



PUTTING EMPLOYEES FIRST

Wage Priority Act Requires Foreclosing Creditors to Pay Back Wages

By Brendan G. Best

Workout and restructuring professionals know firsthand that business liquidations can be devastating for owners, lenders, creditors, vendors, and customers. The impact on employees, however, can often be the most abrupt and hardest felt. When a company is in bankruptcy, employee wages are entitled to legal priority over ordinary unsecured claims, usually ensuring that employees' wages are fully paid. However, most failed businesses do not file bankruptcy. Yet in a handful of states, including Michigan, there are rarely invoked statutes that *require* a creditor that has taken action to close a business to pay the wage claims of its debtor's former employees on a senior-priority basis. In Michigan, wage claims may even have priority over the costs and expenses of the liquidation itself, giving them so-called "super-priority" status.

Fast Facts

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Enacted March 10, 1967, an act referred to as "Debts Owing to or for the Benefit of Employees" (referred to as the Wage Priority Act in this article),¹ requires creditors that "suspend" the business of a debtor to pay claims that have accrued by reason of employment "before other unsecured creditors are paid."² The act also creates an informal claims allowance process for the determination of such claims. Section 2 of the act concludes with the requirement that "[t]he person or court receiving [the claim submission] shall pay the amount of such claim when allowed to the person entitled thereto."³

The sparse provisions of the Wage Priority Act raise numerous questions. Does the act require the payment of wage claims even when the foreclosing creditor is not paid in full? How are multiple wage creditors paid in the event that proceeds of the liquidation are not sufficient to pay all wage claims? Are the costs and expenses of the liquidation given administrative priority status and paid before the payment of the wage claims, or do the wage claims have super-priority status? Given the lack of any reported cases in the act's 40-plus-year existence,⁴ the answers to these questions will have to be sorted out on a case-by-case basis among the parties involved. There is, however, some guidance from similar statutes in other states. For example, the Indiana Supreme Court held that claims of employees took priority over both a mortgage on real property and a security interest on personal property, and required the foreclosing secured creditor to pay such claims.⁵

In practice, many secured lenders that shut down businesses consent to the payment of wages without having to be told by their lawyers that the Wage Priority Act requires them to do so. There are several practical reasons for this. The lender may need the cooperation of key employees during the sale of the com-

pany's assets, and those employees are usually unwilling to continue to work without their wages being paid. The owner of the business, often critical to the lender's ability to liquidate the company quickly and efficiently, may require payment of wages as a quid pro quo to his or her cooperation given the owner's potential liability for unpaid wages.⁶ However, in some cases such natural incentives may not exist, and lawyers involved in secured creditor liquidations would be well served to have a working knowledge and understanding of the Wage Priority Act and the caselaw interpreting similar statutes in other states. ■

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Brendan G. Best represents debtors, secured and unsecured creditors, creditors' committees, and other stakeholders in out-of-court workouts, liquidations, bankruptcy proceedings, corporate transactions, and commercial litigation. He is a member of the Turnaround Management Association, the American Bankruptcy Institute, and the Federal Bar Association. He graduated from the Wayne State University Law School where he was a member of the Law Review and the Order of the Coif.

ENDNOTES

1. MCL 408.511–MCL 408.512. For other states' priority wage statutes, see, e.g., 770 Ill Comp Stat 85/1, Colo Rev Stat § 8-10-101, and Utah Code Ann § 34-26-1.
2. MCL 408.511(1). The act also applies to receivers and trustees, who are usually placed in those positions through the efforts of the foreclosing creditor.
3. MCL 408.512.
4. The Wage Priority Act does make an appearance in *dictum* in one case. See *In re Kitty Hawk, Inc*, 255 BR 428 (ND Tex, 2000) (finding the act to be inapplicable to the facts of that case and also that bankruptcy law would preempt the act in any event).
5. See *First Nat'l Bank v Gabonay*, 562 NE2d 719, 721 (Ind, 1990).
6. See MCL 408.471–MCL 408.490.