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Comment

Awarding Fair Compensation To Bankruptcy Trustees

For almost a century, bankruptcy trustees have argued with courts regarding appropriate compensation. In 1899, a trustee petitioned the court for a lump sum in lieu of the 3 percent commission allowed under the 1898 Bankruptcy Act.¹ The court held that "the 3 percent commission was ample compensation for all the services performed, and it was the only type of compensation allowed under the [A]ct."² In 1986, a trustee submitted a fee application to the court based upon the maximum statutory amount allowed under the 1978 Bankruptcy Code.³ The bankruptcy court reduced the fee.⁴ On appeal, the district court affirmed the award concluding there was no abuse of discretion in the fee reduction.⁵

I. THE PROBLEM

The filing of a bankruptcy petition creates an estate.⁶ A bankruptcy trustee represents the estate in Chapter 7 liquidation cases.⁷ The "debtor in possession" represents the estate in Chapter 11 reor-

1. *In re Carolina Cooperage Co.*, 96 F. 950, 951 (E.D.N.C. 1899).

2. *Id.* at 952.

3. *In re Roco Corp.*, 64 Bankr. 499, 501 (Bankr. D.R.I. 1986).

4. *Id.* at 501. The trustee submitted an application for a fee of \$3990. *Id.* at 501 n.2. The bankruptcy court awarded \$3000. The trustee asserted that he was entitled to the maximum award under section 326 of the Code. *Id.* at 502. The District Court noted that if section 326(a) was meant "as a grant to trustees rather than a mere ceiling on fees, there would have been little need for Congress providing separate standards in 330(a)." *Id.* Further, the bankruptcy judge treated the application conservatively because the trustee failed to provide adequate records on how his time was spent. *Id.* at 504. It should be noted that inadequately prepared fee applications contribute to the courts already difficult task of determining the reasonableness of a trustees fees.

5. *Id.* at 505.

6. 11 U.S.C. § 541(a) (1990).

7. *Id.* § 701.

ganization cases unless a trustee is appointed.⁸ The trustee collects estate property and reduces it to money.⁹ The money collected is disbursed to creditors and the estate is closed as expeditiously as possible.¹⁰ Because the trustee is employed to further the interests of the estate, estate funds are used to compensate the trustee.¹¹

The trustee is a commissioned person.¹² This scheme of compensation works to maximize the advantage of creditors, because it provides a strong incentive for trustees to collect as many of the estate's assets as possible. However, in most liquidation cases, there are few or no assets to collect. As a result, the trustee is inadequately compensated for work performed.¹³ Furthermore, the value of a trustee does not lie solely in the ability to collect and distribute the estate. In reorganization cases, for example, much of the trustee's value to creditors, employees, and the economic system depends upon business savvy and expertise.¹⁴

In the bankruptcy arena, the problem of awarding fees plagues both the trustee and the bench. Although the Bankruptcy Code¹⁵

8. *Id.* § 1104.

9. This is primarily true in a Chapter 7 liquidation case. 11 U.S.C. § 704 (1990). In Chapter 11 reorganizations, the trustee may operate the business rather than liquidate depending upon the plan. *Id.* § 1106.

10. 11 U.S.C. § 704 (1990).

11. *Id.*; see *infra* note 36 for relevant text of statute.

12. 11 U.S.C. § 326(a) (1990); see *infra* note 20.

13. 11 U.S.C. § 330(b) (1990) provides the trustee with a \$45 fee in no asset cases.

14. A fundamental premise of bankruptcy law is "to encourage and facilitate rehabilitation of businesses in financial trouble. Rehabilitation of a business is considered better for the economy because it minimizes employment and waste of business assets." B. WEINTRAUB & A. RESNICK, *BANKRUPTCY LAW MANUAL*, § 8.02 (1980). Individuals also may file Chapter 11 in order to retain more than exempt assets. H. NOVIKOFF, *CHAPTER 11 BUSINESS REORGANIZATIONS* 23 (1989).

Choosing between a Chapter 7 liquidation and a Chapter 11 reorganization depends upon which course offers the greatest opportunity for the total dollar return on the assets. Choosing a Chapter 11 means that the reorganized firm is better for its creditors as a going concern rather than liquidating the assets. T. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 5 (1986). "Administration of a chapter 11 case requires decision about the use of business assets and opportunities." Nimmer & Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 *BANKR. DEV. J.* 1, 4 (1986).

However, the financial opportunities will rarely present themselves with clarity because "most chapter 11 cases entail factual uncertainty, financial distress and explicitly conflicting interests." *Id.* at 1. Successful reorganization depends upon a great deal of "creative, imaginative and high quality work." See Lavien, *Fees as Seen from the Bankruptcy Bench*, 89 *COM. L.J.* 136 (1984). Thus, reorganization cases need trustees who have substantial executive abilities and business "know how" in order to ensure their success.

Under section 326(a) a trustee's compensation in a Chapter 11 case is based upon the same statutory maximums as in a Chapter 7 liquidation case. However, "the maximums may be too limited to attract a trustee in a case which requires substantial executive abilities." 2 W. COLLIER, *COLLIER ON BANKRUPTCY* ¶ 326.01 (L. King 15th ed. 1990). Consequently, financial considerations may hamper trustee appointments in reorganization. *Id.*

15. The Bankruptcy Reform Act of 1978 was signed into law on November 6,

provides statutory guidelines for awarding compensation to trustees,¹⁶ the amount ultimately decided upon has always been vested in the court.¹⁷ The court must apply the Code's complicated scheme of compensation to a variety of factual situations. The resulting problem is that sometimes only slight variations in the facts result in disparate outcomes.

Trustee fees are subject to two limitations under the Bankruptcy Code. Section 330(a)(1) provides that the court may award reasonable compensation.¹⁸ To qualify for compensation under this section, services must be necessary and beneficial to the estate. Section 326(a) fixes the maximum compensation allowed based upon the amount of moneys disbursed.¹⁹ Determining trustee compensation according to these two distinct standards creates a vexing problem for the bankruptcy judge. For example, a fee of \$70,000 might be reasonable under the standards of section 330(a)(1), however, section 326(a) might place a \$60,000 cap on compensation. Similarly, the reasonable value of the trustee's services becomes irrelevant under section 326(a) if little or no money is disbursed. In either case, the trustee may be denied compensation for valuable services performed, resulting in a windfall to the estate.

The legislative history of these two sections of the Code further

1978 and is commonly referred to as the "Code". The Code replaces the entire Bankruptcy Act of 1898. A. PASKAY, HANDBOOK FOR TRUSTEES AND RECEIVERS IN BANKRUPTCY 2 (Supp. 1979).

16. 11 U.S.C. §§ 330 (a)(1), 326(a) (1990).

17. "(a) In a case under chapter 7 or 11, the court *may* allow reasonable compensation under section 330 of [the Code] . . . for the trustee's services . . ." 11 U.S.C. § 326(a) (1990) (emphasis added).

18. 11 U.S.C. § 330(a)(1) (1990).

(a) After notice to any parties in interest . . . and subject to section 326, . . . the court may award to a trustee, . . .

(1) reasonable compensation for actual, necessary services rendered by such trustee, . . . based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title;

. . .

Id.

19. 11 U.S.C. § 326(a) (1990).

