UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

In re:

	Case No.
Robb & Stucky	8:11-bk-02801-CED
Limited, LLLP,	Chapter 11

Debtor.
_____/

ORDER DISALLOWING APPLICATION OF CLIVE LUBNER FOR PAYMENT OF ADMINISTRATIVE EXPENSE (Doc. No. 595)

In this Chapter 11 case, the Debtor's former chief executive officer seeks the allowance of an administrative expense claim for severance benefits arising from the post-petition termination of his pre-petition employment agreement. The Bankruptcy Code and applicable case law do not accord administrative priority to severance pay arising out of a pre-petition employment agreement merely because the employee remained employed post-petition. Under the facts presented by this case, the Court will disallow the application for payment of administrative expense.

Facts and Background

The Debtor filed a Chapter 11 case on February 18, 2011, and has continued operating as a debtor in possession. As of the petition date, Clive Lubner ("Lubner") was employed by the Debtor as its chief executive officer pursuant to an employment agreement dated October 27, 2009 (the "Employment Agreement"). Paragraph 9 of the Employment Agreement provides that if Lubner is terminated without cause, the Debtor shall pay him severance in an amount equal to two years of his then current base salary, and continue to provide him with certain medical, life and disability benefits for two years after the date of termination.

Also on the petition date, the Debtor filed an Application to Employ FTI Consulting, Inc., to provide restructuring management services, and to employ Kevin Regan as its chief restructuring officer (Doc. No. 9) (the "Regan Application"). The Regan Application disclosed that Kevin Regan had been employed as chief restructuring officer by the Debtor effective in October 2010, and that FTI Consulting, Inc., had been paid a total of $547,615 during the 90 days prior to the petition date, including a $200,000 retainer paid immediately prior to the petition date. On February 24, 2011, the Court entered an interim order approving the Regan Application. (Doc. No. 81.)

In addition, again on the petition date, the Debtor filed an emergency motion seeking approval of procedures in connection with the sale of all or substantially all of its assets and authorization to enter into a stalking horse agreement with Hudson Capital Partners, LLC, and HYPERAMS, LLC (Doc. No. 33) (the "Sale Motion"). The Court granted the Sale Motion by order entered on February 23, 2011. (Doc. No. 64.) An auction was held on March 7, 2011, at which Hudson Capital Partners, LLC, and HYPERAMS, LLC, were the successful bidders and were selected as the Debtor's agents to conduct a going out of business sale commencing on the first day after the entry of the order approving the agency agreement, which order was entered on March 9, 2011. (Doc. No. 192.)

On March 11, 2011, just three weeks after the petition date, the Debtor terminated Lubner's employment. The Debtor rejected the Employment Agreement effective March 11, 2011. (Doc. No. 483.) Lubner did not object to the rejection. (Doc. No. 554.) On June 2, 2011, the Court entered an order awarding Lubner his post-petition salary and benefits for the period that he was employed by the Debtor-in-Possession. (Doc. No. 661.)

Lubner filed an Application for Payment of Administrative Expense (Doc. No. 595) (the "Application"). The Debtor objected to the Application. (Doc. No. 684.) The Application was set for hearing on June 7, 2011, at which time the Court heard the arguments of counsel and took the matter under advisement.

Summary of Arguments

Lubner asserts entitlement to nearly $1.3 million of severance pay as an administrative claim pursuant to 11 U.S.C. § 503(b)(1).[1] The Debtor argues that Lubner is not entitled to the requested severance pay as an administrative expense because the Debtor's termination and subsequent rejection of the Employment Agreement constitutes a pre-petition breach, thereby causing Lubner's claim to be treated as a general unsecured claim in the limited amount provided for in section 502(b)(7).

The question before the Court is whether Lubner is entitled to an administrative expense for his severance

[1] Unless otherwise stated, all statutory references are to the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq*.

claim. This determination is a core proceeding, and the Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(b)(2)(A) and 1334. As explained below, the Court finds that Lubner is not entitled to an administrative expense.

