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No Stay for The Weary

Corporate Governance Obligations Continue in Bankruptcy

By Peter B. Ladig and Stephen B. Brauerman

The Delaware Court of Chancery recently emphasized that issues of corporate governance remain the purview of the state of incorporation, notwithstanding the filing of a bankruptcy petition and the accompanying automatic stay, which ordinarily acts to halt proceedings against the debtor. Most significant about the court's opinion in *Fogel v. U.S. Energy Systems*, 2008 WL 151857 (Del. Ch.) is not that it retained jurisdiction over corporate governance issues following a bankruptcy petition, but rather, the ease with which the court reached its decision. Notably, the court took just one day to issue its opinion and did so without allowing the Bankruptcy Court the opportunity first to consider whether a shareholder could continue to seek relief from the Court of Chancery in an action to compel the company to hold an annual meeting. Given this period of economic uncertainty and the recent increase in bankruptcy filings, this decision should make clear that companies cannot hide behind the Bankruptcy Code's automatic stay to avoid corporate governance obligations.

continued on page 5

The Benefits Priority Cap of § 507(a)(5)

Chalk One Up for Statutory Plain Meaning

By Andrew L. Turscak and Curtis L. Tuggle

Understandably, a good deal of excitement and controversy remains over the relatively recent reforms brought about by BAPCPA, many of which have not been tested thoroughly (and some, not at all) since BAPCPA's enactment. But, for perspective's sake, it is worth remembering that, 30 years after its enactment, there are still unresolved issues that arise from time to time under the pre-BAPCPA Bankruptcy Code. One such issue involves the proper application of the statutory priority cap found in Bankruptcy Code § 507(a)(5), including its interplay with § 507(a)(4).

Wage and Benefit Priorities Under § 507(a)(4) and (5)

In relevant part, Bankruptcy Code § 507(a)(4) provides for priority treatment of unsecured claims for up to $10,000 in wages earned within 180 days prior to the petition date "for each individual."

In relevant part, Bankruptcy Code § 507(a)(5) provides for priority treatment of unsecured claims for contributions to an employee benefit plan for services rendered within 180 days prior to the petition date to the extent of "the number of employees covered by each such plan multiplied by $10,000 [minus the wage claims paid on account of such employees under 507(a)(4)]."

Thus, there is a contrast between the two sections. Specifically, while § 507(a)(4) explicitly provides for a *per employee* maximum wage priority (up to $10,000 per individual, period), § 507(a)(5) does not. Instead, the cap under § 507(a)(5) is, on its face, an *aggregate* limit (put simply, the claim cannot exceed the number of employees times $10,000), regardless of whether benefits attributable to a particular employee or employees exceed $10,000.

Statutory Plain Meaning

The primary rule of statutory construction is to give effect to legislative intent. *Good Samaritan Hosp. v. Shalala*, 508 U.S. 402, 409 (1993). The first place to look

continued on page 2

In This Issue

The Benefits Priority Cap of § 507(a)(5) 1

Corporate Governance Obligations 1

Rediscovering Chapter 9 ..3

Bankruptcy Filings 7

On The Move 8

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Wages

continued from page 1

for that intent is the statute's language. *Bd. of Ed. of Westside Cmty. Sch. v. Mergens*, 496 U.S. 226, 237 (1990). In general, a statute means what it says, and it will be construed accordingly, except in those rare instances where a literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).

A case law split on an issue may constitute evidence of ambiguity in a statute. *United States v. Ninety-Three Firearms*, 330 F.3d 414, 421 (6th Cir. 2003); *State Ins. Fund v. S. Star Foods, Inc. (In re S. Star Foods, Inc.)*, 144 F. 3d 712, 715 (10th Cir. 1998). Also, in discerning whether a statute offers a plain meaning, a court may look beyond a single sentence to the language and design of the statute as a whole, including its object and policy. *Massachusetts v. Morash*, 490 U.S. 107, 115 (1989). If the statute's meaning remains unclear or inconsistent after the holistic analysis, or if a case law split exists, a court may opt to look to the statute's legislative history.

