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Sodimedical: the legal saga of a plant shutdown

The so-called SODIMEDICAL case, named after a French subsidiary involved in what has become a legal saga, is undoubtedly a perfect example of the highly grotesque situations in which companies may find themselves when their decisions to proceed with economic dismissals are challenged.

This is clearly a sobering case as, for now, its outcome seems to promote radical solutions that are the most penalizing ones for employees.

1. Background

In April 2010, the German group LOHMANN ET RAUSCHER, to which SODIMEDICAL belongs, resolves to shut down this subsidiary because of serious economic difficulties.

SODIMEDICAL is exclusively a production entity, all the commercial and administrative activities being pooled in and managed by its parent company, LOHMANN ET RAUSCHER FRANCE, itself wholly-owned by LOHMANN ET RAUSCHER GERMANY.

The French subsidiary has 140 employees. The shutdown is announced and a *Plan de Sauvegarde de l'Emploi* (collective lay-off plan or hereinafter "PSE") is negotiated.

On July 30, 2010, the First Instance Court of Troyes orders the nullification of the PSE as it considers not only that the PSE is insufficient but also that the French company was experiencing economic difficulties as a result of a deliberate choice of the Group that had put the French company in competition with other production sites, including those located in low-wage countries.

A new PSE is issued in October 2010 and presented to the employees. This PSE is brought before the First Instance Court of Troyes and nullified pursuant to a judgment dated February 4, 2011.

The nullification of this second PSE is due to the lack of economic motivation, thereby opening possibilities to challenge the economic dismissal procedures, which would allow civil courts to perform an *a priori* control of the economic ground(s) put forth to justify dismissals, i.e. a new kind of prior authorization of economic dismissals that this time would not be entrusted to the labor authorities, as it used to be in the past, but to the judge.

This is exactly what employees had try to do in the Vivéo case (see our June 2012 e-newsletter) but their

attempt failed as the Labor Chamber of the *Cour de Cassation* ruled that the absence of economic motivation did not entail the nullity of the PSE and of the dismissals contemplated therein.

It should finally be noted that the PSE proposed by SODIMEDICAL includes a 9-month redeployment leave as well as an additional dismissal indemnity of 30,000 Euros for each employee – in addition to the indemnity provided for by law.

These proposals were considered as "humiliating" by the works council.

The company launched the process in 2010 but nine months later it is still unable to proceed with the dismissals.

On January 5, 2011, the company files a petition for judicial liquidation. It should be recalled in this respect that under French law the declaration of insolvency must be submitted to the clerk of the competent commercial court within a maximum of 45 days as from the date on which a company becomes insolvent (Article L.631-4 of the French Commercial Code). Such a declaration of insolvency is mandatory and failing to produce it is constitutive of a mismanagement act for which the head of the company can be held liable.

New proceedings are initiated by the employees. The Commercial Court of Troyes and then the Reims Court of Appeals align themselves with the position adopted by the First Instance Court of Troyes and clearly reject the collective dismissal procedure on ground that "*this company does not have a shred of autonomy vis-à-vis its parent company and is in fact only a production site and that the petition for judicial liquidation constitutes in fact an abuse of proceedings in order to escape the provisions of the Labor Code*".

It seems, however, that the courts have omitted the fact that the company was precluded from performing its obligations under the French Labor Code since the works council had considered that its proposals were "humiliating", thereby highlighting that the assessment of a damage suffered as a result of the loss of employment is particularly subjective by nature. This subjectivity is mainly due to the fact that the accompanying measures proposed in the PSE must be commensurate with the resources of the company and of the Group to which it belongs.

SODIMEDICAL files two additional petitions requesting the commencement of judicial liquidation proceedings but both are dismissed.

In October 2011, the company is still unable to proceed with the dismissals and to have its state of insolvency acknowledged.

At this time, the company no longer conducts operations but is still liable for the payment of wages and salaries since the employment contracts have not yet been terminated. As the company has ceased to pay all types of remuneration for lack of resources, the employees go to court and obtain from the judge a decision ordering the parent company to pay such wages and salaries.

The French parent company, jeopardized by this decision, immediately applies for the initiation of safeguard

proceedings[1] to ensure its survival. As such, since the above-mentioned court order cannot be enforced during the whole safeguard proceedings, the employees of SODIMEDICAL decide to request the payment of their salaries and wages directly from the German parent company.

2. The outcome

The decision rendered on July 3, 2012 by the Commercial Chamber of the *Cour de Cassation* (French Supreme court) finally puts an end to this legal saga that was definitively closed by a judgment of the Court of Appeals of Reims that confirmed the liquidation of SODIMEDICAL… two years and a half and forty proceedings after the start of the dismissal procedure…

This decision was long-awaited at a time where the liability of parent companies of French corporations wishing to proceed with economic dismissals or business shutdowns tends to be systematically sought. The Labor Chamber of *the Cour de Cassation* has already relied upon the concepts of co-employment (in case of an intermingling of interests, activities and management) and reprehensible carelessness to seek the liability of the entities that are behind the decisions to shutdown a site or dismiss employees. So far, this incurrence of liability has "only" entailed financial consequences, i.e. the payment of an additional indemnification to the employees.

By initiating all the above-mentioned proceedings, the employees of SODIMEDICAL wanted to go one step further and block the entire process as from its very outset in order to force the Group into maintaining activities – and thus employment – in France or, at the very least, paying a financial contribution up to an amount deemed acceptable by the employees.

The action brought before the Commercial Court was aimed at leaving the judge free to assess the existence of a possible good cause when examining the petition for judicial liquidation filed by SODIMEDICAL.

The Court of Appeals of Reims had indeed rejected the petition for judicial liquidation because (i) the liabilities mainly comprised sums due to parent company under the shareholder's account, (ii) the group had decided to stop supporting its subsidiary that had no autonomy whatsoever and (iii) SODIMEDICAL's position was inconsistent since it claimed to be insolvent whereas it had offered an additional dismissal indemnity of 20,000 Euros to each of its employees. This was, for the judge, an abuse of proceedings with the sole objective – after several unsuccessful PSEs – to proceed with economic dismissals and to have the costs of such dismissals borne by the community.

The Commercial Chamber of the *Cour de Cassation* has clarified this issue by holding that **the state of insolvency is to be assessed objectively, for each group company.** Consequently, the judge hearing a petition for judicial liquidation may not deny such petition only because of the motive(s) of the debtor company that is legally required to declare its state of insolvency.

Indeed, pursuant to Article L.631-1 of the French Commercial Code, a company becomes insolvent when its available assets do not cover its payable liabilities. This is a factual situation in which the debtor company's

actual or presumed motive(s) is/are irrelevant to the judge who has no freedom of interpretation in this respect.

3. Conclusion

Should we conclude from the above developments that, in France, it is now preferable to file for bankruptcy rather than to dismiss employees?

Such conclusion would be of course simplistic and hasty.

Yet, there is no doubt at all that it is worrying and alarming – both for employees and employers – to have to raise this question that now automatically comes to mind given the major legal constraints and case-law trends with respect to the implementation of economic dismissals in France.

But initiating insolvency/bankruptcy proceedings is not a magic solution to discontinue operations in France.

It should be kept in mind that insolvency/bankruptcy proceedings can extend to other group companies. Pursuant to Article L.621-2 of the French Commercial Code, there are only two reasons for extending such proceedings: the existence of a fictitious corporate entity and the intermingling of estates. A company is deemed fictitious when it is merely a corporate veil that has no legal autonomy and no real existence on its own.

To establish the existence of an intermingling of estates between two entities, French courts apply in fact two criteria, i.e. the inextricable intermingling of accounts and abnormal financial flows. This would be the case for example when there exist financial contributions without any sort of compensation or to the exclusive benefit of only one company resulting from the diversion of resources from one company to the other.

Creditors may also seek the liability of the parent company through a liability claim for asset shortfall.

As mentioned in our January 2012 e-newsletter, corporate groups should, as a basic precaution, make sure that their French subsidiaries remain autonomous in terms of organization, decision-making process and management, failing which, their parent company will be asked to pay.

It is certainly regretful that the community has to bear the cost of such business shutdowns but when a company no longer conducts any operations – and has thus no revenue – and is prevented from dismissing its employees, a way out must be found anyhow. In the commented case, a way out was confirmed by the Commercial Chamber of the *Cour de Cassation*, which has widened the gap with the Labor Chamber.

But at a time where the French legislator is led to address the issue of economic dismissals and where the possibility of banning so-called stock-market redundancies is envisaged, we believe that the decision of the Commercial Chamber of the *Cour de Cassation* should be granted credit for underlining the limits of the case-law trends of the past few years and of the judges' interpretation power. The legislator should take actions to avoid that such deadlock and highly grotesque situations become the norm.

It is apparently evident that only the legislator can reduce the great legal uncertainty surrounding economic dismissals in France. This uncertainty is a burden for everyone, employees and companies alike. Clarification is therefore urgently needed.

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[1] The commencement of safeguard proceedings entails the suspension of any proceedings initiated by creditors and the freeze of the debtor's liabilities, as they existed before the opening of the safeguard proceedings, in order to enable the reorganization of the company.