: Netherlands Suspension of Payment Proceeding . . . The Netherlands Chapter 11*?, 77 AM. BANKR. L.J. 377, 389 (2003) (stating judge's supervisory role during suspension of payment proceedings).

[259] *See* Couwenberg & Lubben, *supra* note 256, at 68.

in charge of selling the debtor's assets piecemeal or as a going concern.[260] Statistics show that the suspension of payments procedure is hardly used.[261] In most cases, firms file for the liquidation chapter (the *faillissement*), even when the business (or parts of it) continues as a going concern and even if the former management or shareholders buy back the firm at the end of the liquidation process (a situation referred to in the Netherlands as a restart ("*doorstart*")).[262] One of the main reasons for the popularity of the liquidation process is that the suspension of payments procedure does not offer the same labor law privileges as the liquidation procedure does.[263] Most of the derogations to the labor law discussed earlier in this Article do not apply in suspension of payments, and save a shortening of the pre-termination notice period, the employer must follow all the normal dismissals rules.[264] Sefa Franken explains:[265]

> [E]mployees' rights are less well protected under the liquidation procedure than under the suspension of payments procedure. . . . The reduced protection of employee rights in liquidation bankruptcy may be an important reason for debtors to prefer liquidation to suspension of payments since it allows them to get rid off [sic] employees against lower costs.[266]

Thus, the labor modifications, originally designed to help preserve distressed firms as going concerns, may actually have the opposite effect. Debtors choose

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[260] *See* Oscar Couwenberg and Abe De Jong, *Costs and Recovery Rates in the Dutch Liquidation-Based Bankruptcy System*, 26 EUR. J. L. & ECON. 105, 112 (2008) (discussing appointment procedures at start of bankruptcy proceedings); *see also* Couwenberg & Lubben, *supra* note 256, at 68.

[261] *See* Couwenberg & Lubben, *supra* note 256, at 67 ("The Dutch Bankruptcy Law is best characterized as an auction system, with a rudimentary reorganization provision."); Maria Brouwer, *Reorganization in U.S. and European Bankruptcy Law*, 22 EUR. J. L. & ECON. 5, 10 (2006) ("About 7 percent of all Dutch insolvent firms file for reorganization (surseance van betaling) and 2 percent are actually reorganized"). Note, that in many cases the bankruptcy will start as a suspension of payment procedure that will be converted into bankruptcy later on. The reason is that a bankruptcy procedure requires shareholders' approval, but firms often do not have time to convene a shareholders' meeting prior to filing. The management, therefore, files for suspension, which in turn is converted into bankruptcy. *See* L&L Opinion, *supra* note 47, at § 2.2.

[262] *See* Declercq, *supra* note 258, at 387; Beltzer & Knegt, *supra* note 54.

[263] *See* Sefa Franken, *The Debtor-Oriented Model Versus the Creditor-Oriented Model of Corporate Bankruptcy Law: A U.S.-Dutch Comparison*, TILEC DISCUSSION PAPER, at 20–21 (Dec. 2003), *available at* http://www.researchgate.net/publication/4867626_The_debtor-oriented_model_versus_the_creditor-oriented_model_of_corporate_bankruptcy_law__a_US-Dutch_comparison (discussing employer's preference to liquidation proceedings since employer's are not under any obligation to fulfill existing labor contracts).

[264] *See id.* at 21.

[265] *See id.*; *see also* JACOBS, ENCYCLOPEDIA FOR LABOUR LAW—NETHERLANDS, *supra* note 22, at 115 ("[T]he fact that most of the special rules on dismissals in case of bankruptcy do not apply to the pre-bankruptcy procedures [i.e., suspension of payments] . . . has severely sharpened the differences between bankruptcy and the pre-bankruptcy procedure. It has made this latter procedure less attractive for reorganizing businesses.").

[266] *See* Franken, *supra* note 263, at 21.

bankruptcy proceedings that allow for the labor modifications, but these proceedings require the appointment of trustees, which render the bankruptcy process less efficient. They reduce the debtors' value and decrease the chances for the firms' survival. This undermines the European approach that rehabilitation of firms should be considered one of bankruptcy law's primary goals. Due to the appointment of trustees, more firms delay their filing, and enter bankruptcy when their chances of rehabilitation are very low.[267]

CONCLUSION

The foregoing analysis, we believe, can teach us valuable lessons, both theoretical and practical. From a theoretical perspective, the analysis sheds light on the debate between the traditional and procedural approaches to bankruptcy. It shows that even when bankruptcy specific modifications are designed to promote reorganizations, they do not necessarily achieve this goal. Facilitating the termination of employees in bankruptcy may help distressed corporations continue as going concerns, but it also creates perverse incentives that cause forum shopping and bankruptcy abuse. This observation substantiates the arguments brought by the procedural approach. The procedural approach calls for uniformity between the laws in and outside bankruptcy, and this Article shows the consequences of the absence of such uniformity with regard the Netherlands, and to a lesser extent with regard to France and Germany.

