

Michigan Law Review

Volume 51 | Issue 6

1953

BANKRUPTCY-PROVABILITY AND PRIORITY OF A BACK PAY AWARD

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Recommended Citation

Peter Van Domelen S.Ed, *BANKRUPTCY-PROVABILITY AND PRIORITY OF A BACK PAY AWARD*, 51 MICH. L. REV. 914 (1953).

Available at: <https://repository.law.umich.edu/mlr/vol51/iss6/6>

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RECENT DECISIONS

BANKRUPTCY—PROVABILITY AND PRIORITY OF A BACK PAY AWARD—The NLRB entered a back pay order against the employer. Four months later, and before the order was enforced, the employer was adjudicated a bankrupt. Thereafter, the court enforced the back pay order and the NLRB filed proof of claim in the bankruptcy proceeding. The referee disallowed the claim, but on petition for review the district court¹ set aside the referee's order and gave the claim priority over general creditors. The Court of Appeals for the First Circuit² affirmed, holding (1) that the back pay award was a provable claim under section 63a(1) of the Bankruptcy Act as a fixed liability evidenced by a judgment,³ and (2) that it was entitled to fifth priority under section 64a(5) as a debt owed to the United States.⁴ This precise question had previously been presented to the Court of Appeals for the Eighth Circuit in *NLRB v. Killoren*⁵ where the back pay award was held to be (1) a provable claim under section 63a(4) as a debt on an implied contract,⁶ and (2) entitled to second priority as wages earned under section 64a(2).⁷ To resolve this conflict, the United States Supreme Court granted certiorari. *Held*, reversed and remanded. A back pay order is a provable claim under section 63a(4) and is entitled to second priority under section 64a(2); however the bankruptcy court should remit the award to the NLRB and allow a reasonable time for its liquidation by that agency. *Nathason v. NLRB*, 344 U.S. 25, 73 S.Ct. 80 (1952).

While the ultimate decisions differed, the courts of appeals of both circuits agreed, as an initial premise, that the policy of the National Labor Relations Act would best be served by allowing a back pay award to be a claim provable in bankruptcy. A review of authorities substantiates the soundness of this proposition. Although a back pay award undoubtedly has a deterrent effect upon the employer,⁸ it has been consistently held that the primary purpose of such an award is to compensate employees for losses suffered because of an unfair labor practice,⁹ and to assure them that their wages will not be jeopardized

¹ In re MacKenzie Coach Lines, Inc., (D.C. Mass. 1951) 100 F. Supp. 489.

² *Nathason v. NLRB*, (1st Cir. 1952) 194 F. (2d) 248, noted in 100 UNIV. PA. L. REV. 1237 (1952).

³ 52 Stat. L. 873, §63a(1) (1938), 11 U.S.C. (1946) §103a(1).

⁴ 52 Stat. L. 874, §64a(5) (1938), 11 U.S.C. (1946) §104a(5).

⁵ (8th Cir. 1941) 122 F. (2d) 609, cert. den. 314 U.S. 696, 62 S.Ct. 412 (1941), noted in 90 UNIV. PA. L. REV. 100 (1941); 55 HARV. L. REV. 539 (1942).

⁶ 52 Stat. L. 873, §63a(4) (1938), 11 U.S.C. (1946) §103a(4).

⁷ 52 Stat. L. 874, §64a(2) (1938), 11 U.S.C. (1946) §104a(2).

⁸ If the sole purpose of the back pay award had been to deter the employer from the commission of future unfair labor practices, there would be no reason for allowing it as a provable claim. The order can have no such effect on an employer in bankruptcy because the struggle is then between the various creditors. See 40 COL. L. REV. 1272 (1940), criticizing the decision in the Matter of Hamilton-Brown Shoe Co., (D.C. Mo. 1940) CCH LAB. LAW SERV., 2d ed., ¶18,650, which was subsequently reversed in *NLRB v. Killoren*, note 5 supra.

⁹ *NLRB v. Fansteel Metallurgical Corp.*, 306 U.S. 240, 59 S.Ct. 490 (1939); *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 59 S.Ct. 206 (1938).

through the proper exercise of their rights.¹⁰ If this underlying policy is to be fully realized, the employees' rights to back pay should not be lost by a subsequent act on the part of the employer,¹¹ such as bankruptcy. Because there is no specific language providing for the provability of a back pay award under section 63 of the Bankruptcy Act, and to avoid the necessity of resorting to a special legislative enactment,¹² it was imperative to fit the award into one of the existing categories. The Supreme Court chose to reaffirm the doctrine of the *Killoren* case and to analogize the back pay award to an implied contract under section 63a(4). While no reasons were given for rejecting the approach of the lower court in treating this as a judgment under section 63a(1),¹³ this result appears to be more satisfactory at least from a standpoint of precedent.¹⁴ As far as the practical outcome is concerned, there seems to be little difference whether the award is regarded as an implied contract or as a judgment, because in either instance the policy of the National Labor Relations Act is effectuated by holding the claim to be provable.

The degree of priority to be afforded the award has greater significance because it may have a direct bearing on the percentage of the claim which will eventually be realized. Having taken the position that the purposes of the National Labor Relations Act should be served by recognizing the award as a claim against the bankrupt's estate, the Supreme Court approached the question of priority solely in the context of the Bankruptcy Act. First, the court rejected the contention that the award should be entitled to fifth priority as a debt owed to the United States.¹⁵ While the award may technically be a debt owed the

¹⁰ *Phelps Dodge Corp. v. NLRB*, 313 U.S. 177, 61 S.Ct. 845 (1941). *Republic Steel Corp. v. NLRB*, 311 U.S. 7, 61 S.Ct. 77 (1940).

