

In the United States Bankruptcy Court

for the Northern District of Iowa

D.C. INC.
Debtor(s).

Bankruptcy No. 97-01860-W
Chapter 11

RULING RE DEBTOR'S MOTION TO HIRE PROFESSIONALS

On December 11, 1997, the above-captioned matter came on for hearing on Debtor's Motion to hire professionals to sell real estate of this estate. Debtor moves to hire Realtors Michael McCracken, Coldwell Banker Heart of America, and Dan Baty, Coldwell Banker Hedges. Debtor appeared by Attorney Thomas Fiegen. The Realtors in question were represented by Attorney Thomas G. McCuskey. A record was made on this issue after which the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A).

STATEMENT OF THE CASE

Debtor's Chapter 11 Petition was filed on June 16, 1997. The primary assets of this estate consist of four Hardee's franchises located in various locations throughout East Central Iowa.

The record indicates Debtor felt cash flow would be sufficient throughout the summer to keep the respective businesses operating. However, Debtor was concerned that, after heavy summer sales, business would slow in the fall. Debtor began to consider alternatives to try and keep these businesses operating.

One of the alternatives was to locate buyers for these sites. Mr. Dan Baty testified that he is associated with Michael McCracken of Bloomington, Illinois. Mr. McCracken contacted Baty in May of 1997. Mr. McCracken indicated he needed an agent in Iowa to handle the potential sale of these properties. He testified there was some initial marketing toward the end of May, 1997 and preliminary discussions were held. In June of 1997, Mr. Baty, Mr. McCracken and Attorney Thomas Fiegen met in Cedar Rapids, Iowa to discuss the potential sale of these businesses. At that time, the Realtors indicated some initial local interest existed but the offers were extremely low.

In September 1997, interest began to pick up and marketing began in earnest. Various discussions were held with B.K. Trust. The formal real estate agreement between Debtor and Coldwell Banker was entered into on September 30, 1997. The offer to purchase made by B.K. Trust was signed on October 1, 1997. The application to hire professionals was filed by Debtor on October 14, 1997 and set for hearing and heard on December 12, 1997.

The issue here arises from the fact that the Realtors now seek compensation pursuant to §327 and §328 subsequent to rendering services to Debtor. They obviously performed most if not all of the work required to sell these properties prior to procuring Court approval and prior to filing the application for approval of employment.

A professional hired to represent a trustee or debtor-in-possession must receive court approval prior to being compensated by the estate. 11 U.S.C. §327(a); Fed. R. Bankr. P. 2014. Without such prior approval, ordinarily applications for fees should be denied. Lavender v. Wood Law Firm, 785 F.2d 247, 248 (8th Cir. 1986). "However, in limited circumstances, the bankruptcy court as a matter of fundamental fairness may exercise its discretion and enter a nunc pro tunc order authorizing compensation." Id. (considering retroactive approval of employment of debtor's attorney).

Most courts require the applicant to demonstrate the existence of extraordinary circumstances sufficient to justify the application's untimeliness. In re Jarvis, 53 F.3d 416, 421 (1st Cir. 1995). Courts may consider several factors in making this determination, including

whether the applicant or some other person bore the responsibility for applying for approval; whether the applicant was under time 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. . . .

Id. at 420 (quoting In re F/S Airlease II, Inc., 844 F.2d 99, 105 (3d. Cir.), cert. denied, 488 U.S. 852 (1988)); see also In re McKibbin, No. X85-02156S, slip op. at 5-7 (Bankr. N.D. Iowa Apr. 21, 1992). The court in Jarvis held that mere oversight or inadvertence does not fall within the realm of extraordinary circumstances for these purposes. 53 F.2dat 422. It affirmed the bankruptcy court's denial of a post facto application to employ a real estate broker. Id.; see also In re Haley, 950 F.2d 588, 590 (9th Cir. 1991) (stating that broker "cannot emerge 'out of the blue,' and receive compensation without having obtained prior court approval").

The standards for retroactive approval in the Eighth Circuit are stringent. There are, however, exceptions to accommodate fundamental fairness. Here, it appears that the Realtors were acting in good faith and were in constant contact with Debtor's counsel. The efforts of the Realtors concluded with a \$1.9 million offer which was substantially higher than any other offer previously received. This transaction will eventually guarantee a payout to unsecured creditors. On this basis, fundamental fairness requires that the Realtors be compensated to some extent for their efforts.

The Realtors did not have the responsibility for applying for approval of its employment as a broker under §327(a). This responsibility fell on Debtor and its counsel. The Realtors began their services in a fairly informal manner and worked on the transaction for several weeks before the brokering arrangement was formalized. Approval of employment of the Realtors was filed soon after. No third parties will be prejudiced by paying the Realtors a brokerage fee.

However, the Court also feels strongly that the casual approach utilized by the Realtors, Debtor, and Debtor's counsel must be discouraged in unequivocal terms. While evidence of the Realtors' exact experience with bankruptcy proceedings is not part of the record, they had several meetings with counsel for Debtor during which the requirement of court approval of their employment was discussed. The Court concludes that these individuals are not unfamiliar with the bankruptcy process and a penalty must be attached to the failure of the Realtors on their own behalf to ensure their appointment prior to commencement of work on this project. While retroactive appointment of these real estate brokers as professionals is appropriate, some penalty must be attached to that appointment for their failure to comply with the Code.

It is the conclusion of this Court that a 15% penalty will be deducted from the amount sought by the Realtors for compensation. The Realtors seek a fee of \$110,000. The Court finds that 15% of this

amount will be deducted as a penalty for failure to comply with 11 U.S.C. §327 and §328 requirements of prior approval of their employment.

In addition, it is pointed out by counsel for the Realtors and by counsel for Debtor that part of the responsibility for the failure to attain approval of this appointment was due to Debtor's failure to take action at an appropriate time. It is the conclusion of this Court that not only should the real estate brokers be sanctioned for their failure to procure prior approval of employment, but the principal party responsible for acquiring this approval should also receive some sanction.

It is appropriate in this case that the failure of Debtor to take the steps necessary to gain prior approval of appointment of professionals should subject Debtor and counsel to a surcharge of fees. One court, in reviewing an application by counsel for debtors for compensation, took into account unauthorized payments to an accountant for which no order of employment had been sought. The Court concluded that the attorney had "less than expected management and control" of the case. In re Hunt, 124 B.R. 263, 268 (Bankr. S.D. Ohio 1990). This, combined with other conduct by the attorney, led the court to subtract 20% of the fee request. Id. It stated: "Frankly, such services, or lack of services, only make harder the job of the Court and of other parties to the case. That quality of service must be reflected in a subtraction from the fee request." Id.

It is the conclusion of this Court, based upon the entire record, that the failure to follow the requirements of §327 lies not only with the Realtors, but also with Debtor and its counsel. It is the conclusion of this Court that it will reserve, until final application for fees, authority to place an appropriate sanction upon final attorney's fees approved in this case based upon the failure of Debtor and counsel to timely seek approval of employment of these real estate broker professionals under 11 U.S.C. §327 and §328.

WHEREFORE, the Application to Employ Realtor/Broker and to Approve Proposed Compensation is APPROVED IN PART and DENIED IN PART.

FURTHER, employment of Michael McCracken, Coldwell Banker Heart of America, and Dan Baty, Coldwell Banker Hedges as Realtors/Brokers is APPROVED.

FURTHER, compensation for these Realtors is approved in the amount of \$93,500, which reflects a 15% penalty deduction from proposed compensation of \$110,000.

FURTHER, the Court reserves authority to sanction Debtor and counsel by considering a reduction in attorney fees upon final application for compensation by counsel.

SO ORDERED this 19th day of December, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge