

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

C.G.C. Stores, Inc.

Case No. 87-516-D

Debtor.

Chapter 11

ORDER ON APPLICATION FOR PAYMENT OF ADMINISTRATIVE
CLAIM PURSUANT TO 11 U.S.C. SECTION 503

On April 20, 1988 a hearing on application for payment of section 503 administrative claim filed on behalf of First National Bank of Muscatine, Iowa (Bank) and objections thereto filed on behalf of the debtor, the unsecured creditors committee (committee) and the United States Trustee was held before this court in Davenport, Iowa. Scott A. Young appeared on behalf of the Bank, John M. Titler appeared on behalf of the debtor, Steve L. Nelson appeared on behalf of the committee and Terry L. Gibson appeared on behalf of the U.S. Trustee. At the close of the hearing the parties were given a deadline by which to submit briefs. The matter was considered fully submitted on May 4, 1988.

Factual Background

The debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code on February 27, 1987. The Bank is the major secured creditor holding a "broad brush" security interest in the assets of the debtor. On February 9, 1988 the Bank filed a secured proof of claim in the amount of

\$647,635.48 which includes principal and interest to the date of filing, overdrafts and attorney fees. On February 26, 1988 the Bank filed an application for payment of administrative claim pursuant to 11 U.S.C. section 503(b)(1)(A) seeking the sum of \$54,187.20 for attorney fees and \$3,868.44 for expenses for the period of January 21, 1987 through April 22, 1987. At the time of the April 20, 1988 hearing the Bank submitted an amended statement of fees and expenses and thus now seeks \$42,305.60 for attorney fees and \$3,868.44 for expenses.

The Bank's application states that the Bank retained the law firm of Stanley, Rehling & Lande to represent it in connection with the debtor's financial difficulties. On February 2, 1987 the Bank filed suit in Muscatine County District Court for the appointment of a receiver for the debtor pursuant to Iowa Code Chapter 680. The Wilton Savings Bank was appointed the permanent receiver for the debtor on February 19, 1987. After the filing of the petition in bankruptcy the Bank took steps in conjunction with an officer/shareholder of the debtor to secure the appointment of an independent trustee. A joint stipulation for the appointment of Dennis Fossey as trustee was filed on March 5, 1987 by the debtor and the Bank. This court granted the application for appointment on April 22, 1987. The Bank contends that the above actions made a substantial contribution to the preservation of the assets of the debtor and have been a mutual benefit to all parties in interest.

The debtor filed an objection to the Bank's application for administrative claim on March 11, 1988. The debtor asserts that the claim is not allowable under 11 U.S.C. section 503 for the reason that the state court action filed by the Bank was for the purpose of liquidation of the debtor's assets and not for the preservation of the estate and the benefit of all creditors.

The unsecured creditors committee filed a resistance to the Bank's application for payment of administrative claim on March 24, 1988. The committee asserts that the fees and expenses for services performed prior to the commencement of the case do not qualify as an administrative expense under section 503(b)(1)(A). The committee further contends that the postpetition fees and expenses were not actual and necessary to preserve the estate but rather were incurred to protect the Bank's own interest.

The U.S. Trustee also filed an objection to the Bank's application on March 24, 1988. The U.S. Trustee likewise contends that prepetition attorney fees and expenses are not allowable under section 503(b)(1)(A). Moreover, the U.S. Trustee asserts that neither pre nor post petition fees and expenses were necessary to the preservation of the debtor's estate.

Analysis

Section 503 of the Bankruptcy Code governs administrative expenses allowable in a bankruptcy case. Section 503(b) provides in pertinent part:

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--

(1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case:
....

(3) the actual, necessary expenses., other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by--

(A) a creditor that files a petition under section 303 of this title;

(B) a creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor;

(C) a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor;

(D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title; or

(E) a custodian superseded under section 543 of this title, and compensation for the services of such custodian;

(4) reasonable compensation for professional services rendered by an attorney or an accountant of an

entity whose expense is allowable under paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant;

While the Bank's application specifically refers only to section 503(b)(1)(A), the language used by the Bank in support of its argument for administrative expense status reveals that section 503(b)(3)(D) and 503(b)(4) are also intended as applicable authority. Accordingly, the court will analyze the Bank's application for payment of administrative claim under each of the above provisions.

