

THE MISSING PIECE OF THE PUZZLE: PERSPECTIVES ON THE WAGE PRIORITY IN BANKRUPTCY

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INTRODUCTION

Debate about priorities among creditors has extended for over twenty years and, while slowing, hasn't ended in a consensus. Most of the focus of this debate has been on secured credit.¹ Yet secured credit persists.² The recent revisions of Article 9 of the Uniform Commercial Code³ and the even more recent amendments of the Bankruptcy Code have strengthened the political commitment to the place of secured credit.⁴ And the commitment of the marketplace to secured credit and its contractual priority cousins—complex leasing and asset securitization—grows year by year.⁵

The battleground over priority thus shifts to the world of unsecured credit. And the battlefield for such priority fights today is in the Bankruptcy Code. If as now seems clear secured creditors can take all the pie for which they've contracted, do the remaining unsecured creditors share the pie equally? Or are some unsecured creditors more equal than others? The answer to the latter questions is of course yes. Beginning with Section 5 of the Bankruptcy Act of 1841 Congress determined that one sort of unsecured

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¹ For a selection of articles arguing against full priority for secured credit see Lynn M. LoPucki, *the Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887 (1994); Elizabeth Warren, *Making Policy with Imperfect Information: The Article 9 Full Priority Debates*, 82 CORNELL L. REV. 1373 (1997).

² For some articles supporting contractual secured priority see Jeffrey S. Turner, *The Broad Scope of Revised Article 9 Is Justified*, 50 CONSUMER FIN. L.Q. REP. 328 (1996); Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021 (1994); Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285 (1990).

³ Cite NCCUSL and articles including my own about benefits to secured creditors. See also Heather Lauren Hughes, *Creditors' Imagined Communities and the Unfettered Expansion of Secured Lending*, 83 DENV. U. L. REV. 425, 434 (2005) ("In the midst of this debate [about the priority of secured credit], the 1999 revisions to Article 9 only expand the reach of full priority secured credit.") .

⁴ Cite BAPCPA and articles about benefits to secured creditors, lessors, and securitization. Of course, if asset securitization is illegal, then perhaps its growth will soon be stunted. For a catalog of the "crimes" of securitization see Michael Nwogugu, *SECURITIZATION IS ILLEGAL*, <http://ssrn.com/abstract=883300> (2005).

⁵ See Hughes, *Creditors' Imagined Communities*, supra note 3.

creditors—employees—have statutory priority over other unsecured creditors in the event of bankruptcy.⁶

Not much has been written about the history or justification for this statutory priority.⁷ Granting that secured creditors enjoy the fruits of their consensual interests in a debtor’s property, why should any creditor who has not contracted for priority nonetheless obtain it? Could the wage priority be efficient? Or is there something about the nature of wage claims (or wage claimants) that makes bargaining for priority impossible? Or is this priority justified or at least explained by principles outside the sphere of the market? Part I of this Article summarizes the legal history of the wage priority in bankruptcy beginning with the Bankruptcy Act of 1841. With barely an acknowledgement of priority among creditors in 1800, beginning in 1841 we will see a process of ever-increasing growth in the protection of employees in America’s bankruptcy law. Even though bankruptcy was a Whig political gambit in the election of 1840, I contend that by 1841 the rise of politically active evangelicals also played a role in America’s first modern bankruptcy law.

In Part II I will turn to the Supreme Court’s most recent foray into statutory priorities, *Howard Delivery Service, Inc. v. Zurich Am. Ins. Co.*⁸ The Court in *Howard Delivery* concluded that the statutory priority afforded employee benefits did not extend to unpaid premiums for

⁶ Section 5:

[A]ll creditors coming in and proving their debts . . . shall be entitled to share in the bankrupt’s property and effect, pro rata, without any priority or preference whatsoever, except . . . [that] any person who shall have performed any labor as an operative in the service of any bankrupt shall be entitled to receive the full amount of the wages due to him for such labor, not exceeding twenty-five dollars

⁷ For some exceptions see BRUCE G. CARRUTHERS & TERENCE C. HALLIDAY, *RESCUING BUSINESS: THE MAKING OF CORPORATE BANKRUPTCY LAW IN ENGLAND AND THE UNITED STATES* (1998) [hereinafter CARRUTHERS & HALLIDAY, *RESCUING BUSINESS*]; Paul G. Kauper, *Insolvency Statutes Preferring Wages Due Employees*, 30 MICH. L. REV. 504, 507-08 (1931) (citing five reasons for wage priority statutes: wage-earner dependency, inequality in bargaining power, limited investigatory ability, limited financial resources, and the workers “interest” in the product produced); Daniel Keating, *The Fruits of Labor: Worker Priorities in Bankruptcy*, 35 ARIZ. L. REV. 905, 926 (1993) [hereinafter Keating, *Fruits of Labor*].

⁸ *Howard Delivery Service, Inc. v. Zurich Am. Ins. Co.*, 126 S. Ct. 2105 (2006).

workers compensation insurance.⁹ The Court’s specific holding doesn’t tell the entire story. During the course of its analysis the majority cited several long-standing bankruptcy policies in support of its narrow conclusion but passed over without mention another that had informed its analysis in two decisions under the 1898 Bankruptcy Act,¹⁰ the one normative vision that stretches back to 1841: protection of wage earners and their families.

Thus in Part III I consider three perspectives on the justification of the wage priority. Market failure contrasting with rational autonomy (the situational and the existential perspectives) are the first two. The third perspective—the normative—considers the justice of a wage priority. This Part examines the religious, cultural, and political matrix of the 1841 Act, focusing on ante-bellum American evangelicals and the Whigs. I will argue that religious and political confluences on public morality played a significant role in the creation of the wage priority. Reference to America’s religious history is not a mere add-on. Rather, such a perspective can inform an originalist vision of statutory interpretation and provide significant clues for those who are guided by the text.¹¹

I. HISTORY OF THE WAGE PRIORITY IN BANKRUPTCY

A. THE EARLY YEARS – THE BANKRUPTCY ACT OF 1841 (WITH GLANCES AT THE ACTS OF 1800 AND 1867)

The short-lived¹² Bankruptcy Act of 1800 was a creditor remedy to deal with absconding or otherwise recalcitrant merchants.¹³ The 1800 Act recognized the validity of

⁹ See *infra* text accompanying notes 132-143 for a discussion of Bankruptcy Code § 507(a)(4) (the wage priority statute) and § 507(a)(5) (the employee benefit priority provision).

¹⁰ See *infra* text accompanying notes 143-146.

¹¹ The utility to a purposeful approach to statutory interpretation goes without saying, at least for those who share the purpose of assisting families to survive in the individualistic marketplace.

¹² Passed by the House on April 4, 1800; repealed by the House on December 19, 1803.

¹³ See Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 6-12 (1995) [hereinafter Tabb, *History of the Bankruptcy Laws*] (describing the English antecedents, occasion for enactment, and reasons for the short life of the 1800 Act). See also BRUCE H. MANN, *REPUBLIC OF DEBTORS*

conditional transfers and rights of redemption and empowered the bankrupt's commissioner to satisfy a condition or exercise a right of redemption to regain property for the benefit of the creditors.¹⁴ Interestingly, however, this first stab at bankruptcy legislation effected a prospective elimination of priority in distribution for liens (consensual, statutory, or judicial).¹⁵ Liens existing as of the date of the Act were not affected.¹⁶ An exception to the otherwise egalitarian tenor of the 1800 Act permitted creditors with a right of set-off to reduce their obligation to the estate on a dollar-for-dollar basis regardless of when the obligations arose.¹⁷ Yet the 1800 Act provided for priority for what today would be recognized as administrative expenses of the assignee chosen by the creditors¹⁸ after which net proceeds were to be paid to secured and unsecured creditors pro rata.¹⁹

(2002) [hereinafter MANN, REPUBLIC OF DEBTORS] (discussing incidents of the debtor-creditor relationship in Colonial and early post-colonial America).

¹⁴ Section 12:

[I]f any bankruptcy shall have conveyed or assured any lands, goods or estate, unto any person, upon condition or power of redemption . . . it shall be lawful for the commissioners . . . to make tender of money or other performance according to the nature of such condition, as fully as the bankrupt might have done . . . for the benefit of the creditors, as fully and effectually as any other part of the estate of such bankrupt.

¹⁵ Section 31:

[I]n the distribution of the bankrupt's effect, there shall be paid to every of the creditors a portion-rate, according to the amount of their respective debts, so that every creditor having security for his debt by judgment, statute, recognizance, or specialty, or having an attachment under any of the laws of the individual states, or of the United States, on the estate of such bankrupt . . . shall not be relieved upon any such judgment, statute, recognizance, specialty, or attachment, for more than a rateable [sic] part of his debt, with the other creditors of the bankrupt.

See *Harrison v. Sterry*, 9 U.S. 289, 301 (1809) ("By the bankrupt law of the United States, their [the attaching creditors'] priority, as to the funds of the bankrupt, is lost. They can only claim a dividend with other creditors."); *Harmon v. Jamesson*, 11 F. Cas 555 (C.C.D.C. 1806) (No. 6079) (avoiding an attachment lien and requiring payment of the attached funds assignees for distribution to creditors).

¹⁶ Section 63: "[N]othing contained in this act, shall be taken, or construed to invalidate, or impair any lien existing at the date of this act, upon the lands or chattels of any person who may have become a bankrupt."

¹⁷ Section 42:

[W]here it shall appear to the said commissioners that there hath been mutual credit given by the bankrupt, and any other person, or mutual debts between them at any time before such person became bankrupt, the assignee or assignees of the estate shall state the account between them, and one debt maybe set off against the other, and what shall appear to be due on either side on the balance of such account after such set off, and o more, shall be claimed or paid on either side respectively.

¹⁸ Section 29:

[T]he said assignee or assignees [chosen by the creditors] shall be allowed and retain all such sum and sums of money, as they shall have paid or expended in suing out and prosecuting the

After the repeal of the 1800 Act, Congress left unused its bankruptcy power until another business depression beginning in 1837.²⁰ The Bankruptcy Act of 1841 more closely resembles current bankruptcy law than did the 1800 Act.²¹ Relief under the 1841 Act was explicitly voluntary²² and with certain exceptions was available to all residents of the United States and its territories.²³ The 1841 Act voided fraudulent conveyances and preferential transfers, including preferential transfers of security.²⁴ But it expressly preserved liens and

commission, and all other just allowances on account of, or by reason or means of their being assignee or assignees

¹⁹ Section 29:

[T]he said commissioners shall order such part of the nett [sic] produce of the said bankrupt's estate . . . to be forthwith divided among such of the bankrupt's creditors as have duly proved their debts . . . in proportion to their several and respective debts

Notwithstanding the initial emphasis of the 1800 Act on equality of all creditors, near its end Section 62 of the Act provided for one set of priority claimants whose identity should come as no surprise:

[N]othing contained in this law shall, in any manner, effect the right or preference to prior satisfaction of debts due to the United States as secured or provided by any law heretofore passed, nor shall be construed to lessen or impair any right to, or security for, money due to the United States or to any of them

Section 62 of the Bankruptcy Act of 1800 was almost certainly intended to preserve the federal priority statute enacted only three years earlier by the Fourth Congress, which provided the United States government “shall be paid first” for all obligations to the federal government. Act of Mar. 3, 1797, ch. 20 § 5, 1 Stat. 515 (1797) (current version at 31 U.S.C. § 3713(a) (2000)). *See also* Harrison, *supra* note 15, at 299-300 (holding that section 62 of the Bankruptcy Act of 1800 specifically preserved the rights contained in the federal priority statute).

