Fourth Circuit Affirms Bankruptcy Court Finding that LandAmerica Employees' Severance Benefit Plan Claims Entitled to Priority Under Bankruptcy Code Section 507(a)(4)

In an opinion dated July 6, 2011 (a copy of the opinion is available on our blog: http://blog.ch11cases.com/2011/07/fourth-circuit-affirms-bankruptcy-court.html), the Fourth Circuit Court of Appeals affirmed a decision of Bankruptcy Judge Kevin R. Huennekens of the United States Bankruptcy Court for the Eastern District of Virginia. In the opinion (captioned *Bruce H. Matson, Trustee of the LandAmerica Financial Group, Incorporated Liquidated [sic] Trust vs. Alarcon et al.*), the Fourth Circuit determined that Judge Huennekens was correct in finding that the claims of 125 former employees of LandAmerica Financial Group for unpaid benefits due pursuant to a Severance Benefits Plan were earned on the date that the employees had their employment terminated and, therefore, the entire amount of the severance benefits were entitled to priority pursuant to section 507(a)(4) of the Bankruptcy Code (up to the statutory cap).

LandAmerica established the Severance Benefits Plan in 2004. Employees were eligible to participate in the plan when:

1. the employee was terminated without cause;

2. the employee signed a severance agreement and release; and

3. certain other circumstances were not present, such as the employee was rehired within 30 days of termination, the employee was offered an "equal" position with LandAmerica within a 50-mile radius, or the termination action was due to the employee's death or resignation.

Once an employee became a participant in the plan, the employee was entitled to receive a severance benefit, the amount of which was determined based upon the employee's length of service and salary. Severance benefits were to be paid in either a lump sum or in monthly installments, and the board of directors of LandAmerica retained the "unilateral right to 'modify, alter, or amend the Plan, in whole or in part,' or to eliminate the plan entirely."

The 125 employees whose claims were at issue in the present case were all terminated by LandAmerica between August and November 2008 (i.e., within the last 180 days before LandAmerica filed its bankruptcy petition) and all other conditions for the employees to become participants in the Severance Benefits Plan were met. LandAmerica did not, however, pay any severance benefits owing under the plan to any of the employees prior to the bankruptcy filing (or after).

After the chapter 11 filing, the employees filed proofs of claim asserting claims for their severance plan benefits and that those amounts were entitled to priority pursuant to section 507(a)(4) of the Bankruptcy Code. Section 507(a)(4) provides:

(a) The following expenses and claims have priority in the following order: . . .
(4) Fourth, allowed unsecured claims, but only to the extent of $10,000 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the

petition or the date of the cessation of the debtor's business, whichever occurs first, for—

(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or

(B) sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor.

The Trustee of the LandAmerica Financial Group, Inc. Liquidation Trust did not object to the amounts of the employees' claims, but did object to the assertion that the claims were entitled to priority for the full amount. Rather, the Trustee argued that "the claimants 'earned' severance compensation over the entire course of their employment and that, therefore, only the portion of those claims 'earned' within the 180-day period before LandAmerica filed for bankruptcy (the pre-petition period) was entitled to priority treatment under 11 U.S.C. § 507(a)(4)." To determine the amount of the severance compensation "earned" during the pre-petition period, the Trustee proposed "a formula that computed an employee's daily rate of severance compensation." The opinion provides the following example of how the Trustee's proposed formula would have applied to the claims:

> The employee worked for LandAmerica for a total of 437 weeks, a period exceeding eight years, and was entitled under the plan to receive $8,500 in severance compensation. Before being terminated from employment, the employee worked 22 weeks during the pre-petition period. Because the period of 22 weeks represented 5.03% of the employee's 437 total weeks of employment, the trustee contended that the employee "earned" 5.03% of $8,500 during the pre-petition period, or $429.31. Thus, the trustee contended that only this portion of the employee's severance claim was entitled to priority treatment under 11 U.S.C. § 507(a)(4), while the remaining amount, $8,070.69, should be classified as an unsecured general claim.

The bankruptcy court rejected the Trustee's position and held that the entire severance benefit amount was "earned" when the employee was terminated and became eligible to participate in the plan. The Fourth Circuit applied a de novo standard in reviewing the bankruptcy court's determination. In considering the meaning of the meaning of the word "earned," as it appears in 11 U.S.C. § 507(a)(4), the Fourth Circuit stated that it "presents an issue of first impression in this Court." The court also noted that the term "severance pay" is also undefined in the statute.

The court then noted that the purpose of severance compensation is "to 'alleviate the consequent need for economic readjustment' and 'to recompense [the employee] for certain losses attributable to the dismissal.'" (quoting *Straus-Duparquet, Inc. v. Local Union No. 3, Int'l B'hood of Elec. Workers*, 386 F.2d 649, 651 (2d Cir. 1967)). Because "the triggering events allowing employees to receive 'severance pay' lie within the employer's control and its decision both to provide severance compensation and to terminate the employment relationship," the court determined that "employees do not 'earn' 'severance pay' in exchange for services rendered as they do when they 'earn' wages, salaries, and commissions." Instead, the court held that the appropriate definition for the word "earn" as it relates to severance compensation

is "to come to be duly worthy of or entitled" (quoting *Webster's Third New International Dictionary* 714 (2002)) because that "represents the ordinary meaning of the manner in which employees 'earn' 'severance pay,' within the intendment of Congress in 11 U.S.C. § 507(a)(4)(A)."

Applying that definition, the court stated "we therefore hold that an employee 'earns' the full amount of 'severance pay' on the date the employee becomes entitled to receive such compensation, subject to satisfaction of the contingencies provided in the applicable severance compensation plan." As applied to the LandAmerica employees' claims, the court held that they earned the severance compensation "when the claimants became participants in the plan upon their termination from employment and their signing a severance agreement and release." While the amount of severance compensation to which each employee was entitled was based upon his or her length of service to LandAmerica, the "method of calculation did not . . . dictate that those employees earned severance compensation over the entire course of their employment."

Finally, the Fourth Circuit opinion also notes that its interpretation is "supported by the fact that the board implemented the plan and retained the right to amend the plan or to eliminate it entirely." To adopt the trustee's proposed interpretation would have meant that, for example, "if the board had eliminated the plan before an employee was terminated, then . . . that employee would have earned severance compensation for a period of time but would never receive that compensation." The court also distinguished earlier opinions from other circuits which held that "severance compensation based on length of employment has priority as an administrative expense of the bankruptcy estate only to the extent that the compensation is based on services provided to the bankruptcy estate after the debtor files for bankruptcy." *See In re Roth Am., Inc.*, 975 F.2d 949, 957 (3d Cir. 1992); *In re Mammoth Mart, Inc.*, 536 F.2d 950, 953 (1st Cir. 1976); *In re Health Main. Found.*, 680 F.2d 619, 621 (9th Cir. 1982); *but see Straus-Duparquet*, 386 F.2d at 651. In distinguishing those opinions, the Fourth Circuit noted that "11 U.S.C. § 503(b)(1)(A), the current codification of the statute at issue in those other cases, and 11 U.S.C. § 507(a)(4), the statute at issue in this case, are materially different."