(a) In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title for the trustee's services, payable after the trustee renders such services, not to exceed fifteen percent on the first \$1000 or less, six percent on any amount in excess of \$1000 but not in excess of \$3000, and three percent on any amount in excess of \$3000, 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.

. . .

Id.

exacerbates the problem. Congressional intent behind section 330(a)(1) indicates that bankruptcy courts should award trustee fees "at the same rate that would be used to compensate them for performing comparable services in nonbankruptcy cases."²⁰ The legislative movement away from the notion of strict economy,²¹ pervasive under the Bankruptcy Act, demonstrates Congress' recognition that trustees would leave the bankruptcy field if they could earn more substantial compensation in other areas.²² If bankruptcy specialists left the field, less qualified individuals would administer cases. Creditors would pay the "costs of improper and inefficient administration."²³ This "new marketplace approach"²⁴ reflects a realization that effective estate administration cannot be accomplished cost free.

Nonetheless, Congressional intent that trustees be awarded competitive fees is incompatible with the statutory limitations under section 326(a). When competitive fees exceed the maximums they are not allowed. In addition, competitive fees are disallowed when no funds are disbursed or turned over to creditors despite beneficial services performed on behalf of the estate.

Legislative history also suggests that the statutory maximums under section 326(a) are not entitlements as a matter of right, but are to be regarded by the courts as outer limits on the value of a trustee's services.²⁵ One court noted that "the maximum [limitation] really has no correlation with fair value for services."²⁶ The maximum correlates to moneys disbursed. However, the court must still consider the reasonableness of the fee under the separate standards of section 330(a)(1).

Congressional intent behind section 326(a) that the trustee is not entitled to the statutory maximum despite eligibility is irreconcilable with the structure of the statutory commission scheme. Under this approach, a trustee may never achieve the maximum even though substantial moneys are disbursed. Hence, the original intent of the commission scheme is frustrated because trustee incentive to collect and preserve assets for the estate is diminished.

Moreover, because section 326(a) does not limit the compensation of other professionals, meagerly paid trustees may overuse professionals or paraprofessionals, making case administration more expen-

20. 124 CONG. REC. H11,091-92 (Sept. 28, 1978); 124 CONG. REC. S17,408 (Oct. 6, 1978)), reprinted in 2 W. COLLIER, *supra* note 14, ¶ 330.03.

21. See *infra* notes 41-44 and accompanying text.

22. 2 W. COLLIER, *supra* note 14, ¶ 330.05(2)(e).

23. *Id.*

24. *In re Roco Corp.*, 64 Bankr. 499, 504 (Bankr. D.R.I. 1986) (citing *In re Casco Bay Lines, Inc.*, 25 Bankr. 747 at 753-54 (Bankr. 1st Cir. 1982)).

25. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 327 (1977).

26. *In re Garland Corp.*, 8 Bankr. 826, 833 (Bankr. D. Mass. 1981).

sive under the current statutory scheme.²⁷ As a result, creditor returns are decreased. It is evident that the current statutory scheme is ineffectual in encouraging efficient case administration.

Not surprisingly, courts are presented with a difficult task when awarding fees. The results depict how the conflicting standards cause uncertainties and inequities in the area of trustee compensation. Moreover, disparate outcomes in the cases illustrate the unpredictability of the statutory scheme from the trustee's point of view.²⁸

This Comment explores the differing judicial approaches to the problem of awarding fair compensation to trustees. In order to illustrate the ineffectiveness of the current statutory scheme various situations are discussed. All relate to a single question: does the statutory limitation tied to property distribution actually serve to promote efficient case administration under the Code? It seems anomalous for Congress to intend that trustees be compensated according to the standards set forth under section 330(a)(1) and simultaneously condition their compensation upon the distribution of the moneys from the estate.

II. BACKGROUND OF BANKRUPTCY LAW

A. *Interaction between the Goals of Bankruptcy and Compensation of Trustees*

The two goals of bankruptcy law are: 1) The rehabilitation of overburdened debtors, often called the "fresh start" policy, and 2) equitable treatment of creditors.²⁹ The fresh start policy applies only to individual debtors.³⁰ In accord with this policy, individual debtors are granted the right to discharge their debts, which allows them to keep a shirt on their backs, and to stay off the welfare rolls.³¹

When firms are involved, "bankruptcy law provide[s] creditors

27. See *In re Marsh*, 5 Collier Bankr. Cas. 2d (MB) 106, 110 (Bankr. E.D. Va. 1981) (After reviewing expense reports turned in by the trustee, the judge noted that "[w]e may well learn that section 330 encourages too much professional or paraprofessional help and the riding of expenses to death.").

28. A trustee is placed in a position of financial uncertainty when he agrees to administer a bankruptcy case. The trustee will not receive reasonable compensation for valuable services if no moneys are disbursed. Likewise, if moneys are disbursed the trustee may still be denied reasonable compensation at competitive rates when his fee is capped under section 326(a).

29. T. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 4 (1986).

30. *Id.* at 225; see also 11 U.S.C. § 727(a)(1) ("The court shall grant the debtor a discharge, unless — 1) the debtor is not an individual . . .").

31. T. JACKSON, *supra* note 29, at 231.

with a compulsory and collective forum to sort out their relative entitlements to a debtor's assets."³² The goal of bankruptcy in this regard is to apportion losses among the debtor's creditors in such a way that losses to creditors as a group are reduced.³³ Such reduction occurs because without bankruptcy, creditors resort to individual remedies which are costly and afford little opportunity for returns.³⁴ In addition, the debtors may lose everything if not given the chance to reorganize their business or, in the cases of individuals, the right to discharge their debts.

However, the bankruptcy system does not dispense with all economic costs. Trustees and other officers³⁵ of the estate are paid in full as an administrative expense before distributions to other unsecured claimants are made.³⁶ This priority scheme decreases returns to general unsecured creditors. Thus, compensating the trustee from estate funds comes into direct conflict with the goal of maximizing returns to creditors. Further, in solvency situations, returns to the debtor are reduced.

Efficient case administration is essential to maximize creditor returns as well as to increase returns to solvent debtors. Attracting competent personnel to fulfill this objective was one goal of case administration reform under the Code. Congress provided that all professionals be paid competitive rates.³⁷ Unfortunately, section 326(a), by treating trustees as commissioned persons fails to compensate trustees at a rate which is competitive with the rates other professionals receive.

32. *Id.* at 4.

33. *Id.* at 5.

34. "Since each creditor knows that it must beat out the others if it wants to be paid in full, it will spend time monitoring Debtor and the other creditors—perhaps frequently checking the courthouse records—to make sure that it will be no worse than second in the race (and therefore still be paid in full)," *Id.* at 16. "Each creditor has to spend . . . money just to stay in the race because if it does not, it is a virtual certainty that the others will beat it to the payment punch." *Id.*

35. 11 U.S.C. § 330(a) (1990). Officers may include examiners, professional persons and attorneys, and paraprofessionals employed by such officers.

36. *Id.* § 507(a). Section 507(a) reads in relevant part:

(a) The following expenses and claims have priority in the following order:
(1) First, administrative expenses allowed under section 503(b) of this title.

Id.

Section 503(b) reads in relevant part:

(b) After notice and a hearing, there shall be allowed administrative expenses, . . . including —
1(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case;

11 U.S.C. § 503(b) (1990).

37. 124 CONG. REC. H11,091-92, *supra* note 20.

B. Trustee Compensation and Case Administration Before the Code

Under the Bankruptcy Act, the trustee was compensated in a manner similar to the current scheme.³⁸ The private trustee played a fundamental role in the administration of estates.³⁹ The underlying premise was simple: the trustee "collects the assets of the estate and holds them in trust for the benefit of the debtor's creditors."⁴⁰ The prevailing standard controlling trustee compensation was "the spirit of economy and it required that, when awarding compensation to officers, the court consider as most significant factors the conversation of the estate and the return to creditors."⁴¹ While courts recognized the need for adequate compensation of trustees in order to encourage economical administration of bankruptcy estates, this standard greatly constrained their attempt to provide adequate compensation to the trustee.

Furthermore, the statutory scheme placed trustees in a situation where they were required to take on work of a "contingent nature, but receive compensation based on noncontingent conservative standards."⁴² The trustee was literally placed in a catch 22 situation.⁴³ Trustees collecting assets worth a substantial amount were awarded compensation according to an economically conservative standard. Likewise, if the case turned out to be a nominal or no asset case,

38. Bankruptcy Act, 70 Stat. 216, § 48(c) (1956) (codified as amended at 11 U.S.C. § 76 (1956)). Section 48(c) states in relevant part:

c. Trustees. The compensation of trustees for their services, payable after they are rendered, shall be a fee of \$10 for each estate, deposited with the clerk at the time the petition is filed in each case, . . .

(1) Normal Administration. When the trustee does not conduct the business of the bankrupt, such sum as the court may allow, but in no event to exceed 10 per centum on the first \$5000 or less, 6 per centum on moneys in excess of \$500 and not more than \$1500, 3 per centum on moneys in excess of \$1500 and not more than \$10,000, per centum on moneys in excess of \$25,000, upon all moneys disbursed or turned over by them to any persons, including lienholders: *Provided, however,* That in any case, after the trustee has paid all expenses of administration and has realized upon all available assets, the maximum compensation allowable to him hereunder does not exceed \$150, the court may of its own motion allow the trustee a fee which with the commissions, if any, paid or to be paid him shall not exceed \$150.

Id.

39. A. PASKAY, *supra* note 15, § 7.001, at 158.

40. H.R. REP., *supra* note 25, at 91.

41. 2 W. COLLIER, *supra* note 14, ¶ 330.02.

42. Anderson & Miller, *New Rules for Compensation in Bankruptcy Proceedings*, 86 COM. L. J. 79, 83 (1981).

43. *Id.* at 83.

little or nothing would be paid. Too often the “[e]mphasis on results, while simultaneously emphasizing that fees in bankruptcy proceedings should be less than paid in the private sector, discouraged the aggressive pursuit of case administration. Creditors received limited recoveries as a result.”⁴⁴

Appointment of the trustee created another problem area in case administration under the Act. Theoretically, creditors were to nominate and supervise the trustee.⁴⁵ The creditors “would serve without compensation simply to protect their own interests.”⁴⁶ In reality, however, “creditors took little interest in pursuing a bankrupt debtor. They are unwilling to throw good money after bad,”⁴⁷ and “creditor control in bankruptcy cases proved to be nothing more than a myth.”⁴⁸ As a result, bankruptcy judges often appointed the trustee.⁴⁹ Moreover, “[s]ome judges viewed the power to appoint as an opportunity to dispense patronage; and some judges expressed open hostility toward a creditor’s insistence to nominate and elect a trustee.”⁵⁰

Eventually, the courts’ active role in trustee appointment, coupled with the economically conservative compensation standards, forced the development of an easy to apply rule. The “spirit of economy” gave way to a new standard where the statutory maximums became minimums.⁵¹ More often than not “[i]n all but the largest cases, trustees receive[d] the maximum fee.”⁵² This practice sharply reduced returns to creditors.

Judges also had discretion to award a fee of up to \$150 in cases where the statute would have allowed \$10.⁵³ This discretionary fee provided a strong incentive for trustees to “create” an estate where one did not exist when the statutory ceiling placed on the trustee’s compensation would have been less than \$150. Trustees would take the debtor’s car or pets to sell back to the debtor for a least \$150.⁵⁴ This procedure allowed trustees to collect that amount in fees. The so called “nominal asset cases” provided little for the creditors while compelling debtors to turn over assets.⁵⁵ Actually, “creditors received virtually nothing in nominal assets cases,”⁵⁶ and debtors who

44. *Id.*

45. H.R. REP., *supra* note 25, at 91.

46. *Id.* at 92.

47. *Id.*

48. *Id.*

49. *Id.*

50. A. PASKAY, *supra* note 15, § 7.001 at 159.

51. H.R. REP., *supra* note 25, at 93.

52. *Id.*

53. *Id.*

54. *Id.* at 94.

55. *Id.* at 93.

56. *Id.*

were compelled to repurchase necessary or sentimental personal property were denied an opportunity for a financial "fresh start."⁵⁷ It is no wonder that creditors and debtors viewed the bankruptcy system as having evolved for the benefit of those administering it.⁵⁸

C. Congress Responds: *The Trustee System Today*

1. Case Administrative Reform

Dividing the judicial and administrative roles of a bankruptcy judge was a principal revision under the Code.⁵⁹ A temporary United States trustee system was established in 1978 that "shifted estate administration supervision from the judge to the United States trustee."⁶⁰ Because of its success, the United States trustee office became permanent in 1986.⁶¹ This legislation reflects Congress' intent that "administrative matters should be the United States trustee's responsibility and the court's role should be limited to that of an arbiter of disputes."⁶²

The United States trustee nominates private trustees to serve on a panel.⁶³ Immediately after the court enters an order for relief in Chapter 7 cases, "the United States trustee appoints an interim trustee from the private panel."⁶⁴ "Unsecured creditors may elect a qualified trustee by a majority vote if creditors holding at least 20 percent of the amount of the outstanding unsecured claims call for the election."⁶⁵ Creditors can elect trustees who are not on the panel.⁶⁶ However, creditors infrequently elect trustees because they can seldom comply with the statutory criteria needed for an election.⁶⁷ Thus, an interim trustee will normally act as trustee in Chap-

57. *Id.* at 94.

58. *Id.*

59. G. TREISTER, J. TROST, L. FORMAN, K. KLEE & R. LEVIN, *FUNDAMENTALS OF BANKRUPTCY LAW* § 2.03(a)(1), at 85 (1988) [hereinafter *TREISTER & TROST*].

60. *Id.*

61. *Id.*

62. *Id.* at 85-86.

63. *Id.* at 87; *see* 28 U.S.C. § 586(a)(1) (1990); 11 U.S.C. 1302(a) (1990).

64. *TREISTER & TROST, supra* note 59, § 2.03(a)(3), at 91; *see* 11 U.S.C. § 701(a)(1) (1990).

65. *TREISTER & TROST, supra* note 59, § 2.03 (a)(3), at 91; *see* 11 U.S.C. § 702(c)(1990).

66. *TREISTER & TROST, supra* note 59, § 2.03(a)(3), at 91.