Section 503(b)(1)(A) allows administrative expense status to "actual, necessary costs and expenses of preserving the estate ... for services rendered after the commencement of the case." The policy underlying section 503(b) has been stated as follows:

Congress granted priority to administrative expenses in order to facilitate the efforts of the trustee or debtor in possession to rehabilitate the business for the benefit of all the estate's creditors. Congress reasoned that unless the debts incurred by the debtor in possession could be given priority over the debts which forced the estate into bankruptcy in the first place, persons would not do business with the debtor in possession, which would inhibit rehabilitation of the business and thus harm the creditors. (citations omitted)

Trustee of Amalgamated Ins. Fund v. McFarlin's, 789 F.2d 98, 101 (2nd Cir. 1986); See also, In re Mammoth Mart, Inc., 536

F.2d 950, 953 (1st (Cir. 1976); Matter of Jartra , Inc., 732 F.2d 584, 586 (7th (Cir. 1984)). However, since priority status allows one claimant to be preferred over others it should not be afforded unless it is founded upon a clear statutory purpose. Matter of Jartran, Inc., 732 F.2d at 586. A two part test has been established for determining whether a debt should be afforded administrative priority. First, the debt must arise from a transaction between the creditor and the debtor-in-possession as opposed to the preceding entity and, second, the debt must have directly and substantially benefitted the estate. In re Mammoth Mart, Inc., 732 F.2d at 954.

Application of the above standards to the Bank's application reveals that the requested fees and expenses are not allowable as administrative expenses under section 503(b)(1)(A). The services incident to the appointment of the state court receiver were performed prior to the commencement of the case. Moreover, the services performed postpetition in conjunction with the appointment of a trustee do not fall within the type envisioned by Congress as necessary to the operation and rehabilitation of the debtor's business. The court finds that the Bank's application for payment of administrative expense is more appropriately considered under section 503(b)(3) and (4).

Sections 503(b)(3) and (4) allow creditors and their attorneys to recover fees and expenses as an administrative expense to the extent that they satisfy the statutory

requirement. Pursuant to section 503(b)(3)(D) a creditor can be compensated for services which are of substantial benefit to the debtor's estate. The language of this section also permits the court to allow as administrative expenses certain qualifying pre-petition expenses. In re Valley Isle Broadcasting, Ltd., 56 B.R. 505, 506 (Bankr. D. Hawaii 1985). The underlying policy for allowing such compensation is the promotion of creditor participation in the reorganization process. In re Ace Finance Co., 69 B.R. 827, 829 (Bankr. N.D. Ohio 1987). However, since an administrative expense constitutes a priority claim, any recovery must be subject to strict scrutiny by the court. Matter of Patch Graphics, 58 B.R. 743, 745 (Bankr. W.D. Wis. 1986).

The party seeking an administrative claim has the burden of proving its entitlement thereto. The courts consider two factors in deciding whether to allow an administrative expense. First, the expense in question must be shown to have been "actual and necessary." Second, the expense must not have been incurred primarily in the interest of the claimant but must in fact have benefitted the estate and creditors as a whole. Matter of Patch Graphics, 58 B.R. at 745.

The Bank's application for payment of administrative claim for services performed prepetition incident to the appointment of a receiver does not satisfy the above requirements. The Bank's argument that its actions in securing a state court receiver were beneficial to the estate is not

persuasive. Clearly, the Bank's motivation for instituting such action was for its own protection as a major secured creditor. Moreover, no evidence was presented to establish that the state court receivership was successful in increasing the value of the estate. Indeed, more convincing testimony established that the debtor's business was improperly managed by the receiver. This court views the Bank's prepetition services as akin to an attempted nonbankruptcy workout. Such services do not give rise to a claim for compensation from the estate. In re Valley Isle Broadcasting, Ltd., 56 B.R. 505, 507 (Bankr. D. Hawaii 1985); In re Jensen-Furley Pictures, Inc., 47 B.R. 557, 569 (Bankr. D. Utah 1985).

The Bank's application for payment of administrative claim for services performed postpetition incident to the joint application and subsequent appointment of a trustee is somewhat more compelling. The court, at this juncture, believes that the appointment of a trustee has made a substantial contribution to this bankruptcy case. However, the Bank's actual role in securing the appointment of the trustee has not been clearly established. The evidence revealed that after the filing of the petition the Bank met with an officer of the debtor and the debtor's attorney to discuss the validity of the corporate filing and the use of cash collateral as well as the appointment of a trustee. Clearly, the debtor's use of the Bank's cash collateral was conditioned upon the appointment of the trustee. The debtor

and the Bank thereafter filed a joint application for appointment of a trustee.

