

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

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In re:

New Rochelle Telephone Corporation,

Debtor.

Case No. 8-08-75221-ast

Chapter 7

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**ORDER REGARDING PERMANENT TRUSTEE’S OBJECTION
TO ADMINISTRATIVE CLAIM OF INTERIM TRUSTEE**

Pending before the Court is the objection (the “Objection”) of John Pereira, as permanent chapter 7 trustee (the “Trustee”), to the administrative proof of claim filed by Kenneth Kirschenbaum, who served as the interim chapter 7 trustee (the “Interim Trustee”). The Interim Trustee seeks payment of commissions in accordance with 11 U.S.C. Section 326, in the aggregate amount of \$14,168.17. For the reasons herein, this Court defers ruling on the Objection until such time as the Trustee has filed his final report.

Background

This case started as a chapter 11 case filed by Debtor, New Rochelle Telephone Corporation (“Debtor”), on September 23, 2008 (the “Petition Date”). This Court presided over a number of contested hearings in this case while in the chapter 11 phase, several on an expedited basis, and issued a number of rulings, ultimately resulting in conversion of this case to chapter 7. Debtor’s largest unsecured creditors by far are Verizon Services Corp., Verizon New York, Inc., Verizon New Jersey, Inc., and Verizon Pennsylvania, Inc. (collectively “Verizon”). Verizon has been at the center of many of the hearings and disputes in this case. Many of the hearings in the case also involved Laurus Master Fund, Ltd. (“Laurus”), which claimed it was a secured creditor

of Debtor (“Laurus”).

Debtor and its pre-petition regulatory environment

At the petition date, Debtor was a telephone company that operated in a highly regulated environment. As of the Petition Date, Debtor provided services to approximately 3,000 residential and commercial customers in the New York, New Jersey, and Pennsylvania area. Debtor’s operations included providing customers with dial tone for local, long distance and international calls, as well as broadband internet access and virtual private network services. Debtor had two locations for its business operations; one in Hauppauge, New York and the other in White Plains, New York.

Debtor had operated in a highly regulated environment. Debtor was a competitive local exchange carrier (“CLEC”), which is a telephone corporation that is a “local exchange carrier” as defined by 47 U.S.C. § 153(26). At the federal level, Debtor is regulated by the Federal Communications Commission (the “FCC”). As further described within, Debtor provided resale of services obtained from Verizon, pursuant to 47 U.S.C. § 251(c)(4). Under federal law, Debtor was required to give a minimum of thirty (30) days written notice to its end-user customers advising those customers that Debtor intended to discontinue service. *See* 47 C.F.R. § 63.71 (2008).

Debtor was also subject to regulatory authority at the state level by New York, New Jersey and Pennsylvania. The New York State Public Utility Commission (the “NYPUC”) is charged with regulatory oversight of telephone corporations that own, operate or manage facilities utilized to provide telephone service for hire within the State of New York. *See* N.Y. PUBLIC SERVICE LAW §§ 2(17, 18), 4(1), 5(1)(d). The NYPUC had stated in this case that it

requires a provider such as Debtor to give at least sixty (60) days notice to customers before their service was discontinued. *See* New York Public Service Commission, Order Adopting Revised Mass Migration Guidelines, Case 00-C-0188 (January 2, 2003). [dkt item 48] Similarly, the New Jersey Board of Public Utilities is charged with regulatory oversight of telephone corporations that own, operate or manage facilities utilized to provide telephone service for hire within the State of New Jersey ("NJPUIC"). The NJPUIC requires a withdrawing carrier to provide sixty (60) days written notice to affected end-user customers before any service is discontinued. *See* N.J.A.C. N.J. STAT. ANN. § 14:10-12.5. Similarly, the Pennsylvania Public Utility Commission ("PPUC") requires at least thirty (30) days of advance notice to end-users before a carrier discontinues service. *See* 52 PA. STAT. ANN. § 63.306(e).

The expressed purpose of each of these states' notice requirements is to give a withdrawing carrier's customers a reasonable opportunity to obtain telecommunications service from another provider before that customer's service is discontinued.

Debtor's agreement with Verizon

Well prior to the Petition Date, in or about January 2005, Debtor had entered into a Wholesale Advantage Services Agreement (the "Agreement") with Verizon. Pursuant to the Agreement, Verizon was to provide local switched dial tone services for Debtor to offer to its "end-user" customers. Under the Agreement, Verizon provided services and facilities to Debtor on pricing and other terms that were not available to Verizon customers that do not enter into contracts such as the Agreement.

Verizon's monthly billing for services were based upon a number of factors, including the number of telephone lines, certain monthly recurring and non-recurring charges, usage, and

surcharges. The Agreement also provided that Debtor would receive discounts for the line charges based on certain volume levels. Verizon is an “incumbent local exchange carrier” as defined at 47 U.S.C. § 251(h) (2008). As such, Verizon was required to post tariffs regarding the rates it charges for various services.

Prior to the Petition Date, Debtor ran up a substantial bill to Verizon; as of the Petition Date, Verizon alleged that Debtor owed it in excess of \$4 million; during the chapter 11 phase of this case, Verizon alleged that Debtor was incurring charges for services but not paying for same. Verizon filed a general unsecured claim for \$4,025,165.18 on February 9, 2009, (claim number 20, and filed a priority claim for \$147,833.54 on August 8, 2011 (claim number 37).

Conversion of this case to chapter 7

After significant litigation over the viability of Debtor as a chapter 11 case, and following a number of hearings and ruling by this Court, on January 9, 2009, this Court entered an Order granting Verizon’s motion¹ to convert this case from chapter 11 to chapter 7 (the “Conversion Order”). [dkt item 120] Due to the nature of Debtor’s business as being a provider of telecommunication services, and the impact of the applicable federal and state public utility regulations, the Conversion Order authorized the appointed trustee to operate the business of Debtor in accordance with 11 U.S.C. Section 721. The Conversion Order did not authorize the Interim Trustee to use cash collateral, nor did the Conversion Order relieve the Interim Trustee of compliance with state and federal telecommunications law and regulations.

On January 9, 2009, the Debtor’s case was converted to chapter 7 of the Bankruptcy

¹ Verizon’s motion to convert was filed three weeks into the chapter 11 case, and sought expedited relief. [dkt item 31]

Code, and the UST filed a Notice of Appointment of Trustee on Conversion, designating Kenneth Kirschenbaum as the interim trustee (the “Interim Trustee”). [dkt item 122] On January 11, 2009, the Court provided notice of the Chapter 7 Section 341(a) meeting of creditors to be held on February 10, 2009, at 10:30 a.m. (the “341 Meeting”).

On January 13, 2009, the Interim Trustee filed an Application to Employ Kirschenbaum & Kirschenbaum as Counsel for the Trustee [dkt item 128] and an Application to Employ Hirshfield and Kantor LLP as Accountants for the Trustee. [dkt item 130] On January 16, 2009, this Court entered an Order Granting Application to Employ Kirschenbaum & Kirschenbaum as Counsel for the Trustee [dkt item 133], and Order Granting Application to Employ Hirshfield and Kantor LLP as Accountants for the Trustee. [dkt item 134]

Prior to the 341 Meeting, Verizon decided that it wanted to replace the Interim Trustee. Based upon the report filed by the UST on February 11, 2009 [dkt item 156], on February 10, 2009, Verizon, through its attorney of record, informed the UST that Verizon would be seeking to elect a trustee at the 341 Meeting; an election was held on February 10, 2009 (“Election”); Verizon nominated John Pereira as the Chapter 7 Trustee, and thereafter cast its ballot for Mr. Pereira; Verizon cast the only ballot at the 341 Meeting. Based on the magnitude of the Verizon claims as scheduled and as filed, the UST reported that the twenty percent criteria necessary to hold the Election and elect a trustee were satisfied, and that Mr. Pereira, as a member of the Panel of Trustees for the Eastern District of New York, had previously qualified to serve as a trustee under the Bankruptcy Code and the United States Trustee’s requirements. Thus, Mr. Pereira was elected as the permanent chapter 7 trustee, effective as of February 11, 2009.

The Interim Trustee thus served between January 9, 2009 and February 11, 2009. During

that time, the Interim Trustee operated the business of Debtor in accordance with the Conversion Order.

The Trustee, the Interim Trustee and Laurus, as the alleged holder of an interest in the funds collected or held by the Interim Trustee as cash collateral, entered into a Stipulation concerning the transition of the estate from the Interim Trustee to the Trustee, and as to the disposition of funds held by the Interim Trustee. This Court So Ordered this Stipulation on April 22, 2009 (the "Transition Order") [dkt item 184] As a part of the Transition Order, the Interim Trustee, the Trustee and Laurus agreed as follows:

1. The Interim Trustee shall turn over to the Permanent Trustee the total balance on hand in the estate account upon this Stipulation being "So Ordered" by the Bankruptcy Court. All sums turned over to the Permanent Trustee by the Interim Trustee shall constitute and be deemed "moneys disbursed or turned over in the case by the trustee to parties in interest" in accordance with 11 U.S.C. §326 for the purpose of determining the commission base from which the maximum allowable commission to the Interim Trustee is calculated and determined. Pending the determination of the Pending Adversary Proceeding, any and all funds turned over to the to the Permanent Trustee pursuant to this Stipulation, and any other funds coming in to the possession of the Permanent Trustee from the collection or other disposition of the receivables or other assets of the estate of the Debtor shall be held by the Permanent Trustee in a segregated chapter 7 trustee's account subject to further Order of this Court and subject to the liens, rights and other protections to which Laurus is entitled, including without limitation, the Laurus Liens and Protections.

These parties also agreed to the interim payment of commissions to the Interim Trustee in the sum of \$7,103.98, representing 50% of the sum being sought by the Interim Trustee, together with reimbursement of expenses in the sum of \$34.13, subject to a final award; these parties also agreed to a final award of compensation to Kirschenbaum & Kirschenbaum, P.C., for services rendered as counsel to the Interim Trustee, in the sum of \$7,853.75, together with reimbursement of expenses in the sum of \$155.97. This Court separately approved such interim and final awards in April 2009. [dkt items 182, 183]

The Trustee's objection to the Interim Trustee's commissions

On August 29, 2011, the Trustee objected to the administrative claim of the Interim Trustee. [dkt item 231] On September 15, 2011, the Interim Trustee filed a response [dkt item 237], and on October 25, 2011, the Interim Trustee filed a reply. [dkt item 249] On October 27, 2011, Verizon joined in the Trustee's Objection. [dkt item 250] A hearing was held on the Trustee's objection on November 1, 2011 (the "Hearing").

Essentially, the Trustee asks this Court to limit the Interim Trustee's commission compensation to 50% of the \$14,168.17 of his requested commissions, which is the amount he received on an interim basis in accordance with the Transition Order. The Trustee's Objection stems, in part, from an administrative claim being accrued for services purportedly provided by Verizon in the amount of \$111,985.08 during the Interim Trustee's 33 day tenure. In his Reply to the Interim Trustee's response to the Objection, the Trustee reviews the Interim Trustee's response and states:

Conspicuous by its absence, however, is any valid explanation as to why, on his first day in such capacity, Kirschenbaum did not simply turn the key and shut down the Debtor's operations and minimize the damages suffered by all of the general unsecured creditors of the Debtor and what would become the other administration claimants.

[dkt item 249, para. 1] The Trustee further alleges that "Each day that the Debtor continued to operate – all for the good of Laurus – Verizon's claim continued to accrue, but Kirschenbaum appears to have been either blissfully ignorant of this obvious fact or simply indifferent to the impact that his decision to operate had on Verizon."

The Trustee also states:

Finally, Kirschenbaum's affidavit is mute as to the fact that he was prepared to turn over the *entirety* of the funds he collected to Laurus, based upon its alleged security

interest. It was this reticence by Kirschenbaum to listen to the unsecured creditors of the Debtor that lead to the election of the Permanent Trustee and the expulsion of Kirschenbaum. The Permanent Trustee was then able to secure a settlement with Laurus whereby only \$10,000 of the funds collected were paid to Laurus and the remainder was deemed to be property of the estate. If Kirschenbaum had had his way, there would be no Estate.

[dkt item 249, para. 4] The Trustee stated at the Hearing that this chapter 7 estate is administratively insolvent.

For the following reasons, the Court defers ruling on the Objection of the Chapter 7 Trustee. First, the Trustee has made no showing that the Interim Trustee did not exercise reasonable business judgment by allowing himself a reasonable period of time to investigate the assets and business affairs of the debtor, including litigation claims, and ascertain the viability of debtor's operations. Presumably, when any trustee is appointed in a converted case in which he or she is given operating authority, he or she needs some reasonable period of time to familiarize himself or herself with the nature and operations of the debtor's business. Moreover, Section 959(b) of Title 28 requires that a trustee operate the estate "according to the requirements of the valid laws of the State in which such property is situated" This would include state public utility laws, at a minimum. Verizon had consistently sought to have the Debtor terminate operations immediately during the chapter 11 phase of the case; reminiscent of Verizon's protestations, the Trustee now asserts that the Interim Trustee should have terminated all of the estate's customers telecommunications rights by abruptly terminating phone service; presumably, the Trustee means in accordance with and not in derogation of the laws and regulations of the various public utility commissions which regulated Debtor's business.

At the Hearing, the Interim Trustee stated that he was able to obtain permission of the state regulatory authorities to terminate service on 30 days notice, not on the 60 days notice


which might have been required. If the business operations were not profitable as of the conversion of this case, truncating the notice period would have benefitted Verizon by reducing any continued accrual of services which the estate would not be able to pay for.

Bankruptcy Code Section 326(c) provides that, when more than one trustee serves in a case, the “aggregate compensation of such persons . . . may not exceed the maximum compensation prescribed for a single trustee” under Section 326(a), (b). Thus, as stated at the Hearing, the two case trustees shall not both be compensated for the funds collected and disbursed, including the funds the Interim Trustee turned over to the Trustee. Further, because the Trustee asserts that the estate is administratively insolvent, this Court will review all administrative claims, including the Interim Trustee’s, the Trustee’s and Verizon’s, when all claims are ready for consideration; that will not occur until the Trustee has filed his final report.

Thus, ruling on the Objection is deferred until such time as the Trustee has filed his final report.

Dated: February 22, 2012
Central Islip, New York
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Alan S. Trust
United States Bankruptcy Judge