

# AMERICAN BANKRUPTCY INSTITUTE JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

## Trustee Talk

BY BRIAN R. ANDERSON

### When 7 Becomes 13: Compensating Trustees upon Conversion

A chapter 7 trustee operates a difficult and risky business. A trustee must diligently discharge his/her fiduciary obligations under the Bankruptcy Code by, among other things, investigating the financial affairs of the debtor, and risks nonpayment (other than a \$60 no-asset fee) if those efforts do not bear fruit. Making matters worse, if a trustee's investigation leads to undervalued or undisclosed assets, the debtor could convert his/her case to chapter 13 to prevent the chapter 7 trustee from administering the assets for the benefit of the debtor's creditors.

In such instances, some courts have harshly ruled that a chapter 7 trustee is not entitled to compensation and that conversion is merely a cost of doing business,<sup>1</sup> even though the trustee's efforts benefited the estate. Not only do these holdings unfairly shift the risk of nonpayment to chapter 7 trustees, they promote asset concealment by debtors, disincentivize diligence from hard-working trustees, and are contrary to numerous policies underlying the Code. A *better approach* is to allow chapter 7 trustees compensation after conversion upon a showing of "substantial services" to the estate. *Such an approach* best serves the intent of and policies underlying the Code, and applies equal fairness among debtors, creditors and trustees.

#### Statutory Framework

The Bankruptcy Code does not offer clear guidance on compensation for chapter 7 trustees upon the conversion of a case. This lack of guidance has become a source of controversy for trustees, who seek fair compensation for their work. Section 330(a)(1) of the Code authorizes the court to award a trustee "reasonable compensation for actual,

necessary services rendered" and "reimbursement for actual, necessary expenses."<sup>2</sup> However, § 326(a) sets certain limits on the compensation of trustees.

Specific to chapter 7 trustees, § 326(a) provides that "the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee's services, payable after the trustee renders such services ... 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."<sup>3</sup> When a debtor converts his/her case from chapter 7 to chapter 13, the issue becomes whether the chapter 7 trustee is entitled to statutory commissions when he/she has yet to disburse funds.

#### Denial of Chapter 7 Trustee Compensation Upon Conversion

Courts that strictly construe § 326(a) deny chapter 7 trustee compensation unless the trustee has actually disbursed funds. Of course, disbursement rarely happens in a case converted to chapter 13, as disbursement generally occurs at the end of the case after the trustee has fully administered the estate. These courts take a hard line and view a chapter 7 trustee's compensation as being tied only to "monies disbursed or turned over," notwithstanding the fact that the trustee's services were necessary to the administration of the case.<sup>4</sup> These courts view § 326(a) as unambiguous and state that denying a chapter 7 trustee compensation is consistent with the statute, despite the fact that a debtor's decision to convert the case might be a direct result of the



**Brian R. Anderson**  
Fox Rothschild LLP  
Greensboro, N.C.

Brian Anderson is a partner with Fox Rothschild LLP in Greensboro, N.C., and a chapter 7 trustee for the U.S. Bankruptcy Court for the Middle District of North Carolina. He also serves as a subchapter V trustee and provides strategic counsel on bankruptcy issues.

<sup>2</sup> 11 U.S.C. § 330(a)(1)(A), (B).

<sup>3</sup> 11 U.S.C. § 326(a).

<sup>4</sup> *In re Evans*, 344 B.R. 440, 454 (Bankr. W.D. Va. 2004) ("[H]owever laudable or desirable it might be on fairness and good bankruptcy policy grounds to award compensation ... to do so would be inconsistent with the provisions of 11 U.S.C. § 326(a)."); *In re Silvas*, 329 B.R. 193, 208 (Bankr. E.D. Va. 2005) (citing *In re Fischer*, 210 B.R. 467, 469 (Bankr. D. Minn. 1997)); *Murphy*, 272 B.R. at 486.

<sup>1</sup> *In re Murphy*, 272 B.R. 483, 486 (Bankr. D. Colo. 2002); *In re Fischer*, 210 B.R. 467, 469 (Bankr. D. Minn. 1997).

trustee's efforts in the case and the fulfillment of the trustee's fiduciary responsibilities under § 704.

In addition, these courts have concluded that such a reading of the statute is consistent with congressional intent and the policy that “a debtor should always be given the opportunity to repay his debts.”<sup>5</sup> They express concern that any other interpretation “could dilute the debtor’s absolute rights to convert and in essence punish the debtor (and the debtor’s creditors) for exercising the rights bestowed upon them by Congress.”<sup>6</sup> Despite the harsh result, in these courts’ eyes unambiguous statutory language trumps fairness concerns and *quantum meruit*.

## Allowance of Chapter 7 Trustee Compensation

On the other hand, other courts correctly recognize that chapter 7 trustees should be adequately and fairly compensated for their hard work, as “it is unacceptable and unwarranted to penalize hard-working interim trustees whose services have contributed to the administration of the bankruptcy estate but who have not actually distributed funds by depriving them of fees even though successor trustees, whether in a case pending under the same chapter or converted to another chapter, are successfully able to make distributions to parties in interest.”<sup>7</sup> They employ a variety of methods of statutory interpretation of § 326(a) and similar public policy concerns to reach the conclusion that chapter 7 trustees should be fairly compensated for discharging their duties under the Bankruptcy Code.

## Ambiguity in § 326(a) Supports Trustee Compensation

First, some courts have found significant ambiguity in § 326(a).<sup>8</sup> They struggle to reconcile the strict interpretation of § 326 as resulting in no compensation for the chapter 7 trustee, with the statutory language offering “reasonable compensation” awards “after the trustee renders such services.”<sup>9</sup> A “literal reading of § 326(a) should apply only in fully administered cases[,] and ... in cases which were not fully administered through no fault of the trustee, compensation should be awarded on a *quantum meruit* basis when the trustee preformed substantial services but did not disburse any monies.”<sup>10</sup> Denying compensation would “conflict with Congress’s intent to encourage the conversion of Chapter 7 cases to those under Chapter 13 when circumstances permit a debtor to repay all or a portion of his or her debts.”<sup>11</sup>

5 *In re McConnell*, 2021 WL 203331, at \*27 (Bankr. N.D. Ga. Jan. 4, 2021). (citing *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 372 (2007)).

6 *Silvus*, 329 B.R. at 217.

7 *In re Rodriguez*, 240 B.R. 912, 915 (Bankr. D. Colo. 1999).

8 *In re Philips*, 507 B.R. 2, 6 (Bankr. N.D. Ga. 2014) (“It is difficult to believe [that] Congress intended zero compensation to be reasonable where the trustee has expended significant effort and rendered valuable services marshaling assets on behalf of the estate — which will lead to a dividend for unsecured creditors that would not have been available but for the Chapter 7 Trustee’s efforts — only to be frustrated by a conversion to Chapter 13.”).

9 *Id.* (quoting 11 U.S.C. § 326(a)).

10 *In re Bartlett*, 590 B.R. 175, 177 (Bankr. D. Mass. 2018) (quoting *Matter of Parameswaran*, 64 B.R. 341, 343 (Bankr. S.D.N.Y. 1986)); *In re Schuck*, 2007 WL 2757160, at \*2 (Bankr. C.D. Ill. Sept. 20, 2007); *In re Fernandez*, No. 05-09792 (Bankr. D.P.R. Oct. 10, 2007); *In re Moore*, 235 B.R. 414, 416 (Bankr. W.D. Ky. 2002); *aff’d*, *Schilling v. Moore*, 286 B.R. 846 (W.D. Ky. 2002). *But see In re Silvus*, 329 B.R. at 218 (“[R]ecovery under the theory of *quantum meruit* may only be had upon the basis of an implied contract. Rendering services alone, however, does not create an implied contract, nor does officiously conferring benefits upon another.”).

11 *In re Pivinski*, 366 B.R. 285, 290 (Bankr. D. Del. 2007).

## A Narrow Reading of § 326(a) Supports Trustee Compensation

Second, courts have found that the same narrow reading of the statute, as advanced by those courts that deny compensation to a chapter 7 trustee upon conversion, works in the trustee’s favor. These courts employ a strict reading of the entire statute to find statutory authority to award compensation for chapter 7 trustees in a converted case. For example, in *In re Bartlett*,<sup>12</sup> the court noted that the statutory phrase “in a case under Chapter 7 or 11” renders § 326(a) inapplicable to trustee compensation once the case is converted to chapter 13. Thus, even a strict statutory reading supports a trustee’s right to compensation after a conversion to chapter 13.

**While what constitutes substantial services depends on the specific case, the outright denial of compensation [upon conversion to chapter 13] runs counter to the Code’s framework and policy and does a disservice to chapter 7 trustees everywhere.**

## A Broader Reading of § 326(a) Supports Trustee Compensation

Third, some courts have used a broader, more general statutory interpretation to treat chapter 7 trustees fairly upon conversion. The court in *In re Rodriguez* held that “[i]n order to encourage aggressive action by trustees, the reference to ‘trustee’ in the last sentence of section 326(a) must be read as a generic reference to the composite ‘trustee’ and to the aggregate distributions made in the case by the composite ‘trustee’ to all parties in interest other than the debtor.”<sup>13</sup>

*Rodriguez* reasoned that as long as the chapter 7 trustee executed some level of disbursement at some point during the entirety of the debtor’s case, then all who served as trustees at some point in the process are entitled to compensation. Others read the phrase “monies disbursed or turned over” more broadly than a cash disbursement by a chapter 7 trustee. They reason that if a chapter 7 trustee’s efforts lead to a disbursement to creditors in a chapter 13 plan, it is a disbursement, albeit an indirect one, that eventually finds its way to creditors.<sup>14</sup>

## Bankruptcy Policy Supports Trustee Compensation

Compensating chapter 7 trustees post-conversion also is consistent with the “clear policy under the Bankruptcy Code to see that case trustees are adequately and fairly compensated,”<sup>15</sup> as well as numerous other bankruptcy policies.

12 *Bartlett*, 590 B.R. at 178; *In re Colburn*, 231 B.R. 778, 782 (Bankr. D. Ore. 1999); *In re Scott*, 2006 WL 566441 at \*2 (Bankr. N.D. Ill. 2006) (§ 326(a) “becomes irrelevant once the case is converted”).

13 *In re Rodriguez*, 240 B.R. 912, 915 (Bankr. D. Colo. 1999).

14 *In re Schneider*, 15 B.R. 744, 745 (Bankr. D. Kan 1981); *In re Hages*, 252 B.R. 789, 794 (Bankr. N.D. Cal. 2000).

15 *Rodriguez*, 240 B.R. at 915.

Debtors are less likely to conceal assets when compensation of a chapter 7 trustee is required for pre-conversion efforts.<sup>16</sup> Otherwise, a debtor may be incentivized to hide assets, then convert to chapter 13 once such assets have been discovered without then having to compensate the trustee.

In addition, denying a chapter 7 trustee compensation upon conversion works counter to the Code's desired goal of encouraging diligence to uncover all means by which creditors can be made whole, by creating a disincentive for the trustees diligently to discharge their fiduciary responsibilities.<sup>17</sup> If a chapter 7 trustee uncovers assets that must then be paid for in a chapter 13 plan, those actions have benefited the estate, and the trustee should be compensated accordingly.<sup>18</sup> Further, allowing chapter 7 trustee compensation creates more efficiency in the bankruptcy process and furthers the goal of allowing debtors to repay their debts by minimizing a trustee's opposition to the debtor's efforts to convert to chapter 13.

## Conclusion

Compensating chapter 7 trustees upon a showing of substantial services best advances the intent and policy of the Bankruptcy Code. Doing so not only encourages diligence from the trustee and transparency from the debtor, but also reinforces desires for judicial efficiency by avoiding trustee opposition to conversion and furthers the goal of allowing a debtor to repay his/her creditors. While what constitutes substantial services depends on the specific case, the outright denial of compensation runs counter to the Code's framework and policy and does a disservice to chapter 7 trustees everywhere. **abi**

*Reprinted with permission from the ABI Journal, Vol. XLI, No. 1, January 2022.*

*The American Bankruptcy Institute is a multi-disciplinary, non-partisan organization devoted to bankruptcy issues. ABI has more than 12,000 members, representing all facets of the insolvency field. For more information, visit [abi.org](http://abi.org).*

---

<sup>16</sup> *Bartlett*, 590 B.R. at 177; *Fernandez*, No. 05-09792, at \*3; *Pivinski*, 366 B.R. at 2905.

<sup>17</sup> *Hages*, 252 B.R. at 794; *In re Berry*, 166 B.R. 932, 935 (Bankr. D. Ore. 1994).

<sup>18</sup> *Hages*, 252 B.R. at 794; *In re Washington*, 232 B.R. 814, 816 (Bankr. S.D. Fla. 1999).