Consumer Track:

Hot Topics in Chapter 7, Including Trustee Litigation, Business Liquidation, Churning and Election of Trustees

CONCURRENT SESSION

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CHURNING AND TRUSTEE COMPENSATION

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A. Churning: Does it happen?

Churning is an unethical practice employed by some trustees to increase their commissions by administered assets with little equity to increase their commissions.[1] It is apparently rare as there are relatively few cases which find churning but there are cases which warn against it.

This year, the ugly allegation of churning was raised in *Checks Cashed for Less v. Kipperman,* 2012 WL 2723027 (S.D.Cal. 2012). In this case, after Checks Cashed for Less filed its Chapter 7 case, the trustee asked for basic business documents—general ledger on quickbooks and bank statements. The principal of the debtor decided he could settle with his creditors outside of bankruptcy (he had collected $150,000 of allegedly uncollectible checks which he used to reimburse himself). The Trustee demanded the documents, demanded the debtor's representative show up at a continued 341(a) meeting and opposed the debtor's motion to dismiss. In the end, all the creditors withdrew their claims and the case was dismissed. The Trustee sought compensation based on quantum meruit. The Court awarded $10,347. As the District Court said:

> In this case, no disbursements were made by the Trustee. Consequently, the bankruptcy court relied on the theory of quantum meruit in awarding the fees and costs. Specifically, the court relied on *In re Jankowski,* 382 B.R. 533 (Bankr.M.D.Fla.2007). In *Jankowski,* the court awarded quantum meruit compensation to the trustee for carrying out his duties, including investigating the Debtor's financial affairs and opposing the Debtor's motion to convert and motion to dismiss. Although the case was ultimately voluntarily dismissed, the court held that the services provided by the trustee were in furtherance of the trustee's duties under § 704 and were compensable. *See also In re Tweeten Funeral Home,* 78 B.R. 998 (Bankr.D.N.D.1987) (awarding quantum meruit

[1] It is much more usual to see the term churning come up in bankruptcy when a trustee sues a securities broker for churning a debtors brokerage account. See *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2nd Cir. 1991); *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 885 F.2d 1149, 1150, 1153-54 (3rd Cir.1989).

> trustee fees where the debtors, trustee, and creditors entered into a settlement which resulted in no funds coming into the hands of the trustee for distribution); *In re Smith,* 51 B.R. 273 (Bankr.D.D.C.1984) (holding that trustee was entitled to quantum meruit compensation where the creditor was satisfied as a result of consent order); *In re Pray,* 37 B.R. 27 (Bankr.M.D.Fla.1983) (awarding quantum meruit compensation to trustee where case was voluntarily dismissed by the debtors based on resolution of creditors' claims).

The debtor did not contest the award on the basis that there was no commission earned but on the basis that the Trustee was "churning," and his actions—including insisting on going forward with the meeting of creditors, filing the motion to compel attendance, and opposing the motion to dismiss—were not reasonable or necessary to the administration of the case. The award was upheld because Bankruptcy Code §330 "requires only that the services in question had a reasonable likelihood of benefitting the estate at the time they were provided, not that they actually did provide a benefit." In addition, the Trustee had a duty, until the case was dismissed to collect the financial information, collect the assets and investigate the financial transactions of the debtor.

But the 9th Circuit has held that churning includes investigating after the trustee has sufficient assets to pay creditors in full. *Estes & Hoyt v. Crake (In re Riverside–Linden Investment Co.),* 925 F.2d 320, 322 (9th Cir.1991) (condemning as churning by a bankruptcy trustee and his counsel and stating that investigations become unwarranted when the *only* parties benefitting from such actions are the trustee and his professionals).

This leaves a Trustee with a thin line between fulfilling his statutory duty and churning. When he has just enough to pay creditors does he cease all further investigation and litigation which will benefit equity? See *Stockholders' Protective Comm. For Moulded Prods., Inc. v Barry (In re Moulded Prods., Inc.),*474 F.2d 220, 224 (8th Cir. 1973) (a trustee has a fiduciary duty to act in the best interest of the shareholders of a

debtor corporation as well as creditors); *In re NWFX, Inc.*, 267 B.R. 118, 151 (Bankr.W.D.Ark. 2001) (same); *In re O-Jay Foods, Inc.,* 1991 WL 378164, *16 (D.Minn. 1991) ("The fiduciary duty of the trustee runs to shareholders as well as to creditors.").

In *Sheehan v. Posin*, 2012 WL 1413020 (N.D.W.Va. 2012), the District Court reversed a bankruptcy judge and ordered the debtor to turn over assets so that they could be liquidated to pay an IRS secured claim. In this case, the IRS lien exceeded the value of the assets but the Bankruptcy Code allows a trustee to take his administrative expenses, including his commission, ahead of a tax lien. Bankruptcy Code §724(b). The bankruptcy court had refused to order the turnover of the assets subject to the IRS lien and "conducted no analysis whatsoever of benefit, instead finding without citation that the tax lienholders were required to move to modify the automatic stay to enforce their own liens rather than relying upon the trustee." The District Court held: "Congress intended to allow a trustee to liquidate property of the estate for the benefit of tax lienholders." But the District Court went on to say:

> Though the bankruptcy court did not analyze the "benefit to the estate" as required in § 542(a), this Court finds that § 724(b) indicates that there would be a benefit to the estate in the event that sale proceeds go to administrative expenses only or to administrative expenses and to the tax lienholders. In the former scenario, however, **this Court cautions the trustee that the bankruptcy court may question whether the sale of the Lincoln LS was "an attempt by the trustee to churn property worthless to the estate just to increase fees...."** *In re K.C. Machine & Tool Co.,* 816 F.2d 238, 246 (6th Cir.1987).[2]

[2] *In re K.C. Machine & Tool* is most often cited for the proposition that

> Absent an attempt by the trustee to churn property worthless to the estate just to increase fees, abandonment should rarely be ordered.

816 F.2d at 246. See *In re Viet Vu*, 245 B.R. 644, 647 (9th Cir.BAP 2000).

In *In re Pauline*, 119 B.R. 727 (9th Cir.BAP 1990) it was held that it was appropriate for a bankruptcy court to order a trustee to abandon a property encumbered by an IRS lien (the opposite of the decision in *Sheehan v Posin*). In *Pauline*, the BAP held:

> Second, Appellant Carey's reversal regarding the home was apparently triggered by a realization that if he sold the home, rather than abandoning it, he might be entitled to a trustee's fee on the funds used to satisfy the IRS's tax liens. As such, Appellant Carey's actions would appear to be startlingly similar to those types of property churning actions which 11 U.S.C. § 554 (1986) (the "Abandonment" section) was intended to address. *See, e.g., Morgan v. K.C. Machine & Tool Co. (In re K.C. Machine & Tool Co.),* 816 F.2d 238, 246 Second, Appellant Carey's reversal regarding the home was apparently triggered by a realization that if he sold the home, rather than abandoning it, he might be entitled to a trustee's fee on the funds used to satisfy the IRS's tax liens. As such, Appellant Carey's actions would appear to be startlingly similar to those types of property churnoing actions which 11 U.S.C. § 554 (1986) (the "Abandonment" section) was intended to address. *See, e.g., Morgan v. K.C. Machine & Tool Co. (In re K.C. Machine & Tool Co.),* 816 F.2d 238, 246 (6th Cir.1987) ("In enacting [section] 554, Congress was aware of the claim that formerly some trustees took burdensome or valueless property into the estate and sold it in order to increase their commissions. Some of the early cases condemned this particular practice[,] ... and decried the practice of selling burdensome or valueless property simply to obtain a fund for their own administrative expenses." (citing *Standard Brass Corp. v. Farmers Nat'l Bank,* 388 F.2d 86 (7th Cir.1967); *Miller v. Klein (In re Miller),* 95 F.2d 441 (7th Cir.1938); *Seaboard Nat'l Bank v. Rogers Milk Products Co.,* 21 F.2d 414 (2d Cir.1927))); (6th Cir.1987) ("In enacting [section] 554, Congress was aware of the claim that formerly some trustees took burdensome or valueless property into the estate and sold it in order to increase their commissions. Some of the early cases condemned this particular practice[,] ... and decried the practice of selling burdensome or valueless property simply to obtain a fund for their own administrative expenses."

To make it more confusing, in *In re Bolden*, 327 B.R. 657 (Bankr.C.D.Cal. 2005), the bankruptcy court ordered the debtor to move out of his homesteaded house so that the Trustee could sell an over-encumbered house for the benefit of the IRS which held several tax liens. The Court distinguished the *Pauline* decision by finding that the IRS

supported the Trustee's efforts to sell the house. In *Pauline*, the IRS was silent and the BAP assumed that the IRS preferred to foreclose it own lien.[3]

These cases leave a Trustee with only a guess whether the bankruptcy court will approve a sale for the benefit of a tax lienholder or condemn it as churning.

A relatively new issue has arisen with regard to trustees selling estate property at *short sale*. In Las Vegas and other places, most debtor-owned real property is worth less than the secured debt. Trustees are selling house by short sale for several reasons:

1. Unoccupied houses don't pay rent, HOA fees, real estate taxes and are not maintained harming the surrounding neighborhood.
2. Banks are delaying foreclosure for years (whether from an inability to locate the proper paperwork or based on a strategy to not flood the market with foreclosed homes or based on a strategy to not recognize losses is unknown).
3. Debtors credit rating will take another large detrimental hit if the property they own is foreclosed upon years after their bankruptcy delaying their financial rehabilitation.
4. Banks are willing to allow the bankruptcy estate some fee for employing a broker to find a buyer and getting court approval of a sale. Some portion of the fee goes to creditors and some portion goes to the Trustee.
5. Debtors may face additional tax liability if the foreclosure occurs after December 31, 2012 and the *Mortgage Forgiveness Debt Relief Act of 2007* (which allows taxpayers to exclude income from the discharge of debt on their principal residence) is not renewed.

There are no cases determining if this is churning.

B. Trustee Compensation: Commission or Reasonable Fee or Both?

Fees for trustees in chapter 7 cases are governed by 11 U.S.C. §§ 326 and 330. Section 326(a) states:

> In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee's services, payable after the trustee renders such services, not to exceed 25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of

[3] In 30 years of practice, I have seen the IRS foreclose on only one residence and then only after the taxpayer's family had vacated the residence.

> $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000, 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.

Section 326(a) incorporates by express reference § 330. Section 330(a)(1), entitled "Compensation of officers," provides, in relevant part, that after notice to parties in interest and a hearing, and subject to § 326, the Court may award a trustee "reasonable compensation for actual, necessary services rendered by the trustee" and "reimbursement for actual, necessary expenses." Section § 326(a) was unchanged by BAPCPA as was (at least as is relevant to Chapter 7 trustee compensation). Bankruptcy Code § 330 (a)(7) was added and provides that:

> "In determining the amount of reasonable compensation to be awarded to a trustee, **the court shall treat such compensation as a commission**, based on section 326."

This BAPCPA addition is a critical one and is at the heart of Chapter 7 trustee compensation. It makes the compensation of a Chapter 7 a commission similar to the commissions paid to realtors, auctioneers or a stock broker. For some imperceptible reason, some bankruptcy judges just refuse to recognize that a commission means never having to prove how much time and effort a trustee spent collecting and distributing assets. The "bad cases"[4] are *In re Clemens*, 349 B.R. 725 (Bankr. D. Utah 2006) (time records required); *In re Ward*, 366 B.R. 470 (Bankr. W.D. Pa. 2007) (same); *In re Healy*, 440 B.R. 834 (Bankr. D. Idaho 2010) (same); *In re McKinney*, 374 B.R. 726 (Bankr. N.D. Cal. 2007) (same); *In re Mack Properties*, 381 B.R. 793 (Bankr. M.D. Fla. 2007) (time records not required but refused to authorize full commission); *In re Phillips*, 392

4 As a Chapter 7 Panel Trustee I make no bones about how I view the proper statutory interpretation of Bankruptcy Code § 330 (a)(7).

B.R. 378 (Bankr. N.D. Ill. 2008) (stating that could only be awarded "in those instances of truly excellent work and efforts by a trustee.").

In *In re B & B Autotransfusion Services, Inc.,* 443 B.R. 543 (Bankr.D.Idaho 2011) and *In re Salgada-Nava,* 2011 WL 2518814 (Bkrtcy.D.Idaho 2011), Judge Pappas has held the Trustee must prove, in each case, his commission is justified. In *Salgada-Nava*, the court stated:

> In essence, while § 326(a) caps a chapter 7 trustee's fees, the Court's ultimate responsibility under § 330(a) is always to approve compensation for a chapter 7 trustee that is reasonable in amount.
>
> In this case, Trustee seeks payment of $1,315.14 for compensation, the maximum amount allowed under § 326(a). While the Court generally presumes that the § 326(a) amount constitutes a reasonable fee for trustee services in most cases, the Court must review each case on its facts, and, in the event of questions, **Trustee must prove the requested compensation is reasonable in amount.** In this case, Trustee has not shown that the maximum fee is justified by actual and necessary services he rendered. As a result, a reduced fee is reasonable.

2011 WL 2518814 at *1 (emphasis added).

The better case (but still not a "good" case) is *In re Coyote Ranch Contractors, LLC*, 400 B.R. 84 (Bankr. N.D.Tex. 2009), Judge Jernigan interpreted the revised Chapter 7 Trustee compensation statutes as follows:

> While the wording of Section 330(a)(7) is, without a doubt, somewhat awkward, this court construes the plain meaning of the relevant statutory authority as follows:
>
> 1. Section 330(a)(7) simply means that bankruptcy courts shall, in awarding reasonable compensation to trustees (both chapter 7 and chapter 11 trustees), use a commission-style approach, based on the parameters set forth in section 326. Even though, in the case of chapter 11 trustees, pursuant to the mandate of Section 330(a)(3), such things as "time spent on services" and "rates charged for such services" ***shall*** be considered by the court, the compensation ultimately awarded shall be in the form of a commission (*i.e.,* a percentage of monies disbursed by the trustee to parties in interest).

2. The omission of "chapter 7 trustee" from Section 330(a)(3), from being among those persons with regard to whom the court "shall" take into consideration certain *Johnson*-type factors, must mean that a chapter 7 trustee's fee, calculated under the commission structure set forth in Section 326, ***shall be permitted to be regarded as the reasonable compensation to be paid to him in the chapter 7 case***, and the court ***shall not be required to undertake the Johnson-type analysis contemplated in Section 330(a)(3).*** Whereas with chapter 11 trustees, Congress has clarified that courts ***must*** undertake a *Johnson*-type analysis (and award only what is justified as reasonable compensation—up to no more than the Section 326 cap), with chapter 7 trustees, courts may start and end with the cap (*i.e.,* there is no obligation to consider the factors described in Section 330(a)(3)).12

3. Finally, section 330(a)(1) and (a)(2) cannot be ignored. They still, post-BAPCPA, apply to a chapter 7 trustee, like any other professional person employed in the bankruptcy case. Section 330(a)(1) provides that "the court ***may*** award to the trustee . . . reasonable compensation for actual, necessary services" and "reimbursement for actual, necessary expenses" (emphasis added). Section 330(a)(2) provides that the court, on its own motion, or on motion of a party in interest, may "award compensation that is less than the amount of compensation that is requested." Because of Section 330(a)(1) and (a)(2), courts still, without a doubt, have discretion to award chapter 7 trustees something less than what is generally requested/expected in a Chapter 7 case (*i.e.,* less than the Section 326 commission structure). In such a situation, the court can and should consider all surrounding facts and circumstances in deciding whether to award something less than the Section 326 commission. The court believes the inquiry in such a situation ***may*** include considering the factors set forth in Section 330(a)(3). In other words, just because the court ***shall*** consider these factors in connection with a chapter 11 trustee's fee does not mean that the court ***shall not*** consider these factors if there is an objection to the statutory commission being paid to a chapter 7 trustee. However, the facts and circumstances probably ought to more heavily suggest disproportionality or inequitableness of the award, than simply a mechanical application of *Johnson*-type factors might suggest. To simply mechanically apply the trustee, whenever there is an objection to his fees, would ignore the reality that Congress, in BAPCPA, specifically acted to exclude chapter 7 trustees from this mandatory test.

4. Finally, at least in this Circuit, in light of *Pro-Snax*, a bankruptcy court should focus heavily on whether the chapter 7 Trustee's services "resulted in an identifiable, tangible, and

> material benefit to the bankruptcy estate" when a court is presented with an objection to the chapter 7 trustee's fee. *See Andrews & Kurth L.L.P. v. Family Snacks, Inc. (In re Pro-Snax Distributors, Inc.),* 157 F.3d 414, 426 (5th Cir. 1998).

400 B.R. at 94-5 (emphasis in original).

Note that Judge Jernigan still insists on the bankruptcy court's authority to review and revise of almost any Trustee commission. This is contrary to the position of the Office of the United States Trustee and the National Association of Bankruptcy Trustees which take the position that the compensation rates provided in §326(a) "shall" be awarded "absent extraordinary circumstances."

The decision in *Salgada-Nava* was appealed by the Trustee to the 9th Circuit BAP. The Trustee's brief states his point forcefully:

> [§330(a)(7)] requires that the court treat compensation of panel trustees as commissions based on Section 326. The section expressly uses the word "shall" which mandates the treatment as a commission.

The Amicus Curiae brief of the United States states the position of the Office of the United States Trustee as:

> PURSUANT TO 11 U.S.C. § 330(a)(7), CHAPTER 7 TRUSTEE COMPENSATION MUST BE ALLOWED AS A COMMISSION BASED ON THE PERCENTAGES PROVIDED IN 11 U.S.C. § 326, ABSENT EXTRAORDINARY CIRCUMSTANCES

The National Association of Bankruptcy Trustees filed a brief supporting the Trustee's appeal. It points out the Congressional intent to change the old *lodestar*-based fee structure to a *commission*-based fee.

In the end, we have the "good" case-the BAP decision in *Salgada-Nava* written by Judge Bruce A. Markell (Nevada) with Judge Eileen W. Hollowell (Arizona) and

Judge Meredith A. Jury (California). This BAP panel carefully reviewed the language of the statute, as amended in 2005, parsed the phrases used in § 330(a)(7) and held:

> On its face, § 330(a)(7) is made up of an introductory dependent clause – "In determining the amount of reasonable compensation to be awarded to a trustee" – followed by an independent clause – "the court shall treat such compensation as a commission, based on section 326." In reading this statutory directive, we think the most natural reading of this provision is that the independent clause states a mandatory rule, while the dependent clause states when that rule applies.
>
> **a. The Commission Clause**
>
> If this reading is accepted, it means that we should start with the independent clause – which we will call the commission clause. On its face, this clause requires bankruptcy courts to treat a trustee's fee request as if the trustee were requesting payment of a commission – a fixed amount – based on the rates set forth in § 326. If correct, this reading would change our prior view that § 326 simply "capped" trustee compensation by setting forth maximum compensation rates. See Arnold v. Gill (In re Arnold), 252 B.R. 778, 788 n.12 (9th Cir. BAP 2000).
>
> This change is warranted. Congress's addition of the commission clause changed both the function of § 326 and its relationship with § 330(a). The amendment fixed a statutory commission for chapter 7 trustees tied to – or, in the language of the last provision of the commission clause, "based on" – § 326's compensation scheme.
>
> ***
>
> In short, the use of "commission" before the words "based on" indicates that the normal meaning of commission starts the analysis of the main text, with the addition of "based on section 326" indicating a refinement or limitation of that accepted meaning.
>
> Turning to the accepted meaning of "commission" in normal parlance, a "commission" is a form of compensation set as a fixed percentage of what is sold or transferred. See BLACK'S LAW DICTIONARY 306 (9th ed. 2009) (defining commission as "[a] fee paid to an agent or employee for a particular transaction, usu[ally] as a percentage of the money received from the transaction <a real-estate agent's commission>."); OXFORD ENGLISH DICTIONARY (2d ed. 1989),
>
> ***
>
> As a result of this analysis, the plain language of the commission clause leads us to conclude that § 330(a)(7) sets commissions for bankruptcy trustees based on the rates set forth in § 326. Given this, if the commission clause stood alone, independent of the rest of § 330, we could immediately hold that trustee fees should not be disturbed absent circumstances like those required in order to disturb fees pre-approved

under § 328, or like the circumstances that might justify reformation or rescission of a commission agreement outside of bankruptcy.

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b. Section 330(a)(7)'s Dependent Clause

But the commission clause does not stand alone. We still must construe the remainder of § 330(a)(7), because ascertaining the plain meaning of statutory text requires a contextualreading.

***

Section 330(a)(7), however, applies to all trustees under all chapters. This indicates a shift in treatment and analysis of chapter 7 trustee fees from paragraph (3) and its catalogue of factors, to paragraph (7) and its explicit incorporation of commission rates.

But the shift was not complete. Notwithstanding the applicability of paragraph (7) to chapter 11 trustees, they are still specifically included in paragraph (3) with its litany of reasonableness factors. As a result, we cannot construe paragraph (7) to require a fixed commission in all cases regardless of chapter. Otherwise, we would create an absurd situation in which § 330(a)(3) requires what § 330(a)(7) prohibits.

