

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of
PESTER CORPORATION,
PESTER MARKETING COMPANY,
PESTER REFINING COMPANY,
PETROLEUM SPECIAL, INC.
Debtors.

:
:
Case Nos. 85-338-C
85-339-C
85-340-C
85-341-C
:
Chapter 11
:

ORDER--OBJECTION TO CLAIM BY
LOCAL 5-241 OF OCAW FOR SEVERANCE

On June 13, 1989, a hearing was held on the objection to claim by the Oil, Chemical and Atomic Workers International Union, Local 5-241 (hereinafter "Union") for severance. The following attorneys appeared on behalf of their respective clients: John G. Fletcher for Debtors (hereinafter "Pester") and John H. Neiman for Union. At the conclusion of said hearing, the Court took the matter under advisement.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(B). The Court, upon review of the pleadings, arguments of counsel, evidence admitted and briefs submitted, now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. On February 25, 1985, Pester filed its Chapter 11 petition.
2. Prior to filing its Chapter 11 petition, Pester owned and operated a refinery in El Dorado, Kansas. Pester had purchased the

refinery in 1977 from American Petrofina, Inc. (hereinafter "Fina") and, in connection with the purchase, assumed the collective bargaining agreement in effect with Union. Effective May 8, 1983, Pester and Union entered into a collective bargaining agreement (hereinafter "CBA") that covered certain operating and maintenance employees at Pester's refinery in El Dorado, Kansas. The May 8, 1983 CBA was a negotiated renewal of the prior assumed collective bargaining agreement between Pester and Union.

3. On February 25, 1985, the date Pester filed its Chapter 11 petition, there were 136 individuals employed by Pester who were subject to the terms and provisions of the CBA (hereinafter "Union Claimants").

4. On or about March 6, 1985, the refinery was shut down and most of the Union Claimants were laid off from work.

5. On March 21, 1986, the Court, upon notice and hearing, entered an order confirming Pester's First Amended Joint Plan of Reorganization (hereinafter "Plan"). The Union Claimants voted to confirm the Plan.

6. Pursuant to the terms of the Plan, and a March 12, 1986 agreement entered into between Pester and Union, all Union Claimants not previously terminated as employees of Pester were terminated effective April 10, 1986--the date that the Asset Exchange Agreement referred to in the Plan was consummated by the parties thereto.

7. The CBA remained in force and effect (subject only to certain modifications and amendments not germane to the issues

involved in this proceeding) until April 10, 1986.

8. The March 12, 1986 agreement between Pester and Union, effective upon confirmation of the Plan, rejected the CBA and discharged Pester of its obligation to pay any benefits under the CBA, including vacation, accrued sick pay, severance pay and retirees group insurance premiums. The March 12, 1986 agreement treated such benefits as unsecured claims, except as they may be allowed as priority claims under §507. The March 12, 1986 agreement was approved by an order entered by the Court, and was also incorporated verbatim into Article VII of the Plan which states:

Collective Bargaining Agreement

7.1 The PRC Collective Bargaining Agreement with Oil, Chemical and Atomic Workers Union Local 5-241 ("CBA") is to be rejected unless a new agreement is reached prior to the Confirmation Date of the Order of Confirmation with the following modifications which are necessary to meet obligations under the Plan:

a. PRC may terminate the Pester Refining Company Pension Plan and shall have no obligation to maintain any pension plan;

b. PRC is discharged of its obligation to pay any benefits due under said CBA including vacation, accrued sick pay, severance pay and retirees group insurance premiums, or where applicable in the alternative, such benefits are treated as unsecured claims except as they may be allowed as priority claims under 11 U.S.C. §507;

c. Said CBA, as modified subsequent to February 25, 1985, is terminated and all employees covered by said CBA are terminated on or before the date of closing of the Asset Exchange Agreement and there are no further obligations of PRC to the employees covered by said CBA or Oil, Chemical and Atomic Workers Union Local 5-241 under said CBA or for any other reason except as set forth in the Plan of Reorganization.

9. During the administration of the Pester estate, Union Claimants filed proofs of claim whereby they asserted that severance pay payable pursuant to the CBA was entitled to priority as an administrative expense. Article VI, ¶18 of the CBA states:

8. SEVERANCE PAY: Employees whose services are discontinued through no fault of their own shall receive Severance Pay computed as follows:

PLANT SENIORITY (YEARS)	SEVERANCE PAY
1 but less than 2	1 week
2 but less than 3	2 weeks
3 but less than 5	3 weeks
5 but less than 8	4 weeks
8 but less than 12	5 weeks
12 or more	6 weeks

In calculating the number of plant seniority years for each employee, the years worked by that individual for FINA were added to the years worked for Pester.

10. All vacation pay earned by Union Claimants during the 90 days prior to the date of Pester filing its Chapter 11 petition was paid to the Union claimants. The total amount paid was \$67,018.56. The parties have agreed that \$2,420.80 as additional vacation pay is due as provided in Stipulation No. 10 of the November 7, 1988 pretrial report and agreed stipulation of facts (hereinafter "November 7, 1988 Stipulation").

11. All sick pay earned by the Union Claimants during the 90 days prior to the date Pester filed its Chapter 11 petition was paid by Pester to the Union Claimants. The total amount of such sick pay paid is \$35,156.56 as provided in Stipulation No. 11 of the November

7, 1988 Stipulation.

12. Pester paid post-petition \$15,813.90 as severance pay as described in Stipulation No. 12 of the November 7, 1988 Stipulation.

In Stipulation No. 12, the parties agreed that the amount paid was determined as follows: if the plant seniority year (as referred to in Article VI, ¶8, of the CBA) for a Union Claimant changed during either the 90 days prior to the date Pester filed its petition for reorganization or during the period from the date of the filing of the petition until the individual was laid off from work at Pester, and if the effect of such change in the particular Union Claimant's plant seniority year was to grant the Union Claimant an additional week of severance pay, then such Union Claimant was paid one additional week of wages.

13. Pester has conceded that the \$15,813.90 severance payment is not subject to any §507(a)(3)(B) \$2,000.00 limitation.

14. Pursuant to a March 1, 1985 Order, Pester paid \$104,426.41 for wages earned by Union claimants during the 90 days prior to the date Pester filed its Chapter 11 petition.

15. All wages, salary, vacation pay and sick leave pay, if any, earned and payable to any Union Claimant during the period from the date that Pester filed its Chapter 11 petition until such Union Claimant was laid off from work by Pester has been paid to such Union Claimant.

16. In the First Amendment to Pretrial Report and Agreed Stipulation of Facts filed January 25, 1989, Union and Pester

stipulated that if appropriate officers or representatives of the Coastal Corporation and Derby Refining Company, now known as Coastal-Derby Refining Company, were called as witnesses in this case, they would testify as follows: a) Derby is a wholly owned subsidiary of Coastal. b) In arriving at the value of the refinery that was transferred to Derby on April 10, 1986, as part of the asset exchange agreement dated February 16, 1986 (which asset exchange agreement was attached as an exhibit to Pester's Plan), neither Derby nor Coastal attributed any value to the existence of a collective bargaining agreement between Pester and Union or to the existence of a work force in the El Dorado, Kansas area. c) In hiring the employees to fill available positions at the refinery following consummation of the asset exchange agreement, Derby gave written notice to the former Pester employees concerning the job openings and also placed advertisements in various newspapers and other media throughout the state of Kansas. Some of the positions at the refinery were filled by individuals who were former employees of Pester and Union members; however, many of the positions were filled by individuals who were not former employees of Pester. d) More qualified individuals applied to Derby for employment at the refinery than the number of job openings available to fill because of the substantial number of refineries in the state of Kansas that were closed or operating with reduced work force.

17. Pursuant to the November 7, 1988 Stipulation, Union and Pester have stipulated that the issues to be litigated and resolved

by the Court in this matter are:

(a) Should a claim for severance pay, determined in accordance with the provisions of Article VI paragraph 8 of the C.B.A., be allowed under the facts in this matter as a priority claim pursuant to Section 507(a)(1) of the Bankruptcy Code?

(b) If the Court determines that the answer to subparagraph (a) is "yes," then:

(1) Has the severance pay claim already been paid?

(2) Which of the individual claimants are entitled to assert the claim for severance pay?

(3) What is the amount of the severance pay claim by a particular claimant?

(4) How should the claim be paid and from what source of funds should the claim be paid?

(c) Should a claim for severance pay, determined in accordance with the provisions of Article VI paragraph 8 of the C.B.A., be allowed under the facts in this matter as a priority claim pursuant to Section 507(a)(3) of the Bankruptcy Code?

