

Case Law on Trustee Compensation Continues to Evolve After BAPCPA

by

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Before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), chapter 7 trustees were required to justify their requests for compensation under 11 U.S.C. §§ 326 and 330(a)(3). Because the factors in section 330(a)(3) are similar to the lodestar factors referenced in *Johnson v. Georgia Highway Express, Inc.*, 488 F. 2d 714 (5th Cir. 1974), there was some debate about whether trustees' fees should be treated as straight commissions or whether they should be approved under the lodestar analysis. BAPCPA made two changes to section 330 that should have eliminated some of this uncertainty. Specifically, Congress amended section 330(a)(3) to clarify that the factors used in that section to determine "reasonable compensation" do not apply to chapter 7 trustees, and added section 330(a)(7), which states the following: "In determining the amount of reasonable compensation to be awarded to a trustee, the court **shall treat such compensation as a commission**, based on section 326." 11 U.S.C. § 330(a)(7) (emphasis added).

According to section 326, the commission is the amount a court may allow as reasonable compensation under section 330:

for the trustee's services, ... not to exceed 25 percent on the first \$5,000 or less, 10 percent on any amount in excess of \$5,000 but not in excess of \$50,000, 5 percent on any amount in excess of \$50,000 but not in excess of \$1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of \$1,000,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims.¹

When read together, Sections 330(a)(3), 330(a)(7) and 326 indicate that the calculation of trustee compensation is based solely upon the percentages set forth in section 326. Nonetheless, many courts continue to evaluate requests for compensation under the pre-BAPCPA standard.

The Fall 2007 issue of *NABTalk* published the NABT's Amicus Brief in support of a Florida trustee's request for compensation in *In re Mack Properties*, 381 F.R. 793 (Bankr.

¹ 11 U.S.C. § 326(a).

M.D.Fla. 2007).² In appropriate cases, including *Mack Properties*, U.S. Trustees have filed briefs in support of the trustee's position. In its Brief, the NABT quoted the U.S. Trustee Program's position on this issue:

U.S. Trustees will take the position that, absent extraordinary factors, trustees should be compensated based upon the percentages set forth in section 326... U.S. Trustees will not independently require trustees to maintain time records. U.S. Trustees will give full meaning to the Congressional intent that trustee compensation is a commission, and will interpose objections only in unusual circumstances.³

The court in *Mack Properties* held that labeling the fee a "commission" does not eliminate the requirement that the court review it for reasonableness under section 330(a)(1).⁴ It then decided, without explanation, that of the \$39,893.75 requested pursuant to the formula in section 326, \$15,000 would be awarded as reasonable.⁵

Since the *Mack Properties* case, there have been five reported decisions in five different judicial districts interpreting section 330(a)(7). A summary of each follows.

In re McKinney, 383 B.R. 490 (Bankr. N.D. Cal. 2008) (*McKinney II*) – In *McKinney I*, the court concluded that, while it could no longer apply the lodestar factors to chapter 7 trustees, the term "commission" in section 330(a)(7) could not mean a pure percentage fee because that section also applies to chapter 11 trustees, and under section 330(a)(3) the lodestar analysis still applies to them. Therefore, the court held, calculating a trustee's commission "affirmatively requires consideration of time spent in at least some instances."⁶ In *McKinney II*, the court evaluated time records the trustee was directed to submit in *McKinney I*. The court held that section 330(a)(7) creates a presumption that the maximum commission under section 326(a) is reasonable, but the maximum could be reduced if a review of time records and all other relevant facts and circumstances indicate that the amount is disproportionate to the value of a trustee's

² Robert C. Furr, "Brief of Amicus Curiae, National Association of Bankruptcy Trustee, in Support of the Trustee's Application for Compensation and Expenses," *NABTalk*, Vol. 23, No. 3, Fall 2007.

³ *See Id.* at p. 13 (internal citation omitted).

⁴ Citing *In re Mack Properties, Inc.*, 381 B.R. 793, 798 (Bankr. M.D. Fla. 2007) (quoting *In re Ward*, 366 B.R. 470, 473 (Bankr. W.D. Pa. 2007).

⁵ *In re Mack Properties*, 381 B.R. at 799.

⁶ *In re McKinney*, 374 B.R. 726, 730 (Bankr. N.D. Cal. 2007).

services.⁷ The trustee requested \$35,891 based on net proceeds of \$210,636 from the sale of the debtor's house. The court awarded \$15,000, after evaluating the following factors: functions performed by the trustee, results achieved and quality of services performed, risk of nonpayment, activity in the case by other professionals, and time expended and rates charged. These factors are similar to the factors in section 330(a)(3), which the court conceded in *McKinney I* no longer apply to chapter 7 trustees.

In re Phillips, 392 B.R. 378 (Bankr. N.D. Ill. 2008) – The court in this case noted that, of the twelve lodestar factors, six appear in section 330(a)(3). According to the court, these six factors may no longer be applied to chapter 7 trustees, but the other six may be considered when reviewing a chapter 7 trustee's request for compensation.⁸ The court also rejected the trustee's assertion that, in several post-BAPCPA cases, it was improper for the courts to have considered some or all of the lodestar factors.⁹ The *Phillips* court opined:

Under the present statutory scheme, it is difficult to definitively exercise the Court's discretion absent clear Congressional mandate. Thus, courts will be required to make such fee awards case by case and application by application until higher authority legislates a simpler or mandatory methodology and relieves the bankruptcy courts of this task, or otherwise removes a court's discretion from the calculus.¹⁰

The court also held that the mandated maximum "commission" under section 330(a)(7) should be awarded only where the trustee does truly excellent work. Otherwise, the court said, trustees should be awarded some lesser amount for very good work, even less where the services are merely average and lesser still for lower levels of performance.¹¹ The court then assigned "grades" to the third tier of the section 326(a) formula (5 percent of the next \$950,000 of amounts distributed). Had the trustee performed "A" or excellent work, he would have earned \$34,575.94 at this third tier, but he only performed "very good" work, and thus earned

⁷ *McKinney II*, 383 B.R. at 494.

⁸ *In re Phillips*, 392 B.R. at 385.

⁹ The earlier cases are discussed in the NABT's Amicus Brief, see supra note 2, and are: *In re Clemens*, 349 B.R. 725 (Bankr. D. Utah 2006); *In re Ward*, 366 B.R. 470 (Bankr. W.D. Pa. 2007); *Mack Properties* and *McKinney I*. The *Ward* case is currently on appeal before the U.S. District Court for the Western District of Pennsylvania, *Roeder v. No Appellee*, Civil Action No. 08-00071 SJM.

¹⁰ *Phillips*, 392 B.R. at 390.

¹¹ *Id.* at 391-92.

\$27,660.74.¹²

In re Owens, 2008 WL 4224530 (Bankr. D. Or., Sep. 15, 2008) – The debtors in this case filed their petition on October 12, 2005, less than one week before section 330(a)(7) took effect. The court held that the new language in that section “does no more than clarify Congress’s understanding of section 326,” and therefore, should be retroactively applied.¹³ It then decided to take an “equitable approach” and reduced the trustee’s commission to the extent necessary to give unsecured creditors the amount they lost due to an unexpected secured claim.

In re DeGroof, 2008 WL 4560088 (E.D.N.Y., Sept. 29, 2008) - The trustee filed a fraudulent conveyance action against the debtor’s former wife after the debtor transferred his interest in real estate to her for \$35,000. The adversary proceeding settled for \$12,000. The trustee sought a commission of 1,958 and his attorneys sought fees in the amount of approximately \$7,610. The United States Trustee filed a statement of no objection to both fee applications. The bankruptcy court found it unacceptable that 80 percent of the recovery would be paid to the trustee and his counsel as administrative expenses. It reduced the trustee’s commission to \$1,000 and counsel’s fees to \$2,500. They appealed and argued that the court could not reduce the commission or reasonable attorney fees under sections 330(a)(3)(C) in order to ensure a more proportional distribution of assets.

The district court disagreed. It found that amounts to be awarded under sections 326(a) and 330 are entirely within the discretion of the bankruptcy court. As to section 330, the district court concluded that a court may reduce fees based on a perceived disproportionality between the fees and the amount available for distribution to creditors.¹⁴ The district court did not mention section 330(a)(7) in this case, but held that reducing the trustee’s commission in this case was proper because the trustee only attended the 341 meeting and issued four checks and, therefore, did not earn the maximum permitted by section 326(a).

In re RFS Ecusta, Inc., 2008 WL 506287 (Bankr. W.D.N.C., Feb. 21, 2008) – The trustee sought and was awarded \$505,264 based on disbursements in excess of \$16,000,000, in accordance with the section 326(a) formula. The court held it would review the fee for

¹² The court awarded the trustee the full commission amount in the first two tiers of section 326(a) (25 percent of the first \$5,000 and 10 percent of the next \$45,000), so that the trustee earned a total of \$33,410.74.

¹³ *In re Owens*, 2008 WL 4224530 at *2.

¹⁴ *In re DeGroof*, 2008 WL 4560088, at *4 (E.D.N.Y., Sept. 29, 2008) (citing *In re Stein*, 2005 U.S. Dist. LEXIS 30278 (E.D.N.Y., March 25, 2005); *In re Mennella*, 2008 WL 222557 (E.D.N.Y., Jan. 24, 2008)).

reasonableness because the case was filed pre-BAPCPA. It also concluded that, with the enactment of section 330(a)(7), “Chapter 7 trustees are no longer subject to Section 330(a)(3), which limits the determination of the amount of ‘reasonable compensation to be awarded’ based upon ‘relevant factors’ to ‘an examiner, trustee under chapter 11 , or professional person.’”

As evidenced in the summaries above, many courts continue to apply some form of lodestar analysis to requests for chapter 7 trustee compensation. Despite this trend, Program attorneys will continue to file briefs in support of our statutory interpretation that trustee compensation should be treated “as a commission.” We welcome your thoughts on this issue, and we urge you to contact us if you have a trustee compensation issue before the court.