²⁰ *See* Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 16 (“[T]he devastating Panic of 1837, coupled with the victory of the Whigs over the Democrats in the 1840 election, turned the tide. In a very close vote, the Bankruptcy Act of 1841 was passed.”).

²¹ *See* CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 52 (1935) (“It was the great Panic of 1837 and the depression of the succeeding years that revived the pressure for a bankrupt law”); Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 18 (“The 1841 Act, with its marriage of the concepts of ‘bankruptcy’ and ‘insolvency,’ could be called the first modern bankruptcy law.”).

²² *See* John C. McCoid, II, *The Origins of Voluntary Bankruptcy*, 5 *BANKR. DEV. J.* 361 (1988) (discussing the origins of the voluntary petition in bankruptcy); MANN, *REPUBLIC OF DEBTORS*, *supra* note 13 at 228-39 (documenting cooperative use of 1800 Bankruptcy Act to achieve voluntary bankruptcy).

²³ Section 1:

All persons whatsoever, residing in any State, District or Territory of the United States, owing debts, which shall not have been created in consequence of a defalcation as a public officer; or as executor, administrator, guardian or trustee, or while acting in any other fiduciary capacity, who shall . . . apply to the proper court . . . shall be deemed bankrupts within the purview of this act

The same section went on to reinstate the ability of creditors to seek involuntary bankruptcy with respect to merchants and other persons engaging in business. *See generally* Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 17.

²⁴ Section 2:

[A]ll future payments, securities, conveyances, or transfers of property, or agreements made or given by any bankrupt, in contemplation of bankruptcy, and for the purpose of giving any creditor . . . any preference or priority over the general creditors of such bankrupts, and all other payments, securities, conveyances, or transfers of property, or agreements made or given

security that were otherwise valid under state law.²⁵ And, elaborating on the Act of 1800, the 1841 Act granted the assignee in bankruptcy the power to redeem secured assets for the benefit of creditors after notice and a hearing.²⁶ Pro rata distributions were the norm²⁷ but there were now three categories of priority among creditors: debts to the United States, debts to sureties of federal obligations, and wages due to “operatives” (employees).²⁸ The 1841 Act continued to permit set-offs.²⁹

Insertion of a priority for unpaid wages reflects the effects of increasing industrialization. In his ground breaking book *THE MARKET REVOLUTION*, Charles Sellers

by such bankrupt in contemplation of bankruptcy, to any person . . . not being a bona fide creditor or purchaser, for a valuable consideration, without notice, shall be deemed utterly void . . . : *Provided*, That all dealings and transactions by and with any bankrupt, bona fide made and entered into more than two months before the petition filed against him, or by him, shall not be invalidated or affected by this act . . .

²⁵ Section 2: “[N]othing in this act contained shall be construed to annul, destroy, or impair . . . any liens, mortgages, or other securities on property, real or personal, which may be valid by the laws of the States respectively”

²⁶ Section 11: “[T]he assignee shall have full authority, by and under the order and direction of the proper court in bankruptcy, to redeem and discharge any mortgage or other pledge, or deposit [sic], or lien upon any property, real or personal”

²⁷ Section 5: “[A]ll creditors coming in and proving their debts . . . shall be entitled to share in the bankrupt’s property and effects, pro rata, without any priority or preference whatsoever” The failure of the 1841 Act to make specific provision for priority distributions to secured creditors does not mean that Twenty-Seventh Congress, dominated by Whigs, opposed commercial interests. Instead, the District or Circuit Courts under the 1841 Act had plenary (and non-appealable) jurisdiction to decide the rights of secured creditors by applying state law. *See, e.g., Savage’s Assignee v. Best*, 44 U.S. 111 (1845) (holding that state law governed the timing of the creation of an execution lien); *Ex parte Christy*, 44 U.S. 292, 319 (1845) (holding that the delays that would accompany piecemeal consideration of secured claims in multiple state courts could be “avoided[,] by bringing the whole matter in controversy between all the mortgagees before the District Court of Circuit Court, making them all parties to the summary proceedings in equity, and thus enabling the court to marshal the rights, and priorities, and claims, of all the parties”).

²⁸ Continuing Section 5 it reads as follows:

except only for debts due by such bankruptcy to the United States, and for all debts due by him to persons who, by the laws of the United States, have a preference, in consequence of having paid moneys as his sureties, which shall be first paid out of the assets; and any person who shall have performed any labor as an operative in the service of any bankrupt, shall be entitled to receive the full amount of the wages due to him for such labor, not exceeding twenty-five dollars

Congress may have intended the bankruptcy priority for the United States to capture any obligations or assets to which the general federal priority statute didn’t attach. *See supra* note 18. Or maybe Congress was simply erring on the side of assurance of payment. Priority for sureties of federal obligations should probably be seen as a tool of stimulating international trade and enhancing collection of customs duties.

²⁹ Continuing Section 5 reads as follows: “in all cases where there are mutual debts or mutual credits between the parties, the balance only shall be deemed the true debt or claim between hem, and the residue shall be deemed adjusted by the set-off”

presents an historical narrative beginning with America's Colonial society comprised of self-contained, rural, agrarian communities and urban artisans.³⁰ Domesticity and community solidarity characterized this Jeffersonian idyll. Viewed in prospect, neither bankruptcy nor a wage priority were necessary. Credit would hardly exist outside the small class of merchants.³¹ And, given a pre-industrial economy, most employees would have been apprentices or farm hands from the community whose interests would be protected by close personal relationships. Beginning in the second decade of the nineteenth century, however, Sellers describes a new market economy driven by "mobility, efficiency, individual self-exertion, specialization, productivity, expanding consumption, and a way of life that disrupted communities, uprooted relationships, and commodified family connections."³² No longer was the employment relationship characterized by close communal relationships or traditional articles of indenture. The employment relationship in industrial and far-flung commercial enterprises was commodified. Thus, "[t]he practical issue that faced most American workers [in ante-bellum America] was not the acceptance or rejection of wage labor but acceptance on what terms and with what qualifications."³³

Anticipating the provision of the current Bankruptcy Code at issue in *Howard Delivery*, the 1841 Act both capped the amount of the wage priority (at twenty-five dollars³⁴) and limited the period immediately prior to bankruptcy for which the unpaid employee could

³⁰ CHARLES SELLERS, *THE MARKET REVOLUTION: JACKSONIAN AMERICA, 1815-1846* __ (1991).

³¹ *But see* MANN, *REPUBLIC OF DEBTORS*, *supra* note 13 at 131-32 (discussing effects of massive agricultural indebtedness of Virginia Tidewater plantation owners).

³² Mark A. Noll, *Introduction*, in *GOD AND MAMMON: PROTESTANTS, MONEY, AND THE MARKET, 1790-1860* 3, 16 (Mark A. Noll, ed., 2002) [hereinafter *GOD AND MAMMON*].

³³ R. LAURENCE MOORE, *SELLING GOD: AMERICAN RELIGION IN THE MARKETPLACE OF CULTURE* 76 (1994) [hereinafter *MOORE, SELLING GOD*].

³⁴ There are several means by which to estimate the current worth of twenty-five dollars in 1841. A straight inflation formula equates \$25 in 1840 to \$433 in 2005. *See* <http://www.westegg.com/inflation/>.

asset it (six months).³⁵ The few reported decisions under the 1841 Act dealing with wage priority construed “operative” broadly³⁶ but denied that one could be subrogated to wage priority status.³⁷ Although no federal case analyzed the policy of the wage priority under the 1841 Act, a Massachusetts court held with respect to that state’s wage priority statute that “[w]e think the policy of the statute was to secure to a class of very needy and efficient laborers, who are very dependent and meritorious but who have little means of knowing the credit of their employers, the small amount due them for very recent service.”³⁸ Recognition of the changing nature of employment in the new market economy and a sense of paternalism were at work.

The 1841 Bankruptcy Act was of even shorter duration than its 1800 predecessor—thirteen months compared to forty-four months. But it too was repealed with better economic times³⁹ and the bankruptcy clause lay dormant until 1867. But “[a]fter the Panic of 1857 and the financial cataclysm caused by the American Civil War, overwhelming

³⁵ Continuing Section 5 reads: “*Provided*, That such labor shall have been performed within six months next before the bankruptcy of his employer” The six-month look-back is the same as under the current Bankruptcy Code. See 11 U.S.C. § 507(a)(4) [hereinafter “Bankruptcy Code” § x].

³⁶ See *Ex Parte Steiner*, 22 F. Cas. 1234 (C.C.E.D. Pa. 1842) (No. 13,354) (holding that the claim of an apprentice against a master for extra pay for extra work qualified as a priority claim of an “operative” notwithstanding the possible unenforceability of the claim under state law). A year later the Supreme Judicial Court of Massachusetts considered a virtually identical provision affording priority to “operatives” under Massachusetts law and wrote that

We are not aware, that this clause has received any judicial construction, and the word “operative,” without more qualification than this clause contains, is not definite enough to enable us to lay down any precise general rule. Probably the primary thought, which legislators had in mind, was the wages due to men and women working in manufactories, who usually receive their pay weekly or monthly. But certainly, it is not limited to those working for manufacturers, or mechanics, or to persons working in factories or workshops. Whether it shall extend to farm-laborers, to house servants, to persons working singly or in gangs, in woods, or on marshes, or under contractors on public works, at a distance from the home both of the employer and the laborer, are all open questions

Thayer v. Mann, 56 Mass. 371 (1848).

³⁷ See *In re Paulson*, 19 F. Cas. 4 (D.C.S.D. N.Y. 1842) (No. 10,849) (holding that the claim of one who had lent the bankrupt money for payment of operatives was not entitled to priority under § 5 of the 1841 Bankruptcy Act).

³⁸ *Thayer v. Mann*, *supra* note 36, at 374.

³⁹ See Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 18 (“With immediate goal of relieving the plight of the mass of insolvent debts accomplished, and with little continuing political capital to be gained from the law, the 1841 act was repealed in early 1843 after little more than a year of operation.”).

pressure for another federal bankruptcy law led to the enactment of the Bankruptcy Act of 1867.”⁴⁰ The 1867 Act opened the door to all residents of the United States⁴¹ and represented another step of detailed specification toward the current Bankruptcy Code. The validity of security was expressly acknowledged⁴² and the assignee again had the power to redeem secured assets.⁴³ The same section also for the first time authorized the assignee to sell encumbered property for the benefit of creditors,⁴⁴ who were to enjoy an equality of distribution as of first importance.⁴⁵ The 1867 Act clarified the distribution rights of secured creditors by expressly allowing them to share in dividends for the difference between the value of the collateral and the debt.⁴⁶ The right of set-off remained in place.⁴⁷

⁴⁰ See Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 19.

⁴¹ Section 11.

⁴² See *In re McConnell*, 15 F. Cas. 1297, 1298 (C.D.N.J. 1874) (No. 8,712) (“[I]t is undoubtedly the duty of the court to recognize and enforce any lien which [the creditor] may have by virtue of state law.”).

⁴³ Section 14:

[N]o mortgage of any vessel or of any other goods or chattels, made as security for any debt or debts, in good faith and for present considerations and otherwise valid, and duly recorded, pursuant to any statute of the United States, or of any State, shall be invalidated or affected hereby The assignee shall have authority, under the order and direction of the court, to redeem or discharge any mortgage or conditional contract, or pledge or deposit, or lien upon any property, real or personal, whenever payable, and to tender due performance of the condition thereof

⁴⁴ Section 14: “The assignee shall have the authority, under the order and direction of the court . . . to sell the same [encumbered property] subject to such mortgage, lien or other encumbrances.”

