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The U.S. Supreme Court issued three rulings on the subject of bankruptcy during the first half of 2006. Those rulings dealt with the states' sovereign immunity under the 11th Amendment (*Central Virginia Community College v. Katz*), the effect of the probate exception on a bankruptcy court's jurisdiction (*Marshall v. Marshall*) and, most recently, the priority of unsecured claims based upon unpaid worker's compensation premiums a debtor employer owes its insurance carrier. We reported on *Katz* and *Marshall* in past editions of the *Business Restructuring Review*.

The Court's most recent pronouncement in the realm of bankruptcy in 2006 is contained in *Howard Delivery Service Inc. v. Zurich American Insurance Co.* The debtor is a freight company employing more than 480 workers in twelve states. Each state requires it to maintain workers' compensation insurance, which the debtor obtained from the same insurer in ten states.

When the debtor filed for chapter 11 protection in 2002, it owed the insurer $400,000 for workers' compensation premiums. The insurer asserted that its claim should be afforded priority status under section 507(a)(5) of the Bankruptcy Code, which grants priority (currently up to $10,000 per employee) to "unsecured claims for contributions to an employee benefit plan . . . arising from services rendered within 180 days before the date of the filing of the petition date or the date of cessation of the debtor's business, whichever occurs first." The bankruptcy and district courts denied priority to the insurer's claim, but the Fourth Circuit Court of Appeals reversed, holding that the phrase "employee benefit plan" in section 507(a)(5) is ambiguous and that lawmakers likely intended to give past due workers' compensation premiums priority status. The Supreme Court granted *certiorari* to settle a circuit split on the issue.

The Supreme Court reversed. Writing for the 6-3 majority, Justice Ginsburg explained that another provision in the statute — section 507(a)(4) — which grants priority status to "wages, salaries, or commissions," is linked to section 507(a)(5) by a combined cap on the two priorities per employee. Observing that "[n]o other subsections of § 507 are joined together by a common cap in this way," she noted that subsection (a)(5) allows the provider of an employee benefit plan to recover unpaid premiums "only after the employees' claims for 'wages, salaries, or commissions' have been paid" under subsection (a)(4). According to Justice Ginsburg, the function of subsection (a)(5) is to capture employee compensation that is not covered by subsection (a)(4). The "juxtaposition of the wages and employee benefit plan priorities," she reasoned, "manifests Congress' comprehension that fringe benefits generally complement, or 'substitute' for, hourly pay."

The insurer contended that because the terms encompassed by the phrase "contributions to an employee benefit plan . . . arising from services rendered" are not defined in the Bankruptcy Code, courts searching for a definition should be guided by the Employee Retirement Income Security Act ("ERISA"). Acknowledging that ERISA's definition of these terms is "susceptible" to encompassing workers' compensation plans, Justice Ginsburg rejected this approach and instead examined "the essential character of workers' compensation regimes."

Justice Ginsburg emphasized that, unlike pensions or group life, health and disability plans, which are negotiated or granted as pay supplements or substitutes, workers' compensation has a "dominant employer-oriented thrust" — it modifies, or substitutes for, the common law tort liability to which employers are exposed for work-related accidents. Moreover, she explained, workers' compensation benefits provide a quid pro quo — employees receive limited benefits regardless of fault and employers avoid exposure to substantial judgments and heavy tort costs. "No such tradeoff," Justice Ginsburg observed, "is involved in fringe benefit plans that augment each covered worker's hourly pay." She also drew a distinction between pension plans and group health or life insurance plans, which ordinarily insure only employees, and workers' compensation insurance, which, like other liability insurance, shields the entire insured enterprise. Finally, Justice Ginsburg emphasized, states "overwhelmingly prescribe and regulate insurance coverage for on-the-job accidents, while commonly leaving pension, health, and life insurance plans to private ordering."

Justice Ginsburg rejected the insurer's argument that affording priority status to its claim under section 507(a)(5) would give workers' compensation carriers an incentive to continue insuring a distressed enterprise and promote its prospects for rehabilitation of the business. "Rather than speculating on how workers' compensation insurers might react were they to be granted an (a)(5) priority," she wrote, "we are guided in reaching our decision by the equal distribution objective underlying the Bankruptcy Code, and the corollary principle that provisions allowing preferences must be tightly construed."

Chief Justice Roberts and Justices Stevens, Scalia, Thomas, and Breyer joined the majority opinion. Justice Kennedy, joined by Justices Souter and Alito, dissented, arguing that "'employee benefit plan,' whether viewed as a term of art or in accordance with its plain meaning, includes workers' compensation."

Central Virginia Community College v. Katz, 126 S.Ct. 990 (2006).

Marshall v. Marshall, 126 S.Ct. 1735 (2006).

Howard Delivery Service, Inc. v. Zurich American Ins. Co., 2006 WL 1639224 (June 15, 2006).