UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

AZON CORPORATION — CASE NO. 02-64368

Debtor — Chapter 11

IN RE:

MEDIA DESIGN CORPORATION — CASE NO. 02-64369
Chapter 11

Debtor — Jointly Administered

APPEARANCES:

LESLIE N. REIZES, ESQ.
Attorney for David C. Lee
1177 George Bush Boulevard, Suite 308
Delray Beach, Florida 33483

HANCOCK & ESTABROOK, LLP
Attorneys for Debtors
1500 MONY Tower I
P.O. Box 4976
Syracuse, New York 13221-4976

R. JOHN CLARK, ESQ.
Of Counsel

GUY A. VAN BAALEN, ESQ.
Assistant U.S. Trustee
10 Broad Street
Utica, New York 13501

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Presently under consideration by the Court is motion filed on February 10, 2003, by David C. Lee ("Lee"), requesting payment of an administrative expense in the amount of $83,878 pursuant to § 503(b) of the U.S. Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"). An

Affirmation in Opposition to the motion was filed on February 11, 2003, on behalf of Azon Corporation ("Azon") and Media Design Corporation (collectively the "Debtors").

The motion was heard on March 27, 2003, at the Court's regular motion term in Binghamton, New York. Following oral argument, the Court indicated that it would reserve on the motion and issue a written decision.[1]

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this contested matter pursuant to 28 U.S.C. §§ 1334, 157(a), (b)(1) and (b)(2)(A), (B) and (O).

FACTS

The Debtors filed voluntary petitions pursuant to chapter 11 of the Code on July 24, 2002. The two cases are bing jointly administered pursuant to an Order of this Court dated July 26, 2002.

Lee was the former chief operating officer of Azon. On or about April 20, 2000, in a letter from Valerie Allen, Vice President of Human Resources, addressed to Lee ("Letter Agreement"), Azon accepted Lee's retirement, effective June 2, 2000. *See* Exhibit A of Lee's Memorandum of Law, filed March 17, 2003. The Letter Agreement was signed by Lee and by

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[1] The Court requested that Lee's counsel submit additional information on how he would quantify the value of Lee's services on a *quantum meruit* basis if the Court were to determine that he was entitled to such an award.

William Bordages, President-CEO of Azon, on April 20, 2000. Under the terms of the Letter Agreement, Lee was to receive "Salary continuation of forty-three months as Information Coordinator, at the rate of $4,934.00 per month (total compensation not to exceed $212,162), starting June 1, 2000 . . . and ending December 31, 2003." *See id.* at ¶ 1.a. Paragraph 5 of the Letter Agreement states that "Nothing in this agreement is to prohibit you from consulting with, being employed by or owning a business entity which is not identified as a competitor of Azon Corporation." *Id*. On June 2, 2000, Lee also signed an "Employment Separation Certificate" in which he agreed to "preserve as confidential all trade secrets, confidential knowledge, data or other proprietary information relating to products, processes, etc." *See* Exhibit B of Lee's Motion.

According to Azon's counsel, the monthly payments to Lee were reduced in or about February 2002 due to Azon's financial condition and ceased in or about June 2002. *See* Affirmation of R. John Clark, Esq., dated February 10, 2003. It is Lee's position that pursuant to the Letter Agreement he is still owed $83,878, which constitutes an administrative expense for the postpetition period commencing August 1, 2002.

DISCUSSION

Code § 507(a) provides that administrative expenses under Code § 503(b) are entitled to first priority for distribution purposes. Code § 503(b)(1)(A), in turn, states that the "actual, necessary costs and expenses of preserving the estate, including wages, salaries or commissions for services rendered after the commencement of the case" shall be allowed as administrative expenses.

"Granting priority status, however, is contrary to the fundamental principle of bankruptcy law that the debtor's limited resources are to be distributed equally among similarly situated creditors . . . thus, statutory priorities are narrowly construed, and the burden of proving entitlement rests with the party seeking it (citation omitted)." *Mason v. Official Committee of Unsecured Creditors (In re FBI Distribution Corp.)*, 330 F.3d 36, 41-2 (1st Cir. 2003).

Citing to the decision of the Second Circuit Court of Appeals in *Straus-Duparquet Inc. v. Local Union No. 3, International Brotherhood of Electrical Workers*, 386 F.2d 649 (2d Cir. 1967), as well the decision of Chief Bankruptcy Judge Conrad B. Duberstein for the Eastern District of New York, in *In re Spectrum Information Technologies, Inc.*, 193 B.R. 400 (Bankr. E.D.N.Y. 1996), Lee asserts that the postpetition severance benefits due him are entitled to administrative priority. However, as pointed out by the court in *In re Golden Distributors, Ltd.*, 152 B.R. 35 (S.D.N.Y. 1992), "severance pay is for terminated employees . . . is a cost of carrying on business, and constitutes an administrative expense when the severance occurs post-petition." *Id.* at 36.

Significantly, both cases on which Lee relies involved terminations which occurred postpetition. In fact, *Straus-Duparquet* specifically found that since the employees were "terminated as an incident of the administration of the bankrupt's estate, severance pay was an expense of administration and is entitled to priority as such an expense." *Straus-Duparquet*, 386 F.2d at 651; *see also Spectrum*, 193 B.R. at 405 (indicating that a claim is entitled to administrative priority "if incurred during the administration of the bankruptcy case (citations omitted)").

In this case, the right to severance pay arose prepetition on the date of Lee's retirement in 2000, some two years prior to the filing of the chapter 11 case.. To a large extent, it would

appear that most, if not all, of the severance payments represented compensation for Lee's prepetition services as chief operating officer. Those services would not entitle him to a claim for administrative priority. *See Trustees v. Amalgamated Ins. Fund. v. McFarlin's, Inc.*, 789 F.2d 98, 103 (2d Cir. 1986). However, it is Lee's position that in continuing to comply with the terms of the Letter Agreement and the Employment Separation Certificate not to compete with the Debtor and not to reveal trade secrets and other confidential and proprietary information, he rendered a benefit to the estate postpetition for which he is entitled to an administrative priority claim. The argument is made that by not revealing any trade secrets and/or confidential information, the efforts of the Debtors to sell all of their assets were somehow enhanced.

In *Spectrum* the debtor filed a motion to reject the employment agreement with the former president of one of its subsidiaries. At the time of the motion, the court found that the sole obligation remaining was that of compliance with a "non-interference with contractual relationship" clause for two years. *See Spectrum*, 193 B.R. at 404. The court found this to be a "contingent obligation not rising to the requisite level of materiality necessary to be considered executory under section 365(a) (citation omitted)." *Id.* Nevertheless, the court examined the benefit to the estate from the services rendered by the employee during the two months that he was employed postpetition as president of one of the debtor's subsidiaries before he was terminated by the debtor. The court concluded that "[b]y seeking Marchione's continued employment post-petition, Spectrum received the benefits of his expertise and services during the administration of the estate." *Id.* at 407.

In the matter *sub judice*, Lee was not employed by the Debtor postpetition. However, as noted by the court in *In re Ralph Lauren Womenswear, Inc.*, 197 B.R. 771 (Bankr. S.D.N.Y. 1996), "[w]hether or not contractual severance obligations are entitled to administrative priority,

it is indisputable that a claimant is entitled to a *quantum meruit* recovery for benefit conferred postpetition. *Id.* at 776. At the hearing on March 27, 2003, the Court expressed some doubts about the eligibility of any administrative claim to the extent of $83,878 but requested Lee's attorney to provide the Court with input as to "how you would quantify the value on a *quantum meruit* basis if there is, indeed, a nondisclosure/noncompete provision in the severance agreement." According to the docket of the cases, nothing has been filed on behalf of Lee since that hearing in response to the Court's invitation. The Court also notes that under the circumstances it is difficult to conclude that there was value to the chapter 11 Debtor from Lee complying with any such provisions. Lee's attorney argues that Lee's compliance with the nondisclosure/noncompete provision provided benefit to the estate in connection with the sale of the Debtors' assets.

On September 18, 2002, less than two months after the Debtors filed their petitions, substantially all of the Debtors' assets were sold for $13,450,000. Of that amount, Manufacturers and Traders Trust Company, which had a security interest in said assets and was owed approximately $16,877,070.09 in principal at the time the Debtors filed their petitions, received approximately $12,198,900 in net proceeds after the payment of certain carveouts, including a $350,000 break-up fee. Thus, it appears that any benefit to the Debtor that Lee might have provided during the eight week period prior to the sale was, if anything, minimal and certainly did not justify an award of $83,878 as an administrative expense. This is particularly true given the fact that the Purchase and Sale Agreement considered by the Court was dated five days prepetition, namely July 19, 2002.

As noted above, it was Lee's burden to prove entitlement to an administrative expense claim. The Court concludes that he has not met that burden.

Based on the foregoing, it is hereby

ORDERED that Lee's motion seeking payment of an administrative expense in the amount of $83,878 pursuant to Code § 503(b) is denied.

Dated at Utica, New York

this 8th day of August 2003

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge