

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

ARNCO MECHANICAL, INC.
d/b/a Bluewater Marble

Case No. 03-15582-MAM-7

Debtor.

ORDER DENYING WITHOUT PREJUDICE THE MOTION OF ACO STAFFING SERVICES, INC. FOR ALLOWANCE OF ADMINISTRATIVE EXPENSE FOR POST PETITION STAFFING AND LABOR

C. Michael Smith, Attorney for Debtor
Clay A. Lanham and Thomas E. Sharp, III, Attorneys for ACO Staffing Services, Inc.
J. Robert Turnipseed, Attorney for Blue, LLC
Lynn Harwell Andrews, Chapter 7 Trustee

This matter is before the Court on the motion of ACO Staffing Services, Inc. for allowance of administrative expense for postpetition staffing and labor. Blue, LLC objected to the motion. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2) and the Court has the authority to enter a final order. For the reasons indicated below, the Court is denying ACO's motion without prejudice.

FACTS

Arnco Mechanical, Inc. d/b/a Bluewater Marble was a manufacturer of cultured marble products. On September 26, 2003, Arnco filed a Chapter 11 Bankruptcy. On or about January 2004, ACO and the debtor reached an agreement whereby ACO would provide payroll services and additional employees for Bluewater. The agreement called for ACO to recruit and place whatever employees Bluewater needed to operate its business, as well as requiring ACO to pay

all the employees' related taxes, prepare and file the employees' tax returns, and provide Bluewater with worker's compensation and general liability insurance. For providing these services, ACO charged the debtor a 25% mark-up on Bluewater's regular employee pay rate. Debtor set the employees' hourly pay rates and/or salaries and kept track of their hours. Debtor would then send this information to ACO. ACO would then rely on the information to pay debtor's employees every week for the previous week's work.

The agreement entered into between the parties was not reduced to a written contract. ACO's President and co-owner, Albert Mayfield, testified that ACO did not have written contracts with any of their clients, except for its long-term employees. Likewise, Mark Smith, head of business development for ACO, and the person solely responsible for the Bluewater account, testified that in his five years with ACO, he had never used a written contract for any of the ACO agreements for which he was responsible. ACO's representatives also testified that the 25% mark-up charged to debtor was less than the 45-50% mark-up normally charged by ACO. Mayfield stated ACO agreed to the reduced charge because of the volume of services provided to debtor.

Neither debtor nor ACO got court approval before entering into the agreement. The debtor, however, did file a "motion for approval of employment services agreement" on February 4, 2004, requesting the Court to approve the agreement retroactive to January 1, 2004. The motion stated that "[t]he fee for the services to be provided . . . is 5.71 per cent of the Debtor's weekly payroll." There was no mention of the 25% mark-up ACO actually charged the

debtor¹. Furthermore, although the motion states that ACO is an “employee leasing business,” the agreement only specifies the services provided. It does not specifically state that ACO will provide the debtor with employees. The Court issued an order on March 11, 2004, granting the motion “upon the terms and conditions as set forth in the Debtor’s motion.” The Court made that order “effective nunc pro tunc to January 1, 2004.”

On September 27, 2004, the debtor’s case was subsequently converted to Chapter 7. Blue, LLC, the owner of the property wherein debtor leased space for the operation of Bluewater, filed a request for allowance of administrative expense for postpetition rents on October 19, 2004. That motion was granted by this Court on November 12, 2004, in the amount of \$21,600.

According to testimony, ACO did not know of debtor’s bankruptcy when it entered into the employment agreement with Bluewater. ACO apparently did not learn of the bankruptcy until around March 2004. After learning of the bankruptcy, ACO did not contact the Bankruptcy Court or the bankruptcy administrator’s office concerning the effect the bankruptcy would have on the agreement or the propriety of continuing to work under the agreement. According to ACO’s president, he did not contact the Court or the bankruptcy administrator’s office because he had never been in that situation before and he did not know he needed to. ACO did not file anything with this Court or participate in any of Arncos bankruptcy proceedings until it filed the present motion for allowance of administrative expense on December 20, 2004, some eight months after learning of the bankruptcy.

¹The Court understands the agreement to allow a 25% mark-up, which includes 5.71% profit for ACO. The remaining 19.29% of the mark-up pays ACO’s costs to provide its services to the debtor.

ACO argues that it should be allowed an administrative expense claim of \$90,816.41 for charges incurred for its services from April 10, 2004 through August 21, 2004. ACO's motion states that all of the charges are "fair and reasonable and remain unpaid." Additionally, ACO argues it is entitled to the administrative claim because the Court approved the employment services agreement between the debtor and ACO. Blue objects to ACO's motion for allowance, claiming the motion was belatedly filed, and that ACO is responsible for its own losses because it continued to work for the insolvent debtor without receiving payments or filing anything with the Court to protect itself. In addition, Blue argues that although the Court approved the employment services agreement, it only approved the 5.71% cost indicated in the motion for approval, not the 25% mark-up now claimed by ACO. Alternatively, Blue argues that even if the Court grants ACO an administrative expense, it should not be given priority "over all other claims" as requested in the motion. Blue asserts that ACO's claim, if granted, would have no greater priority than other allowed administrative expenses.

LAW

The Court will first address the timeliness of the motion for allowance of the administrative claim. Section 503 makes two references to the timing of requests for administrative fees. First, section 503(a) states that "[a]n entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause." 11 U.S.C. § 503(a). Legislative history indicates that Congress intended to leave the setting of specific filing deadlines to the Rules of Bankruptcy Procedure. *See* S.Rep. No. 989, 95th Cong., 2d Sess. 66 (1978)(stating that "the Rules of Bankruptcy Procedure will specify the time, the form, and the method of such a filing"). The Rules of Bankruptcy Procedure, in turn,

largely defer the duty to the bankruptcy judges. 3 Collier on Bankruptcy ¶ 503.1, at 503-4 n. 2c (Lawrence P. King ed., 15th ed. 1994)(noting that the Bankruptcy Reform Act of 1994 sets no time limit for filing administrative claims). As a result, bankruptcy judges are allowed to exercise their discretion in setting administrative claim bar dates. *Hall Financial Group, Inc., v. DP Partners, LTD. Partnership (In re DP Partners LTD. Partnership)*, 106 F.3d 667 (5th Cir. 1997). Since the Court has discretion on when to set its bar date for filing requests for administrative claims, and has not yet to set such a date, the Court finds the filing of the motion for allowance for payment of an administrative expense was timely.

The Court now turns to the substance of ACO's motion for allowance of an administrative claim and the priority given to such claim. An administrative expense claim is governed by § 503(b), which states that "there shall be allowed administrative expenses . . . including . . . the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." 11 U.S.C. § 503(b)(1)(A). Section 507(a)(1) of the Bankruptcy Code grants first priority in the distribution of assets of a bankruptcy estate to administrative expenses allowed under § 503(b). 11 U.S.C. § 507(a)(1). The underlying purpose of granting administrative expenses priority status is to encourage creditors to continue dealing with the debtor-in-possession and supply it with the goods and services needed for a successful reorganization. *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)* 963 F.2d 1449, 1453 (11th Cir. 1992). The priority is based on the premise that the continued operation of the business by the debtor-in-possession will benefit prepetition creditors, so any claims resulting from the ongoing operation should be paid before paying the creditors who benefitted from the continued operation of the business. *In*

re Worldcom, Inc., 308 B.R. 157, 165 (Bankr. S.D.N.Y. 2004) (citing *Cramer v. Mammoth Mart, Inc.* (*In re Mammoth Mart, Inc.*), 536 F.2d 950, 954 (1st Cir. 1976)).

To establish the priority of an administrative claim, the claimant must meet the two-part test adopted from *In re Jartran* and *In re Mammoth Mart*. See *In re Jartran, Inc.*, 732 F.2d 584, 587 (7th Cir. 1984); *In re Mammoth Mart, Inc.*, 536 F.2d at 954. Under the test, the claimant must demonstrate that the debt both (1) arose out of a transaction between the creditor and the debtor-in-possession and (2) benefitted the operation of the debtor's business. *In re OES Environmental, Inc.*, 319 B.R. 266, 268 (Bankr. M.D. Fla. 2004). The burden of proof, by a preponderance of the evidence, is on the administrative expense claimant. *In re Food Etc., L.L.C.*, 281 B.R. 82, 84 (Bankr. S.D. Ala. 2001).

Under these guidelines, for ACO's administrative expense claim to be allowed, it must prove by a preponderance of the evidence that its claim arose out of a postpetition transaction with the debtor-in-possession, and that transaction benefitted the operation of debtor's business. Although there was never a written contract evidencing the agreement between ACO and the debtor, the uncontradicted testimony from ACO's representatives established that the debt owed arose from a transaction between it and the debtor-in-possession. This is true even though ACO did not know the debtor was in bankruptcy at the time the transaction was entered into. Accordingly, the Court finds that ACO has met the first element of the *Jartran/Mammoth Mart* test.

To meet the second element of the test, ACO must prove that the employment services provided to the debtor actually benefitted the bankruptcy estate. The language of § 503(b)(1)(A) specifies that administrative priority status is warranted for "actual, necessary costs and expenses

of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.” 11 U.S.C. § 503(b)(1)(A). The Eleventh Circuit has interpreted this section to not only require “that the expense be ‘actual’ and ‘necessary,’ but also that there be a concrete benefit to the debtor’s estate.” *In re Beverage Canners Int’l Corp.*, 255 B.R. 89, 92 (Bankr. S.D. Fla. 2000) (citing *In re Subscription Television of Greater Atlanta*, 789 F.2d 1530 (11th Cir. 1986)).

The debt to ACO is undisputedly for wages and salaries for services rendered after commencement of the case, so administrative priority status is warranted if the charges were “actual,” “necessary,” and conferred a “concrete benefit” to the debtor’s estate. Both ACO’s president and its head of business development testified that, in their opinions, the employment services provided to Bluewater were necessary expenses, and that Bluewater could not have continued operating without ACO’s services. Additionally, they testified that the salaries paid and the rates charged were reasonable and necessary.

Blue and the Trustee argue that ACO’s claim does not deserve priority treatment, but should be treated as unsecured. They reason that ACO should be held responsible for the debt because it knew of the debtor’s bankruptcy, and continued to provide its services, without receiving payment from the debtor. Furthermore, they argue that ACO did not provide any actual benefit to the estate, as evident from the conversion of the case from Chapter 11 to Chapter 7.

In a similarly converted case, the court in *White Front Feed & Seed v. State Nat’l Bank (In re Ramaker)*, 117 B.R. 959, 962 (Bankr. N.D. Iowa 1990) stated:

“The outcome of the bankruptcy . . . is not the test. It is whether the transaction was beneficial to the debtor-in-possession ‘in the operation of the business.’ Despite the fact that the

reorganization failed . . . [the] credit sales of goods were still beneficial to the debtors-in-possession in the operation of the . . . business.”

Id. (citation omitted); *see also In re Southern Soya Corp.*, 251 B.R. 302 (D. S.C. 2000) (the outcome of the bankruptcy case is not conclusive indicia of whether the extension of credit was beneficial to the estate); *In re Molnar Brothers*, 200 B.R. 555 (Bankr. D.N.J. 1996) (same). The *Ramaker* court held the expenses at issue in that case were administrative, stating that it did not accept the “hindsight argument” that the expenses were not necessary merely because the reorganization later failed. *Id.*

