DOCKET NUMBER: 94-12435
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JUDGE: M. A. Mahoney
PARTIES: RAB Industries, Inc., Andrew Horn, 127564 Canada, Inc.
CHAPTER: 11
ATTORNEYS: L. B. Voit, W. A. Gray, Jr., T. M. Bedsole, Jr.
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

RAB INDUSTRIES, INC., Case No. 94-12435-MAM-11

Debtor.

ORDER GRANTING DEBTOR'S MOTION TO APPOINT MANAGEMENT CONSULTANT AND CONTINUING MOTION TO COMPENSATE

Lawrence B. Voit, Mobile, AL for Debtor
W. Alexander Gray, Jr., Mobile, AL for Andrew Horn
Travis M. Bedsole, Jr., Bankruptcy Administrator

This matter came before the Court upon the Debtor's Motion to Appoint Management Consultant pursuant to 11 U.S.C. § 327. Andrew Horn ("Horn"), former CEO of RAB, filed an objection. The Court has jurisdiction to hear this matter pursuant to 11 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A). Proper notice of the hearing was given and appearances were as noted in the record. For the reasons indicated below, RAB's motion to employ 127564 Canada, Inc. ("127564") is granted nunc pro tunc to November 21, 1994, while RAB's motion for approval of compensation of 127564 is continued.

FACTS

RAB, a toy manufacturer located in Selma, Alabama, filed a voluntary petition under Chapter 11 of the Bankruptcy Code on November 21, 1994. In October 1994, RAB engaged 127564 Canada, Inc. as its management consultant after the departure of the prior CEO, Andrew Horn. 127564 Canada Inc. is a Canadian corporation whose president and sole shareholder is

Mickey Cohen ("Cohen"). The sole employee of 127564 is also Mickey Cohen, who was to perform the duties of CEO of RAB. Cohen has acted as RAB's CEO since October 1994 but was never an officer or director of RAB. Cohen's duties included oversight of all financial and administrative matters, negotiations with suppliers and customers and development of sales.

Since 1990, with the bankruptcy and liquidation of the family business in which Cohen had worked for 26 years, Cohen had been employed as a consultant for three Canadian companies in need of management services. In late 1994 Cohen first became familiar with RAB through his personal attorney, John Michelin, who told him Jurge Walker and Paul Michelin (John's brother) were interested in employing someone to manage a company in the United States. Cohen had a series of meetings with Walker and Paul Michelin and sometimes with Jonathan Shepard, corporate counsel for RAB, in September 1994 concerning RAB's management needs and they agreed that RAB would employ 127564 in October 1994.

Paul Michelin is the principal of FMC Group, Inc. ("FMC") which is based in Boca Raton, Florida. It is Cohen's understanding that FMC is involved with the securities industry in some fashion and that it had a prepetition consulting agreement with RAB to promote RAB's possible listing on a stock exchange. FMC also provided financial advice to RAB. Cohen has no knowledge of the FMC/RAB relationship beyond this. According to the stockholder list provided by RAB, neither Paul Michelin nor FMC own any stock in the Debtor. However, it is Cohen's understanding that FMC owns stock options in RAB and has exercised options in the past.

Jurge Walker is a principal of Investa AG, a Swiss company that supplied RAB with a substantial amount of both prepetition and postpetition credit. Investa AG is a portfolio manager for holders of approximately 80% of the outstanding common stock of RAB. Cohen believes

none of the individual clients of Investa AG hold a majority position in RAB's stock, nor do they act as a group with respect to particular business issues regarding RAB.

Paul Michelin and Walker are not on the Board of Directors of RAB. Neither holds any official position with RAB. However, it was Paul Michelin and Walker, not the Board of Directors of RAB, that hired Cohen. The only RAB Board member in October 1994 was Marc Von Daniken of Switzerland. John Michelin (Cohen's personal attorney) was added to the Board in December 1994. Cohen has no knowledge of John Michelin's election to the Board of Directors ever being ratified by the shareholders of RAB. Up until the spring of 1994, Judge John Jones of Selma, Alabama also served on the Board, but resigned for unknown reasons.

Cohen has no written contract regarding his employment or compensation. He orally agreed to the following: (1) pay of $1,500 per week; (2) payment of all expenses; (3) coverage under RAB's health and dental insurance plan; (4) incentive bonus based on any increase in gross sales for the 1995 calendar year; and (5) a stock option plan. Cohen does not know the specifics of his stock option plan. It has not been discussed in detail or reduced to writing.

