

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEW MEXICO

Clerk's Minutes

Before the Honorable James Starzynski

James Burke, Law Clerk
Jill Peterson, Courtroom Deputy

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(505) 242-2809

Sara Edmonds X

Date:
November 21, 2001

Re:
FURRS
No. 11-01-10779 SA

Oral Ruling on Motion for Allowance and Immediate Payment of Administrative Expenses (Severance and Vacation Pay)

Attorney for Debtor: Robert Jacobvitz
Attorney for Heller: Paul Fish
Attorney for MetLife: Thomas Tapia
Attorney for Union Food and Commercial Workers Union: Michael Four and K. Lee Peifer
Attorney for UCC: William Davis
Attorney for UST: Ron Andazola
Attorney for Tax and Rev: Don Harris

Summary of Proceedings:

Exhibits _____

Testimony _____

MOTION GRANTED IN PART AND DENIED IN PART - JACOBVITZ WILL SUBMIT ORDER

FURRS SUPERMARKETS, INC.

01-10779

November 21, 2001

RULING: Motion and supporting papers for Allowance and Immediate Payment of Admin Expenses (Severance and Vacation Pay), filed by Locals 540 and 1654 (doc and exhibits -), and Responses/Objections thereto by DIP (docs) and MetLife (doc) (and Heller)

1334 and 157; core; 7052

The Court directed the parties to brief the legal issues contained in the Motion, on the assumption (without so ruling) that the factual allegations that underlay the Motion were true. This is a ruling on those legal issues.

The Motion is granted in part and denied in part. The severance pay and vacation pay claims are allowed as administrative expenses only as attributable to post-petition service to the estate, and the Court will not order immediate payment (there is no money anyway to pay that now). Should Furrs as the Debtor in Possession ("DIP") (or a trustee) assume the CBAs, that would present a different issue, and the Court is not ruling on such a contingency.

The Motion argues essentially that the Collective Bargaining Agreements (CBAs) have been assumed by the DIP as the representative of the estate, and that as a consequence all the obligations owed to the employees under the CBAs have

there is no finding that the DIP assumed the CBAs, the employees are entitled to administrative expenses for the vacation and severance pay. The Court has found that Furrs promised the employees post-petition that they would be paid the vacation and severance pay and the

ly at. The parties have cited various cases in support of their position, which the Court will

- §365(d)(1), (4) and (5) - but no assumption can occur by inaction; under §1113, which governs the assumption and rejection of CBAs, neither assumption nor rejection apparently takes place by inaction.) In Adventure Resources, Incorporated v. Holland, 137 F.3d 786, 798-99 (4th Cir. 1998), and In re Roth American, Inc., 975 F.2d 949, 957 (3rd Cir. 1992), the Fourth and Third Circuits respectively found that the debtors in possession in those cases had "assumed" (quote marks are from the Roth case) the CBAs because the DIPs did not reject the CBAs. Adventure Resources cites as its authority for this proposition only Roth American, and Roth American in turn cites no authority for that proposition. This Court does not read §1113 to say or even imply that result, and it is so contrary to the thrust of the Code's treatment of executory contracts, and to the policy adopted by the courts throughout the years that makes an inadvertent assumption of an executory contract almost impossible, that this Court will not adopt the approach of Adventure Resources and Roth American. This is so even though §1113 seems to focus almost exclusively on what is needed to reject a CBA. Compare United Food & Commercial Workers Union, Local 211 v. Family Snacks, Inc. (In re Family Snacks, Inc.), 257 B.R. 884, 898-907 (8th Cir. BAP 2001) (holding among other things that the failure to reject a collective bargaining agreement does not in itself constitute assumption of that contract).

A further word on §1113 in the context of this decision: §1113 was enacted by Congress in swift response to NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984), in order to preclude employers from using bankruptcy law as an offensive weapon in labor relations to gain the upper hand over employees and the unions that represented them. Adventure Resources, 137 F.3d at 797-98, citing Roth American, 975 F.2d at 956. Thus the elaborate procedure set out in §1113 to modify or reject a labor contract. However, §1113 does not completely replace the provisions of §365 dealing generally with executory contracts, but rather supplements §365. Adventure Resources, 137 F.3d at 798. In the context of this case, there is no evidence, at least so far, that the reason for this chapter 11 filing was to exert leverage at the bargaining table concerning the CBAs. In fact, the evidence so far seems to be just the opposite: that the DIP went into chapter 11 hoping to rehabilitate its business and intending to keep its employees employed under the same conditions that existed prior to the filing. Obviously that hope and that intention will now remain unfulfilled. But there has been up to now no violation of the spirit or the provisions of §1113, and thus the basic provisions of §365, which the Supreme Court in Bildisco made clear are applicable to labor agreements, continues to apply as well.

In summary, the DIP has neither assumed nor rejected the CBAs, and that is what this ruling is premised on.

The assumption in the Motion is that the employees who worked for the DIP on and after the date of the filing of the petition rendered services to the estate that constituted "actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case..." §503(b)(1)(A), regardless of whether the CBAs were in effect. (The Court does not expect that this assumption will be challenged by anyone, since it takes employees to run the stores and thereby help maintain their value.) And the value of those services was measurable in what was the tacit, if not explicit, understanding

of the DIP and the employees about what the employees were to be paid: their wages, together with the benefits and other programs that were in effect on the date of the filing of the petition and were continued by the Order Authorizing (A) Payment of Prepetition Employee Obligations and (B) Continuation of Employee Benefit Plans and Programs Postpetition ("Benefits Continuation Order") entered on the first day of the case. Doc. 28. The language of that order, to "continue postpetition the employee benefit funds and programs in effect immediately before the filing of this case", was intended to provide each employee with the compensation that he or she was earning on the day before the filing of the petition. That would include not only the wage represented in the periodic paychecks received, but also the health benefits, holiday pay, sick leave, and the accrual on a daily basis of the vacation and severance pay that the employee was entitled to. Thus, part of the administrative claim of each postpetition employee is the unpaid amount of wages, health benefits, holiday pay, sick leave, and vacation and severance pay, accrued or credited for the period from February 8, 2001, until termination.

(Nothing in the Benefits Continuation Order should be read to imply that the issue of the relative priority of chapter 11 claims for prepetition severance pay was resolved or even addressed. The purpose of that order was to make it clear that the DIP had the authority to continue to pay its employees as if the petition had not been filed, and to make sure that the banks honored the checks that the DIP was and would be issuing to its employees. It would be unfair to read the Benefits Continuation Order to have addressed the issue of the postpetition status of severance pay when the Benefits Continuation Order does not even mention such an important component of the compensation package explicitly. It is also useful to note that in In re Amarex, 853 F.2d at 1529, the District Court relied on the provisions of the Operating Order, which continued the claimant's employment at the same rate of compensation, as a basis for finding that an annualized bonus payable at the end of the year - post petition - was an administrative claim. The Court of Appeals reversed that ruling.)

In addressing the issue of vacation and severance pay, there is a split in the cases, some of which support the Unions and some of which support the DIP's position. A listing of the cases, as of 1988, is set out in Isaac v. Temex Energy, Inc. (In re Amarex), 853 F.2d 1526, 1531 n. 5 (10th Cir. 1988). However, the cases which dictate the result in this case are Amarex and Bachman v. Commercial Financial Services, Inc. (In re Commercial Financial Services, Inc.), 246 F.3d 1291 (10th Cir. 2001). Those cases set out the standard by which severance-pay claims, and indeed all administrative claims, are determined. Commercial Financial, at 1294; General American Transportation Corp. v. Martin (In re Mid Region Petroleum, Inc.), 1 F.3d 1130, 1133 n. 5 ((10th Cir. 1993).

The standard set out in Amarex and Commercial Financial is twofold: 1. The expense must arise out of a transaction between the employee and the DIP (not just the debtor, either pre or post petition), and 2. the expense must have resulted in consideration supplied to and beneficial to the DIP (that is, to the estate). Although the DIP argues to the contrary, it is clear to the Court that the employees engaged in a transaction with the DIP - their labor, upon which the DIP relied in continuing its operations. It is also clear that the consideration - the labor -- was supplied to the DIP and was beneficial to

the DIP. But the labor that was provided to the DIP by definition could only be the post petition labor, because prior to the filing of the petition, there was no DIP. Thus, according to the clear standards of Amarex and Commercial Financial, the only administrative priority that can be awarded for unpaid severance is for that severance pay measured by the post petition labor of the employee. The consideration supplied by the employee pre-petition, or measured by pre-petition services, cannot be accorded postpetition administrative expense priority. Amarex, at 1531.

In Commercial Financial, the Court of Appeals upheld a decision not to allow administrative treatment of any of the post petition services of the two employees. But that was because the bankruptcy court (the trial court) found that the DIP had not used the services of the two employees; in effect, there was no "transaction" between the DIP and the employees, and that there was no value rendered to the estate (as represented by the DIP) post petition. Commercial Financial at 1293. In this case the employees clearly have engaged in a transaction with the DIP and have provided value.

Amarex does suggest a scenario in which the full severance pay might be treated as administrative expense. That might occur when the severance pay is awarded solely on the basis of being discharged regardless of the length of service. Amarex at 1531. But that is clearly not the case here.

The Unions creatively argue that the severance pay does not accrue during the prepetition years, but is only measured by those years; rather, the severance pay does not accrue at all until, entirely postpetition, the employee is laid off. The heart of the argument is the attempt to make both the accrual of the severance pay and the event that triggers its payment post petition, such that the entire amount becomes an administrative expense. The argument fails, however, precisely because the previous years of service are what result in the size of the sum to be paid. The amount of the payment is not just "measured by" the years of service; if the employee had not worked those years, he or she would not have been entitled to the severance pay: in other words, the severance was "earned" by the prepetition labor. §503(a)(1) is explicit in requiring that an administrative expense is for services "rendered after the commencement of the case". Thus the value of the services to the estate, for which the employee has an administrative claim, can only be measured by the post petition length of service.

An analogous situation, albeit somewhat inexact, is the treatment that has been accorded the real estate taxes on the various stores formerly owned by the DIP. The portion of the annual real estate taxes that accrued post petition are treated as administrative expenses, while the pre petition portion is not, even though the taxes in their entirety do not come due until some time after the filing of the petition.

And this result is consistent with the Bankruptcy Code policy that grants administrative status to claims sparingly in order to most equally distribute the debtors' limited resources. Amarex at 1530; Commercial Financial, at 1293.

The Unions also argue that the DIP induced the employees to continue working by promising full severance pay. Compare Commercial Financial Services, at 1295. Even assuming the flyers or managers' statements constituted promises to pay the full amount of severance pay (which the Court

is not deciding but only assuming for purposes of this ruling), the estate had no authority to do that without Court approval, and thus such promises, were they made, could not be binding on the estate and on all the other creditors of the estate. It is unfortunate that no one explained to the employees that they might well not receive their severance pay and the employees (or some of them) were thus left with an expectation that could not be fulfilled, but that situation does not change the result that is required by the statute.

The Court recognizes that this ruling will come as a bitter disappointment to many employees, particularly those with 20 and 30 years of service behind them. The jobs which these employees had relied on having until their retirement are now gone (as is, practically speaking, the company itself); what they will receive in severance pay is a pittance compared with what they anticipated; and in fact there is little assurance that they will receive even the small amount that is measured by their post petition work for the DIP, since the DIP at this point has no money except for the small amounts of funds that it has negotiated for in order to finish the work of processing the employees' W-2 forms and 1099s, and preparing their pension and retirement funds so that they are available to the employees. It may be that the DIP and MetLife will negotiate some agreement within the next week that will result in these smaller severance amounts being paid (although they would not be paid until the claims are processed), or failing that, it may be that a chapter 7 trustee will be able to recover enough preferences to make those small payments, although again any such payments would be at least months away.

However, this result is dictated by the Bankruptcy Code, which strictly limits the amounts of claims that are put in the front of the line for payment, what we call administrative expenses. Congress could have written the Bankruptcy Code differently. For example, in §1114(e)(2), Congress specifically provided that a company that was obligated to pay health benefits to its retirees would have to continue paying those after it filed a bankruptcy petition, and that those benefits would be treated as administrative expenses. Congress has done no such thing for severance pay. It could change the law, but that is for Congress to do; this Court can only enforce the law as it is written.

This result is also dictated by the fact that the DIP is out of business and has no money. There are literally over a \$100 million dollars of claims that will not be paid because the DIP simply has no money. Even were the law to allow this Court to award administrative expense priority to all the severance claims, that does not in itself produce any money to pay those claims.

And there will undoubtedly be further anger about the small amount of severance pay compared with the much larger sums that will be received by the professionals that managed the bankruptcy case and by Messrs Golleher and Mays who may receive sums in addition to what they have already received. That result is dictated partially by the Bankruptcy Code and partially by the free market, which both recognize that when the bankruptcy crisis arises, those who have special skills can command a high price for the services of obtaining the most value from the assets.

And finally, there is undoubtedly frustration caused by the fact that some employees who were laid off before the end of August received some or all of the severance pay earned prepetition. The short answer to that

understandable frustration is that because some employees were in effect overpaid is not justification for ignoring the limits imposed by the Bankruptcy Code.