Like *Ramaker*, *Southern Soya*, and *Molnar Brothers*, this Court will not accept the “hindsight argument.” The services provided by ACO were “actual” and “necessary” expenses which benefitted the estate. The Court recognizes that the debtor’s attempt to reorganize its business operations under Chapter 11 have failed and the case has been converted to Chapter 7, but such inability to rehabilitate the business does not per se preclude a finding that ACO’s debt should be granted the priority of an administrative expense. *Southern Soya*, 251 B.R. at 310. The services extended by ACO were used by the debtor in the continuation of its operations. The Court finds that the employees and services provided by ACO were actually utilized by the debtor in the operation of its business, and were necessary costs and expenses of preserving the debtor’s estate. *See In re National Steel Corp.*, 316 B.R. 287, 299 (Bankr. N.D. Ill. 2004) (*citing Reading Co. v. Brown*, 391 U.S. 471, 475 (1968) (preservation of the estate may include the continuation of a debtor’s business)). Thus administrative expense status should be granted pursuant to § 503(b)(1)(A). *In re Subscription Television of Greater Atlanta*, 789 F.2d at 1532 (“That which is actually utilized by a trustee [or debtor-in-possession] in the operation of a debtor’s business is a necessary cost and expense of preserving the estate and should be accorded

the priority of an administrative expense.”); *Southern Soya*, 251 B.R. at 310; *Ford Motor v. Dobbins*, 35 F.3d 860, 867 (4th Cir. 1994). At the time the debt was incurred, the debtor was pursuing rehabilitation of its business. But for the services extended by ACO, the debtor would have been unable to operate its business, which appeared at the time to be in the best interest of the unsecured creditors. *See Southern Soya*, 251 B.R. at 311.

Furthermore, although the debtor never filed BA-1 reports for the months of August and September 2004, the reports filed from January 2004 through the end of July 2004, indicate the debtor’ continued operations earned a total net income of \$11,101.60 during this time, even after accounting for all expenses including payroll. Although the debtor may not have faithfully paid ACO, the BA-1 reports show the debtor’s estate received a concrete benefit by the continued operation of the business, which could not have been done if not for the employees and services ACO provided. The Court finds ACO’s postpetition services provided to the debtor-in-possession were actual, necessary costs and expenses which conferred a concrete benefit on the bankruptcy estate. Accordingly, ACO is entitled to administrative expense priority for its unpaid claim.

Having determined that ACO should receive administrative expense priority, the Court will not grant ACO’s motion as filed because of apparent discrepancies in the amount claimed and the amounts paid. ACO, by its motion, testimony, and exhibit claims the debtor owes it \$90,816.41 for unpaid labor and services from April 10, 2004 through August 21, 2004, all of which ACO states “remain unpaid.” However, some of the BA-1 reports filed by the debtor include bank statements and copies of some checks issued by the debtor during the relevant time period. After examining the invoices submitted into evidence by ACO, and the check copies in


the BA-1 reports, it appears that a substantial portion of the \$90,816.41 claimed due by ACO has already been paid by the debtor. At least four checks totaling \$20,308.91 were issued from the debtor payable to ACO between the end of May 2004 and the beginning of July 2004. All four of these checks were issued in the exact amounts and within a few days of ACO invoices. Furthermore, all four of the checks cleared the debtor's bank account shortly after they were issued, indicating ACO received the checks and received payment on them. See chart below.

ACO Invoice	Date of Invoiced	Invoice Amount	Arnco Check No.	Amount Of check	Date Of check	Date Cleared
642168	05/27/04	6086.30	1350	6086.30	05/28/04	06/02/04
642194	06/02/04	5344.56	1358	5344.56	06/08/04	06/08/04
642225	06/09/04	4058.13	1368	4058.13	06/11/04	06/21/04
642304	07/01/04	4819.92	1400	4819.92	07/02/04	07/14/04

Because the Court does not have copies of all the checks issued by debtor during the applicable time period, the Court cannot correctly determine the amount of ACO's administrative claim. The Court heard testimony from ACO that it received some payments from the debtor during the applicable time, and applied the payments to the debtors past due balances. If this is the case, the Court needs to have that information presented to it as well. Until a correct balance due can be determined, the Court will not grant ACO's motion for allowance of administrative expense.

THEREFORE, IT IS ORDERED that the motion for allowance of administrative expense is DENIED WITHOUT PREJUDICE. If ACO wishes to resubmit its request, it must do so within 45 days with a calculation of all money paid and received from January 2004 to September 27, 2004. If no such request is made within that time, all right to an administrative expense claim is forfeited.

Dated: March 14, 2005


MARGARET A. MAHONEY
U.S. BANKRUPTCY JUDGE