

Research on the Protection Mechanism of Legal Rights and Interests of Employees in Enterprise Bankruptcy Reorganization

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ABSTRACT

Since the outbreak of the epidemic in 2020, many companies are facing the dilemma of bankruptcy reorganization under the impact of the epidemic. Since bankruptcy reorganization involves the rights and interests of employees, improper handling of which can easily lead to social problems. For this reason, this article summarizes the legal rights and interests of employees in bankruptcy reorganization and analyses the phenomenon that the legal rights and interests of employees were harmed in bankruptcy reorganization cases and conducts in-depth analysis from multiple angles. Finally, this article offers several proposals for the protection of legal rights and interests of employees in bankruptcy reorganization for references, such as, the participation of employees in the corporate supervision mechanism for bankruptcy reorganization and so on.

Keywords: Bankruptcy reorganization, legal rights and interests of employees, protection mechanism

1. LEGAL RIGHTS AND INTERESTS OF EMPLOYEES IN BANKRUPTCY REORGANIZATION

1.1. The concept of "employee"

The term "employee" in the normalizative legal documents has basically the same meaning as "laborer". "Laborer" refers to "a natural person who has the ability to work, obtains wages in exchange of labor, and forms labor relations with enterprises and individual economic organizations" [1], while the term "employee" is usually used to refer to an ordinary laborer or a state-owned or collective laborer [2]. The two terms can be interchangeable under certain conditions. In addition, some scholars pointed out that to be an employee, one must meet two conditions, "one condition is to use labor in exchange of wages, and the other is to have a real labor relation with work unit. This includes laborers under various forms of employment, mainly, those who have signed labor contracts, and those are under continuous and relatively stable working hours and under fixed employment relationships. It also includes laborers under an labor relation based on the completion of a certain amount of work, as well as apprentices and interns under

temporary employments. These people are all within the scope of "employees" in the legal domain[3].

1.2. Scope of "employee"

The scope of "employees" is also not specifically defined in the normalizative legal documents in China. The current disputes mainly focus on whether company officers are within the scope of employees. I believe that the current *Labor Contract Law*, *Labor Law* and other social-related law and law departments do not classify laborers or employees, nor exclude company officers from the scope of employees. Company officers, or in other words, directors, supervisors and senior executives, are the concepts of the business law department rather than the social law department. Further, Article 113 of the *Enterprise Bankruptcy Law* clearly stipulates that "the bankruptcy property shall be paid off in the following order after the paying off bankruptcy expenses and common-benefits debts: wages and medical care, disability subsidies and pension expenses owed by the bankrupt enterprises to the employees, basic pension insurance and basic medical insurance expenses that should be credited to the employee's personal account, as well as the compensation payable to the employees according to laws and administrative regulations...The salary of the directors, supervisors and senior executives

of a bankrupt enterprise shall be calculated based on the average salary of the employees of the enterprise." Therefore, in the bankruptcy procedure, "directors, supervisors, and senior executives" are not the same concepts as "employees". Although the wages of directors, supervisors, senior executives and employees of the company are all included in the labor claims, yet there are significant differences between the directors, supervisors, senior executives and the employees of the company.

1.3. Legal rights and interests of employees in bankruptcy reorganization

Labor relations during the period of bankruptcy reorganization of an enterprise are more complicated than that of bankruptcy liquidation and debt reconciliation. During the reorganization, the labor relations between the enterprise and its employees can be subject to various changes, such as, continued performance of labor contracts, amendment of labor contracts and termination of labor contracts.

1.3.1. Labor claims

The *Enterprise Bankruptcy Law* clearly stipulates the content of labor claims. Labor claims are "the wages and medical care, disability subsidies and pension expenses owed by the debtor to the employees, and debts shall be included in the basic pension insurance and basic medical insurance expenses of the employees' personal accounts, as well as compensation payments payable to employees as required by laws and administrative regulations." The subject of labor claims is limited to the laborers who have established a legitimate labor relation with the enterprise before the bankruptcy, and it is critical to the most basic right of survival and development of enterprise employees. Labor claims occur at the performance stage of labor contracts, and are debts incurred from the companies' failure to duly perform the contract to pay wages or expenses such as social insurance on time. Labor claims are different from ordinary claims in the sense that they do not need to be declared by the employees. The administrator lists the debts after investigation and publishes it. The employee who objects to the list can request the administrator to correct it, and if the administrator refuses to make the correction, the employee can then bring a lawsuit with the people's court. If the labor contract between the laborer and the enterprise continues to be performed during the reorganization period, then such claims can be recognized as common-benefit debts in accordance with Article 42.4 of the *Enterprise Bankruptcy Law* which stipulates that "the wages and social insurance fees that should be paid for the debtor's continued business and the other consequential debts", which are given priority in the repayment.

1.3.2. The right to participate

The right of employees to participate in the process of enterprise reorganization is mainly reflected in two aspects. First, the right to participate in creditors' meetings. The creditors' meeting is the highest decision-making body for major issues during the period of an enterprise's bankruptcy, reorganization, liquidation and settlement. Article 59 of the *Enterprise Bankruptcy Law* stipulates that "the creditors' meeting shall be attended by representatives of the debtor's employees and trade unions to express opinions on relevant matters", which clarifies one of the channels for employees to participate in bankruptcy affairs. According to Article 61 of the *Enterprise Bankruptcy Law*, the creditors' meeting can exercise the authority such as approving the reorganization plan. Second, the right to vote in groups for the reorganization plan. Article 82 of the *Enterprise Bankruptcy Law* stipulates that the draft reorganization plan shall be classified according to creditor's rights when being voted and shall be voted in groups according to the classification. Among these groups, second group is the labor claims (employees' claims) group. The reorganization plan can be passed when all voting groups have passed the draft. Enterprise reorganization involves changes in the business policy, direction of operation and organizational structure, and may even involve the measures of reducing staff or lowering wages, which will affect the vital interests of enterprise employees. Therefore, group voting rights can provide employees with a channel to participate in voting on the reorganization plan and to be able to express their opinions and views on the same.

1.3.3. The right to be prioritized in retention

The right to be prioritized in retention means when an employer makes economic layoffs, several types of special personnel have the right to be given priority in retention to avoid being laid off. Article 29 of the *Labor Law* stipulates that if a laborer has one of the following circumstances, the employer shall not terminate the labor contract in accordance with Articles 26 and 27 of the same law: he or she suffers from an occupational disease or is injured at work and is confirmed to have lost or partially lost the capability to work; he or she is sick or injured and is within the prescribed medical treatment period; female employees who are during pregnancy, childbirth, or breastfeeding.

1.3.4. The right to receive economic compensation

Article 56 of the *Provisions on Several Issues Concerning the Trial of Enterprise Bankruptcy Cases of the Supreme People's Court* stipulates that for

termination of a labor contract due to enterprise bankruptcy, the employee shall have the right to claim compensation against the enterprise in accordance with the law or in accordance with the labor contract. The compensation can provide basic guarantee for employees to survive the difficult times.

1.3.5. The Right of priority in re-employment

According to Article 27 of the *Labor Law*, in case of layoffs according to law due to economic reasons and the employer is re-hiring within 6 months following the layoff, the employer shall notify the laid off employees and give them the priority to be re-employed under the same condition. The right of priority in re-employment is very important to employees who have terminated their labor relations with the employer during the reorganization period. Once the enterprise re-hires within a short period of time following the reorganization, the right of priority in re-employment of the laid-off employees shall be guaranteed.

2. STATUS QUO OF THE PROTECTION OF RIGHTS AND INTERESTS OF EMPLOYEES IN ENTERPRISE REORGANIZATION

2.1. Overview of the status quo of the protection of the rights and interests of employees in enterprise reorganization

In the process of enterprise reorganization, most enterprises use bankruptcy reorganization as the main way of reorganizing themselves. Bankruptcy reorganization is the forcible separation of debts and assets through legal means, so that the enterprise can gain a new life. Because bankruptcy reorganization method is extremely compulsory, it is very easy to cause damages to the interests of other people in the process, especially the interests of enterprise employees. Due to the negligence of enterprise employees in the process of asset allocation during bankruptcy reorganization, the interests of many employees are harmed. This is contrary to the purpose of asset reorganization of our country. This phenomenon has also caused certain negative effects in society. Therefore, how to protect the legal rights and interests of employees in the process of bankruptcy reorganization of enterprises is a critical issue.

2.2. Common types of damages to the labor rights of employees

The purpose of bankruptcy reorganization is to use legal means to establish an interest balance mechanism among all stakeholders of the enterprise, so that a balance of economic interests can be achieved among the beneficiaries of the enterprise, and in order that the debtor can get a new life after the enterprise reorganization.

However, in such a process, it is possible to terminate the labor contracts of some employees or even of all employees in order to reduce the burden on the enterprise, followed by the re-financing of the enterprise in the market. Although the *Labor Contract Law* stipulates relevant methods to deal with such a situation, the actual situation is far more complicated, which makes the interests of relevant employees extremely vulnerable in the process of reorganization, and even makes it impossible to protect their legal rights under relevant laws. The following sections will analyze three different situations, that is, continued existence of labor contracts, amendment of labor contracts and termination of labor contracts [4].

2.2.1. Continued existence of labor contracts

Even though the enterprise does not terminate the labor contract, it normally offers long vacations to employees or set hard-to-achieve work targets to semi-force employees to “request to take leaves”. During the vacations, the company only pays minimum wages required by the government in order to avoid liquidated damages or paying compensations to laid offs, so that the costs of the enterprise can be reduced. However, such continuance of the labor contract, to a large extent, violates the rules set out in the labor contract signed at the time of employment, such as those regarding the working hours and the right to be paid [5]. This constitutes an amendment to the labor contract virtually and is a kind of damage to the rights and interests of the employees.

2.2.2. Amendment of labor contracts

Here, amendment means amending labor contracts through negative means such as debts reliefs or reduction, wages reduction, or changing work positions. Regarding labor claims, the *Enterprise Bankruptcy Law* mainly protects the parts of the basic pension and medical insurance which are covered by the social insurance, as well as work injury insurance, unemployment insurance, and maternity insurance. There are no clear provisions on labor claims. Labor creditors participate in the reorganization plan only as a voting group, which can be easily affected by the opinions of other voting groups, that is, “the majority rules”. The *Enterprise Bankruptcy Law* has no relevant requirements for reducing labor remuneration and requires that salary reductions under collective labor contracts must be included in the reorganization plan for consideration as a collective labor contract plan. It is worth mentioning that the collective labor contracts must be negotiated with the employees and cannot be unilaterally determined by the employers. Work position changes generally correspond to the reorganization in backdoor listing, in which employees who cannot be dismissed or are not dismissed for various

reasons are transferred to another company “till old” or fend for themselves.

2.2.3. Termination of labor contracts

This phenomenon is common in "liquidation reorganization" and "reorganization in backdoor listing" [6]. What it does is to remove all the assets around the entire company by selling such assets, which leaves only a clean shell company and the name of the original company. Then the strategic investor pays the relevant assets to deal with the debt crisis faced by the debtor, the reorganized enterprise will then undergo the related bankruptcy procedures. In this reorganization method, although employees of the reorganized enterprise can obtain corresponding economic compensation, they are not given the priority of being employed by the new company after reorganization, because they do not have direct labor relations with the such new enterprise after the reorganization.

3. COUNTERMEASURES AND SUGGESTIONS FOR IMPROVING THE PROTECTION MECHANISM OF EMPLOYEES' RIGHTS AND INTERESTS IN BANKRUPTCY REORGANIZATION

As a legitimate way to rejuvenate the enterprise, bankruptcy reorganization procedure can bring great benefits to the enterprise, however, this cannot be a reason for causing damages to the relevant employees' labor rights. On the contrary, it is the responsibility of every enterprise undergoing reorganization to protect the right of priority in re-employment of its employees, which is the value of the entire mechanism. However, how to protect the labor rights of employees in enterprises in reorganization is a relatively difficult task. The most fundamental thing is to guarantee the labor rights of employees through legal means. The relevant imperfect legal provisions should be improved, starting from the *Enterprise Bankruptcy Law* and *Labor Contract Law* in particular. It can be done mainly from the following aspects:

3.1. The supervision mechanism of bankruptcy reorganization should be participated by employees

The *Enterprise Bankruptcy Law* stipulates that the creditors' committee is the representative body of the creditors and is also the supervisor of the entire reorganization process. Although the *Enterprise Bankruptcy Law* requires that the creditors' committee of bankruptcy reorganization must be participated by employees, the creditors' committee is not a compulsory institution. Therefore, when the creditors' committee is

not established in the enterprise reorganization, the employees cannot participate in the normal process of reorganization, and therefore lack the meaningful voting right in the entire reorganization process. So, when such employee' own rights and interests are harmed, they cannot defend for themselves in a timely manner. Therefore, the relevant provisions of the creditors' committee in the *Enterprise Bankruptcy Law* should be revised. Having clarified that the creditors' committee must have employee representatives, it should also stipulate that the creditors' committee must be established in the process of bankruptcy reorganization, so that the employees can protect their legitimate rights by using the supervisory authority when their rights are harmed. Of course, the *Enterprise Bankruptcy Law* should also appropriately restrict the behavior of investors to prevent the relevant rights and interests of enterprise employees from being harmed due to the excessive self-interest behaviors of investors.

