U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
ENTERED
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TAWANA C. MARSHALL, CLERK
BY _____
Deputy

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS FORT WORTH DIVISION

IN RE:	§	
	§	
KITTY HAWK, INC., et al.	§	
	§	**Case No. 00-42141-BJH-11**
Debtors.	§	**Jointly Administered**
	§	

MEMORANDUM OPINION

This matter came before the Court on November 4, 2002 in connection with the First Omnibus Objection to Certain Unsecured Priority Claims and Amended First Omnibus Objection to Proofs of Claim Filed by Current and Former Employees (the "Objection") filed by Kitty Hawk, Inc. ("Kitty Hawk"). This Court has jurisdiction over Kitty Hawk's case pursuant to 28 U.S.C. §§ 1334 and 157. Claims objections are core proceedings in accordance with 28 U.S.C. § 157.

The Court took one claim under advisement (the claim of Kevin Warner ("Warner")) and disposed of or re-set all other claim objections addressed in the Objection.[1] Appearing before the Court on the Warner claim objection were counsel for Kitty Hawk and counsel for Warner. By agreement, Warner participated in the hearing telephonically. After reviewing the pleadings, evidence, and arguments of counsel, this Court issues this Memorandum Opinion which constitutes its findings of fact and conclusions of law in accordance with Federal Rule of Civil Procedure 52, made applicable here by Federal Rule of Bankruptcy Procedure 7052.

For the reasons explained more fully below, the Court concludes that Warner is entitled to

[1] Counsel for Kitty Hawk agreed at the hearing that the Court's ruling with respect to the Warner claim would also apply to Kitty Hawk's objection to Claim No. 102 filed by Jim Brehm in the amount of $1,460.00. Accordingly, this Memorandum Opinion disposes of that objection as well.

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a priority claim against Kitty Hawk for $4,300.00 of his prepetition wages in accordance with § 507(a)(3)(A) of the Bankruptcy Code.

I. Preliminary Statement

Kitty Hawk filed its bankruptcy case on May 1, 2000 along with various of its affiliates. A plan of reorganization was confirmed for the affiliated debtors on August 5, 2002. On October 2, 2002, Kitty Hawk filed the Objection. On October 30, 2002, Warner responded to the Objection, reasserting his entitlement to a wage priority claim in accordance with § 507(a)(3)(A) of the Bankruptcy Code.

Warner filed a claim in the amount of $4,711.39 for unpaid compensation from March 30, 2000 through April 30, 2000 and requested that $4,300.00 be granted priority under § 507(a)(3)(A). Kitty Hawk objects to Warner's claim and asserts that Warner holds a general unsecured claim and not a priority claim for wages. The parties dispute whether Warner operated in a role equivalent to that of an employee or whether he was an independent contractor and, according to Kitty Hawk, not entitled to a wage priority claim in Kitty Hawk's case.

II. Factual Background

Warner is an aircraft mechanic. As relevant here, he performed aircraft mechanic services for Kitty Hawk both pre- and post-petition at the Seattle-Tacoma International Airport between February and August of 2000. Prior to Kitty Hawk's bankruptcy filing, Warner testified that his title was "contract aircraft mechanic." For whatever reason, after Kitty Hawk's bankruptcy filing he became a formal Kitty Hawk employee.[2]

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[2]Kitty Hawk agrees that Warner was its "employee" post-petition, but asserts that his independent contractor status prepetition precludes his entitlement to a prepetition wage priority claim. No one could explain why Warner became an "employee" of Kitty Hawk after its bankruptcy filing.

Prior to its bankruptcy filing, Warner testified that he was paid by Kitty Hawk on an hourly basis and was directed by Kitty Hawk to work the "graveyard" shift from 10:00 p.m. to 6:00 a.m. Warner further testified that Kitty Hawk also directed him to sometimes work on Saturdays from noon until 5:00 or 6:00 p.m. According to Warner, while he was on duty he would dock the aircraft, make sure it was airworthy, and prepare it for its subsequent departure. If no planes required service, Warner testified that Kitty Hawk directed that he perform other tasks while he was on duty, such as cleaning up the mechanics' work station provided by Kitty Hawk. Warner reported his hours to Kitty Hawk on a "Contractors Weekly Timesheet," and he was paid for the hours set forth on that timesheet irrespective of whether he was servicing aircraft for his entire shift.

Warner also testified that Greg Craig, one of Kitty Hawk's employees in the Seattle area, supervised him. Warner testified that Kitty Hawk provided him with tools to use on the job, a Kitty Hawk uniform, and a Kitty Hawk security pass. The security pass allowed Warner to enter the airport and access the tarmac and was the only pass needed by Warner to report to duty.

Finally, Warner testified that with one exception, nothing changed after Kitty Hawk filed for bankruptcy. His duties remained precisely the same. However, prior to the petition date, Kitty Hawk reported Warner's income to the IRS on a form 1099. After its bankruptcy filing, Kitty Hawk reported Warner's income on a W-2 statement. As noted previously, Kitty Hawk was unable to explain why it changed its method of reporting Warner's wages after filing for bankruptcy. Warner could offer no explanation either. However, Warner did testify that some of his co-workers, who performed the same duties he did, received W-2s from Kitty Hawk both prior to, and after, the bankruptcy filing.

III. Legal Analysis

The parties agree that the sole issue before the Court is whether Warner's claim fits within the category of priority claims allowed under § 507(a)(3)(A) of the Bankruptcy Code. Initially, the Court thought it might have to decide an interesting, and apparently unresolved, question. When Congress used the language "individual" in § 507(a)(3)(A) of the Code, did it intend that provision to encompass more than "employees" of the debtor? However, for the reasons explained below, the Court can decide this case more narrowly.

At the outset, the Court notes that priorities are to be narrowly construed. *See United States v. Embassy Rest., Inc.*, 359 U.S. 29, 35-36 (1959); *In re Quality Beverage Co., Inc.*, 181 B.R. 887, 896 (Bankr. S.D. Tex. 1995); 4 COLLIER ON BANKRUPTCY ¶ 507.01. While wage priority has been included in the bankruptcy statutes since the original enactment of the Bankruptcy Act in 1898, its "history . . . is one of continuous congressional expansion." *United States v. Embassy Rest., Inc.*, 359 U.S. 29, 35-36 (1959) (J. Black, dissent). The claimant asserting wage priority bears the burden of establishing the priority claim and must fit squarely within the statutory requirements to achieve priority status. *See In re Quality Beverage Co., Inc.*, 181 B.R. 887, 896 (Bankr. S.D. Tex. 1995); 4 COLLIER ON BANKRUPTCY ¶ 507.05[1]. "In construction of Code provisions relating to wage priorities courts have liberally construed the statutes to accord the possible intent of Congress by giving broad meaning to the provisions of the Code as to relate to the facts rather than narrow restrictive meanings." *In re Seventh Ave. South, Inc.*, 10 B.R. 289, 291 (Bankr. W.D. Va. 1981).

Based on the Court's research, most courts have held that to fall within the § 507(a)(3) priority, an employer/employee (or master/servant) relationship must exist between the debtor and the claimant. *See, e.g., In re Hutchinson*, 223 B.R. 586, 588 (Bankr. M.D. Fla. 1998) ("key

distinction entitling claimants to priority pursuant to § 507(a)(3) is whether claimants are truly engaged in a master/servant relationship versus those who are engaged in a contractual relationship"); *In re Grant Indus., Inc.*, 133 B.R. 514, 515 (Bankr. W.D. Mo. 1991) (key distinction is master-servant versus contractual relationship); *In re Am. Shelter Sys., Inc.*, 40 B.R. 793, 794 (Bankr. W.D. La. 1984) (holding that independent contractor salesman not entitled to priority, and that "[§ 507(a)(3)] was intended to cover employees within a master-servant relationship"); *In re Saint Joseph's Hosp.*, 126 B.R. 37, 42 (Bankr. E.D. Pa. 1991) (dentist not entitled to priority because debtor had no right to control or direct the dentist); *In re Kasson, Inc.*, 109 B.R. 352, 354 (Bankr. E.D. Wis. 1989) ("degree of control necessary for an employer-employee relationship between the debtor and the milk suppliers was lacking"); *In re Alroco, Inc.*, 92 B.R. 523, 525 (Bankr. M.D. Fla. 1988) (claim not entitled to priority because the claimant was contracting with debtor as an independent contractor).

Only one reported Bankruptcy Code case grants wage priority to independent contractors who performed "services" for the debtor – *i.e.*, *In re Wang Laboratories, Inc.*, 164 B.R. 404 (Bankr. D. Mass. 1994). In that case, the parties did not dispute that the claimants were independent contractors, *see id.* at 405, and the bankruptcy court held that "a fair reading [of § 507(a)(3)] is that independent contractors are included in the preferred class . . . ." 164 B.R. at 407.

However, according to the House Report, subsection (a)(3)(B) was added to the statute as part of the Bankruptcy Reform Act of 1994 to codify *Wang* and clarify "that *independent sales representatives* of a bankrupt debtor are entitled to the same priority as the employees of the debtor . . . ." H.R. REP. NO. 835, 103rd Cong., 2nd Sess. (1994) (emphasis added). Thus, the extent to which other types of "independent contractors" now fall within § 507(a)(3)(A) is unclear.

Moreover, a review of the bankruptcy treatises sheds little light on this question. For example, the discussion of § 507(a)(3) in COLLIER ON BANKRUPTCY, ¶ 507.01-.05, talks in terms of employees of the debtor, without specifically addressing the extent to which independent contractors may be able to fit within the § 507(a)(3)(A) priority.

