

**UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF COLORADO**

Bankruptcy Judge Thomas B. McNamara

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In re:	)	
	)	Case No. 15-22395-TBM
ESCALERA RESOURCES CO., a Maryland	)	
corporation,	)	Chapter 11
	)	
Debtor.	)	

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**FINAL ORDER AUTHORIZING PAYMENT OF PREPETITION WAGES,  
SALARIES, EXPENSES, AND BENEFITS**

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The retention of employees is critical to the success of business reorganizations under Chapter 11 of the Bankruptcy Code. But the mere act of filing for bankruptcy protection no doubt results in some level of heightened angst and uncertainty for employees of the debtor enterprise. To alleviate such employee concerns and also to enhance the chances for successful rehabilitation, corporate debtors frequently seek authorization from the bankruptcy court to pay some or all of the wages, salaries, expenses, and benefits owing to their employees as of the petition date. Such are the circumstances in this nascent energy-industry corporate reorganization.

This matter comes before the Court on the “Request for Order Authorizing Payment of Prepetition Wages, Salaries, Expenses, and Benefits” (the “Employee Wage Request”) included in the “Motion Seeking Expedited Entry of First Day Orders” (Docket No. 7, the “Motion”) filed on November 5, 2015, by Debtor Escalera Resources Co. (the “Debtor”). In the Motion, the Debtor requests Court approval to pay the Debtor’s 22 employees seven days of prepetition wages and benefits. The Debtor’s Employee Wage Request is made expressly subject to the priority claim limitations contained in 11 U.S.C. §§ 507(a)(4) and (a)(5). While the Debtor presented the Motion on a very expedited basis, no party contests the Employee Wage Request.

Although there is a dearth of reported case law in this jurisdiction concerning such matters, bankruptcy courts routinely approve the payment of prepetition wages and benefits in appropriate cases subject to statutory priority claim limitations. The Court determines that the practice is authorized under a combination of 11 U.S.C. §§ 105, 507(a)(4) and (a)(5), and 1106-8 and is warranted by the facts of this case, especially given the lack of any objections.

A. Jurisdiction.

This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334. The issue raised in the Motion is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (B), (M) and (O). Venue is proper in this Court under 28 U.S.C. §§ 1408 and 1409.

B. Procedural Background.

The Debtor filed for protection under Chapter 11 of the Bankruptcy Code on November 5, 2015. The Debtor presented the Motion on an expedited basis pursuant to L.B.R. 2081-1. As required by that rule, the Debtor submitted the “Affidavit of Adam Fenster” (the “Fenster Affidavit”) to provide evidentiary foundation for the allegations in the Motion. The Debtor sent the Motion and a Notice to the parties required under L.B.R. 2081-1(b) including the United States Trustee, secured creditors, priority creditors, regulatory agencies, the 20 largest unsecured creditors, and certain other parties. *See* Docket No. 16. The Court conducted a hearing on the Motion on November 9, 2015. No party opposed the relief requested in the Employee Wage Request.

C. Factual Background.

Based upon the Fenster Affidavit and the testimony proffered at the Hearing, the Court finds as follows:

The Debtor is a publicly-traded, independent energy company engaged in the exploration, development, production, and sale of natural gas and crude oil, primarily in the Rocky Mountain basins of the western United States. Its core operations are natural gas wells in Wyoming. The Debtor’s principal corporate office is located in Denver, Colorado. The Debtor also maintains offices in Texas and Wyoming.

As an operating energy company (and like others in this sector), the Debtor’s financial results were adversely affected by the substantial decline in natural gas and oil commodity prices from the second half of 2014 to the present. With lower prices and a depleting asset base, the Debtor’s prepetition cash flow from operations decreased while its level of indebtedness increased. Nevertheless, the Debtor intends to continue as a going concern and reorganize itself under Chapter 11 of the Bankruptcy Code. The Debtor’s Chief Financial Officer testified that the Debtor proposes to file a “pre-packaged” plan of reorganization within a matter of a few weeks based upon a term sheet presented to the Court.

Successful reorganization depends, at least in part, upon the Debtor’s employees. As of October 31, 2015, the Debtor had 22 employees. None of the employees is subject to a collective bargaining agreement. Prior to the bankruptcy filing on November 5, 2015, the Debtor had paid its employees in a timely fashion. However, because the Debtor’s wage earners are paid one week in arrears, the Debtor’s employees are owed seven days of prepetition wages and salaries. In addition to wages and salaries, the Debtor offers other benefits typical in the corporate environment including vacation leave, sick leave, 401(k) plan match, and group health insurance benefits. Such additional benefits also are owing for the seven-day period prior to the petition date.

The Debtor’s Chief Financial Officer testified that failing to pay the Debtor’s obligations to employees “would seriously undermine the morale and loyalty of the Employees and, as a result, Escalera’s reorganization efforts would be substantially jeopardized.” Although the Debtor did not provide the Court with the exact amount of proposed payments to the Debtor’s

employees, the amount appears fairly limited by both the number of employees and the amount of time (*i.e.*, 22 employees for one week). Furthermore, the Debtor confirms that: “No single Employee will receive payment in excess of the limitations set forth in §§ 507(a)(4) and (a)(5) of the Bankruptcy Code.” *See* Motion at 10. At the hearing, the Debtor proffered that the aggregate amount of proposed payments would be less than \$20,000.

#### D. Legal Analysis.

It is axiomatic that prepetition claims in a Chapter 11 case typically are paid only through a confirmed plan of reorganization and according to the priority scheme established in the Bankruptcy Code. *See, e.g.*, 11 U.S.C. §§ 507 and 1121-1129. But, is there an exception for claims of employees for prepetition wages and benefits that would permit prompt payment at the commencement of the Chapter 11 reorganization process?

The Debtor argues that failure to pay employees “would seriously undermine the morale and loyalty” of the employees and jeopardize reorganization efforts. The Debtor posits that “it is essential” to satisfy prepetition obligations to the employees and that honoring such obligations ultimately may benefit the entire bankruptcy estate including creditors and parties in interest since reorganization is paramount. In essence, and without offering a more fulsome legal analysis, the debtor offers necessity as the foundation for the Employee Wage Request.

While the Debtor’s position certainly appears practical and prompt payment of employees likely is necessary to maintain the possibility of a successful reorganization, the Court requires something more compelling: statutory grounds for granting relief based upon the text of the Bankruptcy Code as enacted by Congress.

#### 1. Statutory Basis for Payment of Prepetition Employee Wages and Benefits.

The statutory starting place is Section 507 of the Bankruptcy Code which generally provides a very high priority to ensure the payment of claims for employee wages and benefits. As specifically applicable to this Chapter 11 reorganization case, since there are no claims for domestic support obligations (11 U.S.C. § 507(a)(1)) and the proceeding is not involuntary (11 U.S.C. §§ 502(f) and 507(a)(3)), the employee wage priority is *second only to allowed administrative expenses*. *See* 11 U.S.C. §§ 503(b) and 507(a)(3). Pursuant to Section 507(a)(4) the employee wage priority extends to:

... allowed unsecured claims, but only to the extent of \$12,475 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the petition... for... wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual....

This statute is supplemented by Section 507(a)(5) which provides, in this case, *a third priority* for:

... allowed unsecured claims for contributions to an employee benefit plan... arising from services rendered within 180 days

before the date of the filing of the petition... but only... for each such plan, to the extent of... (i) the number of employees covered by each such plan multiplied by \$12,475; less (ii) the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.

Thus, Congress itself elevated employee wage and benefits claims to a priority status over general unsecured claims and, in the typical Chapter 11 context, subordinate only to administrative claims as well as the interests of secured creditors with liens in cash collateral necessary to fund payments for employee wages and benefits. *See In re Coserv, L.L.C.*, 273 B.R. 487, 493 n.10 (Bankr. N.D. Tex. 2002) (“in the case of payment of... wage claims, only the Lender (whose cash collateral would be used to pay wage and benefit claims) and professionals [administrative claimants]... could be affected.”).

Put another way, unless the bankruptcy estate is administratively insolvent, claims for employee wages and benefits are required to be paid in a Chapter 11 reorganization. The only real question is: When? Although prepetition employee wage and benefit claims presumptively will be paid through a confirmed plan of reorganization, the Bankruptcy Code allows some flexibility as to the timing of prepetition employee wage and benefits payments.

According to the United States Supreme Court, “[t]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.” *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984), citing H.R. Rep. No. 95-595 at 220 (1977) (“The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.”). It follows that implicit in the duties of a Chapter 11 debtor-in-possession, as provided in Sections 1106, 1107 and 1108 of the Bankruptcy Code is “the duty of such fiduciary to protect and preserve the estate, including an operating business’s going-concern value.” *Coserve*, 273 B.R. at 497. There can be little doubt that employees are the lifeblood of any operating business. Thus, “actions to stabilize a debtor’s relationships with its employees are critical to one of the principal goals of the Chapter 11 process: to preserve going-concern value.” *In re Tusa-Expo Holdings, Inc.*, 2008 WL 4857954 \*2 (Bankr. N.D. Tex. 2008). In many cases, preservation of going-concern value and ensuring the possibility of reorganization requires the timely payment of employee wages and benefits, including prepetition claims. Sections 1106-1108 of the Bankruptcy Code provide a statutory connection from mere Section 507 priority to potential early payment of employee wage and benefit claims in appropriate circumstances to realize a reorganization.