⁴⁵ See *Bailey v. Glover*, 88 U.S. 342, 346 (1874) (“It is obviously one of the purposes of the Bankrupt law, that there should be a speedy disposition of the bankrupt’s assets. This is second in importance to securing equality of distribution.”).

⁴⁶ Section 20:

When a creditor has a mortgage or pledge of real or personal property of the bankrupt, or a lien thereon for securing the payment of a debt owing to him from the bankrupt, he shall be admitted as a creditor only for the balance of the debt after deducting the value of such property.

See *In re McConnell*, *supra* note 42 (holding that unsecured creditors would get a dividend only after a landlord who enjoyed a statutory lien under state law was paid). Of course, the right of secured creditors to realize on their collateral and share in the estate for any shortfall would have been recognized under the 1800 Act (see *Harrison v. Sterry*, *supra* n.15, at 302) and was expressly noted by Justice Story in *Ex Parte Christy*, *supra* note 27, at 319.

⁴⁷ Section 20: “[I]n all cases of mutual debts or mutual credits between the parties, the account between them shall be stated, and one debt set off against the other, and the balance only shall be allowed or paid”

Regardless of the relationship between Sections 27 and 28 of the 1867 Act, unpaid wages continued to enjoy a limited but substantial priority. The wage priority had, however, fallen one place and was now behind certain state claims over which it would have enjoyed priority under the 1841 Act. Judicial construction of Section 28 was generous and a father claiming wages on behalf of his minor son⁵¹ and a temporary accountant⁵² were both afforded priority. However, in 1878 the District Court drew the line for awarding priority at an amount due for services to be rendered under an employment contract that the bankrupt had breached when it went out of business. While the Register in bankruptcy had relied on the family-protection policy of the law—“[t]he statute manifestly contemplates making provision for laborers and their families whose occupation suggests that they have but limited or moderate means, and whose daily, weekly, or monthly wages are necessary for their support”⁵³—to allow the employee a priority for wages he would have earned but his employer’s cessation of business, the District Court reversed. Relying on the plain meaning of Section 28 (“for wages due . . . for labor performed . . .”), the court concluded that the claimant “has not performed labor, and he is not entitled to wages which are a compensation for labor.”⁵⁴ In any event, Congress repealed the 1867 Act in 1878 with little opposition.⁵⁵

provided, That nothing contained in this act shall interfere with the assessment and collection of taxes by the authority of the United States or any State.

The significance of the final proviso can be debated. The editors of the fourteenth edition of *Colliers on Bankruptcy* suggest that it “apparently lifted such debts into a position prior even to costs of administration, notwithstanding their otherwise expressly subordinate charge.” 3A *COLLIERS ON BANKRUPTCY* ¶ 64.01 (1967). Alternatively, it could simply be understood to preserve lien rights and the ability of these units of civil government to collect from the debtor or the debtor’s property after bankruptcy. See Orlando F. Bump, *BUMP ON BANKRUPTCY* 241-42 (10th ed. 1877).

⁵¹ See *In re Harthorn*, 11 F. Cas. 705 (D.C.D. Me. 1870) (No. 6,162).

⁵² See *In re Taylor*, 20 F. Cas. 1070 (D.C.D. Mass. 1876) (No. 11,977).

⁵³ *In re Prevear*, 19 F. Cas. 405 (D.C.N.D. N.Y. 1878) (No. 11,053).

⁵⁴ *Id.* at 406. A New York court added concern for the employee’s family to the purposes of that state’s employee preference law. See *People v. Remington & Sons*, 14 N.Y.S. 441, 442 (N.Y. 1887) (“This was designed to secure the prompt payment of the wages of persons, who as a class, are dependent upon their earnings for the support of themselves and their families.”).

⁵⁵ See Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 21 (“By all accounts, the sentiment for repeal was overwhelming.”). High fees and expenses contributed to the demise of the 1867 Act. See *In re Woodard*, 95 F.

B. THE 1898 ACT

The Bankruptcy Act of 1898 so far has been the most lasting effort of Congress to legislate in the field of bankruptcy.⁵⁶ The 1898 Act continued to provide for priority for wage claims but the relative priority changed several times. Initially the priorities of the 1898 Act followed the Act of 1867. Secured claims were unaffected by the Act and secured creditors received their collateral or its value before any unsecured creditors.⁵⁷ Section 64a appeared to provide for first priority for taxes⁵⁸ but Section 64b went on to provide for all priority claims including taxes.⁵⁹ Wage claims appeared in Section 64b as a fourth level priority to the extent of three hundred dollars for “wages due to workmen, clerks, or servants” now earned only within three months of the adjudication of bankruptcy.⁶⁰

Judicial analysis of the scope of the priority tended toward the narrow with some exceptions. Judge Learned Hand noted that each member of the trilogy of 1898 Act (workmen, clerks, and servants) expanded on their predecessors under the 1867 Act.⁶¹ Yet at the outset of his judicial career he was unwilling to extend the priority to a manager of a branch office of a broker⁶² and fifteen years later he held that “it would be an abuse of

955 (E.D.N.C. 1899) (“One of the purposes of the act of 1898 in establishing a uniform system of bankruptcy was to avoid what was the principal cause of the repeal of the bankrupt act of 1867, – excessive fees and great expense.”).

⁵⁶ Ch. 541, 30 Stat. 544 (repealed 1978).

⁵⁷ Bankruptcy Act § 67d. *See In re Proudfoot*, 173 F. 733 (C.C.N.D. W.Va. 1909). *But see In re Tebo*, 101 F. 419 (D. W.Va. 1900) (holding that priority wage claims must be paid ahead of liens).

⁵⁸ Section 64a: “The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors . . .”

⁵⁹ Quote with liberal ellipses

⁶⁰ Ch. 541, 30 Stat. 563 (repealed 1978).

⁶¹ *See In re Albert O. Brown & Co.*, 171 F. 281 (S.D.N.Y. 1909):

Act March 2, 1867 . . . provided that priority should not be given, ‘except that wages due from him (the bankrupt) to any operative or clerk or house servant’ shall be preferred. In the present act . . . the words are workman, clerk, or servant.’ ‘Workman’ is possible a wider phrase than ‘operative,’ and ‘servant’ is undoubtedly wider than ‘house servant;’ but the section is obviously copied after the law of 1867.

⁶² *Id.* (“It is clear that Olmsted is not a ‘workman’ for the bankrupt. Nor is he a ‘servant,’ because the term does not include all instances of the formal relation of master and servant. . . . In the more limited sense, it is quite clear that Olmsted is not a ‘servant.’”).

terms” to allow a “chief designer” of radios to enjoy priority status.⁶³ And other courts jealously guarded the wage priority gate by denying priority status to the president of a bankrupt corporation,⁶⁴ a general manager,⁶⁵ a traveling salesman,⁶⁶ and a commission agent,⁶⁷ although part time clerks who also worked for others enjoyed the priority.⁶⁸ Congress expanded the class of priority wage claimants in 1906 by adding “traveling or city salesmen.”⁶⁹ But courts continued to treat narrowly the scope of the wage priority by excluding payments due for managing an “outsourced” but in-house department of a manufacturing company,⁷⁰ a plant superintendent who performed extensive manual labor,⁷¹ a

⁶³ *In re Lamsam Electric Co., Inc.*, 300 F. 736 (S.D.N.Y. 1924).

⁶⁴ *In re Carolina Cooperage Co.*, 96 F. 950, 953 (E.D.N.C. 1899):

Slocumb was neither a workman, a clerk, nor a servant, in the sense in which these limiting words are used. If congress had intended this provision to extend to presidents of commercial corporations, it would have said so. Presidents of such corporations do not generally act as workmen, clerks, or servants, but exercise authority over these classes, occasionally arbitrary and oppressive, but always in a way to let them know the president is not one of them.

⁶⁵ *In re Grubbs-Wiley Grocery Co.*, 96 F. 183, 184 (W.D. Mo. 1899):

Ordinarily a workman is understood to be ‘one who labors; one who is employed in labor.’ Doubtless the statute has reference to a workman employed on some character of work, – laboring for some person who sustains to him the relation of an employer or master, for whom he works. So, also, the term ‘servant’ ordinarily means a person employed by another to render personal services to the employer The claimant was himself a stockholder . . . and was one of the board of directors, and was its general manager. . . . He was not a servant, as he had no master over him It is true, he was, in a certain sense, working for the corporation, the legal entity; but . . . he was the representative of the corporate body.

After explaining why the claimant should not enjoy priority status, the District Court went on affirm the decision of the referee to allow priority status for the reasonable value of the claimant’s services. *Id.* at 185.

⁶⁶ *See In re Scanlan*, 97 F. 26 (D. Ky. 1899) (using various dictionary definitions to determine the meaning of the three statutory words). *But see In re Flick*, 105 F. 503, 505 (S.D. Ohio 1900) (“I am inclined to the opinion, and will so hold, that a salesman, properly speaking, will come within the term ‘clerk,’ and is entitled to priority.”).

⁶⁷ *See In re Mayer*, 101 F. 227 (E.D. Wis. 1900) (“[T]he commission service was merely an incidental agency in procuring customers, with no obligation to serve, and the claim is not one entitled to priority . . .”).

⁶⁸ *See In re Baublatt*, 156 F. 422, 423 (E.D. Pa. 1907) (“Exclusive employment by the bankrupt has never been considered necessary to constitute the claimant a clerk . . .”).

⁶⁹ 34 Stat. 267. *See In re Caldwell*, 164 F. 515 (E.D. Ark. 1908):

When Congress found that some of the courts, giving that provision of the act a strict construction, had held that a traveling salesman was not within the classes mentioned [citations omitted], it amended the act so as to avoid that construction by adding the words “traveling or city salesmen.”

⁷⁰ *See In re Thomas Deutsche & Co.*, 182 F. 430 (M.D. Pa. 1910).

⁷¹ *See In re Continental Pain Co.*, 220 F. 189 (N.D.N.Y. 1915):

[T]he referee was right in holding that Wilson was there acting for this corporation in the capacity of superintendent, although he did a great deal of manual labor. This he had the right to do. The fact that there was little work to do as superintendent does not change the fact that he was superintendent and employed as such.

general manager and shop superintendent,⁷² or a teacher.⁷³ And a surety who had advanced funds to the bankrupt for payment of wages could not be subrogated to the wage-earners' priority,⁷⁴ although a specific wage assignment did carry the wage-earner's priority.⁷⁵

Under the 1898 Act courts again articulated a paternalistic rationale for the wage priority. "All creditors are supposed to stand upon an equal footing before the law"⁷⁶ Nonetheless, courts frequently observed that "[t]he bankruptcy act, while primarily intended to secure an equal distribution of the assets of the bankrupt among his creditors, evinces a strong intent on the part of Congress to protect those who are dependent on their daily earnings for their support"⁷⁷ Advancing this normative argument the Ninth Circuit recognized the precarious nature of working class life when it remarked that "[p]riority of payment was intended for the benefit only of those who are dependent upon their wages, and who, having lost their employment by the bankruptcy, would be in need of such protection."⁷⁸ And even the Supreme Court acknowledged this rationale in 1912 in *Guaranty Title* when it held that the wage claims under the 1898 Act had priority over contractual obligations due the United States.⁷⁹ Anticipating concerns for nonadjusting creditors that

⁷² See *Blessing v. Blanchard (In re Pacific Motor Car Co.)*, 223 F. 35, 37 (9th Cir. 1915):

The word 'servants' often has a broad and inclusive meaning, and in a sense it may be said to include all employes in the service of another, and also the officers of corporations. It is very clear, however, that it is not used in that sense in the section under consideration. Although the word 'servant' is broader than the term 'house servant,' as used in the act of 1867, it was not intended by its use in the act of 1898 to include all employees; otherwise, there would have been no necessity for a specific mention of workmen or clerks or salesmen. We think the word 'servant' should be held to mean a restricted class of subordinate helpers who work for wages

⁷³ See *In re Estey*, 6 F.Supp. 570 (S.D.N.Y. 1934) (holding that a teacher is neither a workman, clerk, salesman, nor a servant).

⁷⁴ See *United Surety Co. v. Iowa Mfg. Co.*, 179 F. 55 (8th Cir. 1910).

⁷⁵ See *Shropshire, Woodliff & Co., v. Bush*, 204 U.S. 186 (1907).

⁷⁶ *In re Flick*, *supra* note 66, at 507.

⁷⁷ *In re Caldwell*, *supra* note 69, at 516.

⁷⁸ *Blessing v. Blanchard*, *supra* note 72, at 37.

⁷⁹ See *Guaranty Title & Trust Co. v. Title Guar. & Sur. Co.*, 224 U.S. 152, 160 (1912):

The policy which dictated it was beneficent and well might induce a postponement of the claims, even of the sovereign, in favor of those who necessarily depended upon their daily

would be more specifically articulated forty years later,⁸⁰ by the middle of the twentieth century a District Court noted that typical wage-earners cannot be “expected to know the credit standing of their employer but must accept employment as it comes.”⁸¹

Thus, three factors animated the courts’ application of § 64b (and, after 1938, § 64a): a strong emphasis on creditor equality coupled, however, with the assertion that typical employees could not effectively protect their interests and, thirdly, recognition that Congress had acted to protect several sets of employees who were especially dependent upon wages for survival and whose necessity made them particularly subject to the vagaries of the labor market.⁸² Section 64b (and later section 64a) was narrowly construed from all three directions. Only those closely hewing to the courts’ cabined understanding of the enumerated categories would enjoy a priority.

The continuing confusion over the level of tax claim priority⁸³ led Congress to enact substantial amendments in 1926 that clarified the priority of tax claims.⁸⁴ However, the 1926

labor. And to give such claims priority could in no case seriously affect the sovereign. To deny them priority would in all cases seriously affect the claimants.
The Court carefully distinguished between “civil obligations” and “personal conventions.” [Get some analysis from a civil law text of the day]

⁸⁰ Professors Lucian Ayre Bebhuk and Jesse M. Fried seems to have introduced the term “nonadjusting creditor” in their seminal work *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 Yale L.J. 857 (1996). As they later explained,

A “nonadjusting” creditor is a creditor that, for one reason or another, cannot or does not adjust the terms of its loan to reflect the effect on its loan of all the arrangements the borrower enters into with other creditors, including the creation of security interests which, under full priority, completely subordinate the nonadjusting creditors’ claim in bankruptcy.

Lucian Ayre Bebhuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics*, 82 CORNELL L. REV. 1279, 1295-96 (1997) [hereinafter Bebhuk & Fried, *The Uneasy Case: Thoughts and Reply*].

⁸¹ *In re Inland Waterways, Inc.*, 71 F.Supp. 134, 136 (D. Minn. 1947).

⁸² As Learned Hand put it, “[t]he statute was intended to favor those who could not be expected to know anything of the credit of their employer, but must accept a job as it comes, to whom the personal factor in employment is not a practicable consideration.” See also *In re Lawsom Electric Co., Inc.*, *supra* note 63. Class bias was also at work. According to Hand, a radio engineer “is not in the same economic class as the workers [and] . . . would have been the first to resent the notion that he was a workman or a servant.” *Id.* Of course, the engineer *had* sought priority for his unpaid wages, which seems to belie Hand’s characterization of the claimant’s putative class consciousness.

⁸³ See, e.g., Ralph H. Colin, *An Analysis of the 1926 Amendments to the Bankruptcy Act*, 26 COLUM. L. REV. 789 (1926).

amendments went on to subordinate wage claims to a new priority for the expenses of creditors who opposed confirmation of a composition.⁸⁵ But the amendments also increased the wage priority to six hundred dollars.⁸⁶

As part of the continuing political legacy of the Depression, in 1938 Congress again amended the 1898 Act with the Chandler Act.⁸⁷ A restated Section 64a now contained all priorities and arrayed creditors among five classes:

1. Administrative expenses;
2. Wage claims;
3. Expenses of creditors who successfully blocked an arrangement, plan, or discharge;
4. Taxes due to the United States or any state; and
5. Any other debts granted priority by a law of the United States and rent claims entitled to priority under state law.⁸⁸

Holders of wage claims were the clear beneficiaries of the 1938 amendments. Congress repositioned upward the wage priority and slightly broadened the class of its beneficiaries, clarifying that part-time and non-exclusive traveling salesmen also enjoyed priority.⁸⁹ Yet the apparent improvement of priority for wage claims was tempered because three priorities of the preceding version of the statute were folded into an enhanced category of administrative claims.⁹⁰ With their move to a second priority position, unpaid wage

⁸⁴ See Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 27 (“While many in number, these amendments did not reflect any sea change in fundamental attitude.”).

⁸⁵ Act of May 27, 1926, 44 Stat. 662.

⁸⁶ *Id.*

⁸⁷ Ch. 575, 52 Stat. 840 (1938) (repealed 1978). See Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 28 (“After the Depression came crashing down in 1929, Congress passed several pro-debtor amendments that facilitated rehabilitation through bankruptcy. Severe restraints were laid upon the ability of creditors to collect, even upon their collateral.”); *id.* at 29 (“The fury of bankruptcy legislation came to a head in 1938 with the passage of the comprehensive Chandler Act. . . . The Chandler Act substantially revised virtually all of the provisions of the 1898 Act.”).

⁸⁸ 11 U.S.C. § 104 (19__) (repealed 1978).

⁸⁹ 3A COLLIER'S ON BANKRUPTCY ¶ 64.201 [2.2] (1967).

⁹⁰ *Id.*

earners enjoyed their highest priority ever. And for the first time Congress subordinated all federal claims, including tax claims, to those of wage earners.

The 1898 Act continued to undergo modifications until its repeal in 1978.⁹¹ None of these later amendments changed the high priority status of wage claims afforded with the 1938 Chandler Act although the 1956 amendments again widened the definition of traveling salesmen⁹² and in 1966 Congress modified the extent of the priority of tax claims.⁹³ Yet at all times under the 1898 Act, and notwithstanding the continued permutation and expansion of its priority provisions, the Court continued to assert that “the broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt’s estate among creditors.”⁹⁴

Employee benefits other than wages achieved substantial prominence after World War II.⁹⁵ It is thus not surprising that the question of whether the wage priority extended to such benefits eventually came to the fore. The Supreme Court decided two benefits priority cases under the 1898 Act. In *United States v. Embassy Rest., Inc.*⁹⁶ a six-member majority held that mandatory employer contributions to a union welfare fund required under a collective bargaining agreement did not qualify as “wages . . . due to workmen.”⁹⁷ The majority concluded that the contributions were neither wages nor were they due the employees. The

⁹¹ See Tabb, *History of the Bankruptcy Laws*, *supra* note 13, at 30 (“Over the next forty years, Congress amended the bankruptcy laws dozens of times . . .”).

⁹² Act of July 30, 1956, ch. 784, Pub. L. No. 840 (1956).

⁹³ Act of July 5, 1966, Pub. L. No. 89-496, 80 Stat. 270 (1966) (repealed 1978).

⁹⁴ *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930). See also *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451 (1937) (“[T]he object of bankruptcy laws is the equitable distribution of the debtor’s assets amongst his creditors.”).

⁹⁵ See CARRUTHERS & HALLIDAY, *RESCUING BUSINESS*, *supra* note 7, at 328 (“In the post-World War II period, employee compensation increasingly consisted of both wages and benefits . . .”). See also Michael S. Gordon, *Overview: Why Was ERISA Enacted?*, in *PENSION AND EMPLOYEE BENEFIT LAW* 73, 75 (John H. Langbein & Bruce A. Wolk, 2000); C. Scott Pryor, *Rock, Scissors, Paper: ERISA, The Bankruptcy Code and State Exemption Laws for Individual Retirement Accounts*, 77 *AM. BANKR. L.J.* 65, 69-70 (2003).

⁹⁶ 359 U.S. 29 (1959).

⁹⁷ *Id.*

contributions, even though mandatory, were just that—contributions.⁹⁸ And, because the contributions were to be paid to the trustees of the welfare funds maintained by unions, they were not due to “workmen.”⁹⁹ Nor, the Court noted, were the contributions held in separate accounts for the benefit of specific members.¹⁰⁰

The majority also cited principial and pragmatic reasons for its decision. Citing one of its earlier bankruptcy cases for the proposition that “[t]he broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt’s estate”¹⁰¹ and a labor case for the axiom that exemptions are to be strictly construed,¹⁰² the Court noted that the wage exemption pre-dated the existence of non-wage employee benefits and that the “few and guarded amendments” subsequent to 1898 evidenced Congress’ limited solicitude for employees.¹⁰³ Re-emphasizing the employee-trustee distinction, the majority also expressed concern that permitting benefits contributions to share priority with wages due an employee would end up “reducing his own recovery,”¹⁰⁴ an anti-dilution argument. Finally, the Court returned to the paternalistic principle of its 1912 *Guarantee Title*¹⁰⁵ decision by restating what it believed to be the fundamental policy of the wage priority: “the purpose of Congress has constantly been to enable employees displaced by bankruptcy to secure, with

⁹⁸ *Id.* at 32-33 (“[I]t does not appear that the parties to the collective agreement considered these welfare payments as wages. The contract here refers to them as ‘contributions.’”).

⁹⁹ *Id.* at 33 (“Embassy’s obligation is to contribute sums to the trustee, not to its workmen; it is enforceable only by the trustee who enjoy not only the sole title, but the exclusive management of the funds.”).

¹⁰⁰ *Id.* at 32 (“[These contributions] are flat sums of \$8 per month for each workman. The amount is without relation to his hours, wages or productivity.”).

¹⁰¹ *Id.* at 31 (citing *Kotbe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930)).

¹⁰² *Id.* (“[I]f one claimant is to be preferred over others, the purpose should be clear from the statute.”) (citing *Nathanson v. National Labor Relations Bd.*, 344 U.S. 25, 29 (1952)).

¹⁰³ *Id.* at 32:

This class of claims has been given a preferred position in the Bankruptcy Act for over 100 years, long before welfare funds played any part in labor negotiations. True, the Congress has amended the Act, but such amendments have been few and guarded ones, such as raising the ceiling on the amount permitted, shifting the relative priorities and enlarging the class to salesmen, clerks, etc.

¹⁰⁴ *Id.* at 34.

¹⁰⁵ See *supra* text accompanying note 79.

some promptness, the money directly due them in back wages, and thus to alleviate in some degree the hardship that unemployment usually brings to workers and their families.”¹⁰⁶ Regardless of the pedantic logic of the Court’s reasoning, the unique dependence on wages for the masses of those in the labor market and a heightened concern for the effects of unemployment on closely related third parties clearly animated the majority’s analysis.

Nine years later another six-member majority held that unpaid mandatory contributions to an annuity plan that were credited to the accounts of specific employees were not priority claims. In *Joint Indus. Bd. v. United States*¹⁰⁷ the Court extended the holding of *Embassy Rest.* to an obligation to an annuity payable upon the employee’s death, retirement, or disability.¹⁰⁸ Although crediting the contributions to an employee’s individual account looked more “wage-like” than the non-allocated welfare benefits addressed in *Embassy Rest.*, the majority cited three principal reasons for not relaxing its prior narrow construction. The Court first reiterated the fundamental purpose for the wage priority it had identified in *Guarantee Title* and *Embassy Rest.*: promptly to secure back pay to alleviate “the hardship that unemployment usually brings to workers and their families.”¹⁰⁹ The majority reasoned that the annuity benefits were thus not wage-like because “nothing was payable to employees except upon the occurrence of certain events.”¹¹⁰ Retirement benefits, even though negotiated as part of the employee’s compensation package, were not wages because

¹⁰⁶ *Id.* at 32.

¹⁰⁷ 391 U.S. 224 (1968).

¹⁰⁸ *Id.* at 225-26 (“Contributions received by the trustees are credited to the account of the individual employees but are ‘payable to him . . .’ upon death, retirement from the industry at age 60, permanent disability, entry into the Armed Forces, or ceasing to be a participant under the plan.”).

¹⁰⁹ *Id.* at 227 (quoting *Embassy Rest.*, *supra* note 96 at 32).

¹¹⁰ *Id.*

they were not currently available to the employee.¹¹¹ The majority next returned to its pragmatic anti-dilution rationale:

If delinquent contributions to welfare and annuity funds providing deferred benefits to employees were to have equal priority with wages payable directly to employees, the maximum payable immediately and directly to employees would be reduced whenever the individual wage claims approached \$600 or whenever the assets of the estate would not permit all wage claims to be paid in full.¹¹²

In dicta, the majority extended this reasoning to the protection of junior priority creditors, particularly citing concern for fourth priority claims such as workers compensation.¹¹³ Finally, the Court noted that Congress had reenacted Section 64a of the 1898 Act after *Embassy Rest.* without change, from which it inferred Congressional acquiescence in its earlier decision.¹¹⁴ The Court's normative concern arising out of the dependence of most employees on quick payment of wages to allow them to buy their daily bread constrained its interpretation of "wages." And its pragmatic concern about the effects of broadening the wage priority on both wage earners and those lower on the priority list solidified the Court's conclusion that any change in the scope of the wage priority should come from Congress.

C. THE 1978 CODE

¹¹¹ *Id.* ("[T]he employee could not assign, pledge, or borrow against the contributions, or otherwise use them as his own. Quite obviously the annuity fund was not intended to relieve the distress of temporary unemployment, whether arising from the bankruptcy of the employer or for some other reason.").

¹¹² *Id.* at 228.

¹¹³ *Id.* at 229 ("[I]ncreasing the amounts payable to second priority creditors would reduce the assets available for distribution to lower priority claimants and general creditors, including wage claimants not entitled to priority."). The Court specifically addressed the negative impact of expanding the wage priority on various taxes in a footnote:

It is instructive that workmen's compensation claims were not provable in bankruptcy until 1934, when they were given a seventh priority. In 1938 the priority for compensation claims was abolished. Moreover, taxes and Social Security contributions which are withheld from wages are entitled to a fourth priority as taxes rather than a second priority as wages.

Id., n.7.

¹¹⁴ *Id.* ("Although the section was completely re-enacted in 1967, § 64a (2), was left unchanged despite the fact that in every Congress since *Embassy Restaurant* bills have been introduced to overrule or modify the result reached in that case.").

Work on completely reworking the Bankruptcy Act of 1898 began with a Joint Resolution in 1968,¹¹⁵ culminating with the creation the Commission of the Bankruptcy Laws of the United States in 1970.¹¹⁶ [Insert a sentence or two about the original wage priority under the Code.]

II. *HOWARD DELIVERY SERVICE V. ZURICH AMERICAN INSURANCE*

Howard Delivery Service was an erstwhile West Virginia-based interstate freight carrier that operated in a dozen states and employed nearly 500 people.¹¹⁷ Howard had contracted with Zurich to provide it with workers' compensation insurance in ten of those states.¹¹⁸ By the time Howard filed Chapter 11 in January of 2002, it owed Zurich upwards of \$400,000 in unpaid workers' compensation insurance premiums.¹¹⁹ Zurich ultimately filed a proof of claim for \$410,215 that asserted priority under § 507(a)(4), for "contributions to an employee benefit plan."¹²⁰ Howard objected to Zurich's claim of priority status and the Bankruptcy Court upheld the objection.¹²¹ The District Court affirmed.¹²² Zurich then appealed to the Fourth Circuit, which reversed, 2 to 1.¹²³ Each of the judges wrote separately and the two who voted to reverse did not agree on a rationale.¹²⁴ Only Judge Niemeyer in

¹¹⁵ S.J. Res. 100, 90th Cong., § 2(a) (1968).

¹¹⁶ Law of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

¹¹⁷ See *Howard Delivery*, *supra* note 8, at 2109.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Howard Delivery Service, Inc. v. Zurich American Ins. Co. (In re Howard Delivery Service, Inc.)*, 403 F.2d 228 (4th Cir. 2005).

¹²⁴ *Id.* Judge King asserted that "[t]he language of the Statute is plain and unambiguous" (*id.* at 237) and, by consulting several dictionaries, concluded that Zurich's claim should enjoy priority status. Judge Shedd disagreed with Judge King's first conclusion, holding that "the phrase as a whole [is] ambiguous" (*id.* at 239) but, after consulting the legislative history and ERISA, held that Congress intended that "the workers' compensation insurance plan at issue in this case qualif[y] as an 'employee benefit plan.'" *Id.* at 241. Judge Niemeyer in dissent agreed that the meaning of statutory phrase was plain but, after consulting Supreme Court precedent, concluded that the statute does "not give priority to claims for unpaid workers' compensation insurance premiums." *Id.* at 245.

dissent anticipated the Court's construction against expanding priorities in his substantial use of *Joint Indus. Bd.* and *Embassy Rest.*¹²⁵

The Fourth Circuit was not the first to consider the claim of priority for unpaid workers' compensation premiums. Over a decade earlier the Ninth Circuit held that workers' compensation insurance was an "employee benefit" plan.¹²⁶ The court concluded that neither the statutory mandate of workers' compensation nor the fact that workers' compensation was not a "wage substitute" denied unpaid insurance premiums their bankruptcy priority.¹²⁷ The two decisions intervening before the Fourth Circuit's opinion in *Howard Delivery* went the other way. The Eighth¹²⁸ and Tenth¹²⁹ Circuits agreed that the legislative history of § 507(a)(4) excluded workers' compensation from its scope. The latter circuits held that only bargained-for benefits enjoyed priority.

For the third time the Supreme Court split 6 to 3 when considering the priority of employee benefits. Justice Ginsburg wrote the majority opinion in which the Chief Justice and Justices Stevens, Scalia, Thomas, and Breyer concurred.¹³⁰ Justices Souter and Alito joined Justice Kennedy's opinion in dissent.¹³¹ The majority in *Howard Delivery* limited its analysis of the history of what had become codified at § 507(a)(5)¹³² to the comments of the

¹²⁵ *Id.* at 244-45 ("To read § 507(a)(4) as expansively as do the opinions of Judge King and Judge Shedd not only disregards the explicit language of the statute, but such a reading also violates the underlying ground rules for construing priorities under the Bankruptcy Code.").

¹²⁶ *Employers Ins. of Wausau v. Plaid Pantries, Inc. (In re Plaid Pantries, Inc.)*, 10 F.3d 605 (9th Cir. 1993).

¹²⁷ *Id.* at 607.

¹²⁸ *Employers Ins. of Wausau, Inc. v. Ramette (In re HLM Corp.)*, 62 F.3d 224, 226 (8th Cir. 1995).

¹²⁹ *State Ins. Fund v. Southern Star Foods, Inc. (In re Southern Star Foods, Inc.)*, 144 F.3d 712, 716 (10th Cir. 1998).

¹³⁰ *Howard Delivery*, *supra* n.8 at 2108.

¹³¹ *Id.* at 2117.

¹³² As the Court noted:

At the time respondent Zurich American Insurance Company (Zurich) claimed priority treatment for unpaid workers' compensation premiums, the relevant subsections were numbered (a)(3) (wages) and (a)(4) (employee benefit plans). The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 . . . altered the priority list so that (a)(3) became (a)(4), and (a)(4) became (a)(5).

Id. at 2109, n.1.

House¹³³ and Senate Reports¹³⁴ about its two earlier cases, *Joint Indus. Bd.* and *Embassy Rest.* So circumscribed it was thus “beyond genuine debate,” according to Justice Ginsberg, that “the main office of § 507(a)(5) is to capture portions of employee compensation for services rendered not covered by § 507(a)(4).” And this “main office” did not extend to unpaid workers’ compensation insurance premiums. In other words, only “fringe benefits [that] generally complement, or ‘substitute’ for, hourly pay”¹³⁵ enjoy priority status. And workers’ compensation premiums did not fall into the wage substitute or even wage complement categories.

The majority buttressed its narrow reading of § 507(a)(5) from three directions: the broader ERISA definition of employee benefits was inapplicable to construction of the Bankruptcy Code, workers’ compensation is not a uniquely *employee* benefit, and the long-standing twin policies of equality of distribution and the corresponding narrow construction of priorities. At the outset of its opinion the majority explained that it refused to read ERISA’s definition of the almost identical expression (“employee welfare benefit plan”) into the “employee benefit plan” of the Bankruptcy Code because nothing in the Bankruptcy Code authorized the Court to do so.¹³⁶ Since Congress had cross-referenced a few Bankruptcy Code sections to other statutes,¹³⁷ the majority inferred that lack of a cross-reference to ERISA in §507(a)(5) disabled the Court from doing so of its own accord.

¹³³ *Id.* at 2111 (citing H.R.Rep. No. 95-595, p. 187 (1977), U.S. Code Cong. & Admin. News 1978, pp. 5963, 6147-48 and summarizing it as “explaining that the amendment covers ‘health insurance programs, life insurance plans, pension funds, and all other forms of employee compensation that [are] not in the form of wages’”).

¹³⁴ *Id.* (citing S. Rep. No. 95-989, p. 69 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5787, 5855).

¹³⁵ *Id.*

¹³⁶ *Id.* at 2113 (“[H]ere and there in the Bankruptcy Code Congress has included specific directions that establish the significance for bankruptcy law of a term used elsewhere in the federal statutes. No such directions are contained in § 507(a)(5), and we have no warrant to write them into the text.”) (Internal quotation marks and citations omitted.)

¹³⁷ *See, e.g.*, provisions noted in *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 219 (1996).

The majority next compared workers' compensation to the types of employee benefits at issue in *Joint Indus. Bd.* and *Embassy Rest.* Unlike payments to union welfare funds and retirement annuities that benefit employees with no concomitant gain to employers, "[w]orkers' compensation regimes . . . provide something for employees—they assure limited fixed payments for on-the-job injuries—and something for employers—they remove the risk of large judgments and heavy cost generated by tort litigation."¹³⁸ The six members of the majority also made much of the nearly universally compulsory nature of workers' compensation insurance.¹³⁹ While acknowledging that not all states mandate that employers purchase workers' compensation insurance, the majority asserted that the largely compulsory nature of workers' compensation is a factor that distinguishes commitments to employee benefit plans, which benefit from bankruptcy priority, from run of the mill insurance obligations that do not.¹⁴⁰ Finally, the majority noted that granting priority status to an insurer like Zurich would have the anomalous effect of preferring debts to a private insurance carrier to general obligations such as taxes owing to a state. Without committing themselves, the majority strongly suggested that debts owed by employers to a state workers' compensation fund would enjoy only the standard eighth level priority for unsecured claims

¹³⁸ *Id.* at 2113. Basic economics teaches that one party to commercial transaction would not benefit another without something in return: "Providing health care to workers fosters a healthy and happy workforce, and a contented workforce benefits employers." *Id.* at 2114, n.6. So the majority distinguished traditional employee welfare payments from workers' compensation benefits by asserting they were of a different "order:"

[[T]he benefit employers gain from providing health and pension plans for their employees is of a secondary order These benefits redound to the employer reflexively, as a consequence of the benefit to the employee. Workers' compensation insurance, by contrast, directly benefits insured employers by eliminating their tort liability for workplace accidents.

Id.

¹³⁹ *Id.* at 2114 ("Further distancing workers' compensation arrangements from bargained-for or voluntarily accorded fringe benefits, nearly all States, with limited exceptions, require employers to participate in their workers' compensation systems.").

¹⁴⁰ *Id.* ("We simply count it [mandated participation in workers' compensation systems] a factor relevant to our assessment that States overwhelmingly prescribe and regulate insurance coverage for on-the-job accidents, while commonly leaving pension, health, and life insurance plans to private ordering.").

of governmental units, three levels below the priority for obligations to employee benefit plans.¹⁴¹

Only after canvassing the standard tools of statutory construction did the majority cite two of the long-standing policies adduced to support its narrow construction of priority provisions. “[W]e are guided in reaching our decision,” according to the Justice Ginsburg, “by the equal distribution objective underlying the Bankruptcy Code, and the corollary principle that provisions allowing preferences must be tightly construed.”¹⁴² As it had in *Joint Indus. Bd.* the majority justified narrow construction of priorities out of a pragmatic concern for general unsecured creditors. Every dollar that goes to higher priority creditors would diminish the funds available for those of a lower priority.¹⁴³ And, as it had in both *Embassy Rest.* and *Joint Indus. Bd.*, the Court mentioned the anti-dilution argument and expressed apprehension that expanding the scope of the priority would redound to the detriment of employees whose direct § 507(a)(5) fringe benefits could be reduced by the indirect benefits of workers’ compensation premiums.¹⁴⁴

¹⁴¹ *Id.* at 2115 (“We venture only this observation: It is common for Congress to prefer Government creditors over private creditors [citation omitted]; it would be anomalous, however, to advance Zurich’s claim to level (a)(5) while leaving state-fund creditors at level (a)(8).”) (citing *New Neighborhoods, Inc. v. West Virginia Workers’ Comp. Fund*, 886 F.3d 714 (4th Cir. 1989)). The majority’s opinion failed to note that to hold otherwise would have been inconsistent with its decision in *Guarantee Title*, *supra* note 79. In *Guarantee Title* the Court had concluded that the priority granted to wages over federal taxes under the 1898 Act implicitly modified the long-standing Federal Priority Statute of 1797. To grant a private creditor’s claim for premiums that would otherwise have been paid to a state a priority equal to wages would subvert the policy of the wage priority:

The policy which dictated it [the priority of wages over taxes in the 1898 Act] was beneficent and might well induce a postponement of the claims, even of the sovereign, in favor of those who necessarily depended upon their daily labor. And to give such claims priority could in no case seriously affect the sovereign. To deny them priority would in all cases seriously affect the claimants.

224 U.S. at 160.

¹⁴² *Id.* at 2116.

¹⁴³ *See supra* text accompanying notes 112-113 and *id.* at 2116: (“Every claim granted priority status reduces the funds available to general unsecured creditors and may diminish the recovery of other claimants qualifying for equal or lesser priorities.”).

¹⁴⁴ *See supra* text accompanying notes 142-143 and *id.* at 2116 (“Opening the (a)(5) priority to workers’ compensation carriers could shrink the amount available to cover unpaid contributions to plans paradigmatically qualifying as wage surrogated . . .”).

The majority did not, however, mention the fundamental and longstanding normative principle it had first stated in *Guarantee Title* and employed in both *Joint Indus. Bd.* and *Embassy Rest.*: concern for prompt alleviation of the economic distress suffered by workers and their families occasioned by employer insolvency.¹⁴⁵ The Court nowhere explained why this argument had lost its cogency. Perhaps the presence of widespread and more generous unemployment benefits lessened this concern. Or perhaps observation of the glacial pace of many corporate reorganizations undercut the former the connection between priority and timeliness of relief. Or perhaps the shift from concern for family integrity to advocacy of individual autonomy occasioned the elision of this principle from the Court's set of important policies.¹⁴⁶ In any event, the majority concluded by reiterating the equality principle and restating the argument it had made forty years earlier in *Joint Indus. Bd.* that it was for Congress to specifically provide for deviations from those policies.

Any doubt concerning the appropriate characterization [of unpaid workers' compensation insurance premiums], we conclude, is best resolved in accord with the Bankruptcy Code's equal distribution aim. We therefore reject the expanded interpretation Zurich invites. Unless and until Congress otherwise directs, we hold that carriers' claims for unpaid workers' compensation premiums remain outside the priority allowed by § 507(a)(5).¹⁴⁷

III. EFFICIENCY, AUTONOMY, OR JUSTICE?

A. EMPLOYEES AS MALADJUSTING CREDITORS

¹⁴⁵ See *supra* text accompanying notes 106-109.

¹⁴⁶ The Court's turn from a family-based understanding of privacy to one that is characterized by virtually untrammelled individual autonomy is chronicled in David M. Wagner, *The Constitution and Covenant Marriage Legislation: Rumors of a Constitutional Right to Divorce Have Been Greatly Exaggerated*, 8 REGENT U. L. REV. 54 (1999-2000). See also John Tuskey, *What's a Lower Court to Do? Limiting Lawrence v. Texas and the Right to Sexual Autonomy*, 21 TOURO L. REV. 597 (2005).

¹⁴⁷ *Howard Delivery*, *supra* note 8, at 2116.

A number of bankruptcy scholars have argued that the impact of consensual secured credit on priority should be limited where third parties do not have the capacity to adjust their prices or credit terms.¹⁴⁸ Tort claimants are the archetypal examples of non-adjusting creditors.¹⁴⁹ And employees are frequently cited as another instance of non-adjusting creditors.¹⁵⁰ But unlike tort victims, employees voluntarily chose their employer and assent to the terms of the employment relationship. Indeed, as Professors Elizabeth Warren and Jay Westbrook have recently noted, in theory “[e]mployees can protect themselves from the risk of their employer’s insolvency by investigating the company’s financial condition and either seeking employment elsewhere or demanding higher wages to reflect the risk”¹⁵¹ They quickly go on, however, to make the following three points in arguing for the practical inability of employees to adjust their services in light of the financial condition of their employers:

The substantial sophistication and the high transaction costs required to obtain the necessary information present significant barriers. Moreover, the costs of moving from one employer to another can be quite onerous Similarly, although most creditors have the option of spreading their risks by extending

¹⁴⁸ See, e.g., Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 340 (1993) (“Ideally, nonconsensual creditors would have the highest priority in any sort of firm.”).

¹⁴⁹ *Id.* See also Lynn M. LoPucki, *The Unsecured Creditor’s Bargain*, 80 VA. L. REV. 1887, 1907-08 (1994) (“In recent years, several scholars writing on the puzzle of secured debt have acknowledged the plausibility of the arguments [that involuntary creditors should have priority over secured creditors]”).

¹⁵⁰ See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 885 (1996)

We have just seen that involuntary creditors are not able to adjust the size of their claims when a borrower creates a security interest in favor of another creditor because their claims are fixed by law. But the fact that a creditor voluntarily contracts with a firm does not necessarily make that creditor adjusting with respect to any security interest created by the firm. Many of a firm’s voluntary creditors are customers, employees, and trade creditors that have relatively small claims against the firm. Even though these creditors may sometimes, in principle, be able to take the existence of a security interest into account in contracting with the firm, the small size of their claims will generally make it irrational for them to do so.

¹⁵¹ Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 HARV. L. REV. 1197, 1232 (2005) [hereinafter Warren & Westbrook, *Contracting Out of Bankruptcy*].

credit to several customers, this option is not available to employees, who are unlikely to work for more than a single employer.¹⁵² Employees are what Warren and Westbrook characterize as “maladjusting” creditors.¹⁵³ While they have the potential to adjust their prices or places of employment, employees cannot effectively do so. Since 1887 the courts have acknowledged this perspective when construing the wage priority.¹⁵⁴

Professors Lucian Arye Bebchuk and Jesse M. Fried took a slightly different route to arrive at the same destination. They did not argue that employees cannot adjust but instead that it would be irrational for them to do so: “Many of a firm’s voluntary creditors are . . . employees Even though these creditors can, in principle, take the existence of a security interest into account in contracting with the firm, the small size of their claims will generally make it rational for them not to do so.”¹⁵⁵ Simply put, the costs of calibrating the price of employment services to the potential value of unencumbered assets in the event of bankruptcy outweigh the benefit. It is thus irrational for individual employees to adjust. But Bebchuk and Fried do not address whether the employment market as a whole adjusts for the possibility of nonpayment of wages when a firm enters bankruptcy. Nor do they

¹⁵² *Id.*

¹⁵³ *Id.* at 1232 (“Employees in these circumstances might fairly be described as maladjusting creditors.”). Warren and Westbrook do not clearly define “these circumstances.” Are the concerns they raise about the practical ability of employees to adjust the price of their services (or take their services elsewhere) characteristic of *all* employees or only a subset? Intuitively there would seem to be many individual employees who can and do adjust prices in light of their employer’s financial condition. See 11 U.S.C. § 502(c)(2) (limiting administrative expense priority for certain severance payments to “key employees”). In fact, later in their article Warren and Westbrook admit as much: “We recognize that some of the creditors identified in these categories are only *candidates* for classification as maladjusting creditors; the information about them is too sketchy to permit a confident evaluation of their prebankruptcy readjustment capacities.” *Id.* at 1239.

¹⁵⁴ See *People v. Remington & Sons*, *supra* note 54.

¹⁵⁵ Bebchuk & Fried, *The Uneasy Case: Thoughts and Reply*, *supra* note **Error! Bookmark not defined.** at 1299. Bebchuk and Fried go on to conclude that alternatives to full priority for secured credit should be examined with an eye toward protecting nonadjusting creditors like employees. *Id.* at 1321-27 (discussing fixed-fraction priority, adjustable-priority, and consensual-priority as means of transferring value from secured to nonadjusting unsecured creditors).

satisfactorily explain why the current rules about the priority of security should be modified to take into account what they concede would be an irrational calculus.¹⁵⁶

Because Warren and Westbrook believe that the labor market regularly fails employees on its own terms, they conclude that non-market intervention is necessary. The particular form of non-market intervention for their purposes is retention of a “mandatory” Bankruptcy Code in lieu of various suggested “contractual” insolvency alternatives they describe in their article.¹⁵⁷ Thus while Warren and Westbrook do not address specifically the wage priority in § 507 of the Bankruptcy Code, we can reasonably assume that its presence is one of the non-market factors that they believe should be retained in any bankruptcy law.

B. EMPLOYEES AS AUTONOMOUS ECONOMIC ACTORS

But just as the efficiency questions about secured credit have wound down inconclusively,¹⁵⁸ it is by no means clear that economic arguments will resolve the wisdom of the wage priority provision. Perhaps wage earners can protect themselves through pricing their services, changing employers, or simply by staying put even with financially troubled firms if economically rational. Or, failing those alternatives, maybe they are sufficiently

¹⁵⁶ Bebchuk and Fried make the following argument in support of their thesis:

(1) under full priority, the use of a security interest can effect a transfer of bankruptcy value from nonadjusting creditors; (2) this transfer of value acts as a subsidy for the use of a security interest by reducing the apparent cost . . . of using a security interest to the borrower and the secured creditor; and (3) this “subsidy” can lead to the use of inefficient security interests.

Id. at 1304. This argument remains unpersuasive because, on the one hand, Bebchuk and Fried fail to account for the rationality of nonadjustment and, on the other, they assume the applicability of the Modigliani-Miller indifference thesis, an assumption that is hotly contested. *See* David Gray Carlson, *Secured Lending as a Zero-Sum Game*, 19 CARDOZO L. REV. 1635, 1646-1650 (1997-1998).

¹⁵⁷ Warren and Westbrook place contractualist solutions to corporate insolvency into one of three categories: automated bankruptcy (where priorities are built into a business’s financial instruments), a menu system (where a prospective debtor chooses from among a limited set of statutory insolvency options in its organizing documents), and an evergreen regime (where the debtor and each creditor negotiate a contract for dealing with insolvency, the last of which is controlling on all). *See* Warren & Westbrook, *Contracting Out of Bankruptcy*, *supra* note 151, at 1204.

¹⁵⁸ *See supra* text accompanying notes 135-147.

protected by the market generally and do not need special priority protection in the Bankruptcy Code.

If only vindicating personal autonomy justifies coercive state action, Congress had little warrant for creating a priority for wage earners. The limitations on employee bargaining noted above hardly rise to the level of the incapacity typically associated with governmental paternalism. Employees are neither mentally nor physically disabled from acting rationally. Not all states offer employees a priority claim upon the insolvency of their employers; why should the federal government do so in bankruptcy?¹⁵⁹ Nor are there any legal impediments to bargaining for security by employees. In fact, employees can have a strong bargaining position: “where the employer is attempting to reorganize in bankruptcy, the employees will almost always be crucial to the success of such an undertaking.”¹⁶⁰

A hands-off policy toward wage priorities is consistent with classical liberal economic and political thought. And the Court’s omission of reference to the needs of the employee’s family is certainly consistent with the individualistic bent of autonomy-based theories of ethics.

C. THE WAGE PRIORITY AS JUSTICE

Assuming that economic theory is as inconclusive for the wage priority as it has been for the priority of secured credit, is there anything else to support the missing policy? Do

¹⁵⁹ See Daniel Keating, *The Fruits of Labor: Worker Priorities in Bankruptcy*, 35 ARIZ. L. REV. 905, 926 (1993) [hereinafter Keating, *Fruits of Labor*] (“[W]hy should a worker whose claim against its employer outside of bankruptcy is a general unsecured claim suddenly enjoy a preferred position merely by the happenstance of its employer filing for bankruptcy?”). See also Paul G. Kauper, *Insolvency Statutes Preferring Wages Due Employees*, 30 MICH. L. REV. 504 (1931-1932) (discussing range of employee preference statutes during the early years of the Great Depression).

¹⁶⁰ Keating, *Fruits of Labor*, *supra* note 159, at 907. Keating ultimately concludes that “[p]erhaps the best solution to the worker-priority issue is to eliminate the formal priorities and simply allow the workers to exercise what may be their best leverage anyway: their ability as valuable employees to affect whether or not their employer will prosper as a viable going-concern.” *Id.* at 926. Some early New Jersey decisions remarked that the leverage of employees on founding employers justified the state law preference. See, e.g., *Lehigh Coal & Navigation Co. v. Central R.R.*, 29 N.J. Eq. 252 (1878); *Bedford v. Newark Mach. Co.*, 16 N.J. Eq. 117 (1863).

wage earners (and their families) deserve a priority for any reason other than their putative inability to adjust to an employer's grant of a security interest in its assets? And what are we to make of the Court's obeisance to the principle of equality of distribution in light of the growing number of bankruptcy priorities? To address the wage priority from an explicitly normative point of view takes us back to its origins in the 1841 Act.

The 1841 Bankruptcy Act represents perhaps the earliest example of the confluence of evangelical Christian moralism and a nationalist political party with strong business ties. The direct ancestors of twenty-first century evangelicals came into being in the early nineteenth century. As David Bebbington has observed, evangelical Christianity was and is characterized by four distinctives: biblicism (a particular regard for the Bible as the sole source for moral living and ethics); crucicentrism (a focus on the atoning work of Christ on the cross to the virtual exclusion of other aspects of the biblical description of the significance of Christ's work); conversionism (the belief that human beings, even professing Christians, need to be converted, frequently with an emphasis on emotional suasion); and activism (the belief that the Christian Gospel needs to be expressed in serious effort).¹⁶¹ George Marsden describes ante-bellum evangelicalism in similar terms with its emphasis on the free individual, education, technique, "back to the Bible" for answers to life's questions, and social reform.¹⁶² Bebbington's and Marsden's final distinctive of evangelicalism—activism and social reform—focusing on efforts by which the gospel was to be expressed, included both the individual and the community. Leading among the social

¹⁶¹ See D.W. BEBBINGTON, *EVANGELICALISM IN MODERN BRITAIN: A HISTORY FROM THE 1730S TO THE 1980S* 2-3 (1988). For a discussion of evangelical social reform in America see GEORGE M. MARSDEN, *RELIGION AND AMERICAN CULTURE* 112 (1990) [hereinafter *MARSDEN, RELIGION AND AMERICAN CULTURE*]: Americans from the dominant classes were intensely moralistic, with a strong sense of civic responsibility. Civic responsibility and charity were, in fact, lessons that were always taught alongside the work ethic and tempered its individualism. . . . So reform in America often has a middle-class base, appealing to the Judeo-Christian principles that each person has responsibilities for the welfare of all their neighbors.

¹⁶² *Id.* at 53-63.

expectations of ante-bellum evangelicals were temperance, slavery, and the rights of women.¹⁶³ But the issues arising from the ballooning debtor-creditor relationship did not escape their notice.

None of these distinctives was unique to evangelical Christians; however, evangelicalism's reduction of the scope of even Protestant Christianity to only these four is significant. Two are particularly important for purposes of the relationship of ante-bellum evangelicals to politics. The first was evangelicalism's emphasis on social action. Many evangelicals were post-millennialists.¹⁶⁴ That is, they believed that a reformation of the morality of American society would usher in Christ's millennial kingdom.¹⁶⁵ The second was evangelicalism's implicit depreciation of the place of the church. With the reduction of the typical evangelical's identity to his or her personal relationship to Jesus, evangelicalism cut itself off from Christianity's historic form of collective social action in the church. Christianity in America had become consistent with the market's appeal to subjective value.¹⁶⁶ Without the church as the locus of holy living, society as a whole became the object of evangelicalism's activism. And what broader form of society was there than the nation?

¹⁶³ See, e.g., Daniel Walker Howe, *Charles Sellers, the Market Revolution, and the Shaping of Identity in Whig-Jackson America*, in *GOD AND MAMMON*, *supra* note 32, at 54, 64 ("The reforms undertaken by the evangelicals of the time were typically concerned with redeeming persons who were not functioning as free moral agents: slaves, criminals, the insane, drunkards, children, and even—in the case of the most logically rigorous of the reformers—women.").

¹⁶⁴ See GEORG M. THOMAS, *REVIVALISM AND CULTURAL CHANGE: CHRISTIANITY, NATION BUILDING, AND THE MARKET IN THE NINETEENTH-CENTURY UNITED STATES 75-77* (Year).

¹⁶⁵ See MARSDEN, *RELIGION AND AMERICAN CULTURE*, *supra* note 161, at 61:

Millennial imagery had important implication for American at home as well. Americans regarded themselves, and were widely regarded, as "a city on the hill" for the advancement of civilization. They combined classic republicanism, Protestant dominance, and religious freedom into a belief that American civilization would be in the forefront of an outpouring of the Holy Spirit that would usher in the last millennial golden age of world civilization.

¹⁶⁶ See, e.g., MOORE, *SELLING GOD*, *supra* note 33 (arguing that the market revolution used evangelicalism). For a discussion of the relationship between social/economic change and religious movements in an earlier context see C. Scott Pryor, *The Puritan Revolution and the Law of Contracts*, 11 *TEX. WESLEYAN L. REV.* 291 (2005).

Historian Edward Balleisen develops evangelicalism's moral activism regarding the debtor-creditor relationship in *NAVIGATING FAILURE*.¹⁶⁷ Citing pamphleteers, writers of short stories, other texts, and sermons, Balleisen paints a picture in which both sides of the credit relationship bore moral responsibilities to the other and even third parties. For debtors, the “guiding lights for a failing American were ‘a fair disclosure, a full surrender, and an equal distribution.’”¹⁶⁸ Creditors were not immune from evangelicals' moral strictures: “the holders of claims against insolvents ought to respect the rightful interests of other parties. Rather than seek an advantage over his neighbor, the creditor of a bankrupt should deem his honor of more value than even the preference of a large percentage of pecuniary gain. Other prescriptions emphasized the duty of charity toward those who had suffered misfortune.”¹⁶⁹ The continuing moralization of all debt is significant. Bruce Mann had argued in *REPUBLIC OF DEBTORS* that the early years of the nineteenth century reflected both a mindset of debt (or at least the failure to repay it) as sin as well as a grudging but increasing recognition that debt was necessary for a commercial society:

[T]he moral economy of debt had lost its religious underpinnings by the end of the eighteenth century, at least for commercial debtor. The redefinition of insolvency from moral failure to economic risk did not eliminate debtors' legal obligations to repay their debts. Rather, it secularized the foundations of the moral obligation to repay . . . and changed the general understanding of how the law should treat failure.¹⁷⁰

¹⁶⁷ EDWARD J. BALLEISEN, *NAVIGATING FAILURE: BANKRUPTCY AND COMMERCIAL SOCIETY IN ANTEBELLUM AMERICA* (2001) [hereinafter BALLEISEN, *NAVIGATING FAILURE*].

¹⁶⁸ *Id.* at 70 (quoting an 1839 address of Philadelphia merchant John Sargeant).

¹⁶⁹ *Id.* (internal quotation marks omitted).

¹⁷⁰ MANN, *REPUBLIC OF DEBTORS*, *supra* note 13, at 260. *See also* PETER J. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900* 285 (1974):

[T]he plunging, speculative, promoter type who came to typify the driving, high-risk segment of American business after the Revolution unwittingly contributed to the formation of attitudes essential to the acceptance of the discharge of debts. Initially the old morality prevailed. . . . However, as the nineteenth century advanced more and more Americans became tolerant of and indeed attracted to speculative ventures. . . . And so the pendulum of

Mann may have overly-anticipated the secularizing influences of the burgeoning market economy because both morality and efficiency continued to dominate the debates around the 1841 Act. Like the other moral causes of ante-bellum America—temperance, abolition of slavery, and evangelistic activism—bankruptcy reformers cast their rhetoric in explicitly ethical terms.¹⁷¹ As Balleisen observes, “when the economic dislocations of the late 1830s and early 1840s created political pressures for revisions of debtor-creditor law, and especially for the adoption of a national bankruptcy system, the creed of ‘the church commercial’ guided the labors of congressional draftsmen.”¹⁷²

The congressional draftsmen in 1840 were the Whigs.¹⁷³ The Whig party was led by northern industrialists and western nationalists who had organized for the 1832 election and attempted to pull together all of the opposition the reelection of Andrew Jackson.¹⁷⁴ As articulated by Daniel Walker Howe, in the popular perception of the 1830s “Andrew Jackson typified the authority figure of the West: violent, passionate, and vindictive, unconstrained by the rules of law (or spelling).”¹⁷⁵ In contrast,

opinion swung from hostility to bankruptcy relief to an attitude that mixed indifference with tolerance and outright approval.

¹⁷¹ See, e.g., BALLEISEN, *NAVIGATING FAILURE*, *supra* note 167, at 165 (“In discussing the plight of bankrupts, commercial moralists and their political allies emulated the rhetorical strategies of most antebellum reform movements.”).

¹⁷² BALLEISEN, *NAVIGATING FAILURE*, *supra* note 167, at 99.

¹⁷³ Daniel Webster was the principal draftsman of the 1841 Act. See F. REGIS NOEL, *A HISTORY OF THE BANKRUPTCY LAW 138* (1919) (“The law of 1841 was largely the work of Daniel Webster . . .”). Webster took much of the Act, including the wage priority provision, from a recently enacted Massachusetts statute. See *An Act for the Relief of Insolvent Debtors, and for the more equal distribution of their effects*, ch. CLXIII, § 24, 1838 Mass. Laws. For hints of Webster’s connection with evangelicalism see DANIEL WALKER HOWE, *THE POLITICAL CULTURE OF THE AMERICAN WHIGS* (1979) [hereinafter HOWE, *POLITICAL CULTURE OF AMERICAN WHIGS*] (“Whig political leaders like Henry Clay and Daniel Webster cultivated good public and private relations with clerical opinion-makers.”). *But see id.* at 222 (“Webster’s own religious faith was bland, non-theological, and ecumenical.”). See ROBERT V. REMINI, *DANIEL WEBSTER: THE MAN AND HIS TIME* 87 (1997) (quoting Webster’s orthodox confession of faith written in 1807 as a condition of membership in the Salisbury Congregational Church).

¹⁷⁴ See SAMUEL ELIOT MORISON & HENRY STEELE COMMAGER, 1 *THE GROWTH OF THE AMERICAN REPUBLIC* 485 (1950) [hereinafter MORISON & COMMAGER, *GROWTH OF THE AMERICAN REPUBLIC*].

¹⁷⁵ See Howe, *God and Mammon*, *supra* note 163, at 62.

Whiggery stood for the triumph of the cosmopolitan and national over the provincial and local, of rational order over irrational spontaneity, of school-based learning over traditional folkway and customs, and of self-control over self-expression. Whigs believed that every person had the potential to become moral or good if family, school, and community nurtured the seed of goodness in his moral nature.¹⁷⁶

While the sets of evangelicals and Whigs were by no means identical,¹⁷⁷ there was a substantial overlap, especially in the North. Desire to reform society in terms of manners and decorum easily meshed with maintaining the Second Bank of the United States and protective tariffs to enhance a broadening market economy.¹⁷⁸ The relationship between evangelicalism and the Whig party is undeniable.¹⁷⁹

With no success against Andrew Jackson or against Jackson's successor Martin Van Buren in 1836, the Whigs by 1840 found themselves with a real prospect of victory due to the lingering effects of the Panic of 1837, which by 1840 was a depression. Given the increasing number of persons entitled to vote in most states, the Whigs needed to broaden their appeal to newly enfranchised: "It was necessary to out-demagogue the Democrats."¹⁸⁰ And one of the Whig's means of reaching the non-elite masses was to support bankruptcy

¹⁷⁶ *Id.* (quoting LOUISE STEVENSON, SCHOLARLY MEANS TO EVANGELICAL ENDS: THE NEW HAVEN SCHOLARS AND THE TRANSFORMATION OF HIGHER LEARNING IN AMERICA, 1830-1890 5-6 (1986)).

¹⁷⁷ In other words, evangelical leaders were not mere theological water carriers for the Whig business elites. See Stewart Allen Davenport, *Moral Man, Immoral Economy: Protestant Reflections on Market Capitalism, 1820-1860* 33 (2001) (unpublished Ph.D. dissertation, Yale University) (on file with author):

It is also important to point out . . . that all of the clerical economists, being the intellectual disciples of Adam Smith that they were, strongly supported free-trade: a position on national economic policy that was fundamentally at odds with the predominant Whig agenda of high-tariff protection for America's nascent industries.

¹⁷⁸ See generally Noll, *Introduction*, in *GOD AND MAMMON*, *supra* note 32, at 12.

¹⁷⁹ See HOWE, *POLITICAL CULTURE OF AMERICAN WHIGS*, *supra* note 173, at 9:

Whig political culture was profoundly influenced by the Second Great Awakening, an outburst of evangelical activity which . . . sought to transform society along moral lines. For the religious crusaders who led the temperance, peace, antislavery, missionary, and other benevolent societies, it was not enough to win individual souls to Christ; society as a whole must respond to His call. American Whigs, many of them members of the evangelical sects, typically believed in the collective redemption of society . . .

¹⁸⁰ MORISON & COMMAGER, *GROWTH OF THE AMERICAN REPUBLIC*, *supra* note 174, at 555.

legislation.¹⁸¹ The Whigs swept to victory with the election of William Henry Harrison and took control of Congress. Keeping their promise “the Whig-dominated 27th Congress again created a federal bankruptcy system, largely in the hope of attracting the political support of thousands of American whose businesses had failed”¹⁸² The breadth of who could be a debtor and the ability to seek voluntary bankruptcy relief confirmed the Whigs’ intent to retain the support of the many who suffered greatly from the continuing economic depression.¹⁸³

Creation of the wage priority was consistent with the Whig’s rent-seeking program for continuing electoral success. The wage priority also harmonized with the family-centered moralism of ante-bellum evangelicals.¹⁸⁴ As Balleisen observes in connection with debtor obligations under the 1841 Act,

Drawn from the suggestions of bankruptcy reformers with ties to commercial moralism, these disciplinary elements [e.g., voidability of preferences] reflected a coercive impulse born of frustration with the impacts of moral suasion—much as calls for prohibition of alcohol grew out of impatience among temperance advocates with the results of mere agitation.¹⁸⁵

When one remembers that the evangelical commercial moralists spoke to the ethical duties of creditors as well as debtors,¹⁸⁶ it is reasonable to conclude that the wage priority also grew out of similar sympathies. Even the epithet attached to the 1841 Act by its

¹⁸¹ BALLEISEN, NAVIGATING FAILURE, *supra* note 167, at 104 (“[A]s the presidential election of 1840 approached, Whig leaders seized on bankruptcy reform as a leading issue for their campaign.”).

¹⁸² BALLEISEN, NAVIGATING FAILURE, *supra* note 167, at 102. *See also* DAVID A. SKEEL, JR., DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 31 (2001) (“The 1841 act was the brainchild of the Whig party, which had made bankruptcy law a crucial plank of the platform that brought them the presidency and control of the Senate the year before.”).

¹⁸³ *See supra* text accompanying note 41. *See also* BALLEISEN, NAVIGATING FAILURE, *supra* note 167, at 102 (“To curry favor with these voters, the Whigs made bankruptcy discharges available to all citizens and allowed debtors as well as creditors to initiate bankruptcy proceedings.”).

¹⁸⁴ BALLEISEN, NAVIGATING FAILURE, *supra* note 167, at 104 (“Taking their cue from both the commercial moralists and the fervent demands of bankrupts, Whig leaders cobbled together a bill that gave all Americans the ability to petition for bankruptcy relief.”).

¹⁸⁵ BALLEISEN, NAVIGATING FAILURE, *supra* note 167, at 102.

¹⁸⁶ Insert cross reference

opponents—“Jubilee of the Bankrupts”—pays homage to the biblical perspective in which the new law was considered.¹⁸⁷ If the 1841 Act as a whole was perceived in terms of the release laws recorded in *Leviticus* 25, it is likely that a biblically literate population saw the wage priority in terms of passages such as *Leviticus* 19:13,¹⁸⁸ *Deuteronomy* 24:15,¹⁸⁹ and *James* 5:4,¹⁹⁰ each of which clearly enjoined the prompt payment of wages. Other than payment of vows made to God, no specific financial obligation received such frequent biblical mention as the duty to pay wages. The continuing moralization of the debtor-creditor relationship, consistent with a plain reading of the Bible in the context of a market economy with a rising class of wage earners, carries considerable weight in understanding the moral calculus of the wage priority of the 1841 Act. And the references in judicial opinions to the particular needs of wage-earners and their families over the course of more than a century suggest a continuing recognition of a normative moral principle underlying the wage priority.

CONCLUSION

The majority’s decision in *Zurich American* is solid if uninspiring as a piece of statutory construction. And why should statutory construction of a priority provision in the Bankruptcy Code be inspiring anyway? The dissenting justices also focused on traditional tools of construction. Neither opinion referred to the principle of protection of employees

¹⁸⁷ BALLEISEN, NAVIGATING FAILURE, *supra* note 167, at 132

“Jubilee of the Bankrupts”—so one critic had derisively termed the 1841 Federal Bankruptcy Act, and in hindsight, with considerable justification. In light of the legislation’s expeditious repeal, there is a strong temptation to deem it an ephemeral showering of legal releases upon one generation of ruined proprietors, very much akin to a biblical cancellation of debts. The reference to “jubilee” is taken from *Leviticus* 25 where the Torah provided that every 50 years the Israelites were freed from debt servitude and restored to their ancestral lands.

¹⁸⁸ *Leviticus* 19:13 (“Thou shalt not defraud thy neighbour, neither rob him: the wages of him that is hired shall not abide with thee all night until the morning.”). (All biblical quotes are from the Authorized (King James) Version because it was the single translation commonly in use in nineteenth-century America.)

¹⁸⁹ *Deuteronomy* 24:15 (“At his day thou shalt give him his hire, neither shall the sun go down upon it; for he is poor, and setteth his heart upon it: lest he cry against thee unto the LORD, and it be sin unto thee.”).

¹⁹⁰ *James* 5:4 (“Behold, the hire of the labourers who have reaped down your fields, which is of you kept back by fraud, crieth: and the cries of them which have reaped are entered into the ears of the Lord of sabaoth.”).

and their families by prompt payment of wages that had animated previous decisions in this field.

The dissent's reticence is understandable: There is little reason to conclude that a policy of protecting workers from the vicissitudes of sudden unemployment would buttress awarding a priority for workers compensation insurance. If neither of the forms of employee benefits addressed in *Embassy Rest.* (contributions to union welfare fund) or *Joint Indus. Bd.* (contributions to employee's annuity plan) fell within the purpose of the wage priority, the more attenuated nature of workers compensation could scarcely do so.

It is harder to understand the majority's silence. The Court's precedents had confirmed the purpose of the wage priority as a means by which employees and their families could get their daily bread. Each of the preceding six-member majorities had also established the corollary that deferred employee benefits did not fall within wage priority. When Congress added § 507(a)(4) in 1978 it did so after concluding that over the course of the twentieth century fringe benefits had frequently come to substitute for wages. To be sure, employee benefits now enjoy a priority but that extended priority did not arise from the moral milieu of the original wage priority. Employee benefit plans did not have the same nexus to survival as did the prompt payment of wages. It is not surprising that the majority balked at expanding the reach of employee benefits priority. It is surprising that the opinion failed to acknowledge its consistency with a trajectory beginning over 160 years earlier and regularly confirmed thereafter.