The terms of employment which 127564 Canada, Inc. desired were memorialized in a written proposal styled "Consulting Engagement Between 127564 Canada Inc. and RAB Industries, Inc. effective as of October 12, 1994." RAB, through its corporate counsel, Shepard, countered with its draft of terms which is substantially similar to 127564's. Neither contract was ever executed. Cohen testified that he was working on the basis of the oral agreement outlined above.

Initially, Cohen established his RAB office in Boca Raton, Florida, where RAB paid rent to FMC for use of part of FMC's office space. Eventually, Cohen and RAB agreed that he would work from his home in Montreal, Canada, with RAB paying for certain office equipment,

including a computer, facsimile and copy machine. Cohen traveled to Selma, Alabama for one week per month while working out of his home/office in Montreal at other times. 127564 Canada, Inc. bills RAB every other week for its compensation and expenses. No receipts or other documentation for Cohen's compensation have been provided to the Court to date. Cohen's company was paid in full before the filing of the Chapter 11 case and is not a prepetition creditor. It has been paid in full on an ongoing basis since the bankruptcy filing. According to Cohen, since he has become a management consultant for RAB, he has worked 10-14 hours a day, plus many weekends. He has traveled to the Far East to meet with current suppliers and potential new suppliers. Also, he has worked to develop new markets outside the United States. Overhead costs have been reduced. Lower cost suppliers have been located. Although RAB's costs of production are up and sales are down, Cohen believes that his efforts have been beneficial and will produce good results in the long term.[1]

LAW

The first issue to be discussed is whether 127564 Canada, Inc. and/or Mickey Cohen is a "professional person" whose employment must be approved under 11 U.S.C. § 327(a). The answer is not entirely clear from the case law. A "professional person" has been defined as a person whose duties play a central role in the administration of a bankruptcy case. *In re Bartley Lindsay Co.,*137 B.R. 305 (D.C. Minn. 1991) (management consultant acting as CEO of debtor was professional person); *In re United Color Press, Inc.*, 129 B.R. 143 (Bankr. S.D. Ohio 1991) (management consultant who monitored debtor operations, collected accounts receivable and reestablished customer confidence was professional person); *In re Neidig Corp.*, 117 B.R. 625

[1]When Cohen testified, he did not know the Board of Directors would decide to convert the Debtor to a Chapter 7 case on July 26, 1995.

(D.C. Colo. 1990) (management company is professional person), *In re Florida Airlines, Inc.*, 110 B.R. 570 (M.D. Fla. 1990) (president of debtor is "professional person"); *In re Hooper, Goode Realty*, 60 B.R. 328 (Bankr. S.D. Cal. 1986) (officers are professional persons)*; contra*, *In re Madison Management Group, Inc.*, 137 B.R. 275 (Bankr. N.D. Ill. 1992) (officers and employees are not generally professional persons); *In re Phoenix Steel Corp.*, 110 B.R. 141 (Bankr. D. Del. 1989) (salaried officers who ran company were not professionals); *In re D'Lites of America, Inc.*, 108 B.R. 352 (Bankr. N.D. Ga. 1989) (salaried employees of debtors who worked in operations, finance, marketing and accounting were not professional persons because they didn't assist debtor in handling the bankruptcy case, only in operations); *In re Leslie Oil & Gas Co.*, 98 B.R. 774 (Bankr. S.D. Ohio 1989) (management company is not responsible for management or participation in business decisions concerning bankruptcy issues and therefore is not a professional person). Mr. Cohen's duties as CEO included, among others, development of a plan of reorganization, negotiation of post petition financing and decisions regarding assumption or rejection of executory contracts. He clearly is playing a central role in the bankruptcy process of RAB and therefore, unlike some salaried employees, is central to the bankruptcy process and is a "professional person" in this case.

In order for Cohen to be retained by RAB as a professional, he must not hold or represent an interest adverse to the estate of RAB and he must be disinterested. 11 U.S.C. § 327(a). Each of these issues will be separately addressed.

Horn alleges that the connections between Cohen and the Michelin brothers and their connections to FMC and the manner in which Cohen was hired (by non-RAB Board members) rise to the level of an adverse interest. However, more evidence would be necessary before this Court could find that Cohen holds a position adverse to RAB. Admittedly, the relationship

between Cohen, RAB, the Board of Directors, Jonathan Shepard, FMC and Investa AG is confusing. Yet, there is no evidence that any of these relationships created an actual conflict for Cohen or 127564. Failure to follow correct corporate procedures may raise other issues for RAB or involved individuals and entities but none of these concerns tainted Cohen himself. He was not tied to FMC, Investa AG, the Michelins or anyone else in a way which would adversely affect his ability to work for the estate.

It could be argued that Cohen's incentive bonus linked to corporate profits and his stock option exercisable at specified prices do create a conflict or adverse interest. Compensation terms like these possibly could lead an advisor to favor reorganization of an entity when it is not in the best interests of creditors, or cause an adviser to delay a decision to dismiss or convert a case or propose a plan of liquidation because the adviser would lose bonuses and stock. In this case, although proposed, no formal agreement with Cohen was ever reached which included an incentive bonus or stock plan. Even if it had been, the company's performance up to conversion of the case to Chapter 7 warranted no incentive bonus according to the evidence and the stock was worthless based upon the bankruptcy schedules and the evidence of RAB's performance to date. Cohen's actions could not have been driven by these compensation possibilities when exercise was so valueless or remote.

The second test which 127564 Canada, Inc. must satisfy under Section 327(a), is whether 127564 is "disinterested." A "disinterested person" is one who:

A) is not a creditor, an equity security holder, or an insider;

B) is not and was not an investment banker for any outstanding security of the debtor;

. . .

D) is not and was not, within two years before the date of the filing of the petition, a director, officer or employee of the debtor . . . and

E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor . . . or for any other reason.

11 U.S.C. § 101(14)

Cohen's company, 127564 Canada, Inc., clearly meets all of the disinterestedness requirements except two which it also meets but require explanation. It was employed by RAB prior to the bankruptcy filing which violates 11 U.S.C. § 101(14)(D). However, 11 U.S.C. § 1107(b) cures this violation by stating that no person is disqualified for employment under Section 327 by a debtor "solely because of such person's employment by the debtor before the commencement of the case."

127564 is also arguably an "equity security holder" of RAB due to the stock option plan Cohen wanted as part of his employment package. In a prior ruling, this judge then sitting in another court, held that a management consultant was not disinterested when it incorrectly thought it held a stock warrant and even attempted to exercise it. *In re Daig Corp.*, 48 B.R. 121 (Bankr. D. Minn. 1985). The facts and procedural posture of this case are dissimilar and, therefore, *Daig's* result is not the result in RAB. The *Daig* ruling held that a non-court approved stock warrant agreement is not valid. That being the case, a management consultant is not an equity security holder of a debtor until a court approves it. In both RAB and *Daig*, no approval was ever received.

In the *Daig* case, the consultant, Merrimac Associates, believed the stock warrant was exercisable. It even tried to exercise it (without success). The court ruled that this strong incorrect belief gave rise to "an interest materially adverse to the interest of the estate or of any

class of creditors . . ." 11 U.S.C. § 101(14)(E). In the RAB case, Cohen knew the stock option had not been agreed upon. Neither 127564's draft of the parties' proposed agreement nor RAB's draft spell out the terms of this option. Further, neither agreement was signed.[2] This makes this case unlike *Daig*. No stock plan existed and Cohen knew it did not exist.

There was no bonus plan in the *Daig* matter, but there is in this case. In RAB, the parties appear to have agreed on the terms of such a plan in their drafts although the agreement was not signed. A bonus plan does not automatically disqualify a professional person from employment as a stock plan might. Section 101(14)(A) does not speak of salary terms; only of equity security holdings. The issue is whether the bonus plan would create a "material adverse interest" under 11 U.S.C. § 101(14)(E) for Cohen or 127564. Under the facts in this case, the bonus plan does not create a material adverse interest for several reasons. Cohen received added salary if and when he increased sales of RAB through October 11, 1995. He never came close to achieving the necessary sales. The term of the bonus was limited to a one-year period so there was no expectation he would get such a pay in 1996. Also, if the bonus plan creates a conflict, employment of anyone on any salary terms is problematic. All employees (and usually directors) are paid. This may create anxiety over decisions to convert a case to Chapter 7 or to file a plan of reorganization. It cannot be a conflict. Otherwise, the Code would have created the absurd situation of disqualifying everyone employed by debtors. Stock ownership, by contrast, can be more debilitating. An equity position in a company creates more difficult plan issues and valuation issues than a pure salaried position does and is specifically prohibited by the

[2]Cohen's draft even contemplates that the agreement is a future one. "RAB agrees to offer Mr. Cohen a stock option plan within 120 days of commencement of the agreement."

