UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In Re: **BK. NO. 93-22374**

Flexseal Packaging Corp.,

DECISION & ORDER

Debtor.

BACKGROUND

On October 27, 1993, the Debtor, Flexseal Packaging Corp. ("Flexseal"), and Flexseal Medical Packaging Corp. ("Medical"), owned 75% by Flexseal, each filed a petition initiating a Chapter 11 case.

On September 22, 1994, the Court filed a Decision and Order on a motion (the "Conversion Motion") brought by Flexseal's Creditors' Committee (the "Committee") to convert the Flexseal Chapter 11 case to a Chapter 7 case. That Decision and Order provides a brief procedural history of the Flexseal Chapter 11 case which was later converted to a Chapter 7 case by an Order dated December 22, 1994.

To date the Court has filed four decisions in this highly contested and costly case, and has entered Orders awarding reasonable compensation to professionals for actual, necessary services and expenses of in excess of $170,000.00. This amount includes an award to Lacy, Katzen, Ryen and Mittleman ("Lacy, Katzen") in an amount in excess of $52,000.00 for services rendered and expenses incurred as the Chapter 11 attorneys for Flexseal for the period September 28, 1993 through March 31, 1994.

The Court now has before it for consideration the February 3, 1995 Second and Final Interim

Motion for Fees and Expenses submitted by Lacy, Katzen (the "Final Application"). In the Application, as amended, which covers the period April 1, 1994 through January 30, 1995, Lacy, Katzen has requested an award as reasonable compensation for services rendered the amount of $143,509.00 and for expenses incurred the amount of $11,086.25. The Final Application includes $139,727.00 of the amount requested for services rendered during the pendency of the Chapter 11 and the balance, $3,782.00, for post-conversion Chapter 7 services. The Application has been objected to by: (1) the Office of the United States Trustee (the "U.S. Trustee Objection"); (2) Donald H. Robins (the "Robins Objection"), a former shareholder, officer and director of Flexseal, and one of its creditors; and (3) the Chapter 7 Trustee (the "Trustee Objection").

The Trustee Objection was only to the post-conversion services rendered which Lacy, Katzen requested be awarded as a Chapter 7 administrative expense. After reviewing the Trustee Objection and that portion of the Final Application which relates to services rendered after December 22, 1994, the Court awards Lacy, Katzen the amount of $2,791.00 as a Chapter 7 administrative expense.[1] This award represents $2,130.00 for 14.2 hours of Mr. MacKnight's time, $630.00 for 3.00 hours of Mr. Mayka's time, and $31.00 of the time spent by Mr. Mayka and Ms. Winter in preparing the Final Application.[2]

The U.S. Trustee Objection contended that: (1) no billing judgment was exercised by Lacy,

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[1] A March 3, 1995 Supplementary Motion for $654.00 as a Chapter 7 administrative expense has been separately approved.

[2] The Final Application did not specifically request an amount for post-conversion expenses as a Chapter 7 administrative expense.

Katzen in making its Final Application based upon the overall results in the case; (2) much of the time expended by Lacy, Katzen in preparing and revising a plan and disclosure statement, when there were no negotiations with the Committee which was organized and active in the case, including significant time expended in December, 1994 in preparing a liquidation plan and disclosure statement at a time when the Committee was requesting conversion and was not in support of a liquidation plan, were not reasonable services at the time or necessary or of benefit to the estate or the administration of the case, especially in view of the ultimate conversion of the case to a Chapter 7 case; and (3) throughout the period when services were rendered, there were excessive and duplicative services performed, particularly in connection with defending the Conversion Motion and the discovery process in an Adversary Proceeding commenced by Donald H. Robins (the "Robins Adversary Proceeding").

