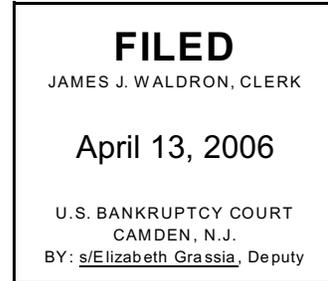


NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEW JERSEY



IN RE:

ZAGARA'S FRESH MARKETS, LLC, a  
New Jersey Limited Liability Company,

Debtor.

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:  
:  
: CHAPTER 11  
:  
: CASE NO. 03-43017 (GMB)  
:  
: MEMORANDUM OPINION

APPEARANCES:

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Unsecured Creditors

Before the Court is Paul Maselli's ("Maselli") application for compensation in the above-captioned chapter 11 case. Also before the Court are objections to the Maselli application filed

by the Debtor, the Chapter 11 Trustee, the U.S. Trustee, and the Official Committee of Unsecured Creditors (the “Committee”).

### **FACTUAL BACKGROUND**

Debtor filed for chapter 11 bankruptcy on October 6, 2003. Debtor hired Maselli as its bankruptcy attorney.<sup>1</sup> Maselli received a \$25,000 pre-petition retainer.<sup>2</sup> Debtor operated as a debtor-in-possession until April 1, 2004, when the Court appointed a chapter 11 trustee. Maselli’s retention was terminated on March 12, 2004. On May 26, 2004, Maselli filed the current application for compensation, which requests approval for attorneys’ fees totaling \$76,606.53.

On June 2, 2004, the Chapter 11 Trustee filed an objection to Maselli’s application and a cross-motion to compel disgorgement of Maselli’s pre-petition retainer and disallowance of professional fees. The Chapter 11 Trustee argues that the Court should deny Maselli’s application and disgorge the retainer he received pre-petition, because:

1. He exhibited a lack of professional competence.
2. He failed to exercise due care and otherwise breached his fiduciary duties to Debtor.
3. He failed to adequately advise the debtor-in-possession as to its duties and obligations under the Rules and Code.

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<sup>1</sup> Maselli attached an Agreement to Provide Legal Services (the “Agreement”), which provides that Debtor retained Maselli “with respect to advice regarding bankruptcy generally,” and that Maselli had not “been engaged at this time to file a bankruptcy proceeding or otherwise prepare bankruptcy papers.” The Agreement submitted to the Court is unsigned and undated.

<sup>2</sup> Maselli noted that the retainer has not been disbursed and remains in his firm’s general account.

4. He permitted knowing violations of the Rules and Code, including:
  - a. the retention of professionals without prior approval from the Court;
  - b. conducting auctions with unapproved auctioneers;
  - c. agreed to an arrangement permitting fee splitting;
  - d. paid for duplicative and unnecessary professionals, such as Bradley.
5. He failed to act to prevent certain unauthorized acts including the disposition of estate property.
6. He instructed Debtor to create a “slush fund” outside of the bankruptcy for the purpose of paying the unapproved professionals.<sup>3</sup>
7. He provided no benefit to the estate.
8. His application contains numerous entries where time is “lumped together,” making it impossible to determine if the time spent was reasonable in light of the corresponding task. Further, his application contains a great number of entries where he spoke with creditors on the phone about the case.

Debtor and the Committee filed objections concurring with the Chapter 11 Trustee’s arguments. The United States Trustee also filed an objection in which he asserted the following additional arguments in favor of denial of Maselli’s application:

1. Maselli failed to guide the professionals through the bankruptcy;
2. He incurred needless fees and costs, including \$100,000 in professionals that performed overlapping services;
3. The retainer is property of the estate and should not be used as a post-petition retainer for representing a debtor out of possession;
4. Debtor paid an additional \$10,000 to Gates & Co. without disclosure;
5. Debtor escrowed \$50,000 of company funds (into the slush fund) with counsel, which remained undisclosed until Maselli was fired;

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<sup>3</sup> Maselli denied any knowledge of this fund at the July 22, 2004 hearing.

6. Maselli failed to take the necessary steps or provide guidance to facilitate an effective reorganization.

Maselli filed a response to the aforementioned objections on June 25, 2004. Maselli asserted the following arguments in his response:

1. Debtor, while operating as a debtor-in-possession, decided that “it needed eight professionals to assist in carrying out its duties.” He also asserted that based on his past experience and the information he had in his possession, he felt that “it was completely appropriate for the DIP to make the applications it made.”
2. He pursued the FEBA auction proceeds.
3. He was not retained to provide business advice and is not competent to do so. It was not he, but Debtor who decided to (a) retain professionals; (b) sell its assets by public and private sale; (c) reject leases, accept leases, and enter new leases; (d) close two stores; and (e) use cash collateral to fund its post-petition operations.
4. If Debtor looked to an attorney for advice, it was Mr. Lanciano, not Maselli. Lanciano had a two-year pre-bankruptcy relationship with Debtor. Debtors felt comfortable making business decisions without his advice, and he had full confidence in Lanciano’s ability to work with Debtor on business issues.
5. He asserts that he was not aware of the existence of a slush fund or the \$10,000 payment to Gates & Co.
6. His services benefitted the estate. More specifically, he (a) handled cash collateral matters; (b) worked with the Committee; (c) convinced NCB to pay more than \$120,000 in post-petition rent, thereby eliminating an administrative expense; (d) negotiated a \$100,000 waiver of post-petition rent with the landlord; and (e) assisted Debtor in bringing Teich Groh up to speed after he was terminated.

### **LEGAL DISCUSSION**

Pursuant to § 330(a)(1), the Court may approve

- (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and
- (B) reimbursement for actual, necessary expenses.

11 U.S.C. § 330(a)(1) (2004).<sup>4</sup> However, the Court may not allow compensation for

- (I) unnecessary duplication of services; or
- (ii) services that were not--
  - (I) reasonably likely to benefit the debtor's estate; or
  - (II) necessary to the administration of the case.

11 U.S.C. § 330(a)(4)(A) (2004). In determining whether an applicant's fees are reasonable, the Court "shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--

- (A) the time spent on such services;
- (B) the rates charged for such services;
- (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
- (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
- (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

11 U.S.C. § 330(3)(A) (2004). If the Court finds that the compensation requested exceeds the reasonable value of such services, the Court may order the return of any excessive payments. 11 U.S.C. § 329(b) (2004).

Further, the Court has the power "to deny fees and disbursements where serious breaches of fiduciary obligations occur." In the Matter of Arlan's Dept Stores, Inc., 615 F.2d 925, 943 (2d Cir. 1979). In cases where "ethical violations are a factor to be considered by the court on fee applications, the absence of competence should be the primary focus, and where unethical

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<sup>4</sup> "The burden of proof is on the party requesting a compensation award." In re LaFrance, 311 B.R. 1, 21 (Bankr. D. Mass. 2004).

conduct has lessened the value of the services rendered the fee should be reduced.” In re Wilde Horse Enterprises, Inc., 136 B.R. 830, 844 (Bankr. C.D. Cal. 1991). If a bankruptcy court “determines that the services were incompetently performed and therefore have no value, then such services cannot be compensated.” Id.; see also LaFrance, 311 B.R. at 25 (“Clients come to attorneys for a service. Where the service is not provided, or provided poorly, they should not be required to pay for the service, regardless of the validity of the excuse offered.”).

Additionally, a bankruptcy attorney “has a duty to supervise clients’ conduct for compliance with the Bankruptcy Code. As a professional, an attorney must instruct the debtor on the appropriate conduct and must develop client control.” In re Michels, 2004 Bankr. LEXIS 1016, \*9-10 (Bankr. N.D. Iowa 2004). Finally, pursuant to the New Jersey Rules of Professional Conduct, an attorney shall not

- (a) Handle or neglect a matter entrusted to the lawyer in such a manner that the lawyer’s conduct constitutes gross negligence.
- (b) Exhibit a pattern of negligence or neglect in the lawyer’s handling of legal matters generally.

N.J. R.P.C. 1.1 (2004).

Thus, a bankruptcy court may approve applications for compensation of services that were competently performed and that were actual, necessary, and beneficial to a debtor’s estate.

In this case, Maselli failed to guide the Debtor through its bankruptcy case by permitting it to commit violations of the Rules and Code, such as hiring unnecessary and expensive professionals with prepetition retainers which were not disclosed to the Court and conducting sales and auctions of estate property without prior Court approval. He also failed to explain

adequately to the Debtor and its principals the impact of its business decisions on its bankruptcy case, and discuss a strategy to emerge from chapter 11. Further, he failed to educate himself as to the Debtor's financial condition, in order to properly advise the Debtor, creditors, and the Court as to the Debtor's viability in chapter 11.

Furthermore, Maselli's argument that he was not retained to provide business advice is inexplicable. In chapter 11 reorganization cases, an attorney cannot bifurcate business advice from bankruptcy advice, because nearly every action a debtor-in-possession takes is effected by its bankruptcy and affects its bankruptcy. In other words, the two areas are necessarily intertwined, and when Maselli entrusted this advice to a non-bankruptcy attorney, it was a dereliction of his duty as a bankruptcy attorney. The debtor may have non-bankruptcy special counsel to advise on certain non-bankruptcy matters, but it is bankruptcy counsel who must guide the debtor through the chapter 11 process.

In his certification, Mr. Maselli asserts that the Debtor decided it needed eight professionals and he believed it "was completely appropriate for the DIP to make the applications it made." (Maselli Certification, ¶ 5).

Could the Debtor, whose plan proposed to reject leases, close operations and retain only one operating market, afford eight professionals? Did Mr. Maselli discuss with the professionals the services each professional would perform and their obligations under the Bankruptcy Code? Did he discuss with the Debtor the propriety of engaging so many professionals? Based on the applicant's time records, the Court proceedings, and Mr. Maselli's certification, the answer to these questions is clearly no.

The representative of Food Equipment Brokers & Appraisers (“FEBA”) testified at a hearing on its compensation that she advised Mr. Maselli that her company was not an auctioneer but a broker who would retain an auctioneer. The actual auctioneer was never properly retained and FEBA lost substantial anticipated profits because Mr. Maselli never properly discussed the retention with the principals or explained to them their responsibilities under the Code. Had they known the restrictions imposed by the Bankruptcy Rules they may have declined to be engaged by the Debtor.

Mr. Maselli so neglected his responsibilities with regard to the appointment of professionals (necessitating numerous hearings with FEBA, Mr. Bradley, the realtor, Mr. Luciano and Gates & Company) that any benefit from his services regarding their appointment was subsumed in the cost to resolve the issues and therefore, no compensation for the appointments should be allowed.

Mr. Maselli asserts that he was not retained to provide business advice and is not competent to do so. If this is true, then he should not have undertaken representation of this Debtor. Although the client is responsible for making decisions as to its business operations, this can only be done properly with guidance and advice from bankruptcy counsel. No where in the record is there evidence that Mr. Maselli explained the DIP’s responsibilities, the options which existed and the manner in which the debtor should proceed in the chapter 11, so that the principals could make informed decisions about the process.

A bankruptcy attorney cannot limit his services to preparing petitions and documents without advising the debtor about the process and its obligations. Chapter 11 proceedings are difficult enough for small businesses to navigate, and good bankruptcy advice is crucial.

Mr. Maselli also claims that excessive costs were caused by the litigious nature of the committee. While the committee was active and assertive, the need for litigation was compelled and exacerbated by continuing failure of the Debtor and its professionals, especially Mr. Maselli to bring matters before the Court in a timely manner and keep the committee apprised of its actions. One of the key elements in a successful reorganization is open and extensive discussions and communication with the committee and other parties which was absent in the matter before this Court.

Additionally, his argument that he bestowed a benefit upon the estate when he assisted Debtor's new attorney after he was fired is likewise non-compensable, especially in light of the fact that Maselli failed to appear at the March 31, 2004 hearing, and that these services were only required because of his inability to perform the services he was engaged to perform, and the Debtor's dissatisfaction with that situation.

In a similar case, the Bankruptcy Court for the Central District of California denied an attorney's fees completely. In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991). In Wilde Horse, the court found that the attorney failed to file a plan or disclosure statement; failed to keep updated documentation; failed to file interim and operating reports for several months; failed to submit fees; failed to deliver post-petition taxes and returns; failed to file a motion to assume or reject Debtor's unexpired leases; failed to file a proper motion to sell; failed to take an active party in the bankruptcy; and otherwise failed to comply with bankruptcy rules and Code provisions, which resulted in the appointment of a trustee. Id. at 835-38. The court also found that she breached her duty of competence under California Law. Id. at 844. As a result, the court found that the attorney's "misconduct in the case; i.e., her breach of her

fiduciary duty to act in the best interests of the estate and her failure to act competently, [was] a sufficient ground to deny her application for compensation in its entirety . . . .” Id. at 834.

In this case, based on the foregoing, Maselli likewise breached his duty to his client by failing to perform competently and by failing to guide Debtor through its bankruptcy. Moreover, most of the services he performed had little value to the estate, especially in light of the countless hearings that were held and motions that that were filed in attempts to correct matters which were not properly handled by the Debtor and/or its counsel.

In reality, Maselli acted more like a petition-preparer, than a bankruptcy attorney guiding a debtor-in-possession through a chapter 11 reorganization case. In contrast to Wilde Horse, in this matter there were some services which were beneficial. As such, the only fees that could be couched as actual and necessary and as having bestowed some benefit upon the estate are those associated with petition preparation, cash collateral, attendance at the Committee formation meeting and 341(a) meeting, resolution of PACA claims and miscellaneous services relating to same. Below is a summary of the fees associated with those tasks.

<b>ATTORNEY'S FEES ALLOWED AS HAVING BENEFITTED THE ESTATE</b>		
<b>DATE</b>	<b>DESCRIPTION</b>	<b>AMOUNT</b>
10/03/03	Various telephone calls with clients, consultants and general counsel	275.00
10/04/03	Preparation of drafts of initial papers including petition, cash collateral motions, applications to appoint counsel, etc.	1,100.00
10/05/03	Review of extensive documents with information regarding projections and forecasts, historical performance, offering of assets for sale, etc.	550.00
10/06/03	Preparation of final papers for filing	1,100.00

10/06/03	Meeting with client to finalize all information and review strategy process and procedure	1,100.00
10/07/03	Telephone call with Mr. Creamer, consultant regarding status and issues and banking	27.50
10/07/03	Drafting of correspondence to Bank with information regarding chapter 11	27.50
10/07/03	Telephone call with US Trustee regarding case filing and issues	27.50
10/07/03	Drafting of correspondence to NCB officer with info regarding bankruptcy and motion	55.00
10/07/03	Telephone call with trustee regarding motion	27.50
10/07/03	Meeting with associate to discuss strategy and assignments	275.00
10/07/03	Assemble motion, telephone call with creditors to provide notice and overnight package to all parties	240.00
10/07/03	Meeting with Mr. Maselli to discuss issues regarding bank lien and reclamation	135.00
10/07/03	analysis of bankruptcy and state law regarding right of reclamation	81.00
10/08/03	Telephone call with attorney for Bank regarding hearing, transmit motion papers	82.50
10/08/03	Several telephone calls with client and with attorney for bank re: cash collateral issues and efforts attendance resolution on cash collateral	495.00
10/08/03	Legal research regarding Perishable Agricultural Commodities Act as applicable to Bankruptcy Code	148.50
10/09/03	Attendance at court regarding cash collateral matter	1,787.50
10/10/03	Drafting of correspondence to manager regarding critical path issues and auction and cash collateral issues; drafting of correspondence to client regarding c.o.d. deliveries	82.50
10/10/03	Telephone call with Ben of Sushi regarding pre-bankruptcy claims	27.50
10/14/03	Assemble addresses and information for purposes of amended and final schedules	240.00

10/14/03	Telephone call with vendors for debtor	148.00
10/15/03	Finalize list of creditors, schedules A to J and Rule 2016 for filing with court	240.00
10/15/03	Telephone call with creditor (Cindy of Klotz Cakes) regarding bankruptcy	13.50
10/15/03	Telephone call with creditors regarding chapter 11	81.00
10/15/03	Calls with creditors regarding chapter 11	54.00
10/15/03	Telephone call with creditors	54.00
10/16/03	Telephone call with general counsel regarding PACA issues	82.50
10/16/03	Travel to committee formation meeting	275.00
10/16/03	Attendance at committee formation meeting	687.50
10/16/03	Telephone call with attorney for bank and attorney for Committee re: cash collateral	27.50
10/16/03	Telephone call with Committee attorney re: cash collateral	55.00
10/16/03	Telephone call with CFO re: cash collateral issues	55.00
10/16/03	Drafting of correspondence to clients re: cash collateral hearing	27.50
10/18/03	Review of correspondence from attorney for Committee and drafting of correspondence to client re: document production and cash collateral adjournment	55.00
10/20/03	Telephone call with attorney for Committee re: extension of cash collateral hearing to next week	55.00
10/20/03	Telephone call with attorney for PACA claimants	55.00
10/20/03	Telephone call with attorney for bank re: issues for cash collateral	55.00
10/20/03	Preparation of and submission of reviewed creditor list	48.00
10/21/03	Drafting of correspondence to Committee and bank re: documents, budget, cash collateral	165.00
10/27/03	Travel to court for cash collateral	275.00
10/27/03	Attendance at court for cash collateral hearing	1,100.00
10/28/03	Drafting of correspondence to attorney for Committee and bank with proposed third cash order	27.50

10/28/03	Meeting with associate to assign motions to be filed with court	55.00
10/29/03	Review of correspondence from and respond to same re: cash collateral and re: other issues	55.00
10/29/03	Preparation of revised third order per comments from committee and bank	82.50
10/30/03	Telephone calls (several) with client, with attorney for bank, with financial manager, re: cash collateral issues, order issues, budget	275.00
10/31/03	Attendance at court for hearing on cash collateral	110.00
10/31/03	Telephone call with client regarding results of hearing, auction and sale issues	55.00
11/03/03	Telephone call with client regarding status of revised budget	0.00
11/03/03	Telephone call with attorney for committee regarding order and budget	27.50
11/03/03	Telephone call with attorney for Bank regarding order and budget	27.50
11/03/03	Drafting of correspondence to transmitting budget to all parties	55.00
11/05/03	Preparation of revisions to 2nd cash collateral order	27.50
11/05/03	Review of court order; telephone call with attorneys regarding issues and resolution of PACA language	220.00
11/05/03	Drafting of correspondence to all regarding minor comments on cash order and revision regarding PACA distributions	27.50
11/19/03	Review of cash report and drafting of correspondence to forward to Committee and bank for period ending 11-14-03	55.00
11/24/03	Review of all correspondence from client and emails to all parties including weekly cash report	27.50
12/08/03	Meeting with associate re: cash collateral motion extending beyond end of current period	165.00
12/08/03	Meeting with P. Maselli to discuss strategy; Compilation and review of interim orders concerning use of cash collateral	165.00
12/09/03	Preparation of and assemble information for motion for cash collateral	550.00
12/09/03	E-file and serve cash collateral motion	80.00
12/16/03	Review of file in preparation of 341 meeting of creditors	35.00

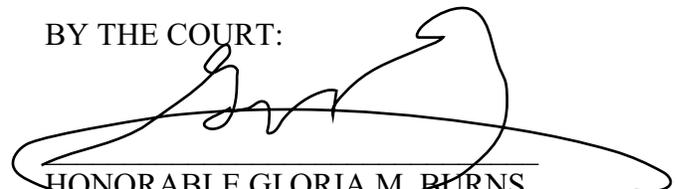
12/16/03	Attendance at Camden U.S. Trustee's Office for meeting of creditors. Conduct hearing. Review of petition in preparation of hearing.	630.00
12/16/03	Meeting with Mr. Paul Maselli about 341 meeting, upcoming hearing and requirement as detailed by U.S. Trustee. Memorandum to file.	52.50
12/17/03	Drafting of correspondence to U.S. Trustee re: initial interview of debtor	27.50
01/20/04	Telephone call with attorney for bank re: order on cash collateral	55.00
01/23/04	Finalize, format and file operating reports for October and November	160.00
01/29/04	Research on collateralized accounts and memorandum of law to Mr. Paul Maselli	70.00
1/31/04	Drafted correspondence to PACA counsel. Drafted Notice of Hearing t Disallow PACA claimants. Memorandum to File.	87.50
02/01/04	Revisions to Notice of PACA objections hearing. Drafting certification of service.	70.00
02/03/04	Drafting of correspondence to circulate 2-week cash report as required by cash collateral order	27.50
03/09/04	Meeting with Paul Maselli about PACA pleadings received on show cause order.	17.50
03/09/04	Review of Complaint and Order to Show Cause filed by PACA claimants. Memorandum of summation and analysis to Mr. Paul Maselli	122.50
03/10/04	Meeting with Mr. Paul Maselli about conversation with PACA trust fund counsel and strategy for tomorrow's hearing	35.00
03/10/04	Meeting with Mr. Paul Maselli about case status, upcoming hearings and deadlines and emergent PACA hearing	87.50
3/10/04	Review of file in preparation for tomorrow's emergent PACA trust fund hearing. Review of case law on PACA. Review of PACA statute.	227.50
3/11/04	Telephone call with attorney for landlord regarding check and distribution	55.00

3/11/04	Attendance at court Camden Bankruptcy Court for emergent PACA show cause hearing. Court denies application.	612.50
<b>TOTAL</b>		<b>\$15,953.00</b>

**CONCLUSION**

Based on the foregoing, the Court grants Maselli's application for compensation in the amount of \$15,953.00. Regarding the \$25,000.00 retainer, Maselli shall return to the trustee that portion of the retainer in excess of the aforementioned amount, \$9,047.00. Counsel for the trustee shall submit an Order to the Court in accordance with this decision.

BY THE COURT:



HONORABLE GLORIA M. BURNS  
United States Bankruptcy Judge