Arguably, resort to legislative history is appropriate here. First, as set forth below, courts have been divided on the effect of the monetary limit of 507(a)(5). Moreover, though plain on its face, § 507(a)(5) does not exist in isolation. It shares textual ties, a tight linkage, and a common cap with § 507(a)(4). *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 659-60 (2006). In addition, bankruptcy provisions granting priority are to be "tightly construed"; preferential treatment of a class of creditors is appropriate only where clearly authorized by Congress. *Id.* at 655, 667. Accordingly, when § 507(a)(5) is read in its overall context, including its linkage with § 507(a)(4), which imposes a per employee limit, a legitimate question arises regarding whether — notwithstanding its language, suggesting an overall limit, without regard to the amounts allocable to each employee — the $10,000 limit, in reality, is intended to be a per-employee limitation. In other words, does § 507(a)(5) clearly and unequivocally authorize preferred treatment of benefit claims beyond a $10,000 per employee limit? As discussed below, this question becomes even sharper in light of the statute's historical underpinnings and legislative history.

What the Courts Have Said

What have the courts said about the statutory cap? Not very much. In fact, over the years, only a relative handful of bankruptcy and district courts has directly addressed this issue. Notably, not a single circuit court of appeals has weighed in.

One View: The $10,000 Limit Is a Per-Employee Limit

A few courts, stating that § 507(a)(5) is subject to, and must be construed in conjunction with, § 507(a)(4), have determined that benefits priority is tied to and limited by the $10,000 per-employee wage limit. Thus, under § 507(a)(5), the amount of a benefits claim is capped at $10,000 per employee, minus what that employee received under § 507(a)(4). *See In re Unimet Corp.*, 100 B.R. 881, 884 (Bankr. N.D. Ohio 1988) ($10,000 wage limit is a concurrent limitation on an individual's benefits priority); *In re B&F Constr. Inc.*, 165 B.R. 745 (Bankr. D.R.I. 1994); *In re Nat'l Bickford Foremost, Inc.*, 116 B.R. 351 (Bankr. D.R.I. 1990); *In re Columbia Packing Co.*, 47 B.R. 126 (Bankr. D. Mass. 1985); and *In re Cornell & Co., Inc.*, 219 B.R. 682, 686-87 (Bankr. E.D. Pa. 1988).

These courts, relying on the statute's history and purpose, have reasoned that § 507(a)(5)'s priority for benefits should not be broadened beyond the wage priority limitations imposed in § 507(a)(4), particularly in light of the statute's purpose, which was to cure certain defects in

continued on page 5

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Rediscovering Chapter 9 As Financial Woes of Municipalities Escalate

Part Two of a Two-Part Article

By Erica M. Ryland and Mark G. Douglas

Last month, we discussed the fact that even though Chapter 9 of the Bankruptcy Code has been in effect for over 30 years, fewer than 100 Chapter 9 cases have been filed during that time. Municipal bankruptcy cases — or, more accurately, proceedings involving the adjustment of a municipality's debts — are a rarity, compared with reorganization cases under Chapter 11. This, however, may be changing. We now continue that discussion.

Bankruptcy Court's Limited Role

Due to constitutional restrictions, the bankruptcy court's role in a Chapter 9 case is quite limited. Section 903 of the Bankruptcy Code expressly reserves to the states the power to control municipalities that file for Chapter 9 protection, with the caveat that any state law (or equivalent judgment) prescribing a method of composition among a municipality's creditors is not binding on dissenters. Section 904 further provides that, without the debtor's consent, the court may not "interfere" with any of the debtor's "political or governmental powers," any of the debtor's property or revenues or the use or enjoyment of its income-producing property. Thus, unlike a Chapter 11 debtor, a municipal debtor is not restricted in its ability to use, sell or lease its property (section 363 does not apply in a Chapter 9 case), and the court may not become involved in the debtor's day to day operations.

In addition, control of a municipal debtor is not subject to defeasance in the form of a bankruptcy trustee (although state laws commonly provide a mechanism for transferring control of the affairs of a distressed municipality). *See* Michael W. McConnell and Randall C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 713 PLI/Comm 35, 75 (March 1995). A trustee, however, may be appointed to pursue avoidance actions (other than transfers to or for the benefit of bondholders) on behalf of the estate if the debtor refuses to do so. 11 U.S.C. § 926. A municipal debtor's ability to borrow money outside of bankruptcy is not limited by Chapter 9 and the municipal debtor is not subject to the reporting requirement and other general duties of a Chapter 11 debtor. *See* David S. Kupetz, *Muncipal Debt Adjustment: A Look at How Chapter 9 Allowed Orange County to Provide Essential Services While Undergoing Debt Restructuring*, 42 Fed. Law. 18, 21 (May 1995); *In re Richmond Unified School Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal. 1991).

Due to constitutional restrictions, the bankruptcy court's role in a Chapter 9 case is quite limited.

A Chapter 9 debtor enjoys may of the rights of a Chapter 11 debtor-in-possession, but is subject to few of the obligations. Pursuant to section 901, many provisions contained elsewhere in the Bankruptcy Code are expressly made applicable to Chapter 9 cases. These include the provisions with respect to the automatic stay, employment and compensation of professionals, adequate protection, post-petition financing, executory contracts, administrative expenses, a bankruptcy trustee's "strong arm" and avoidance powers, financial contracts, the formation of official committees and most, but not all, of the provisions governing vote solicitation, disclosure and confirmation of a Chapter 11 plan. Chapter 9 expands the scope of the automatic stay to enjoin actions against officers and inhabitants of the debtor that seek to enforce claims against it. Non-recourse special revenue obligations do not become recourse debt in a Chapter 9 case, but liens securing such obligations attach to the Chapter 9 debtor's post-petition revenues previously dedicated to the obligation in question. 11 U.S.C. §§ 927 and 928. Municipal leases that are subject to termination if the debtor fails to appropriate rent are not treated as executory contracts in a Chapter 9 case. 11 U.S.C. § 929. Only administrative claims are entitled to priority in a Chapter 9 case — the remaining categories of unsecured priority claims specified in section 507(a) do not apply in Chapter 9. 11 U.S.C. § 901.

Section 1113 does not apply to Chapter 9 cases. Thus, it is unclear what standard would apply (*i.e.*, the standard in section 1113 or the less restrictive requirements in section 365) if a municipal debtor were to attempt to reject a collective bargaining agreement. Section 1114 is also inapplicable, although state law would presumably govern any proposed changes to the benefits of a municipality's retired employees.

Plan for Adjustment of Debts

As with Chapter 11, the raison d'être of Chapter 9 is confirmation of a plan (either consensually or otherwise), but with one significant difference — a municipal debtor may not be liquidated in Chapter 9. Only the Chapter 9 debtor has the right to file a plan, and indeed is obligated to file a plan either with its petition or within such time as the court directs. 11 U.S.C. § 941. The confirmation standards are comparable to Chapter 11. As in Chapter 11, creditor claims must be classified under a plan and at least one impaired class of creditors must approve the plan for it to be confirmed. Chapter 9 also incorporates

continued on page 4

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Chapter 9

continued from page 3

the cram-down confirmation rules, including the requirement that a plan not "discriminate unfairly" and be "fair and equitable" with respect to classes of secured and unsecured claims. The "fair and equitable" requirement, however, offers scant solace to unsecured creditors in a Chapter 9 case. The absolute priority rule in section 1129(b)(2)(B)(ii) provides little protection when the debtor has no shareholders whose interests can be wiped out due to less than full payment of creditor claims. *In re Corcoran Hosp. Dist.*, 233 B.R. 449, 457-58 (Bankr. E.D. Cal. 1999).

A Chapter 9 case can be confirmed only if it "is the best interests of creditors and is feasible." 11 U.S.C. § 943(b)(7). Unlike in Chapter 11, where the test compares creditor recoveries under a plan with what they would receive in a liquidation, the "best interests" requirement in Chapter 9 mandates that a proposed plan provide a better alternative for creditors than what they already have. *Mount Carbon.*, 242 B.R. at 35; *Matter of Sanitary & Imp. Dist., No. 7*, 98 B.R. 970, 974 (Bankr. D. Neb. 1989). This is often fairly easy to demonstrate. Because creditors cannot propose a plan, the case cannot be converted to a liquidation and a trustee cannot be appointed, the only alternative to a Chapter 9 plan is dismissal (discussed below). Outside of bankruptcy, there is little possibility that unsecured creditors will be repaid, especially if the municipality's debt burden is too high to be retired by taxes. Any possibility of payment under a Chapter 9 plan is often perceived by creditors as a better alternative. *Mount Carbon.*, 242 B.R. at 35. Even so, courts are likely to compare what creditors are to receive under a Chapter 9 plan with what they could reasonably expect to recover outside of bankruptcy if they were to exercise their remedies under applicable non-bankruptcy law. *See* Kupet, *Muncipal Debt Adjustment* at 23. To be feasible, "a plan should offer a reasonable prospect of success and be workable." *Mount Carbon*, 242 B.R. at 35. In assessing feasibility, the court must evaluate whether it is probable that the debtor can both pay pre-petition debt and provide future public services at the level necessary to maintain its viability as a municipality. *Id.* at 34-35.

