

## ALLOCATION OF VACATION PAY TO THE WAGE PRIORITY PROVISION OF THE BANKRUPTCY ACT

Vacation pay provisions in collective bargaining agreements generally require, first, that an employee, in order to be eligible to receive vacation pay, must have worked at least a stipulated period, and second, that actual payment be deferred until some designated date after the close of the eligibility period, ranging usually from one day to six months after the close of the period.<sup>1</sup> In the case of a solvent business, an employee's right to collect vacation pay is determined by reference to the conditions in the agreement.<sup>2</sup> If a business is terminated by bankruptcy before one or both of these contractual conditions have been met, a determination must be made of what effect, if any, the terms of the contract are to have upon an employee's claim for vacation pay against the employer in bankruptcy.<sup>3</sup> Given a literal interpretation they may operate to deprive the employee of any claim whatsoever. The problem is of particular importance in view of section 64(a)(2) of the Bankruptcy Act which gives a priority over other claims against the bankrupt for "wages not to exceed \$600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding. . . ."<sup>4</sup> Vacation pay, along with

1. *E.g.*, *Treloar v. Steggeman*, 333 Mich. 166, 52 N.W.2d 647 (1952) (contract provided: "Employees . . . of the company on December 1, 1947, who will have completed at least 6 months' work since December 1, 1946, shall be entitled to compensation in lieu of vacation. Compensation in lieu of vacation shall be payable on December 20. . . ."); *Livestock Feeds, Inc. v. Local Union No. 1634*, 221 Miss. 492, 73 So. 2d 128 (1954) (contract provided: "Each employee of the company who shall not have less than one year . . . continuous service with the company as of June 1, 1951, shall be entitled to two weeks paid vacation. . . ."). All vacations shall be taken during the months of June, July, August and September. . . ."). For additional vacation pay provisions see cases cited in note 6 *infra*.

2. *Division of Labor Law Enforcement v. Standard Coil Products Co.*, 136 Cal. App. 2d 919, 288 P.2d 637 (1955) (employee discharged for cause as stipulated in bargaining agreement; terms of the agreement held controlling and vacation pay forfeited); *Bondio v. Joseph Binder, Inc.*, 24 So. 2d 398 (La. 1946) (employee who left work without authority held to be discharged for cause and vacation pay forfeited). *Cf.* 5 CORBIN, CONTRACTS § 1127 (1951).

3. See text and note at note 7 *infra*.

4. 30 STAT. 563 (1898), as amended, 11 U.S.C. § 104 (1952). See *Blessing v. Blanchard*, 223 Fed. 35 (9th Cir. 1915) (wage priority intended to ameliorate the financial shock loss attendant with discharge for a class that was unable to protect itself); see also *In re Inland Waterways, Inc.*, 71 F. Supp. 134 (D. Minn.), *rev'd on other grounds sub. nom.* *United States v. Fogarty*, 164 F.2d 26 (8th Cir. 1947); *In re Estey*, 6 F. Supp. 570 (S.D.N.Y. 1934). In *United States v. Munro-Van Helms Co.*, 243 F.2d 10 (5th Cir. 1957), the court suggested that an additional purpose of the wage priority is to provide for those who had created assets for the bankrupt immediately prior to the commencement of the proceedings and who had not yet received payment for their labors.

Social Security legislation has, to some extent, relieved the need for wage-earner protection. Social Security Act § 301, 49 STAT. 626 (1935), 42 U.S.C. § 501 (1952). However, neither Congress nor the courts have indicated an intention to depart from the generally broad coverage given the priority. See text and notes at notes 5-6 *infra*.

most other fringe benefits,<sup>5</sup> has been held to be "wages" for the purpose of the priority.<sup>6</sup> However, the courts, in determining what portion, if any, of vacation pay should be considered "earned" for the purpose of qualifying for the "wages" priority, have been unable to formulate a consistent approach to the effect to be given to the conditions in the collective bargaining agreements.<sup>7</sup>

In *United States v. Munro-Van Helms Co.*<sup>8</sup> a collective bargaining contract provided for paid vacations computed as a percentage of earnings during the ensuing year which ran from July 1st through June 30th.<sup>9</sup> Eligibility to receive payment was conditioned upon working a stated per cent of the scheduled work hours for a minimum six-month period immediately preceding termination of the work year.<sup>10</sup> The contract provided further that vacation pay would "accrue as of July 1" to those employees qualifying under the first condition and who were in the employ of the company on that date.<sup>11</sup> On June 30th, the last day of the work year, a petition in bankruptcy was filed. At the subsequent adjudication the employees asserted their claim to a vacation pay priority which was resisted by the Government which claimed a priority for the bankrupt's unpaid taxes.<sup>12</sup>

5. *McCloskey v. Division of Labor Law Enforcement*, 200 F.2d 402 (9th Cir. 1952) (severance pay); *In re Schmidt*, 33 L.R.R.M. 2283 (S.D. Cal. 1953) (employer welfare fund contributions). *Contra*, *In re Sleep Products, Inc.*, 141 F. Supp. 463 (S.D.N.Y. 1956) (employer welfare contributions); *In re Brassel*, 135 F. Supp. 827 (N.D.N.Y. 1955) (same).

Cf. *NLRB v. Killoren*, 122 F.2d 609 (8th Cir. 1941) (NLRB back-pay award held to be "wages"). *Contra*, *Nathanson v. NLRB*, 194 F.2d 248 (1st Cir. 1952) (NLRB back-pay award not "wages" but entitled to a fifth priority as a government debt. 30 STAT. 563 (1898), as amended, 11 U.S.C. § 104 a(5) (1952)). See *General Motors Corp. v. Michigan Unemployment Compensation Comm'n*, 331 Mich. 303, 49 N.W.2d 305 (1951) (holiday pay).

6. *In re Pringle Engineering & Mfg. Co.*, 164 F.2d 299 (7th Cir. 1947); *In re Men's Clothing Code Authority*, 71 F. Supp. 469 (S.D.N.Y. 1937). Wages earned subsequent to initiation of bankruptcy proceedings by employees retained by trustees are generally classified as expenses necessary to preserve the estate and as such are given first priority to the assets of the estate. 30 STAT. 563 (1898), as amended, 11 U.S.C. § 104 a(1) (1952). *In re Wil-Low Cafeterias, Inc.*, 111 F.2d 429 (2d Cir. 1940); *In re Capital Serv., Inc.*, 136 F. Supp. 430 (S.D. Cal. 1955).

7. Compare *In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947) and *In re Kinney Aluminum Co.*, 78 F. Supp. 565 (S.D. Cal. 1948), with *Division of Labor Law Enforcement v. Sampsell*, 172 F.2d 400 (9th Cir. 1949) and *Kavanas v. Mead*, 171 F.2d 195 (4th Cir. 1948) (dictum).

8. 243 F.2d 10 (5th Cir. 1957).

9. The contract is inconsistent within itself as to when the work year ended. Article 18 of the bargaining agreement stated that "the vacation year shall run from July 1st of one year through June 30th of the following year." 243 F.2d at 11. *But see* note 11 *infra*.

10. An employee working 80% of the scheduled work hours was entitled to 2½% of his earnings during the work year as vacation pay. One in the employ of the company for five years was entitled to 5% of his earnings as vacation pay. 243 F.2d at 11-12.

11. Voluntary withdrawal, discharge for just cause and discharge without cause are provided for as follows: "Employees who quit or who are discharged for just cause prior to July 1st shall forfeit any vacation rights accrued during the vacation year ending July 1st. . . . If an employee with one or more years prior service with the Company is on a lay-off status on July 1st he shall be paid vacation pay if he otherwise qualifies . . . and if he has worked as much as 6 months during the vacation year." 243 F.2d at 12.

12. 30 STAT. 563 (1898), as amended, 11 U.S.C. § 104 a(4) (1952).

The referee awarded the wage claimants a priority for their total vacation pay, and on petition to the district court this ruling was upheld.<sup>13</sup> The circuit court reversed, holding that the employees were entitled to a priority but only to the extent of one-fourth of the annual vacation pay.<sup>14</sup>

The granting of the priority in the *Munro-Van Helms* case was necessarily premised on a series of determinations, all dealing with whether vacation pay was in fact "earned" and all using the term "earned" in different though related contexts. First, the court was required to find that there existed at the time bankruptcy proceedings were instituted a valid employee claim for vacation pay. Second, it had to determine that at least a portion of that claim had been "earned" within the three month statutory priority period. Finally, it had to assign a specific portion of the "earned" vacation pay to that period. The terms of the bargaining agreement were relevant to each of these determinations. The opinion, however, does not clearly indicate the reasoning employed by the court, nor the effect given by it to the eligibility clauses in the agreement. Nevertheless, it is clear that the court could not have given effect to the contract term providing that the right to payment "accrued" on July 1st. This term would have precluded recognition of any claim at all,<sup>15</sup> since proceedings were instituted the day prior to the date specified in the contract.<sup>16</sup> On the other hand, in granting priority it was not necessary to determine whether the other eligibility clause, requiring employment for the specified period immediately preceding termination of the work year, governed the existence of a claim in bankruptcy against the employer, since the date of the institution of the proceedings fortuitously coincided with the date marking the close of the work year. Had the proceedings been instituted on any date earlier in the work year than June 30th, the court would have been confronted with the provision.<sup>17</sup> In concluding that the entire year's vacation pay had been earned, for purposes of establishing a claim, by the date proceedings were begun, the court gave some indication that it considered the vacation pay to have been earned as the personal services were rendered during the work year,<sup>18</sup> which would support the proposition that none of the eligibility provisions in the bargaining agreement had to be met in order to quali-

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13. Matter of Munro-Van Helms Co., Bankruptcy No. 3953; N.D. Ala., June 11, 1956.

14. 243 F.2d at 13.

15. The doctrine of substantial performance could be invoked to ameliorate the harshness of denying employees any claim in bankruptcy. Cf. Division of Labor Law Enforcement v. Ryan Aeronautical Co., 106 Cal. App. 2d 833, 236 P.2d 236 (1951).

16. The dissenting opinion was in part founded on a misconception of the factual situation presented in that it rested on the assumption that bankruptcy proceedings were initiated on July 30th, one month after the date when the eligibility requirements of the agreement would have been satisfied. 243 F.2d at 15.

17. Although the instant collective bargaining agreement provides that an employee need only work 80% of the work year to be eligible to receive vacation pay, if bankruptcy would have occurred significantly prior to the end of the vacation year, the right to vacation pay of at least those employees who were hired subsequent to the commencement of the calendar year in which bankruptcy occurred would have been before the court. See note 10 *supra*.

18. 243 F.2d at 13.

fy for a claim in bankruptcy. However, this apparent disregard for the terms of the agreement is negated by the court's substantial reliance on the decision in *Division of Labor Law Enforcement v. Sampsell*.<sup>19</sup> The court quoted with approval language from the *Sampsell* case<sup>20</sup> to the effect that an employee who had not worked the period specified in the bargaining agreement by the date of the institution of the proceedings would have been denied any claim for vacation pay against the bankrupt.<sup>21</sup>

Having given effect to the period-of-employment clause in the collective bargaining agreement and decided that no claim for vacation pay arose until June 30th, the last day of the work year and the day on which the proceedings were instituted, the court apparently then equated the date that the claim arose with the date that vacation pay was "earned" for the purpose of the priority provision of the Bankruptcy Act. Since the bankruptcy proceedings were instituted on the same day as that on which the claim arose, the vacation pay was "earned" within the statutory three month period. The employees, having met the relevant condition in the bargaining agreement, were entitled to a priority for the amount of the full year's vacation pay that could be attributed to the three months preceding the institution of the proceedings. In apportioning the vacation pay to the three month period, the court reasoned that once the work period eligibility requirement had been met the employees were entitled to a priority only to the extent of the services actually performed within the priority period, roughly one-quarter of the full amount.<sup>22</sup> Such a result appears inconsistent with giving effect to the period-of-employment requirement in that had the proceedings been instituted on a day prior to the termination of the work year the employees would not have been entitled to assert that any portion of the vacation pay had been earned, regardless of the amount of work actually performed during the work year.

Other courts faced with the assertion of a priority for vacation pay in bankruptcy have given effect not only to the period-of-employment condition in the bargaining agreement but also to the requirement that the employee be in the employ of the company on the day on which the vacation pay becomes payable.<sup>23</sup> These courts, however, do not apportion the

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19. 172 F.2d 400 (9th Cir. 1949).

20. "Under the terms of the statute the compensation claimed must have been earned within the three months' period and also must be due. If any employee here had not, prior to bankruptcy, completed a year's continuous service no compensation for vacation time would have been due him, regard being had to the wage agreement. All having completed the required year's service prior to bankruptcy, vacation compensation may fairly be regarded as due even though the vacation was not to be taken until some later time; but the vacation had been earned by the performance of the entire year's service, and only one-fourth of it earned during the three months preceding bankruptcy. We see no more justification for giving priority to vacation pay conditionally accruing prior to such three months' period than for giving priority to straight wages earned prior thereto." *Id.* at 401-02.

21. 243 F.2d at 13.

22. As to the remainder of the vacation pay, the employees would have a claim as general creditors of the bankrupt.

23. *In re Kinney Aluminum Co.*, 78 F. Supp. 565 (S.D. Cal. 1948); *cf. In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947).

claim of an employee qualifying under the agreement, but rather award a priority to the employee for the full amount of the vacation pay owing.<sup>24</sup> Such a result avoids the anomalous situation that would exist if the contract provided for termination of the work year more than three months prior to the date on which vacation pay becomes payable.<sup>25</sup> No claim for vacation pay would arise until the date specified in the contract for payment of the vacation pay with the consequence that no vacation would be "earned" for the purpose of the priority provision until such date. Were the court then to prorate the vacation pay on the basis of when services were rendered as in the *Munro-Van Helms* case, it could not grant a priority as all the services would have been rendered by the termination of the work year, an event more than three months prior to the date vacation pay became payable and the institution of the proceedings.<sup>26</sup> Thus, the court would be put in the position of having to decide first that a claim for vacation pay had not arisen until a date within three months of the institution of proceedings, but second that no portion of it had been earned within that period.<sup>27</sup>

The differing approaches taken by the courts in determining the existence of a claim for vacation pay in bankruptcy and in allocating a specific amount of that claim to the three months immediately prior to the commencement of proceedings have produced results which if consistently followed would make employees' recovery in bankruptcy primarily a matter of chance.<sup>28</sup> Since the language of the Bankruptcy Act does not

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24. A unique situation arose in *In re Public Ledger, Inc.*, *supra* note 23. There bankruptcy proceedings were initiated prior to the end of the vacation computation period but the employees were kept in the employ of the bankrupt until after the end of the computation period. The court had to determine how much of the year's vacation pay should be granted a priority under § 64 a(1) as an expense necessary to preserve the bankrupt estate. Relying on the per diem method for computing vacation pay (one day of vacation pay for every twenty-six work days) used in the collective bargaining agreement, the court held that only the portion of the year's vacation pay earned commensurate with services rendered subsequent to initiation of bankruptcy proceedings was entitled to a priority under § 64 a(1). The court then directed that the same formula be applied to determine what portion of vacation should qualify for the wage priority. Thus, the employees were held entitled to a wage priority for vacation pay where bankruptcy occurred prior to the end of the vacation computation year.

25. Courts giving effect to both clauses in the contract have not been faced with a case in which application of both clauses would deny any priority. See cases cited at note 23 *supra*.

26. *Strom v. Peikes*, 123 F.2d 1003 (2d Cir. 1941); *In re Red, White & Blue, Litho, Inc.*, CCH BANKR. L. REP. ¶ 58151 (S.D.N.Y. 1954); *In re Clinton Woolens, Inc.*, 113 F. Supp. 803 (D. Me. 1953).

27. For a case holding that there should be no apportionment, see, *e.g.*, *In re Kinney Aluminum Co.*, 78 F. Supp. 565 (S.D. Cal. 1948).

28. If the court gives effect only to the period-of-employment eligibility requirement in the collective bargaining agreement, no claim for vacation can arise until the end of this period and no priority can be granted unless bankruptcy proceedings are initiated within three months thereafter. If the clause specifying that no right to payment shall accrue until a certain date is also given effect, no claim can arise until that date and no priority can be given unless proceedings are initiated within three months thereafter. If proceedings are initiated in either case before the date held to establish the claim, no claim in bankruptcy arises. If the proceedings are instituted more than three months after the determinative date no priority can be granted.

compel any particular result in dealing with vacation pay,<sup>29</sup> it would seem that a reasonable alternative to the courses presently adopted should merit consideration by the courts. If both of the eligibility conditions in the bargaining agreement were disregarded by the court in bankruptcy and the claim apportioned on the basis of services rendered, employees would be entitled to a claim for vacation pay in the amount that the services rendered from the beginning of the work year until institution of proceedings bears to the amount of the vacation pay that would have been due had they worked the full work year. That portion of the claim entitled to priority would be restricted to the proportional amount of the year's vacation pay that the services rendered in the three months preceding bankruptcy bears to the full year's services. An employee who has worked only two months prior to the commencement of bankruptcy would be entitled to one-sixth of the annual vacation pay, all of which would qualify as a priority. However, it should not necessarily follow that those employees who are discharged for cause or who voluntarily terminate their employment prior to bankruptcy will be entitled to any claim at all were bankruptcy to subsequently ensue. To this class of employees the terms of the bargaining agreement would appear to be applicable to deny a claim since the purpose of eligibility conditions is to discourage rapid labor turnover and to assure the employer a constant body of employees.<sup>30</sup> But these conditions, in light of their purpose, would appear to be irrelevant in the situation of a company that has ceased to be a going concern. Adoption of this proposal would impose on other creditors of the bankrupt no greater burden than that which they already bear.<sup>31</sup> Finally, this approach would provide a treatment of vacation pay consistent with that already afforded to straight wages, which are considered to be earned as the services are rendered by the employees.<sup>32</sup>

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29. Neither § 1 (definitions) nor § 64a(2) of the Bankruptcy Act provide any clarification. Furthermore, the only legislative history helpful in making a determination as to when wages are "earned" is that pertaining to the original enactment in 1898, at which time vacation payments were significantly rare. Therefore, this determination rests solely on judicial "interpretation." See 3 COLLIER, BANKRUPTCY § 64.201 (14th ed. 1941).

30. See cases at note 2 *supra*.

31. A wage priority would be granted in some cases in which no claim and hence no priority is presently honored. But a smaller priority would be awarded in those cases in which at present a priority for the full year's vacation pay is awarded.

32. Employees, paid on a weekly basis, who are discharged upon commencement of bankruptcy proceedings which occurs prior to the end of a current work week receive a claim for those wages based on the services rendered up to the date of the commencement of proceedings even though the contract provides that wages are earned on a weekly basis. Statement of Hon. Bertram K. Wolfe, Referee in Bankruptcy, E.D. Pa.