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In re: CBMC, INC., Debtor

No. 97-10676.

United States Bankruptcy Court. D. Vermont.

Aug. 19, 1998.

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J.J. Kennelly, Esq., of Pratt Vreeland Kennelly & Zonay, Rutland, VT, for Official Committee of Unsecured Creditors (Committee).

MEMORANDUM OF DECISION ON EXECUTIVE COMPENSATION

CONRAD, Bankruptcy J.

*1 Debtor seeks [FN1] to fix the compensation due two corporate executives whose steady hands at the helm of a sinking ship contributed value to the Debtor's liquidation. Complicating the issues to be resolved is the fact that the two executives, Debtor's President-Chief Executive Officer and Chief Financial Officer, approved and implemented their own pay raises without the consent or approval of creditors or this Court.

FN1. Our subject matter jurisdiction over this controversy arises under 28 USC § 1334(b) and the General Reference to this Court under Part V of the Local District Court Rules for the District of Vermont. This is a core matter under 28 USC §§ 157(b) (2) (A) and (B). This Memorandum of Decision constitutes findings of fact and conclusions of law under Fed.R.Civ.P. 52, as made applicable by Fed.R.Bankr.P. 7052.

Two motions by Debtor address the executives' pay for different periods. A "Motion for Approval of Additional Compensation in Lieu of Benefits for Corporate Officers," Doc. # 354-1 (1/21/98) ("Additional Compensation Motion"), asks for retroactive approval of \$183,000 for the 15-week period from Nov. 1, 1997 through Feb. 15, 1998. Debtor's "Motion for Approval to Pay Former Corporate Officers as Consultants," Doc. # 387-1 (2/12/98) ("Consultant Pay Motion"), asks us to authorize Debtor to hire the CEO and CFO as consultants for \$170/hour and \$135/hour respectively.

The Official Committee of Unsecured Creditors objects to the

Additional Compensation Motion, arguing that the compensation we originally approved, before the self-granted pay raises, was fair and just, and that creditors should receive the value the executives were paid to provide. Committee does not object at this point to pay the hourly rates sought in the Consultant Pay Motion, but insists that formal applications be filed for review and approval prior to any payments actually being made.

We consider each motion in turn.

MOTION FOR ADDITIONAL COMPENSATION

Debtor was required by Vermont Local Bankruptcy Rule 2015(a)(6) to obtain our approval of postpetition compensation to corporate officers and executives. The Rule is clear:

Officer's salaries: The Order allowing a ... debtor-in-possession to continue to operate the business, VLBR 2015(a)(1), or a separate order, shall fix the salaries of corporate officers and executives and the amount which an individual debtor may withdraw, and neither the corporate officer or executive nor an individual debtor shall receive a compensation greater than the amount fixed by the order during the pendency of a proceeding without a specific order entered by the court authorizing such an increase. Orders fixing compensation under this subsection of this Rule are subject to review and objection upon motion of the U.S. Trustee, a creditor, or any party in interest at any time.

Shortly after this case was commenced, Debtor filed a "Motion for Approval of Payment of Salaries to Corporate Officers," Doc. # 127-1 (6/4/97) ("Payment Motion"). The motion represented, in pertinent part, that:

2. The Debtor currently employs, and proposes to continue employing, two corporate officers, Jeremiah J. Harrington, the President and Chief Executive Officer, at the rate of \$3,365.38 per week, and Freeman I Davison, III, the Chief Financial Officer at the rate of \$2,692.31 per week....

***2** 3. The compensation proposal set forth above is no different than the compensation received by such officers pre-petition.

(Emphasis added.) We granted the Payment Motion, and signed the "Order of Approval of Payment of Salaries to Corporate Officers," Doc. # 166-1 (6/23/97), submitted by Debtor's counsel. The Order stated, "It appearing that ... the compensation requested being identical to that received by said officers pre-petition, and said amounts appearing to be reasonable," Debtor "is authorized to pay salaries to Jeremiah J. Harrington in the amount of \$3,365.38 per week, [and] Freeman I. Davison, III in the amount of \$2,692.31 per week...."

The salaries we approved equate to annual salaries of \$175,000 and \$140,000, respectively, and hourly rates of \$84.13 and \$67.31, respectively, for a 40-hour work week. At some point, Harrington and Davison agreed that they should receive \$170/hour and \$135, respectively, which equate to weekly salaries of \$6,800 and \$5,400, respectively, and annual salaries of \$353,600 and \$280,800, respectively, for 40-hour work weeks.

As explained by Committee:

Messrs, Harrington and Davison set the new rates by discussion between themselves and agreed with [Debtor's] Counsel that that amount be included in a budget to be submitted to the United States Trustee. Once the budget was prepared, on July 28, 1997, the Debtor, through Mr. Harrington and Mr. Davison, began paying the higher, unapproved salaries based on a 40 hour work week.

Committee's "Post-Hearing Memorandum," Doc. # 505-1, 2-3 (6/30/98).

On learning, in early November, that the two executives were receiving double the approved compensation, Committee counsel promptly registered its objections with Debtor and the two executives. Committee counsel represented to the Court at our March 31, 1998 hearing on the instant motions that after objection, the two executives began foregoing paychecks, effective Nov. 1, 1997, and the excess pay was recouped by Feb. 15. The result, as we understand it, is that Harrington and Davison were not paid for the Nov. 1, 1997 to Feb. 15, 1998 period. Debtor seeks authority to pay them for that 15-week, period at the higher rates of \$6,800 and \$5,400 respectively, a total of \$183,000. [FN2]

FN2. The \$183,000 is allocated \$102,000 to Harrington and \$81,000 to Davison.

Debtor offers a creative rendition of how we came to be here:

Pursuant to the Payment Order, the payment of salaries to Messrs. Harrington and Davison was approved in a timely fashion. However, the Payment Order did not address the issue of benefits, for two obvious reasons. First, at the time the Payment Order was entered, Messrs. Harrington and Davison were receiving benefits, such as healthcare, from the Debtor. [FN3] Second, the Payment Order was limited to the approval of salaries since that is the mandate of V.L.B.R.2015(a)(6). Benefits to be paid to the Debtor's corporate officers are not subject to the local rule. Thus, the Motion addresses the Debtor's request to pay Messrs. Harrington and Davison compensation in lieu of the benefits they were previously receiving when the Payment Order was entered.0

FN3. The benefits terminated when Debtor's assets were sold on July 10, 1997.

***3** Debtor's "Memorandum of Law in Support of Motion for Approval of Additional Compensation in Lieu of Benefits for Corporate Officers," Doc. # 504-1, 3-4 (6/30/98).

At the time we approved payment of the salaries, we did not know that the executives were also receiving additional benefits. Perhaps the reason we did not know is because of Debtor's representation in its Payment Motion that, "The compensation proposal set forth above is no different than the compensation received by such officers pre-petition." The motion says nothing about any other compensation being received in the form of benefits. To the extent that compensation in the form of benefits was paid that was not set out in Debtor's Payment Motion and the Payment Order, they were paid without authority of this Court.

Moreover, benefits are in fact within the purview of V.L.B.R.2015(a)(6). The text of the rule requires a judicial order to "fix the salaries of corporate officers and executives." Without more, Debtor might have a point that benefits aren't covered. But there is more. When Debtor's executives unilaterally began paying themselves twice as much as we had approved, they violated the Rule's directive that "neither the corporate officer [n]or executive ... shall receive a compensation greater than the amount fixed by the Order during the pendency of a proceeding without a specific Order entered by the Court authorizing such an increase." (Emphasis added .)

We issued the Payment Order upon a finding that the salaries therein stated were "reasonable." We find no basis on this record to conclude that they weren't fair then and aren't fair now. [FN4] In addition, due regard for our own rules, and for the constituencies those rules protect, requires us to exercise our discretion to deny the motion.

FN4. If Debtor believes that bonuses are warranted, it is free to seek them at the end of the case.

CONSULTANTS FEES

As appears from the transcript of an April 14, 1998 hearing on this matter, we have already granted Debtor's "Motion for Approval to Pay Former Corporate Officers as Consultants," Doc. # 387-1 (2/12/98). [FN5] Transcript, 4. Committee concedes that we have already approved Debtor's retention of Harrington and Davison as

consultants. The dispute between Debtor and Committee seems to be over the correct procedure to be followed for reviewing and approving the consultants' fees prior to payment. Debtor proposes:

FN5. Our instruction to Debtor to submit the appropriate order was apparently overlooked because it came in the midst of controversy over the status of the Motion for Additional Compensation, dealt with in the first part of this opinion.

Once the Court has entered an Order approving the hourly rates, it should be a simple matter for the Unsecured Creditors Committee to quickly determine which hours, if any, it will consent to be paid. The Debtor can then present an Order to the Court authorizing payment of the hours agreed upon, and simultaneously bring a motion before the Court for consideration of any disputed hours.

Debtor's Memorandum, supra, Doc. # 498-1, 4. Debtor worries that without "an efficient and expedient methodology ... for payment," the two executives will be forced to find other work, depriving Debtor of their expertise and experience. Id.

***4** Debtor has provided copies of the consultants' timesheets to Committee, but has made no formal application for approval. Committee alleges that "the time sheets do not permit any meaningful review." It asks that Debtor be required to submit a formal application that meets the standards of disclosure and explanation required by Fed.R.Bankr.P.2016 and V.L.B.R.2016, which both apply to any "entity seeking interim or final compensation for services, or reimbursement of necessary expenses" from the estate. Committee's Memorandum, supra, Doc. # 505-1, 13-14.

Based on our preliminary review of the timesheets submitted, we will authorize Debtor to immediately pay 50 percent of the amount due to the date of entry of this Memorandum of Decision, upon entry of this Memorandum. Debtor shall also prepare a formal application for approval as required by federal and local rules 2016.

CONCLUSION

Debtor's Additional Compensation Motion is denied. Debtor's Consultant Pay Motion has already been granted. Debtor is authorized, upon entry of this Memorandum of Decision, to pay the two executives 50% of the amounts due them for time worked through the date of entry of this Memorandum. Debtor shall submit an Order consistent with the rulings in this Memorandum within ten days of its entry.