3.2. Establishing the information disclosure mechanism in the bankruptcy reorganization process

In the process of enterprise reorganization, the second major reason for employees' failure to safeguard their own rights and interests is due to the failure to obtain timely information about the reorganization procedure. The *Enterprise Bankruptcy Law* requires investors and administrators to disclose some necessary information. However, most of the information is concealed or refused to be disclosed. This includes information such as those on relevant interests of the employees, the chance of success of the enterprise after reorganization, the handling of rights of priority in re-employment of employees by relevant enterprises, and so on. Since the employees cannot obtain such firsthand information, their own legal rights cannot be safeguarded timely. Although the employees can pursue the relevant civil liabilities of the enterprise, it cannot fundamentally solve the problem.

3.3. Establishing the safeguard mechanism for the right of priority in re-employment of employees

Although the *Enterprise Bankruptcy Law* provides clear protection for the right of priority in re-employment of employees, however, the legal rights and interests of many employees have been harmed due to the variety of reorganization methods. Therefore, the *Enterprise Bankruptcy Law* should include the right of priority in re-employment of employees as one of the obligations that must be performed by the investors and administrators in the process of reorganization. It shall also stipulate that investors and administrators should formulate detailed plans to ensure the protection of the right of priority in re-employment of employees and shall implement such

plans as part of the reorganization. Once the procedure is voted for and approved by the court, employees can safeguard their own interests through appropriate channels to ensure their priority in re-employment. When such a plan of priority in re-employment is not passed, the court cannot approve the entire reorganization plan. Only after the employees' right of priority in re-employment is guaranteed, the reorganization process can move forward. In this way, damage to the right of priority in re-employment of employees can be prevented from happening again [7].

3.4. Protecting the legal rights and interests of creditors and employees

Although the legitimate rights and interests of employees are easily damaged during the reorganization process, the legal rights of creditors are vulnerable to damage as well. Therefore, in the process of enterprise reorganization, attention should be paid to protecting the legitimate rights and interests of enterprise employees and creditors. For employees, it is not only necessary to establish a mechanism for the protection of their related rights and interests, but also to establish a complete supervision mechanism to supervise the implementation of the plan to ensure the protection of the right of priority in re-employment of employees. After the reorganization is successful, attention should be focused on providing skills training to employees of the original enterprise to ensure that they can start working as soon as possible. For enterprises that have failed to reorganize, they should arrange new jobs for the employees to the greatest extent or make corresponding economic compensations.

3.5. Improving the relevant legal provisions

The purpose of Article 41.1(1) of the *Labor Contract Law* is to ensure that the enterprises can successfully reorganize themselves. However, due to the lack of safeguards of the rights and interests of employees of the reorganized enterprise under Article 41.3 of the same law, this clause has become an umbrella for many investors and administrators, causing them wantonly to harm the relevant rights and interests of employees. Although from a rational point of view, there is no inappropriateness of this clause due to the fact that the enterprise will go directly to bankruptcy once failing to reorganize, which will also lead to the direct termination of all employees' labor contracts. But when the enterprise reorganizes successfully, the original employees of the enterprise should not be dismissed. However, if the reorganization of the enterprise fails in order to protect the rights and interests of the employees, then the gain is outweighed by the loss. Therefore, the only way is to give way to the reorganization of the enterprise. However, this also means that the legitimate rights and interests of the employees of the enterprise under reorganization will be harmed. This will not only violate the entire system value

of the *Enterprise Bankruptcy Law*, but also conflict with other legal provisions that protect the rights and interests of employees. Therefore, when reorganizing the enterprises, it is necessary to appropriately revise Article 41.3 of the *Labor Contract Law* from the perspective of facilitating the successful reorganization of enterprises. The way of giving priority in this clause can be changed to unconditional priority, and then the period of priority in re-employment of employees can be extended. In addition, the economic compensation for employees of related enterprises can be increased, so as to force administrators and investors not to cause damages to the rights and interests of employees due to concerns about costs. Only by repealing or modifying the relevant legal provisions can the rights and interests of the employees of the reorganized enterprise be effectively protected, and the re-employment of the employees can be fundamentally resolved.

4. CONCLUSION

The legal rights and interests of employees during the bankruptcy reorganization are crucial to our society, and should be handled carefully. The labor claims, the right to participate, the right to be prioritized in retention, the right to receive economic compensation and the right of priority in re-employment should be given extra attention in this process. In order to improve the protection of legal rights and interests of employees, the administrators and government need to improve the participation of employees in the corporate supervision mechanism, establish an information disclosure system for bankruptcy reorganization procedures, establish a protection mechanism for rights of priority in re-employment of employees, allow employees to file enterprise reorganization applications, and revise the relevant legal provisions under the current law.

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