Section 105(a) of the Bankruptcy Code also augments this Court’s power to approve early payment of prepetition employee wages and benefits. That statute states:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

Section 105(a) codifies the bankruptcy court’s equitable powers. *Scrivner v. Mashburn (In re*

*Scrivner*), 535 F.3d 1258, 1262-3 (10th Cir. 2008). Such equitable powers permit the bankruptcy court to fill in statutory gaps. *Redmond v. Jenkins (In re Alternative Fuels, Inc.)*, 789 F.3d 1139, 1146 (10th Cir. 2015). For example, in *Alternative Fuels*, the Tenth Circuit acknowledged that the Bankruptcy Code did not expressly address recharacterization of debt as equity. Nevertheless, the appellate court confirmed that Section 105(a) provided the statutory basis for the bankruptcy court to recharacterize debt as equity because “[r]echaracterization under § 105(a) is essential to a court’s ability to properly implement the priority scheme of the Bankruptcy Code.” *Id.* This does not mean that Section 105(a) provides an all-purpose *carte blanche* for the bankruptcy court to “do equity” irrespective of the provisions of the Bankruptcy Code. Quite to the contrary. A bankruptcy court may never employ Section 105(a) to “contravene the express provisions of the Code.” *Law v. Siegel*, \_\_\_ U.S. \_\_\_, 134 S. Ct. 1188, 1197 (2014); *Alternative Fuels*, 789 F.3d at 1149. But where the proposed action is not expressly circumscribed and instead is in harmony with other provisions of the Bankruptcy Code as well as its overriding purpose, Section 105(a) provides a bankruptcy court power to act. Such are the circumstances in this Chapter 11 proceeding.

## 2. Payment of Prepetition Employee Wages and Benefits is Warranted in this Case.

The Debtor intends to continue as a going concern pursuant to a “pre-packaged” plan of reorganization. The Debtor presented evidence that the failure to pay employees “would seriously undermine the morale and loyalty” of its employees and would jeopardize reorganization efforts. This stands to reason. If employees are not paid, “they will leave.” *In re CEI Roofing, Inc.*, 315 B.R. 50, 60 (Bankr. N.D. Tex. 2004). And even if employees remain with the Debtor notwithstanding the non-payment of prepetition wages and benefits, “it is probable that their work would be affected by their loss of income.” *Tusa-Expo Holdings*, 2008 WL 4857954 \*3. The Court finds that the failure to pay the Debtor’s employees their prepetition wages and benefits likely would jeopardize the Debtor’s reorganization process.

Sections 507(a)(4) and (a)(5) establish that the employees’ prepetition wage and benefit claims are entitled to priority, to the extent of the statutory caps. The Debtor proposes that “[n]o single Employee will receive payment in excess of the limitations set forth in §§ 507(a)(4) and (a)(5) of the Bankruptcy Code.” *See* Motion at 10. Further, such amounts are narrowly limited by both the small number of employees and the time frame (*i.e.*, one week) and do not appear especially material in the overall context of this case. Thus, the monetary payments proposed in the Employee Wage Request are consistent with, not in contravention of, the priority scheme established in the Bankruptcy Code. The prepetition employee wages and benefits are senior in priority to all other claimants (including general unsecured claims) *except* administrative claimants under 11 U.S.C. §§ 503(b) and 507(a)(3). The Debtor introduced evidence to suggest that the bankruptcy estate is not administratively insolvent. No administrative claimants (such as the Debtor’s professionals) object to the requested relief. The payment of prepetition employee wages and benefits also is consistent with the Chapter 11 duties of the Debtor as provided in Sections 1106, 1107 and 1108 of the Bankruptcy Code including to protect and preserve the estate and a business’s going-concern value.

Even if otherwise appropriate, the payment of prepetition employee wages and benefits might implicate issues of cash collateral protection. Under 11 U.S.C. §§ 363(c) and (e), the Debtor may not utilize cash collateral to pay prepetition employee wages and benefits unless all

cash collateral lienholders consent or the Court allows the use of cash collateral after providing adequate protection for lienholders' interests. In this case, the Debtor does intend to utilize cash collateral to pay the prepetition employee claims for wages and benefits. The Debtor has a Credit Facility with Société Générale and the other financial institutions for which Société Générale serves as Administrative Agent (together, the "Lender"). However, the Debtor and the Lender have negotiated terms for the use of cash collateral. Subject to the Court's approval of such cash collateral terms, the Lender consents to the Debtor's use of cash collateral to pay the prepetition employee wages and benefits at this stage. If both the Lender and the Debtor's professionals consent to the payment of prepetition employee wages and benefits within the statutory priority caps, then no other party should be adversely affected by permitting early payment of such claims rather than waiting for confirmation of a Chapter 11 plan of reorganization. Notably, general unsecured creditors have a priority below the employees and so should not be harmed by a decision at this juncture.

Based upon the foregoing, the Court determines that the Employee Wage Request is appropriate under the facts and warranted under the Bankruptcy Code. *See also Tus-Expo Holdings*, 2008 WL 4857954 \*1 ("absent a question as to whether continuation of its operations is appropriate, prepetition wage and benefit obligations will continue during Chapter 11 to be honored on a timely basis"); *CEI Roofing*, 315 B.R. 50 ("The Code gives employees a statutory priority that elevates the claims above the general unsecured claims... [t]o the extent that the existing holders of claims of higher priority than the wage claims consent or do not timely object, such priority [employee] claims may be made during the pendency of the bankruptcy case.").

#### E. Conclusion and Order.

Based upon the foregoing, the Court ORDERS as follows:

1. The Employee Wage Request is GRANTED provided however that the aggregate amount paid pursuant to the Employee Wage Request shall not exceed \$20,000.
2. All capitalized terms used in this Order, not otherwise defined herein, and unless otherwise indicated, shall have the meaning given them in the Motion.
3. Debtor is authorized to pay, in its sole discretion, the prepetition employee earnings as and when such obligations are due, subject to the priority claim limit set forth in 11 U.S.C. § 507(a)(4).
4. Debtor is authorized to honor and pay, in its sole discretion, the Prepetition Benefit Obligations that were in effect as of the Petition Date, subject to the priority claim limit set forth in 11 U.S.C. § 507(a)(5).
5. Debtor is authorized to continue to maintain the Prepetition Benefit Obligations that were in effect as of the Petition Date.
6. Debtor is authorized, in its sole discretion, (a) to continue to its employment policies, including, but not limited to, paid time off, in the ordinary course of business, and (b) to

pay cash on account of accrued, but unused, paid time off upon termination of an employment relationship in the ordinary course of business and consistent with Debtor's policies.

7. Debtor is authorized to issue new postpetition checks or effect new postpetition fund transfers to pay the Prepetition Benefit Obligations to replace any prepetition checks or fund transfer requests that may be dishonored or rejected.

8. Debtor is authorized to furnish funds to Discovery to pay the Debtor's combined payroll in accordance with this Order.

9. Debtor is authorized to withhold and pay all required and employee-directed deductions, including social security, FICA, federal and state income taxes, garnishments, insurance premiums, retirement fund deferrals, and other types of withholding, whether the withholding relates to the period prior to the Petition Date or after. Any parties receiving payment from Debtor are authorized and directed to rely upon the representations of Debtor as to which payments are authorized by this Order.

10. Nothing in the Motion or this Order or the relief granted (including any actions taken or payments made by Debtor pursuant to the relief shall: (a) be construed as a request for authority to assume any executory contract under 11 U.S.C. § 365; (b) waive, affect or impair any of Debtor's rights, claims or defenses, including, but not limited to, those arising from 11 U.S.C. § 365, other applicable law and any agreement; (c) grant third-party beneficiary status or bestow any additional rights on any third party; or (d) be otherwise enforceable by any third party.

11. Authorizations given to Debtor in this Order permit but do not direct Debtor to effectuate the payments specified herein.

12. Pursuant to Fed. R. Bankr. P. 6003(b), the Court finds that the relief granted in this Order is necessary to avoid immediate and irreparable harm

13. Notwithstanding the possible applicability of Bankruptcy Rules 6004(h), 7062, 9014, or otherwise, the terms and conditions of this Order shall be effective and enforceable upon entry.

14. The Court retains jurisdiction to hear and determine all matters arising from or related to the implementation or interpretation of this Order.

Dated November 9, 2015

BY THE COURT:

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Thomas B. McNamara  
United States Bankruptcy Judge