IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11 Cases
	:	
HECHINGER INVESTMENT COMPANY	:	Case No. 99-2261 (PJW)
OF DELAWARE, INC., et al.,	:	(Jointly Administered)
	:	
Debtors.	:	Civil Action No. 00-171-JJF

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MEMORANDUM OPINION

March 21, 2001.
Wilmington, Delaware.

FARNAN, District Judge.

Presently before the Court is an appeal brought by "certain former employees (the 'Employees') of Builders Square Retail Stores" ("Appellants") from the November 29, 1999 Order of the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") denying in part and granting in part the motion of Appellants requesting allowance and immediate payment of certain severance benefits as administrative expenses pursuant to sections 503(b)(1)(A), 507(a)(1) and 105 of the Bankruptcy Code. For the reasons set forth below, the decision of the Bankruptcy Court will be affirmed.

BACKGROUND

I. Statement of Facts

On June 11, 1999 (the "Petition Date"), Hechinger Investment Company of Delaware, Inc., and related debtors (the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. Debtors' Chapter 11 cases were consolidated for procedural purposes only. On June 24, 1999, the United States Trustee for the District of Delaware appointed an official committee of the Debtors' unsecured creditors. (Appellants' Designation of the Record on Appeal ("App. Rec.") Exh. 3, at 4).

Debtors are leading retailers of home and garden care

products and services. As of the Petition Date, Debtors operated approximately 206 stores, among them a number of Builders Square retail stores (the "Stores"). Debtors continue in possession of their respective properties and the management of their respective businesses as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. (App. Rec. Exh. 3, at 3).

In February 1999, the Debtors, faced with increasing liquidity problems, decided to close 34 of the Stores and determined to conduct going out of business sales ("GOB's") at those locations. (App. Rec. Exh. 6, at 3). In order to staff the Stores during the GOB's, the Debtors offered certain incentives including enhanced severance payments to all employees who agreed to remain on during the GOB's ("Stay-On benefits"). Id. In a memorandum distributed to the Employees on February 10, 1999, the Debtors offered one additional week of severance pay for every year that an employee had worked for the Debtors, up to thirteen (13) weeks, to any eligible employee who remained through the GOB's or until an authorized release date. (App. Rec. Exh. 1, at Exh. B). Additionally, the Debtors offered to pay 100 percent of accrued leave time payments under a company policy by which Employees traditionally received only 50 percent of these accrued leave time payments upon termination of employment (the "BHQ Time").

Id. Again, these enhanced BHQ Time payments were conditioned on length of service and, to be eligible, an employee had to remain on the job throughout the closings of the Stores. Id.

In late Spring 1999, the Debtors' financial problems escalated to the extent that they began to consider the possibility of filing for bankruptcy relief. On June 11, 1999, each of the Debtors filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. (App. Rec. Exh. 3, at 4).

On June 15, 1999, the Debtors issued a letter to the Employees notifying them of the bankruptcy filing and its consequences for the Employees. (App. Rec. Exh. 3, at Exh. A). The letter also alerted the Employees to their rights as claimants against the bankruptcy estate to the extent of any allowed outstanding benefits. Id. Many of the Stores had closed by late June 1999.

On August 3, 1999, counsel representing the Employees filed a motion in the Bankruptcy Court seeking allowance and immediate payment of administrative expense claims pursuant to sections 503(b)(1)(A), 507(a)(1) and 105 of the Bankruptcy Code (the "Motion"). (App. Rec. Exh. 3, at 2). The Bankruptcy Court held a hearing on the Motion on November 17, 1999. (App. Rec. Exh. 5, at 1).

II. The Bankruptcy Court's Order

On November 29, 1999, the Bankruptcy Court issued a Memorandum Opinion and Order denying in part and granting in part the Motion. (App. Rec. Exh. 6, at 1). The Bankruptcy Court granted administrative expense priority to the Stay-On benefits only to the extent they accrued postpetition. Id. All Stay-On benefits that accrued prepetition were not entitled to treatment as administrative expenses and were only entitled to priority treatment to the extent allowed under section 507(a)(3) of the Bankruptcy Code. Id.

The Bankruptcy Court found that:

> [T]he amounts to which the Employees are entitled under the Debtors' enhanced severance package are tied directly to length of service . . . . As such, entitlement to these payments contains a significant element of prepetition service and therefore would be subject to prorata treatment along a prepetition and postpetition dividing line under both In re Roth American and In re Allegheny, with only payments accruing postpetition receiving § 503 administrative expense treatment . . . .

Id. at 15.

DISCUSSION

I. Jurisdiction and Standard of Review

Under 28 U.S.C. § 158(a), this Court has jurisdiction to adjudicate appeals from final judgments, orders and decrees of bankruptcy judges. Pursuant to Federal Rule of Bankruptcy Procedure 8013, the Court "may affirm, modify, or reverse a bankruptcy judge's judgment, order or decree or remand with

instructions for further proceedings." Fed. R. Bankr. P. 8013.

In reviewing a case on appeal, the bankruptcy court's factual determinations are subject to deference and shall not be set aside unless clearly erroneous. Id.; see In re Gutpelet, 137 F.3d 748, 750 (3d Cir. 1998). However, a bankruptcy court's conclusions of law are subject to plenary review and are considered de novo by the reviewing court. Meespierson, Inc. v. Strategic Telecom, Inc., 202 B.R. 845, 847 (D. Del. 1996). Mixed questions of law and fact are subject to a "mixed standard of review" under which the appellate court accepts finding of "historical or narrative facts unless clearly erroneous, but exercise[s] plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts." Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 641-642 (3d Cir. 1991) (citing Universal Mineral, Inc. v. C.A. Hughes & Co., 669 F.2d 98, 101-02 (3d Cir. 1981)), cert. denied., 112 S. Ct. 1476 (1992).

II. Whether the Bankruptcy Court Erred in Concluding that Appellants are Entitled to Administrative Expense Priority Only for Stay-On Benefits Attributable to Services Performed Postpetition.

In appealing the Bankruptcy Court's November 29, 1999

Order, Appellants raise four issues. First, Appellants contend that the Stay-On benefits, in their entirety, are entitled to administrative expense priority. Second, Appellants contend that Stay-On benefits are different from severance benefits. Third, Appellants contend that Debtors will be unjustly enriched if administrative expense priority is not afforded to the entire amount of Stay-On benefits. Fourth, Appellants contend that immediate payment of the Employees' claims should be ordered pursuant to 11 U.S.C. § 105.

A. Whether the Bankruptcy Court properly allocated the Stay-On benefits between the prepetition and postpetition periods.

Appellants contend that the Stay-On benefits are, in their entirety, administrative expenses as defined in Section 503(b)(1)(A) of the Bankruptcy Code,[1] and are entitled to

[1]Section 503(b) of the Bankruptcy Code provides:

> [T]here shall be allowed administrative expenses including-
>
> (1)(A) 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.

first priority under Section 507(a)(a) of the Bankruptcy Code.[2]

Appellants assert that the Stay-On benefits are entitled to administrative expense priority because the flow of consideration given in exchange for the Stay-On benefits occurred post-petition. According to Appellants, the consideration for the Stay-On benefits was being an employee in good standing at the time of the termination.

For purposes of claim treatment in bankruptcy, the Court of Appeals for the Third Circuit has distinguished between severance benefits in lieu of notice of termination and severance benefits based on length of employment. See In re Roth American, Inc., 975 F.2d 949, 957 (3d Cir. 1992)(quoting In re Health Maintenance Found., 680 F.2d 619, 621 (9th Cir. 1982)). "In the first scenario, the consideration for receiving severance pay is being an employee of a debtor-in-possession in good standing at the time of the termination of duties. In the second situation, the consideration for receiving severance pay is the services performed for the

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[2]Section 507 provides in relevant part:

> (a) The following expenses and claims have priority in the following order:
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> > (1) First, administrative expenses allowed under section 503(b) of this title . . . .

11 U.S.C. § 507.

company over the entire period of each employee's employment." In re Allegheny Int'l, Inc., 118 B.R. 276, 279 (Bankr. W.D. Pa. 1990)(citing In re Mammoth Mart, 536 F.2d 950, 955 (1st Cir. 1976)).

Because consideration for the first type of severance pay is deemed not to occur until the termination date, i.e. postpetition, that type of severance is generally accorded administrative expense priority. See Allegheny, 118 B.R. at 278. On the other hand, the second type of severance is deemed to have accrued over the entire term of the employee's employment. Id. Thus, only that portion allocable to work performed during the postpetition period is generally accorded administrative expense priority. Id. The remaining portion allocable to the prepetition period is treated as a general unsecured claim, subject only to the availability of the priority under Section 507(a)(3) of the Bankruptcy Code for wages and benefits earned in the 90 days prior to the petition date. In re Wean Inc., 171 B.R. 528, 531 (Bankr. W.D. Pa. 1994).

Although the Employees had to be in good standing at the time of termination in order to receive the Stay-On benefits, the record in this case clearly demonstrates that the amounts to which the Employees were entitled under the severance package were tied directly to length of service. (D.I. 2,

Exh. 1, at Exh. B). Both the accrual of BHQ Time and the week-per-year cap on the Stay-On benefits correlate to an employee's overall length of tenure with the Debtors. Id. Thus, the Court concludes that the Bankruptcy Court was correct in holding that Appellants are entitled to administrative expense priority only for Stay-On benefits attributable to services performed postpetition.

B. Whether Stay-On benefits are entitled to administrative expense priority because they are different from severance benefits.

Appellants rely on two cases in support of their contention that Stay-On benefits should be treated differently than traditional severance benefits.

In the first case, In re Smith Corona Corp., 210 B.R. 243 (Bankr. D. Del. 1997), the bankruptcy court addressed the extent to which an insurer was entitled to administrative expense treatment for an unpaid insurance premium. Id. at 245-47. The insurance policy in Smith Corona provided for monthly premium payments plus an additional annual premium payable on the last day of the policy year. Id. at 244. In holding that each of the monthly premiums due postpetition as well as the additional annual premium, which became due postpetition, were each administrative expenses of the debtor's estate, the bankruptcy court concluded:

> Nothing in this record supports the assertion that a portion of the additional premium is payment for pre-petition employee insurance benefits. Furthermore, the court cannot agree with Smith Corona's implicit argument that the additional premium may be uniformly attributed to the prior year, which would be necessary for this court to prorate the additional premium due September 1995. The additional premium is a separate element of compensation that the parties agreed to and that benefits the estate.

Id. at 246.

In the instant case, however, the Bankruptcy Court concluded that the amounts to which the Appellants are entitled are attributable to the Appellants' employment with the Debtors prior to the Petition Date because the amounts vary based on length of employment. (D.I. 2, Exh. 6, at 15). Thus, the Court concludes that the rationale in Smith Corona is inapplicable because the record in this case indicates that the payments contain a significant portion of prepetition service.

The second case Appellants rely upon in support of their contention that Stay-On benefits should be treated differently than severance benefits is In re Artesian Indus., Inc., 183 B.R. 496 (Bankr. N.D. Ohio 1995). In Artesian, the debtor was undergoing financial difficulties and, in order to retain key management, entered into severance agreements with eight of its executives on April 1, 1992. Id. at 499. Under the terms of the agreements, each executive was entitled to receive a certain percentage of his annual salary, plus twenty-five

percent to compensate for lost benefits, if they were terminated, other than for cause, within twelve months of the execution of the agreement. Id. at 496-97.

The next day, April 2, 1992, the debtor's principal lender commenced a foreclosure action in state court and a receiver was appointed the same day. Id. at 497. The receiver obtained authority from the state to sell substantially all of the debtor's assets. Id. The sale was completed in August 1992, and the receiver moved in state court to distribute the sale proceeds. Id. While the receiver's motion was pending, an involuntary chapter 7 petition was filed against the debtor. The receiver terminated the eight executives in July and August 1992. Id. at 498. Each of the executives then filed a proof of claim in the bankruptcy court for payment of their severance claim as an expense of the receivership, not as an administrative expense in the chapter 7 proceeding. Id. at 498-99.

In concluding that the severance claims were expenses of the receivership, the bankruptcy court found that:

> The evidence indicates that the retention of Artesian's management through the period of the receivership was important to the company's customers and vendors. Thus, the court finds that the severance agreements and the debt incurred pursuant to the same directly and substantially benefitted the receivership estate.

Id. at 500.

As the Bankruptcy Court in this case correctly concluded,

Artesian is distinguishable on a variety of grounds. First, all but one day of the period of time during which the executives were employed by the debtor subsequent to execution of their severance agreements occurred during the receivership. In this case, a significant portion of the Employees' service occurred pre-petition. Second, the benefits offered to the executives in Artesian were a fixed percentage of the executives' salaries. Here, the benefits offered to the Employees' depended on their length of service with the debtor. Third, while the Artesian court expressly stated that it would apply case law relating to the allowance of administrative expenses in bankruptcy cases by analogy, it noted that the bankruptcy case law was not dispositive. Thus, the Court concludes that Artesian does not support Appellants' position that all Stay-On benefits are entitled to administrative expense priority.

C. Whether proration of the Stay-On benefits would unjustly enrich the Debtors.

Appellants contend that a denial of administrative expense priority for the prepetition portion of their claims would unjustly enrich the Debtors and their creditors by allowing them to retain the benefit of the consideration without expending the promised compensation. Appellants rely on two cases in support of their argument.

In the first case, In re Visual Industries, Inc., 57 F.3d 321, 325 (3d Cir. 1995), the Court of Appeals for the Third Circuit found that no unjust enrichment had taken place where a supplier to a debtor was denied administrative expense priority for services rendered to the debtor's estate after the petition date, because the nature of the those services rendered were of no benefit to the estate. Id. at 325. In the second case, In re Sharon Steel Corp., 206 B.R. 776, 783 (Bankr. W.D. Pa. 1997), the claims of certain employees who provided services to a debtor exclusively in the postpetition period were treated as administrative expenses. The Court concludes that neither case stands for the proposition that denial of administrative expense priority for services rendered prepetition constitutes unjust enrichment.

D. Whether Appellants are entitled to immediate payment under Section 105.

Appellants contend that pursuant to Section 105 of the Bankruptcy Code, the Bankruptcy Court, as a court of equity, should have directed the Debtors to make immediate payment of the Employees' claims for the Stay-On benefits.

Issues within the equitable discretion of a bankruptcy court should be overturned only for an abuse of discretion. See In re Continental Airlines, 91 F.3d 553, 560 (3d Cir. 1996). The Bankruptcy Court rejected Appellants' Section 105

argument, holding:

> The Employees also seek equitable relief in the form of immediate payment of their claims under § 105. To the extent that the clear language of § 503 relegates their claims to general prepetition status, an order for immediate payment under § 105 is inappropriate. To the extent that § 503 and § 507 grant administrative expense status to the Employees' claims, payment will be made according to the schedule of payments for similar claims.

(D.I. 2, Exh. 6, at n.8).

The Court concludes that the Bankruptcy Court's holding did not constitute an abuse of discretion given the clear language of Sections 503(b)(1)(A) and 507(a)(a) of the Bankruptcy Code.

CONCLUSION

For the reasons discussed, the Court concludes that the Bankruptcy Court's November 29, 1999 Memorandum Opinion and Order denying in part and granting in part the motion of Appellants requesting allowance and immediate payment of certain severance benefits as administrative expenses pursuant to sections 503(b)(1)(A), 507(a)(1) and 105 of the Bankruptcy Code should be affirmed.

An appropriate Order will be entered.