From a practical perspective, the analysis is very relevant to the on-going debate regarding the rejection (termination) of collective bargaining agreements.[268] In the United States, outside a bankruptcy procedure, an employer is unable to unilaterally terminate or modify a collective bargaining agreement.[269] A breach of the collective agreement's terms constitutes an unfair labor practice, and may result

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[267] *Cf.* Chien-An Wang, *Determinants of the Choice of Formal Bankruptcy Procedure: An International Comparison of Reorganization and Liquidation*, 48 EMERGING MARKETS FIN. & TRADE 4, 8 (2012) (stating company managers remain in control of the company during reorganization); Brouwer, *supra* note 261, at 21–22 ("Reorganization is more rare in European bankruptcy cases than in the US . . . . We can explain this by pointing out that management, who is a main beneficiary of US reorganizations is either ousted or subject to the orders of an administrator in European bankruptcies. Hence, we cannot expect European managers to be as willing to initiate reorganization proceedings as their US counterparts."); Weber, *supra* note 242, at 296 ("It is not surprising, in this context, to find a high percentage of bankruptcies being channeled to judicial liquidation instead of *redressement* [(the reorganization proceedings)]. The stated goal of firm survival may be subverted by management's perverse incentives to sail the firm into harm's way rather than guide the damaged ship into the protective harbor of *redressement*.").

[268] The standard for the termination of individual employment agreements does not significantly change in bankruptcy. Most states adopted the "employment at will" standard, and this standard applies both inside and outside bankruptcy. *See* Donald R. Korobkin, *Employee Interests in Bankruptcy*, 4 AM. BANKR. INST. L. REV. 5, 17 (1996) ("The Code generally preserves the authority and discretion that a manager enjoys under normal conditions.").

[269] *See id.* at 18 (noting "under section 158(a)(5) of the NLRA [National Labor Relations Act], an employer covered by a collective bargaining agreement ordinarily may not alter the terms of employment without first bargaining to impasse with the union representative").

in proceedings against the employer.[270] Despite the dominant role of the procedural approach in the U.S. bankruptcy law, with respect to collective bargaining agreements, bankruptcy law somewhat changes this legal rule. According to section 1113 of the Bankruptcy Code,[271] a debtor in possession may ask the court to unilaterally reject a collective agreement in order to make some necessary modifications and allow the debtor's reorganization.[272] The court examines whether the debtor meets certain conditions specified in the section, and if the conditions are met the debtor is allowed to reject the agreement despite the union's objection.[273]

Although section 1113 was enacted almost thirty years ago, it is still subject to fierce debate between traditionalists and proceduralists. Whereas traditionalists argue that the section properly balances between the employees and other stakeholders,[274] the proceduralists oppose the Code's current policy and maintain that the unions' rights should also be respected inside a bankruptcy process.[275] This debate also echoes in different interpretations given to conditions specified in the section by the courts. In the *Wheeling-Pittsburgh* case the Third Circuit held that the modification to collective bargaining agreements must be "essential" to prevent liquidations in the short term, and that the court should approve only those minimum modifications required to permit reorganizations.[276] The Second Circuit,

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[270] National Labor Relations Act, Pub. L. No. 74-198, § 8, 49 Stat. 449, 452 (1935) (as amended at 29 U.S.C. § 158(d) (2006)); *see also* Martha S. West, *Life After* Bildisco*: Section 1113 and the Duty to Bargain in Good Faith*, 47 OHIO ST. L.J. 65, 77 (1986) (stating "the National Labor Relations Act also contains a proviso in section 8(d) which protects collective bargaining agreements from modification or premature termination").

