UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

ROBERT CHARLES CLARK
REBECCA MICHELLE CLARK

CASE NO. 97-66684

Debtors

Chapter 7

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

Before this Court, is the motion of Robert C. Clark and Rebecca M. Clark ("Debtors") seeking to reduce the compensation requested by Carolyn J. Cooley, Esq., as Trustee ("Trustee"), to be awarded by the Court in this case voluntarily filed pursuant to Chapter 7 of the Bankruptcy Code (11 U.S.C. §§ 101-1330) ("Code").

The motion, which was opposed by the Trustee, appeared on the Court's motion calendar at Utica, New York on March 30, 1999, and was argued at that time. Following the argument, the Court permitted the parties to file memoranda of law on or before April 20, 1999. The motion was submitted for decision as of that date.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of this contested matter pursuant to 28 U.S.C. §§ 1334(b) and 157(a), (b)(1) and (2)(A).

FACTS

On November 5, 1997, Debtors filed their voluntary petition pursuant to Chapter 7 of the Code. On Schedule B, Personal Property, attached to their Petition, Debtors listed the following item of personal property, "Lawsuit Pending In Favor of Debtor Rebecca (From An Auto Accident) Peter Hobaica Is Attorney For Debtor." On or about January 8, 1998, the Debtors filed what appears to be an amended Schedule C to their Petition in which they claimed as exempt the "Personal Injury Lawsuit Award." The amount claimed as exempt was "$7,500.00" ("the lawsuit").

On November 11, 1997, the Trustee was duly appointed to administer the Debtors' Chapter 7 bankruptcy estate. On January 29, 1998, the Trustee sought and obtained an Order of the Court appointing Peter M. Hobaica, Esq. as Special Counsel ("Special Counsel") to the Trustee "for the purpose of continuing to prosecute a personal injury action and his compensation to be in the amount of one third of the net proceeds....."

On June 30, 1998, the Trustee filed a motion seeking an order approving a compromise of the lawsuit and fixing the fee of Special Counsel. The motion indicated that Special Counsel had recommended a settlement of the lawsuit for the sum of $230,000, consisting of a lump sum cash payment of $120,000 and the purchase of an annuity for the benefit of Debtor Rebecca Clark in the sum of $110,000. Out of the settlement, Special Counsel was to be paid $74,344.50 in fees and $6,964.27 in disbursements. The Debtor, Rebecca Clark, would be allowed her exemption of $7,500 and the balance of the $120,000 would, presumably, be paid to the Trustee. The motion also indicated that there would be sufficient funds to pay unsecured claims in full and that additional monies would be refunded to the Debtors. A notice of the motion was served on all creditors, as well as the Debtors. There were no objections to the motion and the Order approving the settlement was executed on July 22, 1998.

Subsequent to the approval of the settlement, the Trustee, *inter alia*, filed a motion objecting to a proof of claim filed by the Oneida County Department of Social Services ("OCDSS") in the amount of $13,046.70. The motion was granted without opposition by an Order dated December 22, 1998.[1]

On January 21, 1999, the Trustee filed her Final Report and Proposed Distribution ("Final Report") wherein she indicated total receipts of $120,000 plus interest earned of $350.81 minus disbursements of $81,327.46 leaving a balance on hand of $39,023.35. As part of the Final Report, the Trustee sought compensation in the amount of $8,833.90 pursuant to Code § 326. On March 18, 1999, the Debtors filed the instant motion seeking to reduce the Trustee's requested compensation.

ARGUMENTS

[1] It appears that the claim of OCDSS is secured by a lien on Debtors' residential real property.

The Debtors argue that while the Trustee's compensation is awarded pursuant to Code § 326, that section must be read in conjunction with Code § 330 which requires an analysis of several factors bankruptcy courts must consider before awarding compensation to *inter alia* a trustee. Debtors acknowledge that the Trustee, in addition to obtaining this Court's approval of the settlement of the personal injury lawsuit, did move against the OCDSS claim as well as a claim of NBT Bank N.A. Debtors assert, however, that with regard to the settlement of the lawsuit which generated the $120,000 cash payment, the Trustee acted as a "mere conduit" of the settlement monies. (*See* Debtors' Memorandum of Law dated April 8, 1999.) Thus, the Debtors contend that compensation of $8,833.90 is excessive and should be reduced.

The Trustee asserts that she was much more than a "conduit" for the settlement monies. She recites how she encouraged Special Counsel to obtain the best possible settlement, noting that prior to the final offer there were at least two earlier offers, one of which ($100,000) would have been sufficient "to pay all debts" (Affidavit of Trustee sworn to on the 14th day of April 1999 at paragraph 4). Nevertheless, the Trustee "allowed Special Counsel to attempt to improve the terms of the settlement," thus, directly benefitting the Debtors. *Id.*[2]

Special Counsel asserts that he had numerous communications by phone, in person and via correspondence with the Trustee regarding the settlement of the lawsuit. He contends that these communications were necessary in order to develop "strategies relative to a full and fair settlement of the case, both from the point of view of fairness to the debtors and the Trustee's

[2] The Court notes that the argument of this motion occurred on March 30, 1999, with the Court requesting memoranda of law thereafter. On April 14, 1999, the Trustee filed not only a memorandum of law, but also a supplemental affidavit and an affidavit of Special Counsel. On April 16, 1999, the U.S. Trustee submitted a letter in opposition to the Debtors' motion and in support of the Trustee's compensation.

responsibility to the estate regarding the creditors." (*See* Affidavit of Peter M. Hobaica, sworn to the 5th day of April 1999 at paragraph 3.)

The Assistant U.S. Trustee ("UST") advises the Court that in his opinion the Trustee's request for compensation is reasonable after an "exhaustive review of the facts and circumstances..." *See* letter from UST to Court dated April 16, 1999. He characterizes the Trustee's actions as providing the Debtors with a "windfall" and asserts that while the Trustee has no fiduciary obligation to the Debtors, she worked diligently to provide both the estate and the Debtors with the "maximum settlement." *Id.* The UST also references a substantial tax advantage to the Debtors by virtue of the annuity feature of the settlement, as well as the fact that by structuring the settlement in that way the Trustee can claim no compensation on monies paid directly to the Debtors pursuant to the annuity.

On February 1,1999, the Trustee filed her final Report and Proposed Distribution ("Final Report"). Attached to the Final Report is an itemization of the Trustee's "time spent in the performance of her duties as Chapter 7 Trustee." The itemization indicates that through December 23, 1998, she had consumed or would consume some 8 hours in administering the case.

DISCUSSION

Compensation of a Chapter 7 trustee is provided for in Code § 326. That section, however, provides only a sliding scale of compensation a trustee may be paid. It does not provide any guidelines for a bankruptcy court as to what it should consider in ultimately awarding compensation. For those guidelines, the Court is directed to Code § 330. *See In re Guyana Development Corp.*, 201 B.R. 462, 478 (Bankr. S.D. Tex. 1996). What is somewhat uncertain, however, is the actual interplay between those two sections.

It is abundantly clear that Code § 326's sliding scale of compensation is intended only as a guide to a trustee's compensation placing as it does an upper end cap on that compensation. *In re Frost* 214 B.R. 295 (Bankr. S.D.N.Y. 1997), *In re Fischer*, 210 B.R. 467 (Bankr. D. Minn. 1997).

To arrive at the amount of compensation to be paid to a trustee, the Court must also consider the factors set out in Code § 330. *See In re Financial Corp. of America,* 114 B.R. 221 (9th Cir. BAP 1990), *aff'd and remanded*, 946 F.2d 689 (9th Cir. 1991); *In re Stoecker*, 118 B.R. 596 (Bankr. N.D. Ill. 1990); *In re McNar, Inc.,*120 B.R. 149 (Bankr. S.D. Cal. 1990); *In re Orthopedic Technology, Inc.,* 97 B.R. 596 (Bankr. D. Colo. 1989).

Two contrasting views have recently emerged as to the appropriate manner in which the Court must reconcile those sections. The bankruptcy court in *Guyana* observed that "The function of the trustee is different from that of all other professionals working for the estate." *Guyana,* 201 B.R. That court goes on to note that "Because the role of the trustee differs from that of other estate professionals, Congress distinguished the compensation available for trustees under 11 U.S.C. § 326 from that available under 11 U.S.C § 328 for all other professionals hired for the estate." *Id.* at 477.

The bankruptcy court then focused on what its suggests is a trend away from the so-called strict "lodestar" approach to fixing fees, that is the total number of hours multiplied by an hourly rate, as well as the application of the so-called "Johnson factors" enunciated many years ago by the 5th Circuit in the case of *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), particularly in "common fund" cases. Acknowledging that a percentage of fund approach to compensation has some serious flaws, Bankruptcy Judge Karen Kennedy Brown concludes that the marriage of Code §§ 326 and 330 offers a compromise, to wit: "By incorporating both percentage based compensation and a reasonableness analysis, Congress creates an incentive to trustees to search for all assets to maximize distribution to creditors as well as promotes a rational relationship between the effort expended and the results obtained." *Guyana,* at 201 B.R.

The court ultimately gave consideration to the Johnson factors and concluded that the trustee was entitled to the maximum compensation under Code § 326. The court observed that "The Trustee has amply rebutted any presumption that the lodestar fully reflects the novelty and complexity of the issues, the special skill and experience of the trustee, the quality of representation and the results obtained in this rare and exceptional case." *Id.* at 485.

More recently, however, a district court in *In re Marvel Entertainment Group, Inc.,* 234 B.R. 21 (D. Del. 1999) rejected the conclusions reached in *Guyana* and awarded a Chapter 11 trustee a fee based entirely on the lodestar approach. In examining the rationale of the bankruptcy court in *Guyana,* the district court, in *Marvel*, noted six reasons why the bankruptcy court's approach to a trustee's compensation was flawed. First, said the district court, awarding percentage compensation is clearly at odds with the reasonableness factors set out in Code § 330. Second, the percentage compensation theory simply will not work vis a vis a Chapter 11 trustee who is appointed to reorganize rather than liquidate the debtor. Third, the district court observed that there was no "principled relationship between the amounts disbursed by a debtor corporation and what would be reasonable compensation for a trustee appointed to represent the estate." *Id.*

at 39. Fourth, a percentage commission would create a substantial risk of abuse suggesting that when the U.S. Trustee selects a trustee in a large case such as *Marvel*, he (or she) "may be tempted to steer lucrative appointments to friends or cronies who may or may not be qualified for the position."[3] Fifth, basing compensation on the size of the case and the time served would analogize the trustee to a "bullrider" who is typically rewarded based on the size of the bull and time the rider remains in the saddle! Lastly, and perhaps most significantly in the mind of the district court, a percentage commission "could lead to extraordinarily high levels of compensation that bear no reasonable relation to the value of the services provided." *Id.* at 40. This scenario, suggests the district court, could discourage a court from appointing a trustee where a trustee might really be needed. In summary, the district court appears to have concluded that the role of Code § 326 is to serve only as a "cap" on the amount of compensation to be awarded. In arriving at the appropriate level of compensation to be awarded, however, the court in *Marvel* determined that a court is limited by Code § 330 to analyzing the number of hours expended by a trustee solely from a reasonableness perspective guided by the factors set out in that section and then multiply that number by an acceptable hourly rate.[4] (*See In re Narragansett Clothing Co.,* 210 B.R. 493 (1st Cir. BAP 1997)).

In analyzing these starkly contrasting views of how a bankruptcy court must arrive at the appropriate level of compensation for a trustee (be it in Chapter 7 or 11) this Court finds that it must embrace the conclusions reached by Bankruptcy Judge Kennedy Brown in *Guyana*. This

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[3] It is noted that the trustee in the *Marvel* case was the Hon. John J. Gibbons, the former Chief Judge of the United States Court of Appeals for the Third Circuit.

[4] While Trustee Gibbons had initially sought compensation of $2,095, 760.38, the district court awarded him $352,000.

Court believes that, in fact, a bankruptcy trustee was never intended by Congress to be compensated solely by reference to Code § 330 with Code § 326 serving only to "cap" any compensation resulting from the application of Code § 330.[5] Such a view effectively writes the majority of § 326 out of the Code. The sliding scale provided for in Code § 326 clearly was intended to award compensation to a trustee based in significant part on a percentage of the funds disbursed by the trustee. To conclude that a trustee should be awarded compensation solely in reliance on a lodestar approach, coupled with the reasonableness factors of Code § 330, is to ignore the mandate of Congress. *In re Biskup*, 236 B.R. 332, 337 (Bankr. W.D. Pa. 1999 (stating, "We do not espouse a view that trustee compensation is strictly limited to a lodestar analysis...).

As noted by Judge Kennedy Brown in *Guyana*, the sliding scale of Code § 326 encourages a trustee "to search for all assets to maximize distribution to creditors." *Guyana*, 201 B.R. While it is true that in many cases a minimal effort on the part of the trustee may nevertheless generate significant assets for creditors, that is not a sufficient reason to award that trustee minimal compensation. The Trustee here suggests that the Court should accept the adage "that one makes up on the bananas what one loses on the coconuts," pointing out that "For every personal injury action I administer in a bankruptcy case to a favorable outcome, there are least two and possible (sic) three in which I expend substantial time appointing Special Counsel and pursuing the claim only to eventually recover nothing or less than the statutory exemption." *See* Affidavit of Carolyn J. Cooley, sworn to on March 24, 1999 at ¶ 8.) While such rationale is clearly unacceptable if taken literally, it does support Judge Kennedy Brown's observation that

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[5] While the legislative history surrounding the enactment of Code § 326 emphasizes that it was intended to fix the maximum compensation of a trustee, there is no suggestion that the balance of the section is to be ignored in fixing trustee compensation.

the role of the trustee differs from other estate professionals, thus, serving as a basis for Congress to write § 326 into the Code.

In the instant case, it appears that the Debtors have challenged the Trustee's request for compensation not because it impacts adversely on their creditors, but because it impacts adversely on them! Conversely, both the Trustee and Special Counsel assert that because of the position taken by the Trustee, the total settlement was far in excess of anything needed to pay their creditors in full. Arguably, the Trustee even risked violation of her fiduciary duty to creditors by insisting that Special Counsel reject earlier offers of settlement, the second of which would have been sufficient to pay all creditors in full, solely to obtain a greater financial benefit for the Debtors.

In keeping with the rationale of *Guyana*, the Court must nevertheless consider the relevant factors set out in Code § 330(a)(3). The Trustee has attached an itemized record of her time expended in the instant case. That record discloses a total of eight hours which, if judged by the "lodestar" approach, would suggest that the Trustee is seeking to be compensated at the rate of approximately $1,104 per hour.[6]

Of the five significant factors contained in Code § 330(a)(3)(A), only factor (B) "the rate charged for such services" would appear to be unacceptable here. Clearly when assessing the Trustee's performance under factors (A), (C), (D) and (E), the Court does not believe that compensation of $8,878.49 is unreasonable in a case in which a settlement was effected in the sum of $230,000 (Special Counsel received a fee of approximately $75,000) and all of the

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[6] In *Marvel, supra,* District Judge Roderick McKelvie noted a similarly "unreasonable" rate being sought by the trustee of $4,928 per hour.

creditors of the estate with allowable claims were paid in full.

The Court cannot agree with Debtors' counsel that the Trustee was merely a conduit. Both the Trustee and Special Counsel effectively refute that contention, citing to the Trustee's experience and expertise in motivating Special Counsel to craft a settlement that was at least $130,000 more than either of the earlier offers.

The irony of the Debtors' opposition to the Trustee's compensation is that they are the direct beneficiaries of the Trustee's efforts when, in fact, the Trustee owed them no fiduciary duty. Apparently, they are disgruntled because the structure of the settlement leaves them in what they perceive to be a "cash poor" dilemma. To remedy their perceived dilemma, they hope to get into the Trustee's "pockets."

The Debtors, through their attorney, suggest to this Court that while they skillfully used this Chapter 7 proceeding to hold their creditors at bay while they pursued the personal injury litigation that now they should be able to cast off the mantle of bankruptcy as if it never occurred. It is not the fault of the Trustee that they are still facing liability to Oneida County as a secured creditor. In challenging the proof of claim filed by the County, the Trustee was doing nothing more than she's required by law to do.

While this case is factually remote from the scenario in *Guyana*, the principles relied upon by that court are embraced here. To award compensation to a trustee in bankruptcy based solely on a lodestar approach is to ignore the results oriented role that Congress intended trustees to fulfill.

Based on the foregoing, it is

ORDERED that the motion of the Debtors is denied, and it is further

ORDERED that Trustee's Final Report is approved and she is awarded compensation in the sum of $8,833.90 together with expenses in the sum of $44.59.

Dated at Utica, New York

this 13th day of December 1999

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge