UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: BKY 4-90-5759

CPT CORPORATION,

Debtor.

MEMORANDUM ORDER SUSTAINING DEBTOR'S OBJECTION TO THE CLAIM OF ARTHUR B. SIMS

At Minneapolis, Minnesota, November 26, 1991.

The above-entitled matter came on for hearing before the undersigned on the 1st day of October, 1991, on the debtor's objection to the claim of Arthur B. Sims. Appearances were as follows: Keith W. Bartz and Michael B. Fisco on behalf of the debtor; and T. Chris Stewart and Chris Dahl on behalf of the claimant, Arthur B. Sims.

FINDINGS OF FACT

On December 16, 1987, CPT Corporation ("CPT"), the debtor in this case, entered into a written employment agreement with Arthur B. Sims ("Sims"), whereby Sims was to be employed as the president and chief executive officer of CPT. CPT had been experiencing ongoing financial difficulties and hired Sims at an annual salary of $225,000 in an effort to improve its business.

The employment agreement included a provision for termination without cause on 60 days notice. Under that provision, if CPT terminated Sims without cause during the first four years of the employment agreement, Sims was to be paid "a severance allowance equal to 24 months base salary from the date of notice or termination plus a portion of any incentive bonus which would otherwise [have been] paid to [Sims] during such 24 month period. . . ." If Sims were terminated without cause more than

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Filed and Docket Entry made on 11/27/91
Patrick G. De Wane, Clerk, By KK

four years into the employment agreement, then the severance allowance was to be "12 months base salary plus incentive bonus."

Sims was employed under the employment agreement as CPT's president and CEO for approximately 15 months until April 26, 1989 when he was suspended and eventually terminated. Sims filed a formal demand for arbitration contesting the board's actions and CPT filed a district court action seeking damages from Sims. All claims were consolidated and proceeded to arbitration, wherein the arbitration panel awarded Sims a total of $446,615. The award included an allowance for severance pay in the amount of 450,000.[1] The arbitration award was affirmed by the Hennepin County District Court on September 27, 1990 in the amount of $463,082 plus interest and costs, and this judgment was affirmed by the Minnesota Court of Appeals on April 8, 1991 in the amount of $464,267.

On October 11, 1990, shortly after the district court judgment, CPT filed the present chapter 11 case. On December 12, 1990, Sims filed a proof of claim against the estate in the amount of $464,267. On July 29, 1991, CPT objected to Sims' claim, asserting that section 502(b)(7) limits the amount of the claim to the equivalent of one year's salary under the employment agreement, i.e., $225,000. Sims filed a response and it is this objection that is the subject of the present controversy.

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[1] The award also included interest in the amount of $32,106, costs of $5,759, dental expense reimbursement of $6,750, and an offset of $48,000 which Sims owed to CPT on a non-interest bearing note. Additional interest of 7% was allowed on the severance pay portion of the award until the date of payment. Sims was awarded an additional $6,025 as reimbursement for arbitral administrative fees and compensation previously advanced.

<u>DISCUSSION</u>

Section 502(b)(7) of the Bankruptcy Code provides that contested claims should be allowed in the amount in which they are filed except to the extent that:

> (7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds --
>
> > (A) the compensation provided by such contract, without acceleration, for one year following the earlier of --
> >
> > > (i) the date of the filing of the petition; or
> > >
> > > (ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus
> >
> > (B) any unpaid compensation due under such contract without acceleration, on the earlier of such dates.

11 U.S.C. § 502(b) (1982 & Supp. 1987).

It appears that the only reported case discussing section 502(b)(7)'s coverage with respect to a severance allowance is <u>In re Uly-Pak, Inc.</u>, 128 B.R. 763 (Bankr. S.D. Ill. 1991). In <u>Uly-Pak</u>, the debtor's assets were sold approximately ten months after the petition was filed, and this sale terminated the employment contract of the debtor's president and chief executive officer, H. Keith Howard ("Howard"). The employment contract provided that if the contract was terminated, Howard would "receive as severance pay his salary for the remaining term of the contract or, at the option of the debtor, a lump sum equal to 300% of his annual salary, to be paid within 10 days of severance."

Uly-Pak, 128 B.R. at 764. Howard's estate asserted a claim against the bankruptcy estate seeking a lump sum payment of $180,000 -- 300% of his annual salary of $60,000.[2] The court found that the claim for severance pay was one for "damages resulting from the termination of an employment contract," and therefore § 502(b)(7) limited the claim to Howard's annual salary under the employment contract. Id. at 769 (quoting In re Murray Industries, Inc., 114 B.R. 749, 752 (Bankr. M.D. Fla. 1990) (hereinafter "Murray I").

The same reasoning applies to the factual situation in the present case. The employment agreement provided for a lump sum severance payment on the date of termination. Sims was only entitled to the severance payment if he was terminated without cause. The arbitration award that forms the basis of Sims' claim awarded Sims his severance payment for termination without cause. Therefore, Sims' claim against the estate is a claim for damages resulting from the termination of an employment contract as contemplated by section 502(b)(7).