[271] Section 1113 is the product of a compromise reached in Congress after the Supreme Court's decision in the *Bildisco* case. *See* Nat'l Labor Relations Bd. v. Bildisco & Bildisco, 465 U.S 513 (1984). In the case of *Bildisco*, the Supreme Court viewed collective bargaining agreements as an executory contract. It held that the bankruptcy filing suspends the debtor's obligation to bargain in good faith, and allowed the debtor, with the court's permission, to reject the contract and unilaterally change the employment terms. *See id.* at 528–32. After the Supreme Court's decision, Congress amended the Bankruptcy Code and enacted section 1113.

[272] 11 U.S.C. § 1113 (2012).

[273] The court may approve a rejection of a collective bargaining agreement under the following conditions: First, prior to applying for a rejection of a collective bargaining agreement, the debtor must negotiate with unions. He must detail the modifications in the employees' benefits he deems necessary to permit the reorganization, and meet with employees' representatives in an attempt to reach a consensual agreement. *See* 11 U.S.C. § 1113(b). Second, he must show that the authorized representative of the employees has refused to accept his proposals without good cause. *See* 11 U.S.C. § 1113(c)(2). Third, he must prove that the balance of the equities clearly favors the rejection of such agreement. *See* 11 U.S.C. § 1113(c)(3).

[274] Warren, *supra* note 171, at 792.

[275] JACKSON, *supra* note 7, at 194 ("Outside of bankruptcy, collective bargaining agreements cannot be unilaterally avoided . . . . In bankruptcy, however, it has been held that collective bargaining agreements are executory contracts that can be rejected, a solution codified in section 1113. This represents a substantive rule change in bankruptcy that is unrelated to a common pool problem. Predictably it creates incentives to use the bankruptcy process simply to gain access to that rule change."). *See also* BAIRD, *supra* note 184, at 126–27. Baird agrees with Jackson, but believes the effects of section 1113 should not be exaggerated. *See id.* at 127. The rejection process set forth in section 1113 does accelerate the end of the collective bargaining agreement, but the management and the unions must still come to terms.

[276] Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., 791 F.2d 1074, 1085 (3d Cir. 1986) ("[S]ection 1113(e) provides that the bankruptcy court may authorize interim changes in the terms, conditions, wages, benefits or work rules provided by a collective bargaining agreement if the court finds,

on the other hand, held that the section 1113 standard requires that the debtor's proposed modifications would only increase the likelihood of successful reorganization, and it did not obligate the debtor to offer the bare minimum modifications required to prevent liquidation.[277]

The comparative analysis provided in this Article sheds light on this debate, and favors the procedural approach. First, it shows that the greater the gap between the substantive law in and outside bankruptcy, the stronger the forum shopping effects and the dangers of bankruptcy abuse. This effect may be even more relevant in the United States than in Europe, since here the appointment of trustees is not mandatory. The debtor's management retains its control over the debtor, and so it may be more willing to file for bankruptcy in order to cut employment costs. Second, even if we subscribe to a more traditional approach to bankruptcy, there is no point in weakening the unions' powers. The unions themselves have an interest to avoid liquidations, and they should agree to modifications of the collective agreements when such modifications are required to keep the debtor as going concern. As we have seen, even in France and in Germany, which make substantial changes to the general labor laws, the status of the works councils is maintained also inside the bankruptcy procedure.

In the debate between the proceduralists and traditionalists on section 1113, therefore, we support the former. We see no reason to allow the rejection of collective bargaining agreements notwithstanding the unions' objection, especially if the modifications are not "essential" to the successful reorganization of the debtor in the short term. Although modifications to labor protections are sometimes beneficial, forcing them contrary to the interests of the majority of employees enables other stakeholders to transfer value from the employees' pockets to their own. This creates bankruptcy abuse and forum shopping, and at the end of the day decreases social welfare.

Although the labor-bankruptcy conflict is a matter of domestic law, looking at it from a comparative perspective enables us to better evaluate the implications of the various policies. The lessons from EU countries, which generally have high employment protections, reveal that bankruptcy law is not a very good tool for balancing the rigidities of the labor markets.

following a hearing, that an interim change is 'essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate.'") (quoting 11 U.S.C. § 1113(e) (2006)).

[277] Truck Drivers Local 807 v. Carey Transp., Inc., 816 F.2d 82, 89 (2d Cir. 1987); *see* 7 COLLIER ON BANKRUPTCY, ¶ 1113.05[3][a] (Alan N. Resnick & Henry J. Somme eds., 16th ed. 2009) (discussing more flexible definition of "necessary" in section 1113 adopted by Second Circuit.)