67. *Id.* 11 U.S.C. § 702(c) (1990) states:

- (a) A creditor may vote for a candidate for trustee only if such creditor—
 (1) holds an allowable, undisputed, fixed, liquidated, unsecured claim of a kind entitled to distribution. . .
 (2) does not have an interest materially adverse, other than an equity in-

ter 7 cases.⁶⁸

If a private trustee chooses not to serve, a staff member representing the United States trustee acts as the trustee.⁶⁹ Nonetheless, financial restrictions preclude the United States trustee from serving and “it is that Office’s policy to find private trustees.”⁷⁰ Consequently, the private trustee continues to play a central role in Chapter 7 case administration.

The “debtor in possession” represents the estate in Chapter 11 cases, unless the court orders the United States trustee to appoint a private trustee.⁷¹ Unlike Chapter 7 cases, “[n]either the United States trustee nor a staff member may serve in reorganization cases.”⁷² “The appointed Chapter 11 trustee need not be a member of the panel.”⁷³ Because Chapter 11 presumes the debtor will continue to run the business, appointment of a trustee is an extraordinary remedy.⁷⁴ However, “[a]lthough the appointment of a trustee continues to be viewed as extraordinary, the clear trend today is toward a growing number of cases being brought to cause.”⁷⁵ Consequently, private trustees are essential for the administration of both liquidation and reorganization cases.

The United States trustee supervises all aspects of bankruptcy case administration including trustees.⁷⁶ One aspect of trustee supervision involves monitoring applications for compensation and reimbursement of expenses.⁷⁷ By taking an active role in case administra-

terest that is not substantial in relation to such creditor’s interest as a creditor, to the interest of creditors entitled to such distribution; and (3) is not an insider.

68. TREISTER & TROST, *supra* note 59, § 2.03(a)(3), at 91; *see* 11 U.S.C. § 702(d) (1990).

69. TREISTER & TROST, *supra* note 59, § 2.03(a)(1), at 87; *see* 11 U.S.C. § 701(a)(1) (1990).

70. TREISTER & TROST, *supra* note 59, § 2.03(a)(1), at 87.

71. *Id.*

72. *Id.* at 87, 89; *see* 11 U.S.C. § 1104(c) (1990) (“If the court orders the appointment of a trustee. . . , the United States trustee, after consultation with the parties in interest, shall appoint, subject to the court’s approval, one disinterested person other than the United States trustee to serve as trustee.”).

73. TREISTER & TROST, *supra* note 59, § 2.03(a)(1), at 89.

74. *In re General Oil Distributors, Inc.*, 42 Bankr. 402, 408 (Bankr. E.D.N.Y. 1984).

75. Nimmer & Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 57 (1989); *see also* 11 U.S.C. § 1104 (1990). Section 1104 states in relevant part:

(1) the court shall order the appointment of a trustee—

(a) for cause, including, fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause

Id.

76. TREISTER & TROST, *supra* note 59, § 2.03(a)(1), at 89; *see* 28 U.S.C. § 586(a)(3) (1990).

77. TREISTER & TROST, *supra* note 59, § 2.03(a)(1), at 89; *see* 28 U.S.C. § 586(a)(3)(A) (1990).

tion, "the United States trustee can prevent fraud, dishonesty and overreaching in the bankruptcy system."⁷⁸

2. Trustee Compensation Reform

The Code also made significant changes in the area of trustee compensation. First, the \$150 fee was eliminated.⁷⁹ Trustee compensation in Chapter 11 reorganization cases was another statutory change. Under the Act, a reorganization trustee's pay "was equated to that of an executive performing similar services for an entity of like size and complexity."⁸⁰ However, the Code no longer permits Chapter 11 trustees to receive "reasonable compensation based on the value of services without regard to . . . maximum commissions" prescribed by the Act.⁸¹ Therefore, trustee compensation in both Chapter 7 and Chapter 11 are subject to the same maximums under section 326(a).⁸²

Additionally, a court's determination of reasonable fees no longer depends upon notions of strict economy. Congressional intent indicates that "[n]otions of economy of the estate in fixing fees are outdated and have no place in the Bankruptcy Code."⁸³ Courts should take a marketplace approach and award trustee fees "at the same rate that would be used to compensate them for performing comparable services in nonbankruptcy cases."⁸⁴ Congress realized that awarding competitive fees would attract more competent professionals to efficiently administer cases.⁸⁵

Furthermore, Congress increased the statutory percentages under section 326(a) allotting for increased costs of living.⁸⁶ At the same time, however, Congress made it clear that the statutory maximums did not correlate to the fair value of services.⁸⁷ Trustees were not entitled to the maximums as a matter of right. Regardless of the expanded statutory percentages, section 326(a) compensates only for money distribution. Thus, other beneficial and necessary services

78. T. Stanton, *The United States Trustee System: A Time for Assessment*, 90 COM. L. J. 90, 91 (1985).

79. 2 W. COLLIER, *supra* note 14, ¶ 326.01(3).

80. *Id.*

81. *Id.*

82. *Id.*

83. 124 CONG. REC. H11,091-92, *supra* note 20.

84. *Id.*

85. 2 W. COLLIER, *supra* note 14, ¶ 330.05(2)(e).

86. 2 W. COLLIER, *supra* note 14, ¶ 326.01(3). (The bases were doubled under the Bankruptcy Reform Act of 1978 and further increased under the 1984 amendments).

87. H.R. REP., *supra* note 25, at 327.

may go uncompensated especially in nominal or no asset cases.

Consequently, the question remains not whether trustees are entitled to a maximum fee as a matter of right, but whether they are entitled to compensation for the fair value of their services as a matter of right.

3. *The Practical Effects of Reform under the Code: Sources of the Problem — Statutory Construction and Congressional Intent*

The statutory scheme for trustee compensation and the underlying Congressional intent has undermined efforts to increase the overall effectiveness of case administration under the Code. Section 326(a) often restricts courts from awarding competitive compensation by placing a cap on trustee compensation based on a percentage of monies disbursed. In addition, more demands have been placed upon trustees without a corresponding raise in pay.⁸⁸ For example, “[i]ncreased recordkeeping and reporting requirements . . . make a trustee’s job more difficult and time consuming.”⁸⁹ At the same time, “due to liberalized exemption schedules[,] almost every case is rendered a no asset case, slashing trustee compensation by as much as 75% on a per estate basis.”⁹⁰ Not surprisingly, “more work for less pay” has reduced the number of trustees serving on panels.⁹¹ As one court noted, “[t]he trustee in bankruptcy, a modestly compensated and beleaguered creature under the old Bankruptcy Act, has become, under the new Bankruptcy Code, an endangered species.”⁹²

D. *Statutory Restraints: 326(a)*

When a trustee’s fee under section 330(a)(1) exceeds the statutory maximum of section 326(a), the court cannot award the fee. The trustee is denied compensation for beneficial and necessary services even after assisting the court in the administration of its caseload. Thus, section 326(a) undermines the Congressional intent that trustees be awarded competitive fees.

To avoid harsh results, some courts allow compensation even though the statutory requirement of disbursing moneys has not been met. However, because there is no statutory authority permitting compensation in these cases, the approach is utilized in very few sit-

88. *In re Rennison*, 13 Bankr. 951, 952 (Bankr. W.D. Ky. 1981).

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.* (It should be noted that the judge made this statement in 1981, three years after the statutory percentages were increased under section 326(a) for the first time in 1978, and three years after Congress adopted the new marketplace approach under section 330(a)(1)).

uations. Consequently, that approach cannot be effective in furthering the Congressional intent to award competitive rates for valuable and necessary services under section 330(a)(1). Thus, section 326(a) frustrates efforts to attract competent personnel to the bankruptcy area. Case administration suffers as a result.

E. Restraints imposed by Congressional Intent

A further restraint placed upon the court in awarding fees is Congress' intent that statutory maximums under section 326(a) have no correlation to the fair value of services.⁹³ Notwithstanding the commission scheme, the court is instructed by Congress to determine the reasonable value of the trustee's services. The court's highly subjective analysis of "reasonableness" is incompatible with the commission scheme under section 326(a). That approach diminishes trustee incentive to collect and preserve assets for the estate because the commission scheme is not truly a commission scheme.

Consider, for example, a no asset case where the trustee collects substantial assets for the estate qualifying for the maximum allowed. The court subjectively adjusts amounts allowed under section 326(a) to meet the requirements of section 330(a)(1). If the reasonable value of a trustee's services is within the statutory amount allowed under section 326(a), the court is authorized to award the fee which may or may not be the maximum. In such a case, the statutory mandate under section 330(a)(1) of awarding reasonable fees prevails. Ironically, the court may not award the fee where the reasonable value of a trustee's services exceeds the maximum. In this case, the statutory mandate of awarding reasonable fees at competitive rates under section 330(a)(1) gives way to the statutory mandate of section 326(a), capping the fee despite what might otherwise be reasonable.

Arguably, in bankruptcy cases, the commission scheme of section 326(a) no longer serves as an incentive for the trustee to diligently locate assets to bring into the estate. This is because courts have been instructed to award fees according to the "reasonable" standard under section 330(a)(1). The essence of the commission scheme under section 326(a) is undermined when courts award "reasonable" fees that are inconsistent with the amount of moneys distributed from the estate. Therefore, section 326(a) discourages the aggressive pursuit of case administration.

93. See *supra* note 25.

III. THE DIFFERING JUDICIAL APPROACHES TO THE PROBLEM OF AWARDING FAIR COMPENSATION TO TRUSTEES

A. *Disregarding the Statutory Mandate that Moneys be Disbursed: The Law of Natural Justice and Equity*

A literal reading of section 326(a) suggests that a trustee is not entitled to a statutory commission when no moneys are disbursed. In spite of this, several courts avoid the statutory mandate and award compensation to trustee's regardless of their failure to meet the requirement that moneys be disbursed to the parties in interest. Bankruptcy judges dislike denying compensation to trustees who have assisted the court in administering caseloads. Accordingly, courts exercise their equitable power to allow compensation on a quantum meruit basis to those trustees who perform beneficial services for the estate.

1. *Cases that are not fully administered*

One line of cases suggests that a literal reading of section 326(a) reveals that the section only applies to fully administered cases.⁹⁴ Accordingly, "[i]n cases . . . not fully administered, through no fault of the trustee, compensation should be awarded to the trustee on a *quantum meruit* basis when the trustee performed substantial services but did not disburse any moneys."⁹⁵ One court noted that in these cases "debtors would enjoy the benefits of bankruptcy law cost free if section 326(a) was always literally applied."⁹⁶

For example, a debtor may convert a Chapter 7 filing to Chapter 13 "to avoid the consequences of a trustee's actions in locating, identifying and administering assets."⁹⁷ Upon conversion, the trustee's duties end, therefore, preventing the trustee from fully administering the case. Thus, literal application of section 326(a) precludes the awarding of trustee fees regardless of work performed before conversion because no moneys have been disbursed.

In *In re Parameswaran*, the trustee "created [an] asset case from [a] no asset case" by discovering a fraudulent transfer of real prop-

94. *In re Parameswaran*, 64 Bankr. 341, 343 (Bankr. S.D.N.Y. 1986).

95. *Id.*

96. *In re Rennison*, 13 Bankr. 951, 953 (Bankr. W.D. Ky. 1981).

97. *In re Wells*, 87 Bankr. 732, 736 n.3 (Bankr. N.D. Ga. 1988). The Chapter 7 trustee collects all nonexempt assets and reduces them to cash. The cash is disbursed to creditors. In contrast, qualified individual debtors can pay all or part of their debts according to a plan in Chapter 13 cases. "Chapter 13 is attractive to individual debtors because it affords the most liberal discharge provision of any chapter under the Code." H. LEBOWITZ, *BANKRUPTCY DESKBOOK* 73 (2d ed. 1990). For example, "debtors making fraudulent transfers will lose discharge rights under chapter 7 but still may be able to discharge in chapter 13." *Id.* Further, only debtors can begin a Chapter 13 case or convert a case from another Chapter to Chapter 13. *Id.* at 72.

erty.⁹⁸ After the trustee effectively barred the debtor's discharge and retrieved the property for the estate, the debtor exercised his right to convert the Chapter 7 case to Chapter 13. Consequently, "the trustee was prevented from fully administering the Chapter 7 case."⁹⁹ Nonetheless, the court awarded a quantum meruit fee compensable directly from the debtor's estate even though no moneys were disbursed.¹⁰⁰ Thus, the court rewarded the trustee's services and involvement in the case.

Likewise, in *In re Tweeten Funeral Home*, the court awarded a quantum meruit fee to the trustee when no moneys were disbursed to creditors because of stipulation.¹⁰¹ Commenced under Chapter 11, the *Tweeten* case was converted to Chapter 7 when "[t]he four principals of the funeral home filed separate Chapter 7 petitions."¹⁰² The appointed trustee began administering the separate cases but his duties suddenly stopped when "the debtors, the trustee and other interested parties entered into an omnibus stipulation by which all administrative proceedings . . . and . . . claims were settled."¹⁰³ "No funds came into the hands of the trustee" because the individual debtors paid all unsecured claims themselves in accordance with the stipulation.¹⁰⁴ Because of the valuable services performed on behalf of the estate, the court circumvented the requirements of section 326(a) and awarded a quantum meruit fee to the trustee.

2. Cases that are fully administered

Another line of cases allows for compensation even though the statutory requirement of disbursing moneys has not been met.¹⁰⁵ For example, one court allowed fees in excess of the statutory limitations under section 326(a) when funds were returned to the debtor after the case was dismissed.¹⁰⁶ In *In re Flying S Land & Cattle Co., Inc.*,

98. *Parameswaran*, 64 Bankr. at 342-43. (Debtors have the right to convert under 11 U.S.C. § 706 (1990).

99. *Parameswaran*, 64 Bankr. at 343.

100. *Id.* But see *In re Woodworth*, 70 Bankr. 361 (Bankr. N.D.N.Y. 1987) (Debtor converted Chapter 7 to Chapter 13 but court denied compensation because "efforts of trustee did not result in any marshalling of assets or disbursement of funds to creditors." *Id.* at 363.).

101. 78 Bankr. 998, at 999 (Bankr. D.N.D. 1987).

102. *Id.*

103. *Id.*

104. *Id.*

105. A fully administered case is one where the trustee has fulfilled his duties and is ready to disburse cash to the unsecured creditors.

106. See *In re Flying S Land & Cattle Co., Inc.*, 23 Bankr. 56 (Bankr. C.D. Cal.

“[t]he trustee resolved a [boundary] dispute between the debtor and John Travolta who had purchased part of the debtor’s property before the bankruptcy proceedings.”¹⁰⁷ Resolution of the dispute permitted the trustee to prevent a foreclosure and sell the rest of the property for \$12 million.¹⁰⁸ The debtor requested dismissal of the case after his problems were settled.¹⁰⁹ Because the trustee had already reduced the property to cash, moneys held by the trustee were returned to the debtor.

A literal reading of section 326(a) suggests that all disbursements to debtors are excluded from consideration in computing a trustee’s commissions. The court held section 326(a) inapplicable “when funds are returned to the debtor because of a dismissal.”¹¹⁰ The court reasoned that section 326(a) “was meant to exclude the recovery of compensation to the trustee only on exempt property returned to the debtor.”¹¹¹ Here the returned funds were not exempt.

Moreover, there were no unsecured claims to satisfy. Accordingly, “[w]here there is a surplus estate, generated by the efforts of the trustee but not claimed because creditors have not filed proofs of claim, it would be unfair to reward the debtor and not compensate the trustee [after dismissal of the case].”¹¹² The debtor agreed to pay a fee to the trustee in an amount that exceeded the statutory maximum allowed by section 326(a).¹¹³ By holding section 326(a) inapplicable, the court allowed compensation in excess of the statutory amount to the trustee who invested time and effort in the administration of the case.

B. Compensation For Exempt Property Returned to Debtor

The court in *In re Myatt*¹¹⁴ went one step beyond *In re Flying S Land & Cattle*. *Myatt* allowed compensation when the trustee returned exempt property to the debtor.¹¹⁵ As the *Myatt* court pointed

1982).

107. *Id.* at 57.

108. *Id.*

109. *Id.*

110. *Id.* at 58; *cf. In re Pray*, 37 Bankr. 27 (Bankr. M.D. Fla. 1983) (Trustee was awarded quantum meruit after debtors requested a voluntary dismissal and where trustee did not liquidate any property.) *In re Rennison*, 13 Bankr. 951 (Bankr. W.D. Ky. 1981) (Court held section 326(a) inapplicable in voluntary dismissal cases where the *only* disbursement is to the debtors).

111. *In re Flying S Land & Cattle Co., Inc.*, 23 Bankr. at 57. “Under 541 the debtor’s exempt property becomes part of the estate. . . . The phrase ‘excluding the debtor’ in 326(a) protects the debtor’s exempt property from diminution because it is not a base upon which compensation can be computed.” *Id.* at 58.

112. *Id.* at 58.

113. *Id.* at 57.

114. 101 Bankr. 197 (Bankr. E.D. Cal. 1989).

115. *Id.* *But see In re Flying S Land & Cattle Co. Inc.*, 23 Bankr. 56, 57 (Bankr. C.D. Cal. 1982) (stating that “section 326(a) was meant to exclude the recovery of com-

out:

There is great unfairness in having a trustee diligently take charge of assets not claimed exempt and reduce the asset to cash, expending considerable time, effort and expense in the process. Then when the cash would otherwise be distributed to creditors, the debtor seeks to amend his exemptions to claim the benefit of the trustee's work without bearing the burden of the trustee's efforts.¹¹⁶

The debtor was allowed to amend his exemptions on the condition that the trustee was paid.¹¹⁷ Consequently, some courts use their equitable powers to prevent the otherwise harsh results of a literal application of section 326(a) even where exempt property is returned to the debtor.

C. Analysis of the Equitable Approach

The trend in these cases is to award reasonable fees to trustees for beneficial services performed on behalf of the estate even though no moneys are disbursed. Awarding quantum meruit fees is consistent with the section 330(a)(1) reasonable value standard. One court noted that "when considering an award on equitable principles and based on quantum meruit, the nature and the extent of the services rendered by the trustee must obviously be examined."¹¹⁸ Similarly, courts examine the nature and extent of the trustee's services in order to award reasonable compensation under section 330(a)(1). It is interesting that the same factors apply whether the courts are awarding compensation on the basis of quantum meruit or according to the reasonable value of services test under section 330(a)(1).¹¹⁹

Both approaches recognize that the estate should compensate a trustee's efforts when the trustee is employed to further the interests of the estate. The court gives proper effect to Congress' intent under section 330(a)(1) when it disregards the statutory language of sec-

pensation to the trustee only on exempt property returned to the debtor"); *In re Dondey*, 50 Bankr. 12 (Bankr. S.D. Fla. 1985) (Denying compensation after trustee had fully administered estate but whole estate turned out to be exempt). The *Dondey* court noted "that the harsh consequence of the literal application of 326(a) has led some courts . . . to grant compensation to a trustee when the estate is returned to the debtor upon a dismissal." *Id.* at 13. There was no "precedent for disregarding the plain language of the statute with respect to that part of the estate which is exempt." *Id.*

116. *In re Myatt*, 101 Bankr. at 201 (quoting *In re Salem*, 7 Bankr. 889, 890 (Bankr. D.N.M. 1980)).

117. *Id.* at 201.

118. *Id.*

119. *But see In re Rennison*, 13 Bankr. 951 (Bankr. W.D. Ky. 1981) (Court held that trustee is entitled to *statutory commission* in case of voluntary dismissal). (Emphasis added).

tion 326(a) and allows compensation to the trustee for valuable services performed. Otherwise, the trustee will act as “an unpaid collection agent for the debtor.”¹²⁰ These cases illustrate why section 326(a) should be repealed.

The equitable approach yields a result consistent with the goals of bankruptcy law. Trustees are rewarded for diligently beginning their work and acting to protect the interests of unsecured creditors. The debtor’s property is collected and reduced to cash. In addition, settlements are encouraged. Therefore, the equitable approach encourages efficient case administration.

However, there remains the question of whether bankruptcy courts have authority to disregard statutory language when it is unambiguous.¹²¹ “Legislative history can be a legitimate guide to a statutory purpose obscured by ambiguity, but in the absence of a clearly expressed legislative intention to the contrary, the language of the statute itself “must ordinarily be regarded as conclusive.”¹²² According to one leading commentator, “equitable powers [were] to be exercised within the limits laid down by the [Bankruptcy] Act and subject to and consistent with any specific provisions contained in it.”¹²³

The legislative history of section 326(a) does not suggest that courts are authorized to use their equitable powers to award trustee fees when statutory requirements are not met.¹²⁴ Actually, the discretionary \$150 fee allowed under the Act was eliminated under the Code.¹²⁵ That implies Congress’ disfavored judicial discretion in the trustee compensation area and preferred that judges work within the statutory scheme.

In addition, a problem arises as to when equitable powers should be exercised. Although case law is developing, the standards are inconsistently applied. The results suggest that it may depend upon the judge’s point of view. Equitable results have been allowed in cases where no moneys have been disbursed to unsecured creditors. Yet, the equitable approach cannot be relied upon as a tool to further the goal of promoting efficient case administration under the Code.

120. *Id.* at 953.

121. See generally Klee & Merola, *Ignoring Congressional Intent: Eight Years of Judicial Legislation*, 62 AM. BANKR. L. J. (1988) (discussing judicial legislation under the Bankruptcy Code in areas other than trustee compensation).

122. *Cavazos v. Simmons*, 90 Bankr. 234, 239 (Bankr. N.D. Tx. 1988) (citing *Burlington Northern Railroad Co. v. Oklahoma Tax Commission*, 481 U.S. 454 (1987)).

123. 1 W. COLLIER, *supra* note 14, ¶ 2.09. (footnotes omitted) (citing *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940); *cf. Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978) (“There is a basic difference between filling a gap left by Congress’ silence and rewriting rules that Congress has affirmatively and specifically enacted.”).

124. H.R. REP., *supra* note 25, at 327.

125. 2 W. COLLIER, *supra* note 14, ¶ 326.01(3).

There should be other statutory authority before the courts disregard the unambiguous statutory language under section 326(a) in order to further the marketplace approach policy espoused under section 330(a)(1).

D. Interpreting the Statutory Mandate that Moneys be Disbursed: The Theory of Constructive Disbursement

Absent those limited situations which compel some courts to invoke their equitable powers, the courts must struggle to award fair compensation within the boundaries of the statutory scheme. While staying within the confines of section 326(a), a court attempts to determine a reasonable fee according to the guidelines set forth under section 330(a)(1). The statutory language of section 326(a) that compensation be determined according to moneys actually paid or turned over to creditors complicates the court's assignment of determining fees. There is a split of authority regarding whether any liquid assets other than cash can be considered as moneys disbursed.¹²⁶

Some courts allow compensation to be computed on the basis of property turned over.¹²⁷ Compensation is allowed on the theory that turning over property is a constructive disbursement of moneys to the creditors. However, other courts hold that "when the statute says money disbursed or turned over, it means money, and not property."¹²⁸

126. *Id.*

127. *In re Greenley*, 102 Bankr. 400 (Bankr. E.D. Pa. 1989). The court held that "guaranteed contracts have been constructively disbursed to the creditors" and therefore "qualify as being money turned over to the estate upon which the trustee's commission may be based. . . ." *Id.* at 405; see also *In re Toole*, 294 F. 975 (S.D.N.Y. 1920) (Court held that the words "or turned over" were sufficient to include property at value received, as well as "moneys disbursed.").

128. *In re Morris Bros.*, 8 F.2d 629, 630 (D. Ore. 1925) (The court held that commissions are determined according to "moneys disbursed to creditors" and not on property turned over. This is consistent with "the plain and unambiguous meaning of the statute."); see also *In re New England Fish Co.*, 34 Bankr. 899, 902 (Bankr. W.D. Wa. 1983) (The court concluded that "trustee's compensation must be based on actual monies disbursed to parties in interest, and not on assets or settlements which can be construed as a constructive disbursement." The court noted that even if the "trustee's efforts deserve compensation in excess of the maximum allowable under the law, the solution is not with the Court but with Congress."); *In re Brigantine Beach Hotel Corp.*, 197 F.2d 296, 299 (3d Cir. 1952) (Court held debtor's principal asset that was returned to debtor could not be used as a basis on which to calculate compensation. The court reasoning that the term "moneys" is not the equivalent of property), *cert. denied*, 344 U.S. 832 (1952).

1. *The Greenley Case*

In *In re Greenley*, the bankruptcy court reduced the trustee's fee after holding that future income generated under negotiated contracts could not be considered as disbursements to the creditors.¹²⁹ In *Greenley*, "[t]he debtor, whose principal business was reprocessing coal refuse, accumulated four large waste coal or 'gob' piles."¹³⁰ When "prices of competitive fuels declined in the early 1980s . . . the main asset, the 'gob' piles, came to be viewed more as an environmental hazard and an eyesore than as valuable property."¹³¹

The trustee arranged several contracts between the debtor and a newly formed power company "whereby the debtor would supply its coal refuse . . . on a long term basis."¹³² The contracts would generate over twenty eight million dollars.¹³³ The contracts were included in a plan that was backed and later confirmed by the creditors and shareholders.¹³⁴ Subsequently, the trustee submitted an application seeking \$362,500 by using the value of the contracts as a basis upon which to calculate his commission.¹³⁵

The court felt compelled to review "what appeared to be a very large commission," despite creditor support.¹³⁶ Moreover, "[c]ounsel for a large creditor . . . vigorously support[ed] the application" at the fee hearing.¹³⁷ Yet, the court reduced the commission to \$53,594.¹³⁸

The court held that the trustee was not entitled to commissions after confirmation of the plan because "section 326(a) expressly excludes consideration of disbursements to the debtor."¹³⁹ The court noted that "[e]ntry of the order confirming the [p]lan 'vests all of the property of the estate in the debtor.'"¹⁴⁰ Thus, the court concluded that anticipated profits under the agreements were "turned over to the debtor by the Trustee."¹⁴¹

The court also held "that compensation is limited to only those funds actually disbursed or paid over."¹⁴² Negotiated contracts an-

129. 94 Bankr. 854 (Bankr. E.D. Pa. 1989).

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.* at 856.

137. *Id.*

138. *Id.* at 855.

139. *Id.* at 859; *cf. In re Flying S Land & Cattle Co., Inc.*, 23 Bankr. 56 (Bankr. C.D. Cal. 1982) (Court held section 326(a) inapplicable to get around this same statutory language).

140. *Id.*

141. *Id.*

142. *Id.*

ticipating future income could not be considered as moneys disbursed or turned over because of valuation problems.¹⁴³ Unfortunately, under this view the trustee went uncompensated for his ingenuity and negotiation skills despite enormous benefits to the estate. Section 326(a) interfered with this court's approach to awarding a fair fee for beneficial services performed by the trustee. Consequently, the estate was unjustly enriched in light of the disproportional benefit conferred compared to the trustee's compensation.

The bankruptcy court was reversed on appeal.¹⁴⁴ The district court held that "[t]he guaranteed contracts have been constructively disbursed to the creditors" and therefore "qualify as being money turned over to the estate upon which the trustee's commissions may be based."¹⁴⁵ The court noted that the creditors and shareholders were "perhaps in the best position to judge the reasonableness of the fees."¹⁴⁶ According to the reviewing court, requiring trustees to disburse money before receiving their fees would cause "perverse incentives" inconsistent with "the basic goals underlying bankruptcy law, that is, the protection of creditors and successful reorganization of the debtor."¹⁴⁷ The court noted that "[t]he trustee could have put [the business] up for sale, obtained cash, then passed it onto creditors."¹⁴⁸ Thus, the bankruptcy court's narrow interpretations of section 326(a) could motivate other trustees to devise optimum cash payout reorganization plans.¹⁴⁹ Immediate sales will be favored over valuable "long term contracts."¹⁵⁰

Finally, the court reasoned that the trustee "created new property, the guaranteed contracts," from which the "creditors and stockholders have obtained the benefits."¹⁵¹ The contracts were valued at "their present value because this is the amount which is . . . being constructively turned over."¹⁵² The district court held the fee re-

143. *Id.* at 860; see *In re Lehenkrauss*, 16 F. Supp. 792, 794 (E.D.N.Y. 1936) (The *Lehenkrauss* court held that "[i]f in appropriate circumstances, the transfer of property may be regarded as the equivalent of turning over money . . . the requirement of equivalence cannot be met, in the absence of proof of the value of the property transferred.").

144. *Greenley*, 102 Bankr. 400, 407 (E.D. Pa. 1989).

145. *Id.* at 405.

146. *Id.* at 406.

147. *Id.* at 404.

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.* at 405.

quested by the trustee was reasonable and awarded the full amount.