(d) If the Court determines that the answer to subparagraph (c) above is "yes," then:

(1) Has the full amount of the claim already been paid to the claimants?

(2) What is the amount of the severance pay that was earned by the respective claimant within 90 days before the filing of the petition?

(3) Is the severance pay claim subject to the \$2,000 maximum set forth in §507(a)(3) of the Bankruptcy Code?

(4) If the severance pay claim is subject to the \$2,000 maximum, is the amount thereof reduced by the amount of vacation pay, sick-leave pay, severance pay and wages earned by the claimants within 90 days before the date of filing the petition and paid post-

petition by the Debtor to the claimants?

(5) How should the claim be paid and from what source of funds should the claim be paid?

DISCUSSION

A. Claim for Severance Pay as Priority Claim Pursuant to §507(a)(1)

Section 507(a)(1) provides that administrative expenses allowed under §503(b) are given first priority. Section 503(b)(1)(A) provides that administrative expenses include the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after commencement of the case.

An expense is administrative only where the claim meets the following criteria: (1) "arise(s) from a transaction with the debtor-in-possession" and (2) is "beneficial to the debtor-in-possession and the operation of the business." In re Mammoth Mart, Inc., 536 F.2d 950, 954 (1st Cir. 1976); In re White Motor Corp., 831 F.2d 106, 110 (3rd Cir. 1987); In re Keegan Utility Contractors, Inc., 70 B.R. 89 (W.D.N.Y. 1987). A debt is not entitled to a priority merely because the right to payment arises after the debtor-in-possession has begun managing the estate. Mammoth Mart, 536 F.2d at 955; In the Matter of Jartran, Inc., 732 F.2d 584, 587 (7th Cir. 1984).

Courts have identified two general types of severance pay plans: 1) pay a termination in lieu of notice; and 2) pay a termination based on length of employment. The first type of severance pay plan (i.e., typically, two weeks' pay in lieu of notice) has been allowed priority as an administrative expense. See In the Matter of Tucson Yellow Cab Co., 789 F.2d 701 (9th Cir. 1986); Matter of Health

Maintenance Foundation, 680 F.2d 619, 621 (9th Cir. 1982).

Concerning the second type of severance pay, a majority of the circuits hold that severance pay based on the length of employment accrues over the entire period of employment and thus is not entitled to priority as a cost of administration. Matter of Health Maintenance Foundation, 680 F.2d 619 (9th Cir. 1982); In re Mammoth Mart, 536 F.2d 950 (1st Cir. 1976); In re Public Ledger, 161 F.2d 762 (3rd Cir. 1947). One circuit, the Second Circuit, holds that the right to severance pay arises on the date of discharge, and, therefore, a claimant who was discharged during the period of administration of the bankruptcy estate is entitled to first priority. Trustees of the Amalgamated Insurance Co. v. McFarlin's, Inc., 789 F.2d 98 (2nd Cir. 1986); In re W. T. Grant Co., 620 F.2d 319 (2nd Cir. 1980), cert. den. 446 U.S. 983, 100 S.Ct. 2963, 64 L.Ed. 2d 839 (1980); Straus-Duparquet, Inc. v. Local No. 3 Int. Bro. of Elec. Wkrs., 386 F.2d 649 (2d Cir. 1967).

The Court finds the decisions of the First, Third, and Ninth Circuit Courts persuasive. The Court therefore finds that severance pay based on the length of employment accrues over the entire period of employment and thus is not entitled to priority as a cost of administration under §507(a)(1). The rationale for this finding is stated in Rawson Food Services, Inc. v. Creditors Committee, 67 B.R. 351, 353 (M.D. Fla. 1986):

The majority rule regarding severance pay claims is the better-reasoned approach and is more consistent with the purposes of the Bankruptcy Code itself. The

basic purpose of Chapter 11 reorganization is rehabilitation of the debtor's business. Health Maintenance Foundation, at 621. The statutory provisions that guarantee priority payment to creditors of the debtor-in-possession serve this basic purpose by encouraging creditors to do business with the company undergoing Chapter 11 reorganization. Id. Thus, the creditor's right to payment is afforded first priority only when the consideration supporting its right to payment was both supplied to and beneficial to the debtor-in-possession. Mammoth Mart, at 954.

In light of these principles, the majority of circuits have determined that severance pay claims that arise during Chapter 11 proceedings and are computed based on the length of the claimant's employment shall not be awarded first priority. Under a severance pay program which recognizes employees for their years of service with the debtor, all the consideration necessary for their severance pay claim accrues before bankruptcy occurs. See Health Maintenance Foundation, at 622. Because the consideration supporting the employees right to severance pay is supplied to the debtor rather than the debtor-in-possession, the severance pay claims cannot be considered to be "actual, necessary costs and expenses of preserving the estate" within the meaning of §503(b)(1)(A).

In the case *sub judice*, the terms of the severance pay obligation are set forth in Article VI, ¶8, of the CBA. Such severance pay is computed solely on the basis of the employee's length of service and ranges from one week's pay for more than one and less than two years' employment, to six weeks' pay for more than 12 years' employment. Therefore, the consideration supporting the employee's claim for severance pay was given over the entire period of employment with both Pester, and the former owner of the refinery, FINA. The severance pay is thus not entitled to priority treatment under §507(a)(1) and §503(b)(1)(A).

The Court notes that there was no consideration given by the Union claimants after the petition was filed that would support the severance pay claim. The parties have stipulated that most of the Union claimants were laid off from work and the refinery substantially shut down on March 6, 1985, seven working days after the filing of Pester's Chapter 11 petition. The approximately one week of service provided by the employees between the date of filing the petition and the date the employees were laid off from work is so de minimis that it cannot be the basis for adequate consideration to Pester. See In re Rawson Food Services, Inc., 61 B.R. 207, 210 (Bankr. M.D. Fla. 1986). The Court also finds that Union has provided no evidence that Pester had induced any employees to remain on the job post-petition by reaffirmation of Pester's severance program. See Rawson, 61 B.R. at 209; Mammoth Mart, 536 F.2d at 955, Fn. 14. Therefore, any services performed by Union claimants post-petition do not constitute post-petition consideration which would entitle the Union Claimants to severance payable as an administrative expense.

B. Claim for Severance Pay as a Priority Claim Pursuant to §507(a)(3)

Section 507(a)(3) provides for third priority treatment of:

...Unsecured claims for wages, salaries, or commissions, including vacation, severance, and sick leave pay--

(A) earned by an individual within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) to the extent of \$2,000 for each such individual.

Pester paid post-petition \$15,813.90 as severance pay pursuant to §507(a)(3). The amount paid was determined as follows: if the plant seniority year (as referred to in Article VI, ¶8, of the CBA) for a Union claimant changed during either the 90 days prior to the date Pester filed its petition for reorganization or during the period from the date of the filing of the petition until the individual was laid off from work at Pester, and if the effect of such change in the particular Union Claimant's plant seniority year was to grant the Union Claimant an additional week of severance pay, then such Union Claimant was paid one additional week of wages. In Union's pre-trial and post-trial brief, Union did not dispute Pester's assertion that this \$15,813.90 amount is payment in full for any priority severance pay claim due under §507(a)(3).

The Court finds that Pester has paid those amounts of unsecured claims that were "earned" by individual Union Claimants within 90 days before the date of the filing of the petition. See In re Northwest Engineering Co., 43 B.R. 603 (Bankr. E.D. Wisc. 1984). Further, Pester has conceded that the \$15,813.90 severance payments are not subject to any §507(a)(3)(B) \$2,000.00 limitation. The \$15,813.90 severance payments are thus payment in full for any §507(a)(3) priority severance payments due to Union claimants.

The Court notes that Union asserts in its post-trial brief that its claim is prior and superior to claims of the secured creditors.

This issue was not stipulated to by the parties. Further, the Union voted to confirm the Plan, and the Plan clearly sets forth the rights and privileges of the various classes of creditors. Union did not appeal from the March 21, 1986 confirmation order. Therefore, Union is barred and estopped from litigating the rights and priorities of the various classes of creditors. See §1141.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes:

1) Union Claimants' severance pay claims are not priority claims under §507(a)(1) and §503(b); and (2) the \$15,813.90 severance payments are payment in full for any §507(a)(3) severance payments due to Union Claimants.

IT IS ACCORDINGLY ORDERED that Pester's objection to Union Claimants' administrative expense priority claims is sustained.

Dated this 12th day of February, 1990.

RUSSELL J. HILL
U. S. Bankruptcy Judge