Benchnotes

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Statutory Commission for Chapter 7 Trustees Must Be Awarded Absent Exceptional Circumstances

In the Matter of *JFK Capital Holdings LLC*,[1] the Fifth Circuit Court of Appeals held that the statutory commission for a chapter 7 trustee set forth in § 326(a) of the Bankruptcy Code must be awarded absent exceptional circumstances. Prior to commencing a chapter 7 case, the debtor defrauded his investors of millions through an 80-plus-entity business enterprise. Unlike most of the debtor's businesses, one entity, a limited liability company (LLC), was solvent.

The LLC was awaiting the receipt of an $876,000 settlement check from an unrelated matter. Because the law firms that negotiated that settlement on the LLC's behalf had not yet received their $320,000 in legal fees, they filed a state court lawsuit against the LLC in order to secure payment. In response, the debtor's chapter 7 trustee filed a second chapter 7 case on the LLC's behalf. A separate trustee was appointed in the LLC bankruptcy.

The individual trustee sought to consolidate the two bankruptcy cases. The LLC trustee opposed consolidation, arguing that the LLC's sole creditors, the law firms, were entitled to payment in full before any funds went to the estate of the individual debtor. Tensions between the parties grew, and as a result, "nearly every aspect of the [LLC] Bankruptcy was contested."[2] The LLC trustee sought $15,000 in interim trustee fees under § 326(a) in addition to the fees of her lawyers. Finding that some of the work done in the course of the proceedings was "absolutely ridiculous," the bankruptcy court reduced the LLC trustee's § 326(a) commission from 7 percent to 3 percent of the money distributed to creditors.[3]

On appeal, the Fifth Circuit noted that two statutory provisions, §§ 326(a) and 330, were at issue. In 2005, Congress amended the two provisions as they pertain to chapter 7 trustees. Chapter 7 trustees, the court noted, may receive two different types of compensation under § 330. First, they are awarded a fee of $60 per case under § 330(b), as well as "reasonable compensation" for each case under § 330(a).

Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), § 330(a)(3) provided factors for the court to consider when determining whether a chapter 7 trustee's fee was reasonable. "In enacting BAPCPA, however, Congress removed Chapter 7 trustees from the list of professionals subject to the Section 330(a)(3) factors" while leaving in chapter 11 trustees and other professionals.[4] In concert with the removal of chapter 7 trustees from § 330(a)(3), BAPCPA introduced a new provision, § 330(a)(7), requiring courts to treat the reasonable compensation awarded to trustees as a "commission, based on section 326(a)."[5] In turn, § 326(a) sets a sliding cap on the maximum amount payable to trustees, which is based on the amount distributed to creditors.

The court noted that two approaches for determining the appropriate compensation for chapter 7 trustees have emerged post-BAPCPA. Under the first approach, § 326(a) is not simply a maximum, but also a presumptively reasonable fixed commission rate to be deviated from only in rare instances. The second approach declines to presume § 326(a) percentages as reasonable because the "bankruptcy court has discretion to award reasonable compensation only for actual and necessary services," and thus might award an amount less than that contemplated by § 326(a) where appropriate.[6]

The Fifth Circuit adopted the first approach, finding that the percentage amounts listed in § 326 are presumptively reasonable and should be awarded to a trustee absent extraordinary circumstances. Thus, "[i]n removing Chapter 7 trustees from § 330(a)(3) and directing courts to treat the trustee's compensation as a commission, Congress made [it] clear that a trustee's compensation should be determined on the basis of a percentage, rather than on a factor-based assessment of the trustee's services."[7] The court reasoned that the commission-based framework facilitates more efficient chapter 7 trustee compensation by placing the burden on trustees to avoid wasting resources, "as their commission remains the same regardless of potentially duplicative or unnecessary services."[8]

Sixth Circuit Clarifies Requirement for Preserving Causes of Action

In *In re Mountain Glacier LLC*,[9] the Sixth Circuit Court of Appeals provided much-needed clarity with respect to its 2002 opinion in *Browning v. Levy*, holding that a debtor can preserve a cause of action for pursuit post-confirmation merely by

1 *Lejeune v. JFK Capital Holdings LLC (Matter of JFK Capital Holdings LLC)*, 880 F.3d 747 (5th Cir. 2018).
2 *Id.* at 750.
3 *Id.* at 751.
4 *Id.*
5 *Id.* at 752.
6 *Id.* at 753 (citing cases).
7 *Id.* (citing *Mohns Inc. v. Lanser*, 522 B.R. 594, 601 (E.D. Wis.); *aff'd sub. nom.*, *In re Wilson*, 796 F.3d 818 (7th Cir. 2015)).
8 *Id.* at 756.
9 *Nestle Waters N. Am. Inc. v. Mountain Glacier LLC (In re Mountain Glacier LLC)*, 877 F.3d 246 (6th Cir. 2017).

continued on page 79

providing sufficient information in the disclosure statement such that creditors can identify the potential claim.[10] Notably, the court held that *Browning* does not require a debtor to name each potential defendant and state the factual basis for each potential cause of action in the disclosure statement.

The debtor and Nestle Waters were in the middle of an arbitration when the debtor filed for bankruptcy relief. The arbitration was automatically stayed as a result of the filing, and remained stayed until the debtor confirmed a reorganization plan. Post-confirmation, the debtor attempted to resume arbitration, but Nestle Waters objected, claiming that the debtor had failed to properly preserve the claim in its disclosure statement. The debtor disagreed, as did the bankruptcy and district courts.

The Sixth Circuit began its analysis by noting that a debtor seeking to preserve a cause of action post-confirmation must identify and reserve the cause of action in its disclosure statement in order to avoid application of *res judicata* to deny continued pursuit of the claim. In this case, the debtor's disclosure statement disclosed "a counterclaim asserted by the Debtor against Nestle Waters North American Inc. in arbitration pending in Chicago," which "remain[ed] unliquidated and ha[d] unknown value."[11] The disclosure statement stated that such claim would be transferred to the reorganized debtor upon confirmation.

Relying on *Browning*, Nestle Waters argued that *res judicata* barred the debtor's attempt to restart the arbitration. In *Browning*, the court held that "a debtor's reservation is sufficient so long as it enables creditors to (1) identify the claims (or potential claims) at issue and (2) evaluate whether those claims might provide additional assets for distribution."[12] However, similar to many in the Sixth Circuit, Nestle Waters interpreted certain *dicta* in *Browning* as requiring that a debtor's reservation of claims must name each potential defendant and state, with some detail — the factual basis for each potential cause of action. The Sixth Circuit rejected that notion, stating that "[a]ny such suggestion by *Browning* was not part of its holding, but a mere statement of reasons for why the debtor's blanket reservation in that case did not give sufficient notice to creditors."[13]

Turning to the specific reservation language in the debtor's disclosure statement, the court found that sufficient detail was provided to enable creditors "to identify [the] claim and evaluate whether additional assets might be available for distribution."[14] The court reasoned that the debtor's disclosure statement had identified the claim, counterparty and litigation forum. If creditors wanted more information, the court stated that they could have objected to the plan and asked the bankruptcy court to require a more fulsome description. Since no one objected, the court concluded, neither *Browning* nor the bankruptcy court required the debtor to provide more information than it did.

10 *Id.* at 249 (discussing *Browning v. Levy*, 283 F.3d 761 (6th Cir. 2002)).
11 *Id.* at 248.
12 *Id.* at 249 (citing *Browning*, 283 F.3d at 774-75).
13 *Id.*
14 *Id.*

Miscellaneous

• *In re Addison*, --- B.R. ---, 2018 WL 461122 (Bankr. E.D.N.Y. 2018) (bankruptcy court held that single chapter 7 debtor can deduct expenses for operating two vehicles when calculating means test under 11 U.S.C. § 707(b) despite IRS guidelines that would otherwise limit single debtor to one vehicle; bankruptcy court determined that § 707(b) does not direct court to look to IRS guidelines, and Official Form 122A-2 does not expressly limit single debtor to one vehicle);

• *In re Eppolito*, --- B.R. ---, 2018 WL 539773 (Bankr. S.D.N.Y. 2018) (bankruptcy court held mortgagee in contempt for violating debtor's discharge injunction four years after debtor received discharge in chapter 7 proceeding and awarded debtor her attorneys' fees for enforcing discharge injunction; court found that mortgagee violated discharge injunction when it offered mortgage modification to debtor that would have reimposed personal liability on debtor for refinancing of discharged arrearage liability);

• *In re Hatton*, --- B.R. ---, 2018 WL 770363 (Bankr. D.N.H. 2018) (bankruptcy court reviewed split among courts as to applicability of two-year expansion of statutes of limitations under 11 U.S.C. § 108(a) in chapter 13 cases, with certain courts holding that benefits of extension under § 108(a) inure only to chapter 13 trustee, and others holding that benefit also extends to chapter 13 debtors; Hon. **Bruce A. Harwood** ruled that better-reasoned cases limit extension to chapter 13 trustees only, as plain reading of statute limits its extension to cases that might be commenced by "trustee" and not "debtor" (*id.* at *5); unlike in chapter 11, chapter 13 debtors are not generally granted powers of trustee in bankruptcy);

• *In re Maui Indus. Loan & Fin. Co.*, --- B.R. ---, 2018 WL 625101 (D. Hawaii 2018) (on appeal, district court upheld bankruptcy court ruling that creditor was not automatically entitled to assert claim under 11 U.S.C. § 502(d) after creditor's repayment of fraudulent transfer; bankruptcy court did not err in disallowing the asserted § 502(d) claim in reliance on its prior judgment in adversary proceeding giving rise to avoidance obligation; in prior adversary, bankruptcy court found that stock repurchase agreement giving rise to avoidance action was illegal, therefore creditor had no legitimate restitution claim; district court determined that court's ruling on trustee's claim objection, which included alternative requests for subordination without requiring filing of separate adversary proceeding, was harmless error because creditor did not suffer any prejudices as a result); and

• *Arrowsmith v. U.S. (In re Health Diagnostic Lab. Inc.)*, 578 B.R. 552 (Bankr. E.D. Va. 2017) (noting split in case law, court held that S-corp status is not "property" under federal tax law and thus is not property within scope of § 541; as such, shareholders' pre-petition decision to change debtor's status to a C-corp cannot constitute fraudulent transfer; "To the extent there is value inherent in the S election, it is value Congress intended for the corporation's shareholders and not for the corporation."). abi

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