The Robins Objection contended that: (1) there were substantial hours spent by Lacy, Katzen on matters without any effective and continuing cost-benefit analysis, including a motion involving the sale of equipment in Somerville, Massachusetts and a motion to consolidate the Flexseal and Medical Chapter 11 cases, where both the motions were withdrawn before the scheduled hearing dates; (2) the Flexseal Chapter 11 case was overworked by Lacy, Katzen; (3) no billing judgment was exercised by Lacy, Katzen in requesting compensation for services rendered, including for services rendered which principally benefitted Medical or the principal shareholder of Flexseal, Gerald Kramer ("Kramer"); (4) the Final Application requested compensation for services which were duplicative of services provided by other attorneys appointed as special counsel to Flexseal;

and (5) expenses incurred were excessive in that some of the expenses could have been contracted out for a lesser amount and some expenses were unnecessary, including copying charges incurred for the liquidation plan and disclosure statement prepared at the last minute when the Committee was not in support of a liquidation plan.

The Response by Lacy, Katzen to the U.S. Trustee Objection alleged that: (1) it was in the best interests of all parties for Flexseal and Lacy, Katzen to prepare an orderly liquidation plan and disclosure statement even in the face of the Conversion Motion when it appeared that the Committee and Flexseal's largest potential creditor, Shawmut Bank ("Shawmut"), could not agree to conditions which might otherwise allow Flexseal to propose an earn-out plan which would be acceptable to and in the best interests of its creditors; (2) the services rendered by the various professionals at Lacy, Katzen in connection with the Conversion Motion and the Robins Adversary Proceeding were not duplicative, since those professionals worked on different aspects of those projects with only a minimum of cross-review or consultation; and (3) attendance and participation by more than one attorney at the hearings on the Conversion Motion were necessary because of the complexity of the case and the Motion, including the existence of difficult accounting and financial issues.

The Response by Lacy, Katzen to the Robins Objection alleged that: (1) its handling of the Somerville property sale was ultimately of benefit to the Flexseal estate; (2) the motion to substantively consolidate the Flexseal and Medical cases had practical merit; (3) the Robins Adversary Proceeding was commenced by Robins and aggressively pursued by him which required Flexseal to defend, raise counterclaims and aggressively litigate the matter, even though settlement

proposals were made to Robins and no counterproposals were elicited from him; (4) the orderly liquidation plan proposed in the face of the Conversion Motion was of benefit to the estate and reasonable at the time, in that the implementation of an orderly liquidation, as proposed, would have, it was believed, generated more for creditors than a forced liquidation in Chapter 7.

DISCUSSION

I. The Final Application

Section 330 provides for the Court, in its discretion, to award reasonable compensation to professionals and attorneys for actual, necessary services rendered. This is an important but sometimes difficult responsibility because the Court often must look back with hindsight at the services rendered when it never had any direct involvement with them at the time they were rendered. At times it seems like the Court is being asked to be a Monday Morning Quarterback when it did not see the game either in person or on television, but only read about it in the newspaper the next day.

The Final Application requests an award of compensation for over 830 hours of time devoted to the Flexseal case by three attorneys and a paralegal at Lacy, Katzen. The Application requests compensation for every one of these hours at the normal hourly rates for the professionals who rendered the services. This lack of any discount indicates that when Lacy, Katzen reviewed its time records, all of the facts and circumstances of the Flexseal case and its representation, and then prepared the Final Application and exercised normal billing judgment, it apparently believed that

each and every hour expended was necessary in the exercise of Lacy, Katzen's fiduciary duty to the estate as the attorneys for the debtor in possession. Furthermore, Lacy, Katzen apparently determined that every one of those hours expended had full hourly rate dollar value to the estate.

This Court disagrees that on the facts and circumstances presented that the proper exercise of billing judgment would not have resulted in any of the time Lacy, Katzen expended in the Flexseal case being discounted.

Rather, the Court believes that although the services performed by Lacy, Katzen were generally of very high quality and in some cases even exceptional, the value of the services performed in the following professional project areas was less than the compensation requested for those services: (1) the approximately 65 hours of time in discussing, formulating, drafting, reviewing, discussing, revising and discussing and discussing proposed plans of reorganization and disclosure statements in the absence of any meaningful negotiations with the Committee, which was active and interested in the case, when knowledgeable and sophisticated counsel, such as those working on the Flexseal case at Lacy, Katzen, could and should have seen and understood the implications of the credibility problems of Kramer and Flexseal in view of their prepetition history with the creditors; (2) the time spent in defending the Conversion Motion, particularly in the presentation of complex economic theories in the pleadings, arguments and expert testimony, rather than focusing on the long-term ability of Flexseal to rehabilitate as opposed to possibly being able to fund a plan by cannibalizing itself; (3) the time spent on trying to hold the Kramer Empire together as it related to Medical, various obligations to Shawmut, various guaranty liabilities and

other matters which had an uncertain benefit to the estate given the real prospects of Flexseal to rehabilitate; and (4) some time spent in the furtherance of the perceived duty to vigorously represent the debtor in possession as directed by that debtor in possession, which in this case was in a winner-take-all mode apparently without regard to cost, when that duty may have been out of balance with the fiduciary duty attorneys for a debtor in possession also have to an estate and its creditors.

As the Court said in its September 22, 1994 Decision and Order in connection with the Conversion Motion:

> "The pleadings and proceedings in this case to date indicate that Kramer is an intelligent, experienced entrepreneur who is a tough negotiator, always willing to fight the fight, and who has learned well the importance of hiring competent and tough professionals to assist him. Flexseal's attorneys have done an excellent job in `managing the case' and overcoming opposition to many of Flexseal's proposed actions by continuously presenting Flexseal's case in its most favorable light and well-prepared and thorough presentations. However, the proceedings also indicate that Flexseal is but a part of the Kramer empire, Flexseal's creditors really consider Flexseal to be Kramer, and even though the Disclosure Statement filed with the Draft Plan appears to attempt to explain and untangle a tangled web, the reader gets the feeling that at best it discloses only the tip of the iceberg."[3]

Lacy, Katzen's efforts in `managing the case' appear at times to have been more for the benefit of Kramer and his desire to keep the Kramer Empire afloat. They may have not been rendered with an eye to balancing that goal with the need to evaluate and re-evaluate services as they were being performed to determine whether the services were truly of value and benefit to the estate

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[3] *In re Flexseal Packaging Corp.*, No. 93-22374, at 18-19 (Bankr. W.D.N.Y. Sept. 22, 1994).

and the creditors at the time they are being performed.[4]

The Court is not suggesting that Lacy, Katzen has crossed the line which would warrant the kinds of admonitions set out in *Matter of Taxman Clothing Co.*, 49 F.3d at 316 that "[e]ven after the passage of 11 U.S.C. §330(a)(1), bankruptcy is not intended to be a feast for lawyers"; or in *In re Toney*, 171 B.R. 414, 415 (Bankr. S.D.Fla. 1994) that "[a]bsent extraordinary circumstances, bankruptcy estates should not be consumed by the fees and expenses of court-appointed professionals." However, the essence of the U.S. Trustee and Robins Objections is that the Final Application cried out for the exercise of some billing judgment and there was none.

After reviewing the Final Application in detail, and particularly the areas of concern identified above, the Court, in the exercise of its discretion, under Section 330, awards Lacy, Katzen the sum of $116,416.00 as a Chapter 11 administrative expense as reasonable compensation for the actual and necessary services rendered and $9,150.65 for the actual and necessary expenses incurred.[5]

II. Future Procedures

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[4] Chief Judge Posner provides an excellent analysis of the independent fiduciary duty of professionals to the estate and the danger, in *Bleak House* fashion, of consuming an estate by the fees and expenses of professionals. *Matter of Taxman Clothing Co.*, 49 F.3d 310 (7th Cir. 1995), *reh'g en banc denied* (1995).

[5] The expenses were reduced by $1,935.60 in connection with the copying of the liquidation plan and disclosure statement which the Court does not believe was a reasonable and necessary expense at the time incurred. Too much expense had been incurred to that point and Kramer had not overcome the lack of credibility which would likely have resulted in the creditors or the Court allowing him to be in charge of an orderly liquidation.

In order to allow the Court to more efficiently and effectively exercise its discretion in awarding reasonable compensation to professionals in cases where significant services have been rendered, especially in cases where objections are filed, pursuant to its authority under Section 105 and Rule 16 of the Federal Rules of Civil Procedure, made applicable by Rule 7016 of the Rules of Bankruptcy Procedure, the Court in all future cases will require the following when it becomes reasonably certain that any professional in a case will ultimately be applying for an award of compensation in an aggregate amount in excess of $15,000:

(1) As soon as it becomes reasonably certain that a professional appointed in a case under Section 327 or 1103 will ultimately be applying for compensation in an aggregate amount in excess of $15,000, that professional shall contact the Office of the United States Trustee, the entity for which it is performing services (a debtor in possession, Chapter 7 Trustee, Chapter 11 Creditors Committee, etc.) and representatives of other clearly interested parties in the case (the debtor-in-possession if the professional is employed by a Creditors Committee, any Creditors Committee if the professional is employed by a debtor-in-possession, etc.) and then schedule a telephonic status conference with those entities and the Court to discuss the nature and extent of the professional services to be rendered.[6]

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[6] The status conference is specifically provided for in the 1994 amendments to Section 105, as clarified in the legislative history of Pub. L. No. 103-394 at §104(a) (enacted Oct. 22, 1994) (codified as 11 U.S.C. §105(d)):

> Subsection (a) authorizes bankruptcy court judges to hold status conferences in bankruptcy cases and thereby manage their dockets in a more efficient and expeditious manner. Notwithstanding the adoption of Bankruptcy Rule 7016 (relating to pretrial conferences), some judges have appeared reluctant to do so without clear and explicit statutory authorization. This provision clarifies that such authority exists in the Bankruptcy Code in adversary and nonadversary proceedings.

140 CONG. REC. H10,764 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks), *reprinted in* App. Vol. 4 Collier on Bankruptcy, Pt. XLI at XLI-6 to XLI-7 (15th ed. 1995).

(2) The telephonic status conference must be scheduled with the Court at a time mutually convenient to all of the interested parties, at which time the Court, the professional and the interested parties will discuss and establish appropriate procedures and periodic reports to be filed, if any, in connection with the specific services to be rendered. These procedures and reports may include: (a) a cost-benefit analysis for anticipated professional projects; (b) budgeting for identified professional projects; (c) the filing of periodic reports to update or identify any variances from prior cost-benefit analyses or budgeting pro formas; (d) a mechanism for the parties to present periodic comments on professional services rendered; (e) a liquidation analysis in a Chapter 11 case to identify assets available to pay professional compensation; and (f) possible adjourned conferences.

(3) All such professionals shall render monthly statements to the entity by which they are employed which shall show the services performed to date, who performed the services and that professional's normal hourly rate for the services. The professional shall not be required to actually bill for the services, since the exercise of billing judgment will be more appropriate at the time an application for an award of compensation is made. Copies of such statements shall be filed with the Court and provided to the interested parties identified at the conference.

(4) All such professionals shall file their applications for compensation in a form which sets out the services by specific professional project or task, and all monthly statements shall be prepared on such a project basis. (Reference should be made to the project categories set out on Exhibit A to the March 22, 1995 Guidelines of the Office of the United States Trustees.)

(5) It is anticipated that by these status conferences the Court, the Office of the United States Trustees, attorneys and other professionals will develop effective procedures to enable the Court to better evaluate applications for professional compensation in larger cases.

It is not the Court's intention to cause significantly more work or expense in such cases or to affect the strategies of a case or particular aspects of a case or the representation by professionals, but simply to develop a methodology to assist it and other interested parties in evaluating applications for awards of professional compensation in larger cases. As more of the required status conferences are conducted in the future, and the Office of the U.S. Trustee, panel trustees, attorneys,

accountants and other professionals offer their input, I am certain that these procedures will become very efficient and effective.

As an additional benefit of these new procedures, the concerns expressed in *Matter of Taxman Clothing Co.* and *In re Toney* will seldom, if ever, be heard about bankruptcy proceedings in this Court.

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY JUDGE

Dated: December 29, 1995