

## Insolvency & Restructuring - Sweden

### State wage guarantee in company reorganisation

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If a debtor is unable to pay its debts as they fall due, or will shortly become unable to do so, it may apply for company reorganisation (Company Reorganisation Act). Company reorganisation grants undertakings with financial difficulties respite to take measures to improve their business and negotiate a judicial composition with creditors. During company reorganisation the court commonly rules, at the request of the debtor, that judicial composition proceedings shall take place. Creditors with unsecured claims participate in such proceedings, but only creditors whose claims arose before the application for company reorganisation are affected by the proceedings.

The alternative to company reorganisation is insolvent liquidation. Once a legal entity has been placed into insolvent liquidation and the proceedings have been completed, the legal entity is dissolved. However, insolvent liquidation may also involve the reorganisation of a business, where a profitable part of the business is transferred to a different legal entity which continues to run that business.

The choice between company reorganisation and insolvent liquidation depends on many elements, such as the extent of the debtor's financial difficulties, the business concept or the possibility to transfer favourable agreements. Another factor is the judicial framework.

Since its adoption, the Company Reorganisation Act has been criticised for not being favourable enough to debtors. However, an important change to the legislation in June 2005 saw the implementation of a state wage guarantee in company reorganisations (the Wage Guarantee Act). The wage guarantee was considered important to achieve neutrality between insolvent liquidation and company reorganisation.

The wage guarantee is equivalent to the rules applicable in insolvent liquidation and includes, among other things, employees' claims for salary or other remuneration and dismissal wages. It covers claims accrued three months before the company reorganisation application and one month after the court order. The wage guarantee may also cover dismissal wages for a period of more than one month from the court order, if an employee is dismissed and does not work for the employer throughout the notice period.

It is the appointed administrator who autonomously grants the wage guarantee in company reorganisation. Even though there are no explicit restrictions, the appointed administrator shall not grant the wage guarantee if it believes that the reorganisation is unlikely to succeed. That is a consequence of the administrator's obligation to continuously investigate whether the reorganisation may succeed. The administrator can further request that the court terminate the company reorganisation where its purpose cannot be achieved.

Where an administrator has granted the wage guarantee and the state has consequently financed the employees' claims, the state assumes the employees' claims on the debtor. However, the state's claim on the debtor converts from a secured to an unsecured claim. Claims that have accrued before an application for company reorganisation will therefore be comprised by a judicial composition, while claims accrued after an application do not form part of the proceedings.

When the company reorganisation is complete, the debtor must make full payment to the state for wages that accrued after the application for reorganisation. Such paid wages are a loan during the reorganisation for payment of wages. However, wages regarding dismissal accrued after a reorganisation application are also considered to form part of a judicial composition if the employee does not work for the debtor throughout the notice period.

The state's payment of the wage guarantee is a loan to the company on a short-term basis. The loan provides a cash injection that improves the debtor's possibilities to

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reorganise the business. Further, some of the state's claims due to the wage guarantee may be reduced in a judicial composition. Thus, the wage guarantee will ease the debtor's burden of prior secured claims and may also include some claims that have accrued during the reorganisation. The wage guarantee may thus have a positive impact on the company's liquidity as well as on the balance sheet. The rules on wage guarantee are particularly favourable when a company is downsizing and reduces the number of staff. The state, as the actual payer of the wages, is responsible for payment of employers' contributions and has no basis under the law to make claims on the debtor for repayment of these costs.

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