

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

In re:	)	Chapter 11
	)	
GARDEN RIDGE CORPORATION, et al.	)	Case No. 04-10324(KJC)
	)	(Jointly Administered)
Debtors.	)	

**MEMORANDUM**

**BY: KEVIN J. CAREY, UNITED STATES BANKRUPTCY JUDGE**

Before the Court is the Debtor’s Seventh Omnibus Objection (Substantive) to Administrative and Priority Claims Pursuant to Sections 105 and 502(b) of the Bankruptcy Code and Rules 3001, 3003 and 3007 of the Federal Rules of Bankruptcy Procedure (Docket No. 2042) (“Objection”) and two responses thereto: one filed on behalf of Jane Arbuthnot (“Arbuthnot”)(Docket No. 2062) and another on behalf of Barbara Heim (“Heim”)(Docket No. \_\_\_), both former employees of the Debtor, Garden Ridge Corporation.<sup>1</sup>

The facts concerning each claimant are similar. Heim entered into an employment agreement with the Debtor dated February 26, 2003 (“Heim Agreement”), which was offered in evidence by the Debtor at the claim objection hearing on February 17, 2006. The salient portion of the Heim Agreement provides simply: “In the event of a change of control in the company, or if you are terminated without cause, you will receive a severance equal to one year’s salary [\$220,000 per year at the time of the agreement].” The Debtor does not dispute that Heim was terminated without cause on December 19, 2003, triggering her right to receive severance pay.

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<sup>1</sup>This Memorandum constitutes the findings of fact and conclusion of law, as required by Fed.R.Bankr.P. 7052. The court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334 and § 157. This is a core proceeding pursuant to 28 U.S.C. § 157 (b)(2)(B).

This chapter 11 case was commenced on February 2, 2004.

Arbuthnot entered into an employment agreement with the Debtor “dated effective February 1, 2000” (“Arbuthnot Agreement”), which was attached to her response to the Objection and taken into evidence at the February 17, 2006 hearing. The Arbuthnot Agreement is somewhat more involved than the Heim Agreement, but provides, similarly, that if Arbuthnot’s employment is terminated for any reason other than “for cause,” she is entitled to severance pay equal to her Base Compensation [\$240,000 at the time of her termination] over an 18-month period. The Debtor does not dispute that Arbuthnot was terminated for a reason other than “for cause” on December 3, 2003.

Both Heim and Arbuthnot filed priority claims in the amount of \$4,650 for unpaid severance, under the applicable version of 11 U.S.C. §507(a)(3), which provides, in pertinent part:<sup>2</sup>

(a) The following expenses and claims have priority in the following order:

....

(3) Third, allowed unsecured claims, but only to the extent of \$4,650 for each individual or corporation, as the case may be, earned within 90 days before the date of the filing of the petition or the date of the cessation of the debtor’s business, whichever occurs first, for—

(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual;

The Debtor objects to both priority claims, arguing that since the claimants’ entitlement to severance pay arose at the time of the respective employment agreements, severance was not

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<sup>2</sup>This version was superceded by the Bankruptcy Abuse and Consumer Protection Act of 2005 (Pub.L. No. 109-8)(“BAPCPA”) for cases filed on or after October 17, 2005.

“earned” within the 90-day priority period.<sup>3</sup> In support of its argument, the Debtor cites to decisions concluding that eligibility for severance arises immediately upon signing of an employment agreement. See, In re M Group, Inc., 268 B.R. 896, 901 (Bankr. D.Del. 2001), relying, in part, upon In re My-Pak, Inc., 128 B.R. 763 (Bankr. S.D. Ill. 1991); In re General Information Services, 68 B.R. 419 (Bankr. E.D. Pa. 1986).

A wage priority has been a feature of the bankruptcy law since 1898. 4 Collier on Bankruptcy §507.05[1] (15<sup>th</sup> ed. 2005). Its purpose is to “alleviate hardship on workers....”who may have no other source of income and “to encourage employees to stand by an employer in financial difficulty.” Id. This priority extends to certain other “benefits that are considered akin to compensation, such as vacation, severance and sick leave pay.” Id. Severance serves the same purpose as, and as a substitute for, a wage or salary: to provide income to an employee for a period of time after her employment is terminated.<sup>4</sup>

By entering into the employment agreements at issue, the Debtor incurred contingent

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<sup>3</sup>Merriam-Webster offers the following definitions of “earn”:

1a: to receive as return for effort and especially for work done or services rendered b: to bring in by way of return

2a: to come to be duly worthy of or entitled or suited to b: to make worthy of or obtain for

Merriam-Webster’s Collegiate Dictionary, Tenth Edition, available at <http://www.merriam-webster.com> (accessed Feb. 21, 2006).

Arguably, these definitions could support either view in this dispute.

<sup>4</sup>The claimants here were executives: Heim was Senior Vice President of Human Resources and Arbuthnot, Senior Vice President and Chief Financial Officer. However, so that higher income individuals did not benefit disproportionately over lower income individuals from the §507(a)(3) priority, Congress imposed a cap of \$4,650, thereby eliminating any perceived “windfall” to those entitled, among other compensation, to severance pay. (BAPCPA increased the priority to \$10,000 and expanded the former 507(a)(3) priority period (now 11 U.S.C. §507(a)(4)) to 180 days.)

obligations. The contingencies actually occurred when the Debtor exercised its right to terminate the claimants' respective employment agreements, upon which events the Debtor became obligated to make severance payments. Arbuthnot argues that if the term "earned," as it is used in §507(b)(3), were to be read as urged by the Debtor, an employee would have to be hired and fired within the priority period to be entitled to a priority claim for severance pay.

I conclude that, for purposes of §507(a)(3), this right to receive severance payments was "earned" no earlier than upon termination of employment, which occurred during the 90-day priority period.<sup>5</sup> To treat such claims otherwise invites disparate treatment with the other types of compensation accorded §507(a)(3) priority. An employee's rights to wages, salary, commissions, vacation and sick leave earned during the priority period are protected. An employee's severance right cannot be similarly protected, as Congress apparently intended, if such rights are deemed "earned" when the employment relationship begins, often and, perhaps, almost always, outside of the priority period.

An appropriate Order follows.

Dated: March 2, 2006

BY THE COURT:



KEVIN J. CAREY  
UNITED STATES BANKRUPTCY JUDGE

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<sup>5</sup>Here both claimants' employment was terminated during the 90 days prior to the Debtor's bankruptcy filing. If it is said that severance is "earned" for §507(a)(3) purposes upon such termination, this leaves for another day an answer to the question of what happens if termination occurs outside of the priority period, but payments fall due within it? The answer may depend upon the specific terms of the individual employment agreement involved.

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**ORDER**

**AND NOW**, this 2<sup>nd</sup> day of March, 2006, upon consideration of the Debtor's Seventh Omnibus Objection (Substantive) to Administrative and Priority Claims Pursuant to Sections 105 and 502(b) of the Bankruptcy Code and Rules 3001, 3003 and 3007 of the Federal Rules of Bankruptcy Procedure (Docket No. 2042)("Objection"), the responses thereto, after hearing thereon, and for the reasons expressed in the accompanying Memorandum, it is hereby

**ORDERED and DECREED** that with respect to Claim No. 262 (Jane Arbuthnot) and Claim No. 260 (Barbara Heim), the Objection is **OVERRULED** and these two claims **ALLOWED** as unsecured priority claims in the amount of \$4,650. each.

**BY THE COURT:**



**KEVIN J. CAREY  
UNITED STATES BANKRUPTCY JUDGE**