Sims presents three arguments, two of which would remove the severance payment from the pale of section 502(b)(7) altogether, and one which would entitle Sims to the entire amount claimed even if section 502(b)(7) applies.

First, Sims argues that his termination was too remote from the filing of CPT's bankruptcy petition for the claim to be

[2] Howard was deceased and his estate assumed his claim against the debtor.

limited by section 502(b)(7). Sims relies on the case of In re Vic Snyder, Inc., 23 B.R. 185 (Bankr. E.D. Pa. 1982). In Vic Snyder, an employee was terminated over four and a half years prior to the filing of the debtor's bankruptcy petition, and had reduced his claim to judgment nearly a year and a half prior to the petition. The court found "the termination of [the employee] and the fixing of damages by the state court to be too remote from the bankruptcy to be affected by the Code." Vic Snyder, 23 B.R. at 186. In reaching its remoteness holding, the court inferred from the legislative history that Congress intended section 502(b)(7) to apply to breaches of contract that occurred "as a result of the bankruptcy or from an [employment] agreement rejected in the reorganization proceeding." Id. at 187. Two recent decisions suggest that Vic Snyder also implies that section 502(b)(7) would apply where an employee was terminated pre-petition "as part of a deepening financial problem." See In re Johnson, 117 B.R. 461, 467 (Bankr. D. Minn. 1990) (Kishel, J.); In re Murray, 130 B.R. 113, 117 (M.D. Fla. 1991) ("Murray II").

Vic Snyder was criticized by Judge Kishel in In re Johnson, 117 B.R. 461 (Bankr. D. Minn. 1990). In Johnson, Judge Kishel correctly observed that Vic Snyder "is an isolated holding, not explicitly followed in any other reported decision." Johnson, 117 B.R. at 467. Judge Kishel also found that the express language of both the statute and the legislative history belie any suggestion that section 502(b)(7) should be limited to contracts terminated as a result of the bankruptcy case or through post-petition

rejection or as part of a deepening financial problem prior to bankruptcy.[3] Johnson, 117 B.R. at 467. I agree with Judge Kishel's reasoning. Section 502(b)(7) and its legislative history are devoid of language suggesting that the section should not apply to contract terminations which are deemed to be too remote from the filing of the petition.

I note that the recent opinion in Uly-Pak contains language which, if read in a vacuum, would seem to suggest that section 502(b)(7) only applies to post-petition termination of employment contracts. In Uly-Pak the court applied section 502(b)(7)'s limitations to the claim for severance pay of an employee that was terminated post-petition. The court stated:

> Had Uly-Pak terminated Howard's employment outside of bankruptcy, and had Howard found employment immediately after, Uly-Pak would have been liable for the full amount of the severance pay specified by the contract.

Uly-Pak, 128 B.R. at 769. However, when this statement is read in the context in which it was made, it is clear that the court was merely observing that the employee would have been entitled to the entire severance payment, regardless of mitigation, had no bankruptcy case been filed. Thus, the case cannot be read as holding that section 502(b)(7) only applies to post-petition terminations. This would lead to the anomalous result that the severance pay of an employee who was terminated the day before the

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[3] The District Court for the Middle District of Florida has similarly declined to follow Vic Snyder in In re Murray Industries, Inc., 130 B.R. 113, 117 (M.D. Fla. 1991). However, rather than disagreeing with Vic Snyder, it did so on the ground that its case was distinguishable from Vic Snyder. Murray II, 130 B.R. at 117.

petition would not be limited by section 502(b)(7), while the severance pay of an employee terminated 24 hours later would be so limited.

I am also aware of the recent holding in In re Murray, 130 B.R. 113, 117 (M.D. Fla. 1991) (hereinafter "Murray II") wherein the court declined to apply section 502(b)(7), finding that Vic Snyder could be read as treating the claimant as a judgment creditor rather than an employee with a pending claim. Murray II, 130 B.R. at 117. However, I do not read Murray II as holding that section 502(b)(7) does not apply to a claim which is reduced to judgment because that claim somehow loses its character as a claim for damages resulting from the termination of an employment contract. The court in Murray II simply observed that one of the determinative facts in Vic Snyder was that the employee was a judgment creditor.

Second, Sims argues that his severance allowance was a bargained-for incentive that became vested on the date the employment agreement was signed. He argues that section 502(b)(7) limits claims for future earnings which would have been due had the contract not been terminated, and does not limit vested benefits where the employee has given all of the consideration entitling him to the benefit.

In support of this argument, Sims relies on In re Gee & Missler Services, Inc., 62 B.R. 841 (Bankr. E.D. Mich. 1986) and In re Prospect Hill Resources, Inc., 837 F.2d 453 (11th Cir. 1988). In Gee & Missler, the court found that section 502(b)(7) was

inapplicable to a pension fund's claim for damages from post-petition withdrawal from participation in the fund. In Prospect Hill, the court refused to apply section 502(b)(7) to a claim for retirement benefits by an employee that had retired pre-petition. In Gee & Missler, the court stated:

> Section 502(b)(7) limits a claim for future compensation, which conceivably would have been earned had the parties continued to perform under the terminated contract. Section 502(b)(7) does not limit a claim for which the employer has received all the consideration for which it has bargained, and all that remains to be done is for the employer to fulfill its obligation of payment.

Gee & Missler, 62 B.R. at 845. Prospect Hill contains similar language. See Prospect Hill, 837 F.2d at 455.

Sims argues that these cases are applicable to the present fact situation because the severance allowance, like the pension and retirement benefits in Gee & Missler and Prospect Hill, were vested in the sense that Sims would be entitled to payment without providing further consideration. However, the present severance allowance is distinguishable from the pension and retirement benefits that were being claimed in Gee & Missler and Prospect Hill because those benefits were not damages from termination of an employment agreement. They were vested benefits payable upon retirement and can in no way be construed as damages resulting from the termination of the employment contract. Sims' severance allowance, on the other hand, is clearly a measure of damages from the termination of his employment contract. It was designed to compensate him for the loss he would suffer upon being terminated

without cause. The allowance is simply a liquidation or an estimation of the damages that would result from such termination. The mere fact that the provision was negotiated at the outset of the employment relationship, rather than litigated before a court after Sims was terminated, does not change the nature of the payment. This distinction is implicit in both Gee & Missler and Prospect Hill because the courts refused to apply section 502(b)(7) to retirement and pension plans finding that the section only limits "claims for future compensation." Section 502(b)(7) applies to Sims' severance allowance because the claim for that allowance is a claim for damages from the termination of an employment contract.

Third, Sims argues that even if section 502(b)(7) applies, he is still entitled to the full amount of his claim because subsection (A) only limits his claim to the compensation provided by the contract, without acceleration, for one year following his termination.[4] 11 U.S.C. § 502(b)(7)(A). Since his employment contract provided for a lump sum payment of $450,000 -- the equivalent of 24 months salary -- due on the date of termination, Sims asserts that this is the amount provided by the contract for one year following termination and that the provision contains no acceleration of future compensation. Sims cites no authority for this argument and I find none.

[4] The section limits claims to the amount provided by the contract for one year following the earlier of either the employee's termination or the filing of the bankruptcy petition. In Sims' case, termination of the employment contract preceded the filing of the petition.

Although this is an interesting argument, I cannot escape the conclusion that Sims' severance allowance does constitute an acceleration of payment as contemplated by the statute. As stated above, the severance payment is essentially a liquidated damages provision, and certainly took into account the probability of lost income due to termination without cause. Thus, while the severance allowance does not expressly provide for acceleration, it has the same effect by liquidating future amounts that would have been due had the contract not been terminated.

Any other conclusion would relegate the application of section 502(b)(7) to the skill of the parties drafting the employment agreement. Where severance pay was stated as an acceleration of the amount that would have been due absent termination of the contract, section 502(b)(7) would limit the amount of the payment. However, severance pay stated as a dollar amount or as a calculation based on the employee's base salary, like the provisions in this case and in Uly-Pak, would not be limited by section 502(b)(7) even though the differently worded provisions compensate the employee for the exact same damage. Such a result should not be condoned.

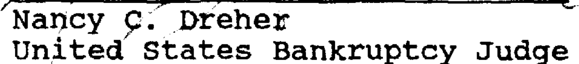
Finally, the holding today is in keeping with the legislative intent behind section 502(b)(7) as construed by every court considering the issue. These courts conclude that section 502(b)(7) was intended to protect the estate from the burdensome claims of key executive employees who were able to exact high salaries and favorable terms in their employment contracts. See

Murray I, 114 B.R. at 752; Prospect Hill, 837 F.2d at 455; Gee & Missler, 62 B.R. at 844. Although Sims was not previously associated with CPT prior to the present employment contract, CPT's financial distress and its need to find a CEO to turn its business around gave Sims substantial bargaining power. The nature of CPT's financial distress may have precluded Sims from obtaining a long-term employment agreement, but he was still able to exact lucrative short-term benefits including an annual salary of $225,000 and a severance payment of twice that amount. Sims states that his salary was higher in his prior position than it was with CPT but this does not suggest that the legislative intent is not served in this case. On the contrary, Sims' substantial prior salary most likely improved his bargaining position with respect to CPT. From the facts it appears that this is exactly the type of employment contract contemplated by the legislative intent as set forth above.

ACCORDINGLY IT IS HEREBY ORDERED:

1. CPT's objection to the claim of Arthur B. Sims is SUSTAINED;

2. Sims claim against the bankruptcy estate is allowed in the amount of $225,000.



Nancy C. Dreher
United States Bankruptcy Judge