Bankruptcy Code. Therefore, although *Daig* seems on point, it really is not and 127564 may be employed.

Taken together, therefore, RAB has satisfied the two prongs of the Section 327 test; Cohen is disinterested and does not possess any interest adverse to the debtor. Although not the most qualified CEO candidate this Court has ever seen, Cohen was qualified enough. The business judgment of a debtor as to whom to hire should not be disturbed unless it is without any reasonable basis. Therefore, if RAB's application to employ 127564 had been made on or around November 21, 1994, 127654's employment would have been approved by the Court. However, the application to employ 127564 was not filed until May 4, 1995. Now successor debtor counsel seeks to have the employment approved retroactively to November 21, 1994.

Two theories have evolved regarding approval of nunc pro tunc applications. One line of cases allows retroactive retention in "extraordinary circumstances." For a court to find extraordinary circumstances, the court should consider several factors including:

> whether the applicant or some other person bore responsibility for applying for approval; whether the applicant was under pressure to begin service without approval; the amount of delay after the applicant learned that initial approval had not been granted; [and] the extent to which compensation to the applicant will prejudice innocent third parties . . .

In re F/S Airlease II, Inc., 844 F.2d 99, 105 (3d Cir.), *cert. denied*, 488 U.S. 852, 109 S. Ct. 137, 102 L. Ed. 2d 110 (1988); *In re Jarvis*, 53 F.3d 416 (1st Cir. 1995); *In re Land*, 943 F.2d 1265 (10th Cir. 1991); *Matter of Arkansas Co, Inc.*., 798 F.2d 645 (3d Cir. 1986); *Matter of Triangle Chemicals, Inc.*, 697 F.2d 1280 (5th Cir. 1983); *In re Kroeger Properties and Development, Inc.*, 57 B.R. 821 (Bankr. 9th Cir. 1986). The other test allows for retroactive employment and compensation in instances of "excusable neglect." *In re Singson*, 41 F.3d 316 (7th Cir. 1994). This test sets a more lenient standard of proof for a party seeking nunc pro tunc approval of

employment. This Court believes that this is the proper standard to use based on the reasoning in *Singson*. Some courts in this circuit have already adopted the "excusable neglect" approach. *In re Jones*, 138 B.R. 289 (Bankr. M.D. Fla. 1992); *In re Smith*, 125 B.R. 841 (Bankr. M.D. Fla. 1991); *Matter of Lindo's Tours, USA, Inc.*, 55 B.R. 475 (Bankr. M.D. Fla. 1985). In *Lindo's Tours*, *supra*, the court described the two-prong test applicable to excusable neglect situations.

> While nunc pro tunc approvals should be the exception, it may be proper upon a showing, first, that the application would have been approved had the same been presented prior to the employment of the professional and, second, the failure to file a timely application was due to excusable neglect and the fault of the trustee or the debtor-in-possession and not the professional. *In re American Cooler Co.*, 125 F.2d 496 (2d Cir. 1942); *Avorn Dress Co., Inc.*, 79 F.2d 337 (2d Cir. 1935).

55 B.R. 478 (citation omitted). Regardless of whether the extraordinary circumstances or excusable neglect test is used, 127564's employment should be approved based on the facts presented.

Cohen testified that he is a Canadian businessman with little knowledge of American bankruptcy laws. When he was engaged by RAB, it had not yet filed for Chapter 11 protection. Yet, once it did, Cohen relied on RAB's bankruptcy attorney to guide him through the necessary procedures. For whatever reason, Debtor's counsel informed Cohen there was no need for court approval for his continued employment. Cohen relied on this advice. He provided management for the company during a difficult period. These facts constitute excusable neglect and extraordinary circumstances.

On July 26, 1995, RAB voluntarily converted its case to a liquidation under Chapter 7. Consequently, this order does not speak to the appropriateness of Cohen's compensation pursuant to 11 U.S.C. § 330 and previously paid. No itemized billings were offered into evidence which will be necessary for the Court and others to consider the proper payment

amount. A hearing on that sole issue is set for October 10, 1995 at 9:30 a.m. This hearing is to be held in Courtroom No. 2 of the United States Bankruptcy Court, Southern District of Alabama, Mobile, Alabama.

Therefore, the application for employment of 127564 Canada, Inc. by the Debtor is APPROVED nunc pro tunc. The issue of the final approval of compensation and expenses paid is continued to October 10, 1995 at 9:30 a.m.

Dated: August 15, 1995

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MARGARET A. MAHONEY
U.S. BANKRUPTCY JUDGE