Analysis

1. Severance benefit is a pre-petition claim.

The Employment Agreement was entered into prior to the Debtor's bankruptcy, and its terms became effective immediately. As a result, Lubner earned his severance pay when he entered into the contract. *In re Phones for All, Inc.*, 288 F.3d 730, 732 (5th Cir. 2002). In other words, at the time he executed the Employment Agreement, Lubner acquired contingent pre-petition rights, which would be triggered upon the occurrence of the contingency, i.e., his termination. The fact that Lubner's termination occurred post-petition does not alter the fact that the Debtor's liability for Lubner's severance compensation arises from the pre-petition act of entering into the Employment Agreement. *See In re Phones for All, Inc.*, 249 B.R. 426 (Bankr. N.D. Tex. 2000); *In re FBI Distribution Corp.*, 330 F.3d 36, 46 (1st Cir. 2003) (holding that a terminated employee's claim for severance pay based on pre-petition employment agreement was not entitled to an administrative expense despite fact that termination occurred post-petition); *In re Commercial Financial Services, Inc.*, 246 F.3d 1291, 1294-95 (10th Cir. 2001) (same). A debt is not entitled to priority solely because the right to payment occurs within the post-petition period. *Isaac v. Temex Energy, Inc. (In re Amarex, Inc.)*, 853 F.2d 1526, 1530 (10th Cir. 1988); *In re Commercial Financial Services, Inc.*, 246 F.3d at 1295 ("[i]n determining administrative priority, courts look to 'when the acts giving rise to a liability took place, not when they accrued'") (internal citations omitted).

In order for the Court to treat Lubner's claim for severance pay as an administrative expense, the liability must have occurred post-petition as part of a transaction with the Debtor-in-Possession. *In re Commercial Financial Services, Inc.*, 246 F.3d at 1294; *In re Phones for All, Inc.*, 288 F.3d at 732 (employee must reconfirm or renegotiate post-petition any severance packages he may have if he continues to work for the debtor in order to obtain priority administrative expense status). Here, however, the Debtor's liability for Lubner's severance pay did not arise post-petition, but rather pre-petition upon the execution of the Employment Agreement. It is simply not enough that the right to payment arose post-petition. Therefore, Lubner's right to severance pay cannot be afforded priority as an administrative expense.

The Court acknowledges that a contrary result was reached by the court in *In re Miami General Hospital, Inc.*, 89 B.R. 980 (Bankr. S.D. Fla. 1988). However, *Miami General Hospital* is distinguishable on the law and on the facts. *Miami General Hospital* holds that there are two types of severance pay: (i) pay at termination in lieu of notice; and (ii) pay at termination based on length of employment. *Id.* at 984 (citing *Matter of Health Maintenance Foundation*, 680 F.2d 619, 621 (9th Cir. 1982)). The court in *Health Maintenance Foundation*, in turn, cited *In re Public Ledger*, 161 F.2d 762 (3d Cir. 1947), for this proposition, reading *Public Ledger* as holding that the first type of severance pay "appears to be entitled to priority payment as a cost of administration." 680 F.2d at 621. This statement appears to be the basis on which the *Miami General Hospital* court determined that the terminated employee was entitled to severance pay as an administrative expense.

The decision in *Public Ledger* pre-dates the enactment of the Bankruptcy Code, and the court, in determining whether severance pay was entitled to priority as costs of administration, equated the employees' continued post-petition employment with an assumption of their contracts. 161 F.2d at 771 ("At any rate the trustees' action in assuming the contract obligations was taken in good faith and according to their best judgment and must be held to have been a necessary expense in administering the estate and is entitled to priority as an administration expense.") (emphasis supplied). It appears from this statement that *Public Ledger's* holding that the severance pay was entitled to administrative priority was based on an implied finding that the contracts had been assumed.

The Bankruptcy Code does not permit such an implied finding, as section 365(a) requires express court approval for the assumption or rejection of executory contracts. Furthermore, the *Public Ledger* holding is simply inapplicable to the instant case because Lubner's employment agreement was rejected—not assumed. (Doc. No. 483). Therefore, the Court declines to follow *Miami General Hospital* as the authority on which it relies may no longer be good law, and, in any event, is inapposite to the instant case.[2]

[2] Other authority cited in *Miami General Hospital* comes from the Second Circuit Court of Appeals, which espouses the minority view that where employment is terminated as an incident of administration of the estate, severance pay is an expense of the administration and is thus entitled to priority as such an expense. 89 B.R. at 985 (citing *Straus-Duparquet, Inc. v. Local No. 3 Int. Bro. of Elec. Wkrs.*, 386

Finally, the Court also finds *Miami General Hospital* distinguishable on the facts. In *Miami General Hospital*, the court found that the subject employee was critical to the hospital's reorganization efforts. She was the only person who possessed knowledge about the hospital's operations and its financial affairs, and was the only person who knew how to file the necessary reports to prevent the hospital from losing its license, which, in turn, would have prevented the hospital from being sold as a going concern. In short, the employee was "extremely valuable" and "an essential element . . . in keeping the hospital going." *Miami General Hospital*, 89 B.R. at 987.

In contrast, Lubner was not essential to the Debtor's reorganization efforts. The Debtor, as part of its first day motions, sought to and did employ an already-in-place chief restructuring officer and sought approval of the sale of all of its assets. A stalking horse agreement with the ultimately successful bidder was negotiated and executed pre-petition. From the inception of the Chapter 11 filing, the Debtor contemplated liquidation rather than reorganization. There are no equities favoring the treatment of Lubner's severance pay as an administrative expense as the court found present in *Miami General Hospital*.

2. Severance claim not entitled to priority under section 503(b)(1).

The Court finds that the severance compensation does not qualify, as a matter of statutory construction, as an administrative expense under section 503(b)(1). Section 503(b)(1)(A)(i) includes as allowed administrative expenses "the actual, necessary costs and expenses of preserving the estate including wages, salaries, and commissions for services rendered after the commencement of the case." Lubner asserts that his "post-petition services were necessary in preserving the Debtor's estate within the contemplation of § 503 of the Bankruptcy Code." (Doc. No. 595, ¶ 3.) However, the Application is silent on the issue of the nature of the services provided by Lubner, and Lubner did, in fact, receive compensation for his post-petition services.

The Court finds that severance compensation is not included within the meaning of "wages" or "salaries" under section 503(b)(1). Unlike other sections of the Bankruptcy Code, section 503(b)(1) does not expressly include "severance" within the "wages, salaries, and commissions" that are treated as administrative expenses. *See* section 507(a)(4)(A) (assigning fourth priority to certain allowed unsecured claims for "wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual") (emphasis added). The Court construes the contrast between (i) the inclusion of severance pay in unsecured wage/salary claims, and (ii) the omission of severance pay from administrative expenses, as an indication that Congress intended to exclude severance compensation from administrative expenses. Other courts have reached the same conclusion. *See In re Phones for All, Inc.*, 249 B.R. at 428-29, *aff'd* 288 F.3d at 732.

3. Severance does not qualify as administrative claim under section 503(c)(2).

The Court's analysis is buttressed by section 503(c)(2), which prohibits severance payments to the debtor's insiders unless the payment is (i) part of a program that is generally applicable to all full-time employees, and (ii) does not exceed ten times the amount of the mean severance pay given to non-management employees during the calendar year in which the payment is made. Here, Lubner was the chief executive officer of the Debtor and thus qualifies as an "insider" under section 101(a)(31)(B)(ii). Consequently, Lubner may receive severance pay only if the payment is made pursuant to a program that is generally applicable to all full-time employees. Lubner's severance pay, though, arises from his own individual employment agreement—not a generally applicable program.[3] Therefore, his severance payment is prohibited by section 503(c)(2).

Conclusion

There is good reason for the exclusion of severance pay from administrative expenses. If an employee such as Lubner could work just a single day for the debtor post-petition and still be allowed to receive a large severance package (here, nearly $1.3 million), then payment of the severance compensation as an administrative expense would devour a large portion of money that would otherwise be available to

F.2d 649 (2d Cir. 1967)). This Court finds the majority position, as discussed in *In re Phones for All* and *In re FBI Distribution Corp.*, *supra*, more persuasive.

[3] The Debtor's Employee Incentive Program ("EIP") proposed severance payments to the EIP's participants based on their employment "from and after" March 11, 2011. *See* Debtor's Motion for Approval of EIP (Doc. No. 453, ¶ 14), granted per this Court's Order dated May 24, 2011 (Doc. No. 592). As Lubner was terminated on the commencement date of the EIP, he was not, nor could he have been, a participant in the EIP.

pay more deserving creditors.[4] Administrative expense claims require a benefit to the estate. *In re Phones for All, Inc.*, 249 B.R. at 430. Lubner's post-petition services as an employee did not contribute to the Debtor's reorganization effort;[5] the stalking horse agreement and proposed going out of business sale were in place pre-petition. And, Kevin Regan was in place as chief restructuring officer even prior to the filing of the petition.

While Lubner's services performed during the three week post-petition period before his termination may have been of some benefit to the estate, the Court has already ordered that Lubner be paid his salary for that period. (Doc. No. 661.) Accordingly, the Court finds that Lubner is not entitled to any additional severance compensation as an administrative expense. *See In re FBI Distribution Corp.*, 330 F.3d at 48 ("[a]bsent a court approved assumption of [his] Employment Agreement, this was all [he] is entitled to receive.").

For the foregoing reasons, the Court concludes that Lubner's severance pay is not entitled to priority as an administrative expense. Accordingly, it is

ORDERED that the Application is DISALLOWED.

DONE and **ORDERED** in Chambers at Tampa, Florida on September 7, 2011.

/s/ Caryl E. Delano

Caryl E. Delano
United States Bankruptcy Judge

[4] The Court notes that this Chapter 11 case is likely to be administratively insolvent. (Transcript, Doc. No. 1034, p. 21.)

[5] The Debtor's motion for dismissal of the Chapter 11 case (Doc. No. 1000) is presently pending, as is the United States Trustee's motion to convert the case to a case under Chapter 7. (Doc. No. 1039.)