Dismissal

If the debtor cannot confirm a plan, the only option available to the court (and creditors) is dismissal of the Chapter 9 case. Under section 930, a court may dismiss a Chapter 9 case for "cause," which includes unreasonable delay by the debtor that is prejudicial to creditors, failure to propose or obtain confirmation of a plan or material default under a plan after it has been confirmed. If the court refuses to confirm the debtor's plan (either on the first attempt or after giving the debtor additional time to modify the plan or propose a new one), it "shall" dismiss the Chapter 9 case. 11 U.S.C. § 930(b). Dismissal is appropriate even if the debtor is clearly insolvent and creditors would be better off if the Chapter 9 case were not dismissed. *See Richmond Unified*, 133 B.R. at 225-26.

Outlook

The present-day legislative scheme for municipal debt reorganizations was implemented in the aftermath of New York City's financial crisis and federal government bailout in 1975, but Chapter 9 has proved to be of limited utility thus far. Only a handful of cities have filed for Chapter 9 protection. The vast majority of Chapter 9 filings involve municipal instrumentalities, such as irrigation districts, public utility districts, waste removal districts, and health care or hospital districts. Bridgeport, CT (pop. 138,000) is the only large city even to have attempted a Chapter 9 filing, but its effort to use Chapter 9 in 1991 to reorganize its debts failed because it did not meet the insolvency requirement. Mid-sized Camden, NJ (pop. 87,000) and Prichard, AL (pop. 28,000) also filed for Chapter 9 in 1999. Camden's stay in Chapter 9 ended abruptly when the State of New Jersey took over the failing city in 2000. Prichard confirmed its Chapter 9 plan in October 2000. Orange County, CA (pop. 2.8 million) is the other prominent municipality to have taken the plunge. Having filed the largest Chapter 9 case in U.S. history and confirmed a plan in 2005, Orange County stands alone as the only large municipal debtor to have navigated through Chapter 9.

More recently, the City Council of Vallejo, CA (pop. 117,000) voted unanimously on May 6, 2008, to file a Chapter 9 petition, claiming that the city lacks sufficient cash to pay its bills after negotiations with labor unions failed to win salary concessions from firefighters and police. If the filing goes forward as anticipated, the San Francisco suburb will become the largest city in California to file for bankruptcy, and the first local government in the state to seek protection from creditors because it ran out of money amid the worst housing slump in the U.S. in over a quarter century."

Even so, the only alternative to Chapter 9 is restructuring by the municipality under applicable state law, which may be difficult and require voter approval. The ability to bind dissenting creditors without obtaining voter approval may make Chapter 9 preferable. Thus, as the financial problems of municipalities continue to mount, there may be a significant surge in Chapter 9 filings. To be sure, Chapter 9's utility in dealing with some of these problems may be limited. For example, to the extent that a municipality's questionable investments include securities, forward or commodities contracts, or swap, repurchase or master netting agreements, bankruptcy (and the automatic stay) will not prevent the contract parties from exercising their rights. Also, although a Chapter 9 debtor can restructure its existing debt, new long-term borrowing at any kind of favorable rate of interest is likely to be problematic. Still, the suspension of creditor collection efforts and the prospect of restructuring existing debt may mean that Chapter 9 is the most viable strategy for many beleaguered municipalities.

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Corporate Governance

continued from page 1

THE *FOGEL* CASE

On Dec. 13, 2007, Chancellor Chandler issued a post-trial memorandum opinion directing U.S. Energy Systems, Inc. ("U.S. Energy") to hold a shareholder meeting. In its opinion, the court determined that Asher Fogel had not been terminated as U.S. Energy's Chief Executive Officer when Mr. Fogel exercised the right conferred on the Chief Executive Officer in the company's bylaws to call a special meeting and, therefore, the exercise of this power by Mr. Fogel was valid and effective. Concerned that the company would take steps to evade the court's ruling, Mr. Fogel filed a motion requesting that the court order the company to hold the shareholder meeting on Jan. 7, 2008. After the parties briefed the motion, but before the court could rule on it, the company filed for bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York on Jan. 9, 2008.

Relying on § 362 of the Bankruptcy Code, the company argued that the Court of Chancery could not schedule the shareholder meeting it had previously ordered because the automatic stay acts to prohibit all proceedings against the debtor outside the bankruptcy. In response, Mr. Fogel attempted, albeit unsuccessfully, to fit the scheduling of the shareholders meeting into the ministerial act exception to the automatic stay and argued that corporate governance obligations survive the filing of a bankruptcy petition. The company argued that should the court agree with Mr. Fogel that corporate governance obligations survive notwithstanding the bankruptcy, the Bankruptcy Court, and not the Court of Chancery, should properly determine the propriety of scheduling the shareholders meeting after the filing of a bankruptcy petition.

Although Chancellor Chandler noted that setting a date for the shareholder meeting requires the exercise of judicial discretion beyond a mere clerical act rendering the ministerial act exception to the automatic stay inapplicable, nevertheless he found that the automatic stay does not prevent the court from scheduling a shareholder meeting under the facts and circumstances of this case. More notably, Chancellor Chandler refused to defer to the Bankruptcy Court before issuing his decision. As the court explained, "This Court, the Delaware Supreme Court, and federal bankruptcy courts have held that corporate governance does not cease when a company files a petition under Chapter 11 and that issues of corporate governance are best left to the courts of the state of incorporation." In supporting his decision, Chancellor Chandler noted that the Second Circuit Court of Appeals has already "implicitly approved" the "well-settled rule that the right to [apply to a Delaware court] to compel a shareholders' meeting for the purpose of electing a new board subsists during reorganization proceedings."

FOGEL'S IMPACT

Hardly ground-breaking, in that state and federal courts within and outside of Delaware previously had held that corporate governance obligations survive the filing of a bankruptcy petition, *Fogel* is noteworthy because of the ease with which the opinion was issued. Taking less than one day to decide the issue, the Court of Chancery demonstrated its comfort with the impact of the Bankruptcy Code's automatic stay on corporate governance. Rather than wait for the Bankruptcy Court to

continued on page 8

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Wages

continued from page 2

§ 507(a)(4). Pursuant to this rationale, the wage and priority provisions of § 507(a) share a common priority cap, and the amount of benefits contributions entitled to priority is tied to and limited by what each individual employee receives as a wage priority. Accordingly, no employee may receive priority in excess of $10,000 for wages and employee benefits combined.

Bolstering this proposition is a passage from the legislative history of § 507(a)(5), which, discussing the impact on the wage priority limit of the addition of the then-new benefits priority, states, "Any one employee's combined priority for wages and fringe benefits … cannot exceed $[10,000]." S. Rep. No. 95-989, 95th Cong., 2d Sess. 21 (1978). *See* 1978 U.S.C.C.A.N. 5787, 1978 WL 8531 (Leg.Hist.). *See also Unimet*, 100 B.R. at 883. (Citing and quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 187 (1977), which states, "The priority [for benefit contributions] is limited to the unused amount of the wage priority.")

Further bolstering this position is the statute's historical purpose, as discussed recently by the Supreme Court (in a case where the proper application of the benefits limit of § 507(a)(5) was not before the Court; the issue before the Court was whether claims for unpaid workers' compensation premiums are entitled to priority under § 507(a)(5)). According to the Court, the benefits priority of § 507(a)(5) was enacted in response to two previous Supreme Court decisions that had held that the priority provision for "wages" contained in the 1898 Bankruptcy Act did not encompass employee benefits. *Howard Delivery Serv.*, 547 U.S. at 658.

As explained by the Court, fringe benefits usually are bargained for wage substitutes, and the main purpose of 507(a)(5) is to capture these portions of employee compensation not covered by the wage priority of 507(a)(4). Sections 507(a)(4) and (5) are joined together by a "common cap." *Id.* at 660. Claims for wages are paid first, up to the $10,000 limit; then, claims for contributions to employee benefit plans can be recovered up to the remainder of the $10,000 ceiling. This priority ceiling allows a total sum of $10,000 to be paid per employee. *Id.* at 655, n. 1.

continued on page 6

Wages

continued from page 5

Another View: The $10,000 Limit Is an Overall, Aggregate Limit

Other courts, citing the statute's plain language, have arrived at the opposite conclusion, holding that the limit set forth in § 507(a)(5) operates as a limit on the maximum aggregate priority amount that can be allowed and paid to an employee benefit plan, and that there is no further reduction for excess benefits attributable to each individual employee under the statute. *See, e.g., In re New England Cartage Co.*, 220 B.R. 503, 504 (D. Mass. 1998); *In re C&S Cartage & Leasing Co.*, 204 B.R. 565, 566 (Bankr. D. Neb. 1996); *In re Edgar B, Inc.*, 200 B.R. 119 (M.D.N.C. 1996); *In re P.C. White Truck Line, Inc.*, 22 B.R. 540 (Bankr. M.D. Ala. 1982); and *Falcon Creditor Trust v. Blue Cross Blue Shield (In re Falcon Products, Inc.)*, 372 B.R. 474, 485 (Bankr. E.D. Miss. 2007).

These courts adopt a plain reading of the statute, one that reveals no per employee limitation. Instead, the statute specifically contemplates a pure multiplication of the number of employees by $10,000. *In re Braniff, Inc.*, 218 B.R. 628, 635 (Bankr. M.D. Fla. 1998). One of these courts, in fact, was so offended by holdings to the contrary that it went so far as to find that those cases had been "overruled" by the bankruptcy court for the Middle District of Florida. *See In re Consol. Freightways Corp.*, 363 B.R. 110, 123 (Bankr. C.D. Cal. 2007).

Recently, the bankruptcy court for the Northern District of Ohio addressed the issue (again). Siding with the courts that have relied on the statutory plain language, the court examined the statute's language, the differing interpretations thereunder, and the legislative history and purpose of the statute. *See In re H.L. Crouse Constr. Co., Inc.*, No. 03-38463, (Bankr. N.D. Ohio filed Jan. 31, 2008).

In what could ultimately prove to be the decisive word on the subject, the court held that the cap is an aggregate limit on a priority benefit plan's claim, not a per employee limit. In its holding, the court rejected any contention that the statute is unclear either on its face or in its context, reasoning that Congress demonstrated in § 507(a)(4) that it clearly knew how to impose a per employee limitation, and had it intended to impose a similar limitation in § 507(a)(5), it would have done so.

The court was similarly unimpressed by passages in the legislative history suggesting a per-employee limit, finding resort to legislative history in the context of a clear statute to be inappropriate …

The court was similarly unimpressed by passages in the legislative history suggesting a per-employee limit, finding resort to legislative history in the context of a clear statute to be inappropriate and concluding that the legislative history on the subject was ambiguous in any event. Moreover, the court rejected the line of cases stating that the limit is a per-employee cap, suggesting (correctly) that those cases finding a per-employee limitation did so either in dicta or without significant discussion or analysis. Finally, the court found the Supreme Court's recent discussion in *Howard Delivery Service* inapplicable. Because the question of the statutory limit was not before the Supreme Court, and because the discussion of the cap was not necessary to the Court's decision, the *H.L. Crouse* court found any suggestion in *Howard Delivery Service* of a per employee limitation to be non-binding dicta.

THE VERDICT

The question becomes whether the *H.L. Crouse* decision is the final word that settles the matter once and for all. On one hand, it might seem so. Clearly, the reported cases that have considered the issue in detail have arrived at the same result, a result seemingly mandated by the statute's plain language. Thus, the momentum clearly has swung in that direction. On the other hand, notwithstanding the sound reasoning of the *H.L. Crouse* decision, it — like all prior decisions on the subject — is not binding on other courts. Thus, it remains conceivable that a similar controversy could arise in the same or another jurisdiction and result in a different outcome. If that does occur, hopefully a circuit court of appeals will have the opportunity to weigh in for the first time on what arguably remains an open issue after 30 years and counting.

Given the statute's recognized purpose, and given the legislative history that is largely consistent with that purpose, it is conceivable that a district or bankruptcy judge somewhere in the nation will be persuaded that the statute is awkwardly worded, unintentionally setting forth a generous cap that is seemingly at odds with the priority scheme. If and when that occurs, the issue that has not been conclusively resolved in the thirty years post-Bankruptcy Code may linger on well beyond the time when many of the questions created by BAPCPA have since been fully answered. For now, though, it appears the matter has been settled and the tentative winner is the statute's plain language.

POSTSCRIPT

Pre-BAPCPA, §§ 507 (a)(4) and (5) were numbered as (a)(3) and (4), respectively (BAPCPA brought about the insertion of a new 507(a)(1) relating to domestic support obligations). Also, prior to BAPCPA, the priority period was 90 days, and the dollar limit was $4,650 for wage and benefits claims. For all other purposes, including the proper application of the priority cap discussed above, the revised and former statutes are identical.

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Bankruptcy Filings Recover in Calendar Year 2007

The Administrative Office of the U.S. Courts has reported that bankruptcy filings increased by 38% in calendar year 2007 from the same 12-month period ending Dec. 31, 2006. The number of bankruptcies filed in the 12-month period ending Dec. 31, 2007, totaled 850,912, up from 617,660 bankruptcies filed in calendar year 2006. Filings rebounded from a 70% drop in calendar year 2006, which was the first full 12-month period after the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) took effect.

A record-breaking number of bankruptcies filings was seen in calendar year 2005, when over 2 million bankruptcies were filed, primarily because, in October 2005, many of the provisions of BAPCPA were enacted. Although filings fell drastically in 2006, as expected, they have started their gradual climb back up in 2007.

Business and Non-Business Filings

The vast majority of petitions filed during 2007 were non-business cases; in fact 96.7% of all cases filed in 2007 were non-business. In calendar year 2007, there were 822,590 non-business cases filed, a 38% increase from the 597,965 non-business bankruptcy filings in 2006. By contrast, in 2005, non-business filings totaled 2,039,214.

As for business filings, in calendar year 2007, there were 28,322 filings, an increase of 44% from the 19,695 business bankruptcy filings in CY 2006. Once again, a significant drop from 2005 when there were 39,201 business filings for the calendar year.

First Quarter of FY 2008

The last three months of calendar year 2007 were the first quarter of the Judiciary's 2008 fiscal year. The number of bankruptcies filed during the first quarter of fiscal year 2008 (Oct. 1-Dec. 31, 2007) was 226,413, an increase of 27% from the 177,599 filings in the first quarter of fiscal year 2007.

By the Numbers

- In calendar year 2007, filings rose under Chapters 7, 11, 12 and 13.
- Chapter 7 filings totaled 519,364, up 44 % from the 360,890 Chapter 7 filings reported in CY 2006.
- Chapter 11 filings rose 23% to 6,353 in calendar year 2007 from the 5,163 filings in 2006.
- Chapter 12 filings totaled 376, up 8% from the 348 Chapter 12 bankruptcy filings in 2006.
- Chapter 13 filings were 324,771, up 29 % from 251,179 Chapter 13 filings in calendar year 2006.

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Filings By Circuits for the 12-Month Periods

Filings By Circuits for the 12-Month Periods Ending Dec. 31, 2007; Dec. 31, 2006; and Dec. 31, 2005

	2007	2006	2005
1st	29,595	18,723	58,440
2nd	47,304	35,940	127,495
3rd	51,935	39,524	132,972
4th	64,704	48,936	156,741
5th	68,425	56,683	181,625
6th	153,663	113,099	331,321
7th	88,429	63,994	224,205
8th	59,983	44,032	147,387
9th	127,392	78,505	335,454
10th	43,360	32,045	143,122
11th	115,410	85,629	237,221
DC Cir	712	550	2,432

The 12 Most Active Districts for Business Filings During the Quarter Ending Dec. 31, 2007

(1)	Central California	562
(2)	Middle Florida	374
(3)	Northern Georgia	311
(4)	Southern Florida	260
(5)	Northern Texas	253
(6)	New Jersey	230
(7)	Southern Ohio	225
(8)	Eastern Michigan	218
(9)	Northern Illinois	212
(10)	Eastern California	208
(11)	Northern Ohio	179
(12)	Northern California	177

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ON THE MOVE

Morrison & Foerster LLP announced that bankruptcy attorneys **Brett Miller** and **Lorenzo Marinuzzi** have joined the firm as partners in its New York office. Miller and Marinuzzi chiefly represent official committees of unsecured creditors in all aspects of the reorganization and liquidation of public and private companies. Notable cases handled by Mr. Miller and Mr. Marinuzzi included Northwest Airlines, US Airways, Hawaiian Airlines, Aloha Airlines, American Plumbing and Mechanical, HomeBanc Mortgage, Phar-Mor, Midland Foods, AmeriServe and Fruit of the Loom.

Most recently, in a case filed in February, Miller and Marinuzzi are representing the creditors' committee of prominent New York retailer Fortunoff. The pair also represents the liquidating trust established in connection with the liquidation of FLYi, Inc., and its subsidiary, Independence Air. Since joining Morrison & Foerster, Mr. Miller was selected as counsel to the creditors' committee in the Skybus Airlines case pending in Delaware.

The firm also announced that Of Counsel **Melissa Hager** and associates **Todd Goren** and **Jordan Wishnew** have joined its New York office.

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Corporate Governance

continued from page 5

decide whether the propriety of scheduling a shareholder meeting ordered prior to the petition date, when faced with an explicit request by the Company to do so, the Court of Chancery clearly and emphatically stated that bankruptcy will not provide a basis for Delaware corporations to avoid their corporate governance obligations.

A close reading of *Fogel* leaves open the possibility of limited impact because the Court of Chancery simply scheduled a shareholder meeting it had already ordered the company to hold. As a result, one could argue, the court may not have so easily overcome the protections of the automatic stay if it had not previously ordered the company to hold the shareholder meeting. Indeed, the opinion itself seems to welcome such an argument, as the court explained that its ruling merely sets the time when the shareholders will have the meeting to which they are entitled. Such a narrow reading, however, ignores the court's unmistakable holding that "the right to compel a shareholders' meeting for the purpose of electing a new board subsists during reorganization proceedings." While a company may reasonably argue for a limited reading of *Fogel* to avoid corporate governance obligations, it should do so at its peril because the court's opinion makes clear that "the passage into bankruptcy does not sound the death knell for the shareholders' role in corporate governance." Even in the face of pressure from creditors, troubled companies should not ignore the fundamental corporate governance structure set forth in their charters and bylaws.

… the Court of Chancery clearly and emphatically stated that bankruptcy will not provide a basis for Delaware corporations to avoid their corporate governance obligations.

With recession looming on the horizon and the accompanying economic uncertainty making life more difficult for Delaware corporations, their management, and advisors, bankruptcy often provides a haven, at least temporarily, to rethink corporate strategy and right the proverbial sinking ship. Ironically, the same principles that justify the automatic stay similarly justify the exclusion of corporate governance from its grasp. As the Court of Chancery observed in *Fogel*, "[i]f the primary purpose of Chapter 11 is the rehabilitation of debtor corporations, there is no reason to disenfranchise equity holders so long as their exercise of voting rights does not impair such rehabilitation." As a result, absent specific statutory authority set forth in the Bankruptcy Code, Delaware companies will not be able to avoid corporate governance problems and responsibilities, simply by filing for bankruptcy protection. To avoid such obligations entirely, they will need to show how continued corporate governance burdens the reorganization process.

CONCLUSION

The Court of Chancery's recent decision in *Fogel v. U.S. Energy Systems* makes clear that Delaware companies will not be able to avoid their corporate governance obligations simply by filing a bankruptcy petition because, at least in the absence of evidence that such obligations impair the reorganization process, the automatic stay will not divest shareholders of Delaware corporations of the powers of corporate democracy. Quickly issuing its opinion without allowing the bankruptcy court the opportunity to address the issue, the Court of Chancery's decision provides clear guidance to Delaware corporations. Although recent economic uncertainty makes the corporate environment more challenging, and the protections of the automatic stay more appealing, companies will not be able to avoid their obligations to shareholders simply by filing for bankruptcy.

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