However, the Court notes that Congress knew how to say employee in the Code when it intended to, *see e.g.*, § 507(a)(4), and the arguably broader language "individual" in § 507(a)(3)(A) may have significance. While interesting, the Court does not have to wrestle this issue to the ground here. Rather, the Court concludes that Warner's prepetition relationship with Kitty Hawk had sufficient earmarks of an employee/employer relationship to entitle him to a priority claim in accordance with § 507(a)(3)(A). Thus, the Court sustains Warner's alternative contention that for purposes of allowing him a § 507(a)(3)(A) claim, Warner should be treated like a Kitty Hawk employee.

To determine if Warner is entitled to be treated as an "employee" of Kitty Hawk for purposes of his prepetition claim for wages, this Court must look to applicable state law. *See, e.g.*, *In re Saint Joseph's Hosp.*, 126 B.R. 37, 41-42 (looking to Pennsylvania law to determine if dentist was employee); *In re Kasson, Inc.*, 109 B.R. 352, 353-54 (Bankr. E.D. Wis. 1989) (looking to Wisconsin law to determine if milk suppliers earned wages); *In re Dahlman Truck Lines, Inc.*, 59 B.R. 218, 220 (Bankr. W.D. Wis. 1986) (looking to Wisconsin law to determine if one corporation's employees were actually Debtor's employees). While Warner's counsel did not argue to the Court which state's law – Texas or Washington – applied, Warner's relationship with Kitty Hawk would qualify as an employee/employer relationship under either Texas or Washington law.

The law in both states is substantially similar. First, whether an individual is an independent

contractor or an employee depends on the facts and circumstances of each case. *See Keith v. Blanscett*, 450 S.W.2d 124, 128 (Tex. Civ. App. – El Paso 1969); *Chapman v. Black*, 741 P.2d 998, 1001-02 (Wa. Ct. App. 1987). The ultimate test in determining whether a relationship is that of an employee/employer is whether the employer had the right to control the manner and means of doing the work. *See Ross v. Texas One P'ship*, 796 S.W.2d 206 (Tex. App. – Dallas 1990, writ denied); *DeWater v. State*, 921 P.2d 1059 (Wa. 1996) (citing *Cassidy v. Peters*, 309 P.2d 767 (Wa. 1957)). While the method of payment is considered, it is not a controlling factor, *Ross*, 796 S.W.2d at 210-11; *Cassidy*, 309 P.2d at 770. Other factors, such as the employer's furnishment of tools, supplies, and necessary equipment, the employer's setting of the work schedule, and the employer's direction as to the details of the work are also considered. *See Thompson v. Travelers Indem. Co. of R.I.*, 789 S.W.2d 277, 278-79 (Tex. 1990); *Chapman v. Black*, 741 P.2d 998, 1001-02 (Wa. Ct. App. 1987). Nevertheless, the "crucial factor" and the "primary test" is the employer's right to control. *See Ross*, 796 S.W.2d at 210; *Chapman,* 741 P.2d at 1002.

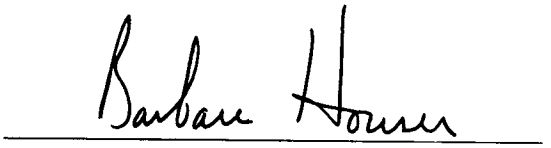
This record contains substantial evidence that Kitty Hawk exerted the necessary right to control Warner's work. The relationship between Kitty Hawk and Warner exhibits substantially all of the earmarks of an employer/employee relationship. Kitty Hawk told Warner when to work and what duties he was to perform while on duty. Greg Craig, an admitted Kitty Hawk employee, supervised Warner's work. Kitty Hawk provided Warner with the necessary tools and equipment to perform maintenance on the aircraft. Kitty Hawk also provided Warner, and the other mechanics, with a work station. Additionally, Kitty Hawk provided Warner with a Kitty Hawk uniform and the security pass needed for Warner to enter the airport and access the tarmac. Warner was paid hourly based on timesheets that he furnished to Kitty Hawk.

While Warner received a 1099 instead of a W-2 prior to the bankruptcy filing, Kitty Hawk did not explain why other aircraft mechanics performing the same duties as Warner received W-2s while he did not. Moreover, after the bankruptcy filing, Warner continued to perform the same duties but Kitty Hawk provided him with a W-2.

For these reasons, the Court concludes that under either Texas or Washington law, Warner's relationship with Kitty Hawk was equivalent to that of an employee/employer relationship. Thus, for purposes of § 507(a)(3)(A), Warner is entitled to a priority claim against Kitty Hawk for $4,300.00 of his prepetition wages.

An order consistent with this Memorandum Opinion will be entered separately.

DATED: November 26, 2002.



Barbara J. Houser
United States Bankruptcy Judge

U.S. Bankruptcy Court

Northern District of Texas
1100 Commerce Street, Room 1254
Dallas, Texas 75242-1496
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Barbara J. Houser
United States Bankruptcy Judge

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