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JUDGE: M. A. Mahoney
PARTIES: Southeastern Fabrication, Inc., Irvine Company, Inc.
CHAPTER: 11
ATTORNEYS: C. M. Smith, M. E. Wynne
DATE: 11/3/97
KEY WORDS:
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

SOUTHEASTERN FABRICATION, INC. Case No. 97-10648-MAM-11

Debtor.

ORDER SUSTAINING DEBTOR'S OBJECTION TO IRVINE COMPANY, INC.'S CLAIM #10 AS AN ADMINISTRATIVE CLAIM AND DECLARING DEBTOR'S CONTRACT WITH IRVINE COMPANY, INC. NONEXECUTORY

C. Michael Smith, Mobile, AL, attorney for Debtor
Marion E. Wynne, Fairhope, AL, attorney for Irvine Company, Inc.

This case is before the Court on two matters: (1) Debtor's objection to Claim No. 12 of Irvine Company, Inc.; and (2) Debtor's motion to reject executory contract with Irvine Company, Inc., or, in the alternative, for determination that contract is nonexecutory. The Court has jurisdiction to hear these matters pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. The matters are core proceedings pursuant to 28 U.S.C. § 157(b)(2) and therefore the Court has authority to enter a final order.

For the reasons indicated below, the Court is sustaining the Debtor's objection to Claim No. 12 as an administrative claim and allowing it as a general unsecured claim in the amount of $62,500 and is declaring the Debtor's contract with Irvine Company, Inc. to be a nonexecutory contract.

FACTS

Southeastern Fabrication, Inc., the Debtor, is in the business of metal fabrication and finishing. Southeastern owned property at 3105 North Highway 59, Loxley, Alabama, which it

desired to sell. On December 1, 1993, Southeastern entered into an "Exclusive Property Listing Agreement" with Irvine Company, Inc. Irvine agreed to market the property for Southeastern.

The listing was effective from December 1, 1993 through December 1, 1996. Southeastern agreed to pay Irvine a 10% commission of "the gross amount of any sale, agreement to sell, or exchange, which may be negotiated during the existence of this contract." On or about July 18, 1996, RMS Precision, Inc. agreed to buy the property for $625,000. The purchase agreement contained no agreements between Irvine and Southeastern, only agreements between Southeastern and RMS.

There were numerous liens and mortgages against the property and equipment to be sold which exceeded the gross sales price. After attempting to close the transaction outside bankruptcy court, Southeastern found that it could not. Southeastern ultimately filed a Chapter 11 bankruptcy case on February 19, 1997. On March 7, 1997, the Debtor filed a motion under 11 U.S.C. § 363 to sell the property free and clear of liens for $625,000 which the Court granted. Liens, if any, attached to the proceeds of the sale which were paid into the Registry of the Court. No party objected to the sale. The order approving the sale was entered on March 19, 1997. On June 25, 1997, the sale closed. The net proceeds of sale of $617,307.97 were paid into the Registry of the Court.

On March 24, 1997, Irvine filed its own motion seeking employment as a professional in this case pursuant to 11 U.S.C. § 327. By order dated July 7, 1997, the Court denied the request because only the Debtor could seek such an appointment according to the words of the statute. Thereafter, Irvine filed a claim requesting administrative expense status under 11 U.S.C. § 503(b). In response, Southeastern filed its motion to reject the listing agreement if it is an

executory contract under 11 U.S.C. § 365, or, alternatively, to have the contract declared nonexecutory.

Irvine's listing agent who marketed the Loxley property, Jeff Smith, performed work on the sale both before and after the bankruptcy filing. RMS spoke with Irvine representatives (Jeff Smith and Starke Irvine) two to six times[1] after the bankruptcy filing about closing. The sale was expected to close initially in September 1996. When Southeastern could not obtain lien clearance, the date was deferred. RMS's business needed the larger facility which Southeastern's property offered immediately so Jeff Smith suggested that a lease might be appropriate during the interim. A lease was negotiated which was to be in place until a December 1996 closing. When closing did not occur in December 1996, Jeff Smith encouraged RMS to continue to wait for title clearance. When the bankruptcy case was filed, Jeff Smith continued to persuade RMS to stay in the contract. RMS never looked at other property to purchase. RMS's attorney was in contact with Debtor's counsel during the bankruptcy as well.

Jeff Smith and Starke Irvine believe that their efforts kept RMS from voiding the contract and Irvine was, at least in part, the reason the sale was finally concluded. Jeff Smith recalls that Southeastern's principal asked him to "keep RMS in the deal." Irvine estimates the company expended approximately 20 hours or more on the sale after February 19, 1997. They did the following:

(1) discussions with Tim Lazzari and Tom Fleur, principals of RMS, about reasons to remain in the contract;

(2) conversations with parties about closing issues;

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[1]RMS's principal stated he recalled two to three conversations. Jeff Smith, Irvine's listing agent, and Starke Irvine recalled about six conversations.

(3) conversations with Ron Brown, principal of Southeastern, about the survey;

(4) other conversations with Ron Brown; and

(5) fax of sales agreement to taxing authorities.

Irvine believed from the conversations its agents had with Ron Brown and Southeastern's bankruptcy counsel that it would be paid at closing. They testified that they were never clearly told they would be paid at closing, but they understood that from the comments made.

Starke Irvine, the head of the Commercial Sales Division of Irvine Company, Inc., testified that Irvine, according to its listing agreement, is entitled to a commission when the agreement to sell is signed. However, the commission is traditionally paid at closing, not at the signing of the sales agreement. The amount of the commission is not tied to expenses incurred or time spent by Irvine. It is a flat percentage.

LAW

A.

Irvine Company asserts that its commission claim of $62,500 is an administrative expense pursuant to 11 U.S.C. § 503(b). Section 503(b) contains three sections which might be applicable. Section 503(b)(1)(A) classifies as administrative expenses "the actual, necessary costs and expenses of preserving the estate, including . . . commissions for services rendered after the commencement of the case." Section 503(b)(2) classifies as administrative expense "compensation and reimbursement awarded under section 330(a) of this title." Section 503(b)(3)(D) covers "actual, necessary expenses . . . incurred by . . . a creditor . . . in making a substantial contribution in a case under chapter . . . 11."

Based upon how this Court ruled previously, section 503(b)(2) does not apply because Irvine was never employed as a professional of the Debtor under 11 U.S.C. §327. The Debtor objected to Irvine's request for employment. Section 327(a) states that "the trustee, with the court's approval, may employ . . . professional persons." The debtor in possession in a Chapter 11 case has all of the duties and powers of a trustee. 11 U.S.C. § 1107. Fed. R. Bankr. P. 2014(a) indicates that an order approving employment of a professional person "shall be made only on application of the trustee or committee." *In re WAPI, Inc.*, 171 B.R. 130 (Bankr. N.D. Ala. 1994); *In re Office Products of America, Inc.*, 136 B.R. 675 (Bankr. W.D. Tex. 1992); *In re L. D. Patella Const. Corp.*, 114 B.R. 53, 56 (Bankr. D.N.J. 1990); *In re Charter Co.*, 52 B.R. 267 (Bankr. M.D. Fla. 1985). Some cases have disagreed with this position in limited circumstances such as when the professional provides significant benefit and the debtor or trustee assures the professional an application for employment will be filed. *In re Albert*, 206 B.R. 636, 642 (Bankr. D. Mass. 1997) (attorney who performed services regarding prepetition lawsuit which settled postpetition was entitled to reasonable compensation for postpetition services); *Matter of Lindo's Tours, USA, Inc.*, 55 B.R. 475, 477 (Bankr. M.D. Fla. 1985) (entire agreement was signed and performed during bankruptcy case); *Atkins v. Wain Samuel & Co. (In re Atkins)*, 69 F.3d 970 (9th Cir. 1995) (postpetition accounting services provided on an emergency basis). None of the exceptions apply to this case. The debtor did not assure Irvine it would file an employment application for it. Even if it had, the Court would have denied it due to the nonexecutory nature of the contract between Southeastern and Irvine. As discussed below, Irvine had nothing further to do to complete its contract when the bankruptcy case was filed. *In re Precision Carwash Corp.*, 90 B.R. 34 (Bankr. E.D.N.Y. 1988); *In re Moskovic*, 77 B.R. 421 (Bankr. S.D.N.Y. 1987). Irvine is also a prepetition creditor by virtue of the listing agreement.

As a prepetition creditor, Irvine is not "disinterested" as required for employment pursuant to 11 U.S.C. § 327. *In re HSD Venture*, 178 B.R. 831 (Bankr. S.D. Cal. 1995). Therefore, it cannot be compensated pursuant to 11 U.S.C. §§ 330 and 503(b)(2).

Once the services are not compensable under section 503(b)(2), case law concludes that a recovery under sections 503(b)(1) or (b)(3)(D) would not be appropriate. "If compensation cannot be awarded under section 503(b)(2), then the question is whether it can be awarded under section 503(b)(1) . . . [Such] an interpretation of section 503 [would render] section 503(b)(2), as well as section 327, 'nugatory.' (Citation omitted.)" *In re HSD Venture*, 178 B.R. 831, 834; *In re Weibel, Inc.*, 176 B.R. 209 (9th Cir. BAP 1994); *In re Snowcrest Development Group, Inc.*, 200 B.R. 473 (Bankr. D. Mass. 1996). The Court agrees with the reasoning of these cases.

However, even if sections 503(b)(1) and (b)(3)(D) are considered independently, Irvine's claim fails. The Court concludes the services were not "necessary" under section 503(b)(1) and the services did not make a "substantial contribution" to this case under section 503(b)(3)(D).

Section 503(b)(1) requires that services be "necessary" to be compensable. The inquiry as to necessity requires a court to determine if the expenses are beneficial to the estate. *In re Lease-a-Fleet, Inc.*, 140 B.R. 840 (Bankr. E.D. Pa. 1992). "The benefit to the business must be direct and substantial." *In re Lull Corp.,* 162 B.R. 234, 240 (Bankr. D. Minn. 1993). The right to allowance of such an expense as administrative must be narrowly construed "to maximize the value of the estate preserved for the benefit of all creditors." *Varsity Carpet Services, Inc. v. Richardson (In re Colortex Industries, Inc.)*, 19 F.3d 1371, 1374 (11th Cir. 1994). Although concerned about the bankruptcy, RMS never looked at other properties. The fact that RMS was occupying the premises by November 1996 made a move unlikely. What Irvine did, although certainly admirable, did not substantially benefit the estate. The Court concludes the sale would

have occurred anyway. Irvine had a prepetition vested interest in assuring that the sale closed and their 20 hours of conversations reflect that fact.

Section 503(b)(3)(D) requires that a "creditor" provide a "substantial contribution" to the case. For the reasons indicated below, the Court concludes Irvine is a prepetition creditor. Its rejected executory contract gives rise to a prepetition unsecured claim. A substantial contribution requires that the services have primarily benefitted the estate, have a significant effect on the estate and were not duplicative of services performed by others. *Trade Creditor Group v. L. J. Hooker Corp. (In re Hooker Investments, Inc.)*, 188 B.R. 117 (S.D.N.Y. 1995). In this case, the benefit was not "substantial" as indicated above; the debtor, debtor's counsel and others were also attempting to close the transaction; and Irvine acted, at least in part, to obtain its commission, not to benefit the estate and all creditors.

Therefore, the full amount of the claim is not allowable as an administrative expense or any part of it. It does not meet the criteria of section 503.

B.

Southeastern alleges that the listing agreement at the bankruptcy filing was not an executory contract as that term is used in 11 U.S.C. § 365, or, if it is, the Debtor seeks to reject it. The Bankruptcy Code does not define "executory contract." There are three different theories courts have used to determine if a contract is executory—the Professor Countryman test, the Bildisco test and the Benefit/Burden test.

