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In re First Magnus Financial Corp. Revisited: The *Powermate* Decision

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Editor's Note: *Please see the Last in Line column on page 32 for a broader discussion of WARN Act claims and their effects on unsecured creditors.*

About the Author

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As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Congress added §503(b)(1)(A)(ii) to the Bankruptcy Code. As amended, §503(b)(1)(A) provides as follows:

(b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under §502(f) of this title, including—

(1)(A) The actual, necessary costs and expenses of preserving the estate, including—

(i) wages, salaries, ~~or~~ *and* commissions for services rendered after the commencement of the case; *and*

(ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title[.]—11 U.S.C. §503(b)(1)(A)

Before BAPCPA, damage claims for violations of the Workers Adjustment and Retraining Notification (WARN) Act were determined based on the timing of the violation. Damage claims for prepetition terminations in violation of the WARN Act constituted fourth- or fifth-level priority claims under §507(b) of the Code. In contrast, claims arising out of postpetition terminations were granted administrative expense status.

Following the amendment to §503, lawyers began to argue that a former employee who had been terminated before a bankruptcy petition filing under chapter 11 was entitled to administrative expense priority for claims arising from prepetition WARN Act violations. These arguments stem from the added language in §503(b)(1)(A)(ii) that provides for an administrative expense claim for "wages and benefits awarded pursuant to a judicial proceeding...as a result of a violation of federal or state law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered[.]"

Until last June, there was no decisional law interpreting the recently amended §503(b)(1)(A). Now, in a span of months, there have appeared two conflicting interpretations. The first decision, *In re First Magnus Financial Corp.*,[1] was rendered on June 20, 2008, in the U.S. Bankruptcy Court for the District of Arizona.[2] The second decision, *In re Powermate Holding Corp.*,[3] was rendered on Oct. 10, 2008, in the U.S. Bankruptcy Court for the District of Delaware. The purpose of this article is to discuss the *Powermate* decision and compare it to is predecessor, the *First Magnus* decision.

In the *Powermate* decision, Hon. **Kevin Gross** held that claims of former employees relating to a prepetition failure to provide 60 days' notice of a mass layoff and/or plant closing as required under the WARN Act were not entitled to administrative expense status under §503(b)(1)(A).

Feature

Background Facts

On March 17, 2008, Powermate Holding Corp., Powermate Corp. and Powermate International Inc. filed voluntary petitions for relief under chapter 11. Before the chapter 11 filings, the debtors terminated the employment of all of their approximately 260 workers without providing notice.

1 *In re First Magnus Financial Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008).
2 This decision was the subject of a prior article. *See* Paul A. Avron and Frank Scruggs, "Are WARN Act Claims Within the Scope of §503(b)(1)(A)(ii) of the Bankruptcy Code?," *ABI Journal*, Vol. XXVII, No. 7, cover, page 50-51, September 2008.
3 *In re Powermate Holding Corp.*, 394 B.R. 765 (Bankr. D. Del. 2008).

A former employee of Powermate, Greg Henderson (plaintiff), on his own behalf as well as on behalf of other similarly discharged workers, filed suit in the bankruptcy court, alleging that the debtors had violated the WARN Act. He alleged that his discharge was part of a mass layoff and/or plant closing, and that as a result, under the WARN Act, he was entitled to damages for wages, ERISA and other benefits for 60 days. He further alleged that his WARN Act claim was entitled to administrative expense claim status under §503(b)(1)(A)(ii).

Legal Analysis

After a determination that the priority of the plaintiff's claim was ripe for adjudication, the court found that the issue was one of first impression in the Third Circuit. To interpret the newly enacted statute, the court looked first to its plain language.[4] The court found the critical language to be as follows:

"(b)...there shall be allowed, administrative expenses...*including*... (1)(A) the actual, necessary costs and expenses of preserving the estate, *including*—(i) wages, salaries...; *and* (ii) wages and benefits awarded....."[5]

Interpreting "and"

In making its decision, the *Powermate* court reviewed the holding in the *First Magnus* case. In *First Magnus*, the court held that the "and" between subsections (i) and (ii) in §503(b)(1)(A) required the two subsections to be read together: "Essentially, the [*First Magnus*] court held that the requirements of *both* sections must be satisfied for a claim to qualify as an administrative expense."[6] The *Powermate* court, however, viewed the word "and" between subsections (i) and (ii) differently.

Relying on the placement of the word "including" before subsection (i), the *Powermate* court held that, correctly interpreted, the "and" between subsections (i) and (ii) is meant to indicate "categories within a particular subset of allowable administrative expenses."[7] As support for this conclusion, the court noted that the word "including" followed by an "and" appears twice in §503(b). The word "including" appears as the final word before the listing of types of administrative expense claims, with a trailing "and" between (b)(8)(B) and (b)(9).

4 *Id.* at 773.
5 *Id.* at 774 (emphasis in original).
6 *Id.* (emphasis in original).
7 *Id.*

Applying the *First Magnus* court's interpretation, the *Powermate* court observed, would require that "everything in subsection (b)...be present in order for a claimant to have an administrative expense."[8] The unstated implication is that, since §503(b) cannot reasonably be read to require that a claimant satisfy all of its nine subsections, the "and" in subsection (b)(1)(A) should similarly not be seen as requiring that subsections (b)(1)(A)(i) and (ii) both be met.

Interpreting the Language of §503(b)(1)(A)(ii)

Turning to the language of §503(b)(1)(A)(ii) of the Code, the *Powermate* court observed that at first blush, the subsection appears confusing in that it describes two different applicable time periods that must be compared to the filing date of the chapter 11 petition: "the period to which back pay is *attributable* and the time of the *occurrence* of the unlawful conduct and/or when the services were rendered."[9] However, the court held that upon closer reading, the text "reveals that the only relevant consideration is the former time, the time to which the back pay is attributable which is when the rights or claims *vest* or *accrue*, and how that time relates to the petition date."[10]

Under this interpretation, therefore, the status of the claim is not determined by when the unlawful conduct occurred, when services were rendered or when the payment for such claim comes due.[11] Instead, the key is when "the rights under the WARN Act vest."[12] According to the court's analysis, a claim for back pay that vests prepetition is not entitled to administrative expense claim status, whereas a claim for back pay that vests postpetition is entitled to administrative expense claim status.[13]

To answer the vesting question, the court observed that back pay under the WARN Act is meant as a "payment at termination in lieu of notice."[14] The court next looked to the significant body of law in the Third Circuit surrounding the priority status of severance pay established in *In re Public Ledger Inc.*, 161 F. 2d 762 (3d Cir. 1947), and *In re Roth American Inc.*, 975 F.2d 949 (3d Cir. 1992). As the *Powermate* court explained, there are "'two types of severance pay: '(1) pay at termination in lieu of notice; and (2) pay at termination based on length of employment.'"[15] Severance pay "at termination in lieu of notice[...] vests at the time of the termination because it is based solely on lack of notice."[16] When such severance pay is claimed as a result of a postpetition discharge, it is entitled to administrative expense status. On the other hand, when a claim for severance pay in lieu of notice results from a prepetition discharge, the claim is not entitled to administrative expense status.[17] Thus, since "WARN damages are...like payment at termination in lieu of notice," the court concluded that "the rights of workers discharged in violation of the WARN Act accrue in their entirety upon their termination."[18]

Turning to the WARN Act claims at issue, the *Powermate* court found that since the plaintiff had been terminated prepetition, his claims vested prepetition and were not entitled to administrative expense claim status.[19] "Further, because the vesting date is the only crucial time, and WARN Act claims vest entirely upon termination, whether the back pay was due for the time prior to the vesting or the time following the vesting is irrelevant."[20] Thus, the *Powermate* court concluded that whether a WARN Act claim is entitled to administrative expense status "depends on whether the termination without notice occurred pre- or postpetition."[21]

While not necessary for its ruling (as the court determined the statute to be unambiguous), the court for "the sake of completeness" also examined the legislative intent.[22] Here, the court noted that its holding was consistent with pre-BAPCPA law that required a claimant to render services postpetition to have an administrative expense claim.[23] The plaintiff's reading of amended §503(b)(1)(A), by contrast, would result in an "enormous increase in the value of wage claims..."[24] The court reasoned that "if Congress intended for such a

8 *Id.* at 774, fn 52.
9 *Id.* at 774 (emphasis in original).
10 *Id.* at 774-775 (emphasis in original).
11 *Id.* at 775.
12 *Id.*
13 *Id.* at 775-776.
14 *Id.* at 776.
15 *Id.* at 775 (quoting *In re Roth American*, 975 F.2d at 957.
16 *Id.* at 775.
17 *Id.* at 776.
18 *Id.* at 776 (citing *In re Cargo Inc.*, 138 B.R. 923, 928 (Bankr. N.D. Iowa 1992), and *In re Hanlin Group Inc.*, 176 B.R. 329 (Bankr. D. N.J. 1995)).
19 *Id.* at 777.
20 *Id.* at 776-777.
21 *Id.* at 778.
22 *Id.* at 777.
23 *Id.*
24 *Id.* at 777-778.

monumental shift in the administration of estates under bankruptcy law, there would be significant legislative history."[25] Since, instead, the legislative history is "extremely sparse," the court concluded that it supports the court's interpretation and not that of the plaintiff.[26]

Conclusion

The *Powermate* court's interpretation of §503(b)(1)(A)(ii) is consistent both with the statutory language and structure of the Bankruptcy Code in general, and with the specific language of the section. By giving a natural reading to the word "and" between subsections (b)(1)(A)(i) and (ii), and by rooting its interpretation in the case law on WARN Act claims, the *Powermate* court reached the same conclusion as the *First Magnus* court, while—the author submits—providing a more robust basis for its holding. ■

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[25] *Id.*
[26] *Id.* at 778, fn 73.