

BY MICHAEL R. HERZ AND STEPHANIE SLATER

Litigation Trust's Responsibility to Pay Quarterly U.S. Trustee Fees May Depend on Plan Language



Coordinating Editor
Michael R. Herz
Fox Rothschild LLP
Morristown, N.J.



Stephanie Slater
Fox Rothschild LLP
Wilmington, Del.

Michael Herz is a partner with Fox Rothschild LLP in Morristown, N.J., and part of the firm's Financial Restructuring and Bankruptcy Group. Stephanie Slater is an associate in the firm's Wilmington, Del., office.

Section 1141(b) of Bankruptcy Code explains that “except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.”¹ Chapter 11 plans may provide a mechanism for the pursuit of any claims or interests by a debtor, trustee or “representative of the estate.”² If the plan proponent so chooses, a “representative of the estate” may be designated to pursue claims or interests on behalf of the estate. These estate representatives may include — but are not limited to — litigation trustees, liquidation trustees or plan administrators. The chapter 11 plans must provide, with a degree of specificity, the types of claims or interests being retained by these estate representatives, and who will be pursuing the claims and interests on behalf of the estate.

For example, post-confirmation litigation or liquidation trusts are frequently created in chapter 11 plans so that the trust can administer specified assets and/or prosecute and settle certain claims for the benefit of designated beneficiary classes (often unsecured creditors). The assets and claims are typically assigned or transferred by the debtor to the trust free and clear pursuant to the plan and confirmation order.

Once the plan is effective, administration of the transferred assets and claims is no longer the debtor's function; rather, it is within the purview of the trust and the appointed trustee, with disbursements to trust beneficiaries to be made directly from the trust. The plan may provide that the bankruptcy court retains jurisdiction to oversee the trust administration, including claim objections and adversary proceedings. However, plans sometimes provide liquidating/litigating trustees or plan administrators discretion to compromise and settle claims (including affirmative claims held by the trust and/or claims asserted by trust beneficiaries/creditors), without the need for court approval.

Pursuant to 28 U.S.C. § 1930(a)(6), chapter 11 debtors must pay a quarterly fee to the U.S. Trustee for deposit in the U.S. Treasury until the case has been converted or dismissed. The fee is based on a formula tied to the amount of disbursements made by the debtor during each quarter

of the pendency of its chapter 11 case, currently capped at \$250,000 per quarter.³

The fees demanded by the U.S. Trustee's office have faced criticism by courts at all levels. Most notably, the U.S. Supreme Court in *Siegel v. Fitzgerald*⁴ found that Congress's enactment of a temporary increase in the fee rates, which were applicable to large chapter 11 cases in 2017 to address a shortfall in the U.S. Trustee System Fund,⁵ violated the uniformity requirement of the Bankruptcy Clause set forth in Article I, § 7, cl. 4 of the Constitution, which empowers Congress to establish “uniform Laws on the subject of Bankruptcies throughout” the U.S. The aftermath of *Siegel* is being grappled with in circuit courts across the nation.

As previously mentioned, assets and claims may be transferred by the debtor into a litigation/liquidation trust for administration by the trust and appointed trustee. Notwithstanding the fact that the debtor no longer owns the assets and claims, and is no longer administering the assets and claims and making disbursements following the transition to a post-confirmation trust, the U.S. Trustee has sought payment of statutory quarterly fees under 28 U.S.C. § 1930(a) for disbursements made by post-confirmation trusts.

The prospect of post-confirmation trusts having to pay quarterly fees to the U.S. Trustee can make the administration of such trusts costly. The trusts will often look for ways to administratively close bankruptcy cases, even with adversary proceedings pending, in order to avoid having to make ongoing payments to the U.S. Trustee. However, circumstances may necessitate that cases remain open for prolonged periods, such as to facilitate claims administration or if the plan requires the bankruptcy court to approve asset sales or settlements entered into by the trust. The quarterly payments, which can be exorbitant, will come at the expense of distributions to the trust's beneficiaries, which, as noted, often include unsecured creditors that may already be receiving a small fraction of their claims.

1 11 U.S.C. § 1141(b).

2 11 U.S.C. § 1123(b)(3)(B).

3 Subchapter V debtors are exempt from having to pay the quarterly fees.

4 142 S. Ct. 1770 (2022).

5 Pub. L. 115-72, Div. B, 131 Stat. 1229.

Hon. **Christopher S. Sontchi** (ret.) stated in *Paragon Offshore PLC*⁶ that he believed that the payment of post-confirmation quarterly fees by a litigation trust was not only inappropriate, but “offensive.”⁷ In *Paragon Offshore*, the confirmed plan established a litigation trust into which the debtor transferred the right to pursue certain claims for the trust’s beneficiaries (creditors of the debtor). The debtors and estates transferred to the litigation trust “with good, clean title to such property, free and clear of all liens, charges, Claims, encumbrances and interests.”⁸ The plan provided that quarterly fees owed to the U.S. Trustee shall be paid by the debtors and reorganized debtors until the debtors’ chapter 11 cases are closed.

The plan and litigation trust became effective on July 18, 2017. For the quarter between July 1, 2017, and Sept. 30, 2017, the period during which the claims were transferred by the debtor to the litigation trust, the debtors’ distributions exceeded \$623 million and the debtors accordingly paid the maximum fee due to the U.S. Trustee for that period under 28 U.S.C. § 1930(a).

Certain of the claims transferred to the litigation trust were settled in early 2021 for \$90,375,000 and were approved by the bankruptcy court on Feb. 24, 2021. The trust received all of the settlement proceeds on March 19, 2021. On May 12, 2021, the U.S. Trustee filed a motion to compel the trust to file post-confirmation quarterly reports and pay quarterly fees pursuant to 28 U.S.C. § 1930(a)(6) in connection with the settlement.

Chief Bankruptcy Judge Sontchi determined that the quarterly fee requirement of 28 U.S.C. § 1930(a)(6) is triggered only by “payments by or on behalf of the debtor.”⁹ The litigation trust was not paying any expenses on behalf of the debtors, but for the beneficiaries of the trust. All disbursements related to the debtors’ obligations occurred on the effective date when the debtor transferred the claims to the litigation trust. Chief Bankruptcy Judge Sontchi regarded that as the “ultimate payment” made by the debtors, following which the debtor remitted the required quarterly fee to the U.S. Trustee.¹⁰ He noted that the litigation trust’s distributions four years later are from the trust’s assets, which vested “free and clear” in the trust years earlier, for the benefit of the trust’s beneficiaries. The debtors did not have any interest in or control over the money disbursed.

Further, Chief Bankruptcy Judge Sontchi regarded any payment of quarterly fees by the litigation trust at this point as effectively a tax on creditors, given that the debtors had previously paid the required quarterly fees to the U.S. Trustee when the claims were transferred to the trust. Making his feelings clear, Chief Bankruptcy Judge Sontchi stated:

I cannot stress enough how offensive I find the [U.S. Trustee’s] attempt to double, or triple its “tax.” It would be hypocritical for a person whose livelihood depends on the taxation of his fellow citizens

to suggest that taxation is, in and of itself, reprehensible. It is, of course, necessary. What is reprehensible is attempting to take money out of the pockets of creditors, which are already receiving a small recovery on their claims, multiple times for the same distribution.¹¹

Read together, *Paragon Offshore* and *Health Diagnostic* reflect that plan language and circumstances of the case will inform whether a post-confirmation trust is obligated to pay quarterly fees.

Although *Paragon Offshore* had specific circumstances that supported Chief Bankruptcy Judge Sontchi’s determination that the litigation trust did not have to pay the quarterly fees to the U.S. Trustee, including the language in the plan vesting the transferred assets and claims free and clear in the trust, and that the debtors paid quarterly fees to the U.S. Trustee when transferring the assets and claims to the trusts, the opinion’s tone seemed to adopt a more general disapproval of requiring post-confirmation trusts to pay quarterly fees. It remained to be seen whether other courts would follow *Paragon Offshore* as a blueprint to more widely exempt post-confirmation trusts from paying quarterly fees, or whether courts would view the decision as restricted to the circumstances of the case.

The extent of the *Paragon Offshore* decision was recently tested in *Health Diagnostic Laboratory Inc.*¹² Relying on *Paragon Offshore*, the liquidating trustee appointed for the liquidating trust created in *Health Diagnostic* argued that the trust should not be liable for quarterly fees to the U.S. Trustee under 28 U.S.C. § 1930(a)(6).

The liquidating trustee filed a motion to approve interim distribution and for estimation of a substantial general unsecured claim, in order to allow the trustee to make an interim distribution to general unsecured creditors.¹³ The bankruptcy court granted the motion and approved the interim distribution to general unsecured creditors and the reserve for a disputed general unsecured claim in the amount of \$24.5 million.¹⁴ The trustee sought a determination on the extent of the trust’s liability for quarterly fees after the trustee made an interim distribution, which the U.S. Trustee asserted had triggered the maximum \$250,000 quarterly payment. The trustee argued that the confirmed plan in the case did not require him to pay quarterly fees on distributions to beneficiaries of the trust, and that such distributions were not “disbursements” under 28 U.S.C. § 1930(a)(6) because the beneficiaries are equitable owners of the trust’s assets.

However, the bankruptcy court disagreed and distinguished the circumstances in the case from *Paragon*

6 *In re Paragon Offshore PLC*, 629 B.R. 227 (Bankr. D. Del. 2021).

7 *Id.* at 232, n.31.

8 *Id.* at 229.

9 *Id.* at 231.

10 *Id.* at 232 (“Accordingly, this 2017 transfer pursuant to the Plan was the ‘ultimate payment’ made by or on behalf of the Debtors. And consistent with section 1930(a), the United States Trustee received its quarterly fee in connection with disbursements then.”) (emphasis in original).

11 *Id.* at 232, n.31.

12 2023 WL 105586 (Bankr. E.D. Va. Jan. 4, 2023).

13 *In re Health Diagnostics Lab. Inc., et al.*, Case No. 15-32919-KRH; Docket No. 5049.

14 *Id.* at Docket No. 5066.

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Offshore. The court noted that the plan in *Health Diagnostic* substantively consolidated the multiple bankruptcy estates, and that unlike *Paragon Offshore*, the liquidating trust was the successor to the debtor under the plan, and the plan included explicit and unambiguous language transferring the debtors' obligation to pay quarterly fees to the trustee under 28 U.S.C. § 1930(a)(6). This language in the plan was specifically requested by the U.S. Trustee; therefore, the U.S. Trustee was entitled to the benefit of the bargain that it negotiated with the debtors. In contrast, the court noted that the trust in *Paragon Offshore* "did not become the successor to the debtors, and the liquidating trustee did not step into the shoes and acquire all of the duties of the debtors." Further, unlike *Paragon Offshore*, no quarterly fees were assessed with respect to the transfer of assets from the debtors to the liquidating trust.

Health Diagnostic indicates that bankruptcy courts might not follow *Paragon Offshore* as a blanket blueprint for finding that post-confirmation trusts are exempt from paying U.S. Trustee quarterly fees on the basis that 28 U.S.C. § 1930(a)(6) is only limited to the actual debtor. The court further noted that holding otherwise could virtually eliminate quarterly fees "by the simple expedient of transferring

assets from the bankruptcy estate to a post-confirmation entity for subsequent payment."

However, the court acknowledged that one side effect of this determination is that liquidating/litigation trustees may bypass making interim distributions to trust beneficiaries and instead defer to a single distribution at the end of the trust's administration so that the trust would only have to make one fee payment to the U.S. Trustee.¹⁵ While this would preserve additional funds for the trusts, recovery for beneficiaries could be delayed, potentially for years, until the trust is fully administered.

Read together, *Paragon Offshore* and *Health Diagnostic* reflect that plan language and circumstances of the case will inform whether a post-confirmation trust is obligated to pay quarterly fees. Plan proponents desiring to prevent a post-confirmation trust from having to pay quarterly fees to the U.S. Trustee may want to look closely at the plan in *Paragon Offshore* as a potential model, although it still remains unclear whether other courts will follow Chief Bankruptcy Judge Sontchi's rationale under similar circumstances. **abi**

¹⁵ 2023 WL 105586 at *4, n.8.

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