The Professor Countryman definition is that a contract is executory if it is a "contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other." Countryman, Executory Contracts in

Bankruptcy, 57 Minn. L. Rev. 439, 460 (1973) (Part I). The U.S. Supreme Court stated in the *Bildisco* case that Congress intended the term executory contract "to mean a contract 'on which performance is due to some extent on both sides.'" *NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 522, n.6 (1984) (quoting from H.R. Rep. No. 95-595 at 347 (1977)). The Benefits/Burden definition looks at whether treatment of the contract as executory would be consistent with the policies of the Bankruptcy Code and whether it would best serve the interests of the estate. *In re Becknell & Crace Coal Co., Inc.*, 761 F.2d 319 (6th Cir. 1985). The Eleventh Circuit in dicta commented upon this approach. *Martin Bros. Toolmakers, Inc. v. Industrial Dev. Bd. (In re Martin Bros. Toolmakers, Inc.)*, 796 F.2d 1435, 1439 (11th Cir. 1986) ("The determination in bankruptcy . . . of whether a particular agreement is in fact a lease or security agreement for purposes of § 365 often depends on which characterization will best serve the interests of the estate.")

Under any of the three definitions, Irvine's listing agreement is not executory. The listing agreement was signed prepetition. The right to receive a commission arises when the sale contract is "negotiated." As stated by Starke Irvine, the liability for a commission matured when the contract for sale to RMS was signed. The listing agreement specifies no duties which Irvine must perform after the contract for sale is signed. The only obligation remaining to be performed is the payment of the commission.

Under the Countryman definition, both sides must have material performance duties remaining. Since Irvine has none, the contract is not executory under the Countryman definition. Under the Bildisco theory, less than "material" performance need be due, but still performance by both sides is necessary. Again, Irvine has no duties. Finally, under the Benefits/Burdens test, there would be no benefit derived by the estate if this contract were executory. If it is,

Southeastern wants to reject it. Irvine ends up in the same place either way. It has a prepetition general unsecured claim if the contract is nonexecutory or executory but rejected. *See*, *Byrd v. Gardinier, Inc. (In re Gardinier, Inc.)*, 831 F.2d 974, 976, n.2 (11th Cir. 1987).

Case law supports this view. *In re Snowcrest Development Group, Inc.*, 200 B.R. 473 (Bankr. D. Mass. 1996); *In re L. D. Patella Const. Corp.*, 114 B.R. 53 (Bankr. D.N.J. 1990); *Marcus & Millichap Inc. of San Francisco v. Munple, Ltd. (In re Munple, Ltd.)*, 868 F.2d 1129 (9th Cir. 1989); *In re Precision Car Wash Corp.*, 90 B.R. 34 (Bankr. E.D.N.Y. 1988); *In re Moskovic*, 77 B.R. 421 (Bankr. S.D.N.Y. 1987). *But see*, *In re Clavis Smith Bldg., Inc.*, 112 B.R. 768 (Bankr. E.D. Va. 1990). However, the *Clavis Smith Building* case is distinguishable. The court held that that commission agreement, which was part of the sales contract, was a part of the entire contract and not severable. Therefore, to assume the contract of sale, the debtor had to assume both the unconsummated sales contract and included commission agreement. In this case, the listing/commission agreement and sales agreement were completely separate.

CONCLUSION

The Irvine Company, Inc. provided a valuable service to Southeastern prebankruptcy. It sold its property. However, the sale could not be closed until after the bankruptcy filing. That left Irvine in the position of many important creditors in bankruptcy cases—unpaid. The Bankruptcy Code has established rules for priority and for payment and for determining who is a prepetition and who is a postpetition creditor. Unfortunately for Irvine, due to the clear words of its contract, it fell on the prepetition side of that line. Its claim is not administrative pursuant to 11 U.S.C. § 503(b); its listing agreement is not executory pursuant to 11 U.S.C. § 365.

Therefore, it is ORDERED:

1. Debtor's objection to Claim No. 12 of Irvine Company, Inc. is SUSTAINED to the extent of allowing the claim as a general unsecured claim in the amount of $62,500; and

2. Debtor's motion to reject its executory contract with Irvine Company, Inc. is DENIED because the contract is not an executory contract subject to 11 U.S.C. 365.

Dated: November 3, 1997

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MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE