

June 30, 2006

THE UNITED STATES SUPREME COURT HOLDS THAT INSURANCE CARRIER CREDITORS DO NOT RECEIVE PRIORITY IN BANKRUPTCY PROCEEDINGS FOR UNPAID WORKERS' COMPENSATION PREMIUMS UNDER 11 U.S.C. § 507(a)(5)

The Bankruptcy Code accords priorities, among unsecured creditors' claims for unpaid "wages, salaries, or commissions," 11 U.S.C. § 507(a)(4), and for unpaid contributions to "an employee benefit plan," § 507(a)(5). In Howard Delivery Serv., Inc. et al. v. Zurich Am. Ins. Co., __ U.S. __ (No. 05-128, June 15, 2006), the United States Supreme Court held that this priority for contributions to "an employee benefit plan," does not extend to insurance carrier creditors claiming unpaid workers' compensation premiums.

Petitioner Howard Delivery Service, Inc. (Howard), maintained workers' compensation for its employees. Howard contracted with respondent Zurich American Insurance Co. (Zurich) to provide this insurance. After Howard filed a Chapter 11 bankruptcy petition, Zurich filed an unsecured creditor's claim for some \$400,000 in premiums, asserting that they qualified as "contributions to an employee benefit plan" entitled to priority under § 507(a)(5). The Bankruptcy Court denied priority status to the claim. The District Court affirmed and a Fourth Circuit panel reversed granting the claim priority.

The enactment of § 507 (a)(5) which grants priority for contributions to "an employee benefit plan," was prompted by Congress's recognition that fringe benefits generally complement or substitute for hourly pay. The Court's rationale in denying priority status for unpaid workers' compensation premiums was largely based on the fact that workers' compensation plans are unlike other "employee benefit plans" because they are beneficial to the employer as well as the employee. While workers' compensation plans do provide employees with insurance for on the job injuries regardless of fault, they also protect employers by removing the danger of the large costs and judgments sometimes associated with traditional tort litigation. The Court also felt that awarding priority status to these types of claims would shrink the pool available for other wage surrogate creditors since there is a \$10,000 cap on priority payments to these categories. This would be contrary to aim of the Bankruptcy Code, which is to secure equal distribution among creditors. The Court's final conclusion was that workers' compensation premiums owed by an employer fall outside the priority allowed by § 507(a)(5) and that such premiums are more appropriately bracketed with liability insurance premiums.

If you have any questions regarding this case or other workers' compensation related issues, please contact any member of our Workers' Compensation Practice Group at (952) 831-6544, or through our website, www.johnson-condon.com. A copy of this letter is available on the News and Resources page at <http://www.johnson-condon.com/news-resources.htm>.

Sincerely,

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