

What Happens to My Unpaid Wages if My Employer Files for Bankruptcy?

Creditor's Rights Toolkit

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This article will discuss what happens to unpaid wages when an employer files for bankruptcy.

When a company files for bankruptcy, it can be an unsettling time for the company's employees, who may worry about job and financial security, including unpaid wages and employee benefits. Though these concerns are legitimate, the Bankruptcy Code and bankruptcy process provide some protection to employees in certain circumstances.

KEY ISSUES FOR EMPLOYEES IN CHAPTER 7 AND CHAPTER 11 CASES

CHAPTER 7 BANKRUPTCY

In Chapter 7 bankruptcy cases, a company must be liquidated and all employees will therefore be laid off. If, as of the bankruptcy filing date, an employee is still owed wages and other benefits, the employee may file a claim against the company. Apart from the opportunity to file a claim for unpaid wages and benefits, which may be entitled to priority (discussed below), an employee will not receive other special protections under the Bankruptcy Code.

CHAPTER 11 BANKRUPTCY

In Chapter 11 bankruptcy cases, the company remains in business as it proceeds through bankruptcy. As the company reorganizes in Chapter 11, it will determine which employees to keep and which to lay off. Often, at the start of the case, the company will file what is referred to as a "wages motion," seeking authority to continue paying employee wages and other benefits in the ordinary course of business while the company is in bankruptcy and to pay prepetition amounts owed to employees necessary to maintain operations. Notably, even if a wages motion is not filed, wages and benefits earned after a bankruptcy case has been filed still will be entitled to administrative expense status. On the other hand, if an employee already has been laid off when the company files for Chapter 11 bankruptcy, it is afforded the same protection as employees in a Chapter 7 bankruptcy — the employee may file a claim against the company and such claim may be entitled to priority.

PRIORITY TREATMENT

In both Chapter 7 and Chapter 11 bankruptcies, certain claims for unpaid wages and benefits are entitled to

priority treatment. A claim entitled to priority will be paid after secured claims are paid but before general unsecured claims receive a distribution. Under Section 507(a)(4) of the Bankruptcy Code, wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual, *up to \$17,150 in the aggregate*, are entitled to priority, *so long as the wages, salaries, or commissions are earned within 180 days before the date of filing for bankruptcy or the cessation of the business.*¹ An employee must show that the unpaid wages and benefits falls within the parameters (i.e., earned within 180 days and not exceeding the cap), but this provision in the Bankruptcy Code offers important protections to employees. Unpaid wages and benefits exceeding the monetary cap or earned outside the 180-day period will not be entitled to priority and instead be classified as a nonpriority general unsecured claim. Section 507(a)(5) of the Bankruptcy Code also provides priority status to certain claims for contributions to an employee benefit plan, so long as certain other conditions have been met.

WARN CLAIMS

In certain circumstances, federal law requires companies to provide advance notice of certain events to its employees, such as a mass layoff or a closing. If the company violates these requirements, the affected employees may be entitled to file a claim against the company in the bankruptcy.

TAKEAWAY

Employees of a bankrupt company may have to wade through numerous complex issues throughout a bankruptcy case. While the Bankruptcy Code offers some protection to employees and the company may secure court approval to pay certain employee obligations, employees must remain vigilant to ensure they place themselves in the best position to get paid. Particularly when they have substantial or contract-based claims, employees should consult legal counsel as soon as they become aware a company will or has filed for bankruptcy to ensure their rights are adequately protected.

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¹ As of April 2025. Amount changes yearly.

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