While the court believes that the Bank's efforts in obtaining the appointment of a trustee are the type of efforts any secured creditor might pursue to protect their interest, in this case those efforts were successful and have resulted in the continued operation of the debtor's business. It is not apparent whether a trustee would have been considered absent the insistence of the Bank. Accordingly, the court will allow compensation for services expended in connection with the appointment of the trustee. However, the court must guard against compensating duplicative efforts. See In re Paolino, 71 B.R. 576, 580 (Bankr. E.D. Pa. 1987). The debtors as well as the proposed trustee were instrumental in the negotiation and resolution of the trustee's appointment. Certainly, compensation for the efforts has been requested in separate applications. Therefore, the court will allow the Bank 50 percent of the fees and expenses found to be reasonable and in connection with the trustee's appointment.

Section 503(b)(4) allows compensation for professional services rendered on behalf of a creditor who has made a substantial contribution to a case. The compensation must be "reasonable" and "based on the time, the nature, the extent, and the value of such services". This standard integrates the standards of 11 U.S.C. section 330(a)(1) applicable to professional services rendered to the trustee

(or debtor in possession) and for which compensation is sought. 3 Collier on Bankruptcy, ¶ 503.04[4] at 503-51 (15th ed. 1987). Accordingly, the reasonableness of an application for payment of administrative expense for compensation of professional services rendered by an attorney to a creditor shall be judged by the standards applicable to applications for attorney fees under section 330.

This court has enunciated the applicable guidelines for review of attorney's applications for fees and expenses in Matter of Pothoven, et al., 84 B.R. 579 (Bankr. S.D. Iowa 1988). The Bank has submitted an itemization of services rendered and expenses incurred for the period of January 21, 1987 through April 22, 1987. As noted previously, services rendered prepetition in conjunction with the appointment of a state court receiver will not be allowed as an administrative expense. Services rendered in conjunction with the appointment of the Trustee in bankruptcy will be allowed but reduced by 50 percent to prevent duplication.

The itemization of services, on the whole, lacks the detail generally required for a determination of reasonableness. See In re Johnson, 72 B.R. 115, 119 (Bankr. E.D. N.C. 1987). Many entries contain little or no explanation of the nature., extent or necessity of the services. Indeed, determining which services were performed in conjunction with the appointment of a trustee is very difficult. From pages 6 through 10 of the Bank's Exhibit No. 3 the court has found

services which appear to relate to the Bank's involvement in securing the appointment of a trustee. Only those services that are sufficiently documented will be allowed. The court will not engage in guesswork or undertake extensive labor to justify a fee for attorneys that have not met their burden of establishing the reasonableness of this request. After consideration of the Bank's itemization the court finds that \$4,413.00 in fees are properly associated with the Bank's efforts in obtaining the appointment of the trustee.¹ The Bank's itemization for expenses contained within Exhibit No. 3 contains no information from which this court can determine the expenses that were actual and necessary in conjunction with the appointment of the trustee. Accordingly, no allowance will be given for the requested expenses.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the court hereby finds that the First National Bank of Muscatine, Iowa has made some substantial contribution to this case so as to warrant reasonable compensation for services rendered.

¹ The allowed amount reflects the sum for relevant services rendered on the following dates: 3-1-87 (\$495.00); 3-2-87 (\$135.00); 3-2-87 (\$748.00); 3-2-87 (\$561.00); 3-3-87 (\$663.00); 3-4-87 (\$40.00); 3-11-87 (\$306.00); 3-13-87 (\$30.00); 3-13-87 (\$72.80); 3-17-87 (\$187.00); 3-20-87 (\$342.00); 3-20-87 (\$195.00); 3-24-87 (\$51.00); 4-15-87 (\$17.00); 4-20-87 (\$36.00); 4-21-87 (\$60.00); 4-21-87 (\$135.00); 4-22-87 (\$340.00).

THERTFORE, the application for payment of administrative claim pursuant to 11 U.S.C. section,503 filed on behalf of the First National Bank of Muscatine, Iowa is granted in the amount of \$2,206.50.

Signed and filed this 7th day of June, 1988.

LEE M. JACKWIG
CHIEF U.S. BANKRUPTCY JUDGE