2. *Analysis of the Constructive Disbursement Theory*

The theory of constructive disbursement allows the court to circumvent the literal language of section 326(a) and award fair compensation after a trustee performs beneficial services for the estate. This gives effect to Congress' intent to compensate trustees at competitive rates for work performed. Moreover, higher pay invites superior performances and encourages trustees to think of productive "imaginative resolutions [for] problems posed by estates which they are managing."¹⁵³ Trustees are encouraged to be creative in saving a business undergoing reorganization. "This translates into thousands of jobs saved, reduction of creditor losses, and increased economic health."¹⁵⁴

Awarding compensation strictly according to the statutory mandate that moneys be disbursed encourages optimum cash pay out plans and discourages qualified individuals from serving as trustees. Such a result is incompatible with the purpose of maximizing creditor claims through efficient case administration. The theory of constructive disbursement allows the court to award competitive fees thereby retaining competent bankruptcy professionals who can effectively administer cases.

On the other hand, the constructive disbursement theory is an ineffective tool to further the goal of promoting efficient case administration. While some courts utilize this approach, others do not. Reliance on judicial discretion produces inconsistent results. The cases demonstrate that trustees are often forced to resort to an appeal where courts requiring moneys to be disbursed to creditors unfairly determine their compensation according to the statutory mandates of section 326(a). Utilizing the theory of constructive disbursement can aid the bankruptcy court in awarding competitive fees to prevent future fee disputes that contribute to judicial backlogs.

Further, Congress could have included properties turned over as well as moneys as the basis on which commissions are to be computed when it enacted the Code. Although valuation problems exist, the burden of proof is on the trustee. The statutory mandate that fees should be awarded for beneficial and necessary services performed on behalf of the estate provides additional guidance for the courts. In the absence of other statutory reform, a compelling argument can be made that Congress should amend section 326(a) to include the language "upon property and moneys disbursed or turned over in the case" in order to bring consistency, predictability

153. *Greenley*, 94 Bankr. at 860.

154. *T. Stanton*, *supra* note 78, at 94.

and fairness to trustee compensation.

IV. SOLUTIONS

A. *Repeal Section 326(a)*

The most obvious solution is to repeal section 326(a). It appears that the statutory limitation no longer serves the original purpose intended by Congress. The commission scheme does not promote diligent and efficient work. Section 326(a) deters the trustee from performing valuable services for the estate other than the distribution of moneys. A "get in and get out" attitude as well as misplaced incentives may develop, especially in reorganization cases. There is little encouragement to salvage assets and maximize returns under the current scheme.

Furthermore, section 326(a) may actually serve to increase estate expenses because it does not apply to other professionals involved in estate administration. Indeed, one bankruptcy judge noted after reviewing a trustee's expense report: "[T]rustees are receiving so little pay, that where previously they handled most matters themselves (almost all are attorneys), now there is more of a tendency to employ attorneys . . . usually themselves."¹⁵⁵ Hence, the commission scheme cannot serve to maximize creditor returns when increased expenses are charged to the estate.

Finally, the United States trustee system has rectified case administration problems that developed under the Act. The system "serve[s] as [a] bankruptcy watchdog to prevent fraud, dishonesty and overreaching in the bankruptcy system."¹⁵⁶ In fact, "there are twice as many successful Chapter 11 reorganizations in districts where a United States trustee is in place."¹⁵⁷ There is also "ensure[d] increased integrity and financial controls in Chapter 7 case administration."¹⁵⁸ The Office of the United States Trustee should continue to play an important role in case administration, diminishing the need for the statutory mandates of section 326(a).

Absent section 326(a), the courts could award reasonable compensation to trustees and other professionals according to the standards set forth in section 330(a)(1). The "reasonable value of services" test

155. *In re Marsh*, 5 Collier Bankr. Cas. 2d (MB) 106, 108 (Bankr. E.D. Va. 1981).

156. T. Stanton, *supra* note 78, at 91.

157. *Id.* at 94.

158. *Id.* at 91.

requires that all necessary and beneficial services performed on behalf of the estate should be compensated. Although requiring a subjective analysis by the court, such a scheme lends more predictability to trustee fee awards. In addition, efficient, creative and expedient case administration will be encouraged when competitive fees are awarded. All professionals hired to advance the interests of the estate will be compensated according to similar standards, encouraging those qualified to do the work themselves. With reduced expenses, increased returns to creditors would become a reality. Using the consistent "reasonable value" standard provides a less complicated approach for the court when it determines trustee fees.

B. *New Legislation*

In the absence of repeal, Congress should amend the present statutory scheme to authorize quantum meruit compensation in appropriate cases under section 326(a). Additionally, section 326(a) could be amended to allow property turned over to be used as a basis for calculating trustee fees. These amendments would lend financial certainty, fairness and predictability to the current scheme. The trustee who diligently begins to administer the estate will be rewarded.

Another alternative would be to enact a new standard for Chapter 11 reorganization trustees. The current scheme would continue in effect for Chapter 7 cases. Chapter 11 cases are usually more complex and raise more financial uncertainties for creditors than a Chapter 7 liquidation case. As one commentator noted, "[t]here is a substantial amount of . . . work that becomes necessary, much of it creative, imaginative and of a very high quality."¹⁵⁹ Thus, a different standard is warranted for Chapter 11 trustees.

Compensation for Chapter 11 trustees should not be capped or tied to money distribution. With successful reorganization comes "thousands of jobs saved, reduction of creditor losses, and increased economic health."¹⁶⁰ Because reorganization cases have the most potential for positive and far reaching social and economic benefits, trustees should be paid pursuant to standards that recognize those benefits.

CONCLUSION

Courts have struggled to balance the competing interests behind sections 326(a) and 330(a)(1) of the Bankruptcy Code. Left unanswered is the question of the effectiveness of the statutory limitation of section 326(a) in promoting efficient case administration. Trustees

159. Lavién, *supra* note 14.

160. T. Stanton, *supra* note 78, at 94.

working in a prompt manner to maintain and collect assets, settle claims and disburse moneys as soon as possible are needed to run the bankruptcy system efficiently. The increased number of bankruptcies since the enactment of the Code underscores the need to attract and retain competent trustees. Indeed, one court noted “[r]easonable compensation for trustees is not only just, it is essential to the maintenance of the system.”¹⁶¹

Reasonable payment, in light of the economic realities, is imperative to attract such competent trustees — the backbone of an efficient system. The increased number of bankruptcies has far reaching economic and social effects. These effects need to be considered when evaluating the proper amount of compensation for trustees. In particular, these effects should play an important role when awarding compensation in the context of a reorganization case. Salvaged businesses represent employment and boost this country’s fiscal well being.

The bankruptcy system as it exists today cannot expect to convert assets of a debtor at substantially lower rates than would be afforded creditors who resort to individual remedies. Individual remedies may consume vast amounts of time and expense with little or no chance of receiving a return. The advantage of bankruptcy is that it offers greater chances for return especially when estates are administered in a timely and effective manner. New statutory provisions regarding trustee compensation are needed. Congress must act in this regard to “fine tune” the Code so that competent trustees continue to serve. Creditors, debtors, the courts and society in general will benefit as a result.

KATHERINE KRUIS

161. *In re Marsh*, 5 Collier Bankr. Cas. 2d (MB) 106, 110 (Bankr. E.D. Va. 1981).