¹¹ Other courts have minimized the deterrent effect of a back pay award by holding that its validity was not impaired by events subsequent to its issuance. *NLRB v. Colton*, (6th Cir. 1939) 105 F. (2d) 179 (deceased partner's estate held liable with surviving partners for back pay award against partnership); *NLRB v. Timken Silent Automatic Co.*, (2d Cir. 1940) 114 F. (2d) 449 (corporation held liable for back pay order issued during its existence but not affirmed until after its charter had expired); *Waterman S.S. Co. v. NLRB*, (5th Cir. 1941) 119 F. (2d) 760 (employer held liable for back pay order in favor of a seaman even though he subsequently sold his ship).

¹² See *Lane v. Industrial Commissioner*, (2d Cir. 1931) 54 F. (2d) 338, which decision was closely followed by an amendment to §63 of the Bankruptcy Act making workmen's compensation awards expressly provable in bankruptcy. 48 Stat. L. 923, §63a(6) (1934), 11 U.S.C. (1946) §103a(6).

¹³ Technically this was not a judgment because the back pay order had not been enforced by the court at the time the petition in bankruptcy was filed. Nevertheless, the lower courts entertained the view that the word "judgment" had a broader connotation as used in the context of §63 of the Bankruptcy Act. See *In re Mackenzie Coach Lines, Inc.*, note 1 *supra*, at 490.

¹⁴ In the leading case of *Brown v. O'Keefe*, 300 U.S. 598, 57 S.Ct. 543 (1937), the statutory liability imposed upon bank stockholders was held to be quasi-contractual in origin and hence a claim provable in bankruptcy. COLLIER, BANKRUPTCY, 14th ed., §63.24 (1941), suggests that §63a(4) has been expanded beyond its apparent scope and has become a basis for the proof of statutory rights. But *contra Lane v. Industrial Commissioner*, note 12 *supra*; *In re Paramount Publix Corp.*, (D.C. N.Y. 1934) 8 F. Supp. 644.

¹⁵ This priority operates in conjunction with Rev. Stat. §3466 (1875), 31 U.S.C. (1941) §191, giving the United States first satisfaction from insolvents.

United States through the agency of the NLRB,¹⁶ it does not fall within the spirit of this priority classification. It has been held that the policy behind allowing the United States preferential payment from insolvents is to secure adequate public revenue.¹⁷ The reason for this rule fails when the beneficiaries of the claims are private persons as is the case here.¹⁸ The Supreme Court again followed the *Killoren* case by holding that the back pay award should be entitled to second priority under section 64a(2) as wages earned within three months of bankruptcy with a maximum limit not to exceed \$600 per claimant. This priority of payment was intended to protect those who are dependent upon wages for their livelihood and who are generally not aware of their employer's financial status.¹⁹ The limitations on this priority are consistent with this policy because after either a three month delay in payment or a \$600 wage claim the wage earner should be put on notice of his employer's financial difficulty and should bear the risk of continued employment. However, when this priority is applied in favor of the claimant of a back pay award, often the practical effect is to throw him into the class of general creditors because of his failure to comply with the three month limitation.²⁰ Consequently, he is deprived of the priority even though he has had no reason to be wary of the employer's financial position as in the usual case of delayed payment. Although this result may not be entirely satisfactory, it does give the back pay claimant the most favorable position permissible under the existing language of the Bankruptcy Act without violating the purpose of the governmental priority under section 64a(5). Moreover, any harsh effect on the employee will be minimized by the fact that he can secure other employment during the period of his discharge, thereby mitigating the amount of his actual loss. The employee will generally wish to pursue this course in any event because of the possibility that the NLRB may refuse to grant a back pay order in the first instance.

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¹⁶ The back pay award is not a private right, but can be enforced only by the NLRB, *Amalgamated Utility Workers v. Consolidated Edison Co. of New York*, 309 U.S. 261, 60 S.Ct. 561 (1940), and the employees need not be made parties to the action, *National Licorice Co. v. NLRB*, 309 U.S. 350, 60 S.Ct. 569 (1940).

¹⁷ *United States v. State Bank of North Carolina*, 31 U.S. 29 (1832).

¹⁸ *American Surety Co. v. Akron Savings Bank*, 212 U.S. 557, 29 S.Ct. 686 (1908). Compare *Bramwell v. U.S. Fidelity & Guaranty Co.*, 269 U.S. 483, 46 S.Ct. 176 (1926), where the priority under Rev. Stat. §3466 (1875) was afforded the United States for the collection of Indian moneys on the theory that the Indians were the wards of the government.

¹⁹ *Blessing v. Blanchard*, (9th Cir. 1915) 223 F. 35. *Matter of Lawsam Electric Co., Inc.*, (D.C. N.Y. 1924) 300 F. 736. See also COLLIER, *BANKRUPTCY*, 14th ed., §64.201 (1941).

²⁰ There is an inevitable lag occasioned by the NLRB proceedings to determine the propriety of the reinstatement order and the back pay award. In both the *Killoren* and *Nathason* cases, the wage claimant was unable to meet the three month limitation.