This requires us to search for an interpretation of the § 330(a)(7) that harmonizes the various provisions.

***

c. Synthesis: Fixed Commissions for Non-extraordinary Duties

The challenge is, if possible, to give a meaning to both § 330(a)(3) and § 330(a)(7) that can be applied in all cases regardless of the applicable chapter.11 In the process, we must try to minimize any potential conflict between the two provisions. Fortunately, non-bankruptcy federal law suggests a possible solution. There are certain instances outside of bankruptcy when federal law requires federal agencies and federal courts to consider the reasonableness of percentage-fee or commission-based compensation.

***

But we know of no reason why courts should second-guess Congress's clearly expressed intent to fix trustee commission rates for the vast majority of cases, especially given that Congress has set the duties that trustees such as Hopkins must perform to earn that commission.

Accordingly, absent extraordinary circumstances, chapter 7, 12 and 13 trustee fees should be presumed reasonable if they are requested at the statutory rate. Congress would not have set commission rates for bankruptcy trustees in §§ 326 and 330(a)(7), and taken them out of the considerations set forth in § 330(a)(3), unless it considered them reasonable in most instances. **Thus, absent extraordinary circumstances, bankruptcy courts should approve chapter 7, 12 and 13 trustee fees without any significant additional review.** Indeed, the Office of the United States Trustee has indicated that it will not object in these circumstances if the trustee does not even keep contemporaneous time records.

> Against this background, we must assume that Congress already has approved fees set as commissions in § 326 as reasonable for the duties it has set out for such trustees in § 704 and elsewhere in the Code. In effect, Congress has set both the duties of a trustee and the "market" rate for compensation related to the delivery of those services.
>
> On the other hand, if extraordinary circumstances exist, or if chapter 11 trustee fees are at issue, the bankruptcy court may be called upon in those cases to determine whether there exists a rational relationship between the amount of the commission and the type and level of services rendered.

With this outcome of the appeal, Trustees in the 9th Circuit are likely to feel safer claiming that their commission is set at the rates provided in § 326(a).[5] But even trustees outside the 9th Circuit will still hope for a case with lots of easy money and will worry about whether the maximum fee is paid later. On the other hand, any reversion to anything other than a straight commission creates an inherent conflict of interest for a trustee in case that could settle quickly as compared to a case which can be investigated, litigated and negotiated for many hours. Congress may have actually done something right by making trustee's compensation a commission.

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5 The authoritative effect of a BAP decision remains an open question in the 9th Circuit. *Bank of Maui v. Estate Analysis, Inc.,* 904 F.2d 470, 472 (9th Cir.1990); *see also Zimmer v. PSB Lending Corp. (In re Zimmer),* 313 F.3d 1220, 1225 (9th Cir.2002) (footnote 3). In *Bank of Maui,* the Ninth Circuit expressly declined to reach the issue, but it held that the binding effect of a BAP decision was so uncertain that it cannot be the basis for sanctioning a party under Rule 9011 of the Federal Rules of Bankruptcy Procedure. *Bank of Maui,* 904 F.2d at 471.

The bankruptcy courts of the circuit are divided as to whether BAP decisions are binding on them, and even within this judicial district, the bankruptcy courts are divided on the issue. *Compare In re Windmill Farms, Inc.,* 70 B.R. 618 (9th Cir. BAP 1987), *rev'd on other grounds,* 841 F.2d 1467 (9th Cir.1988) (BAP decisions are binding on bankruptcy courts in the circuit), *Life Insurance Co. of Virginia v. Barakat (In re Barakat),* 173 B.R. 672 (Bankr.C.D.Cal.1994) (same), *Coyne v. Westinghouse Credit Corp. (In re Globe Illumination Co.),* 149 B.R. 614 (Bankr.C.D.Cal.1993) (same) *with Rinard v. Positive Investments, Inc. (In re Rinard),* 451 B.R. 12 (Bankr.C.D.Cal.2011) (BAP decisions not binding), *Crain v. PSB Lending Corp. (In re Crain),* 243 B.R. 75 (Bankr.C.D.Cal.1999) (same); *In re 4th Street East Investors, Inc.*, 2012 WL 2562660 (Bankr.C.D.Cal.2012) (same); *In re Arnold,* 471 B.R. 578, 589-90 (Bankr.C.D.Cal. 2012) (same).

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. ID-11-1389-MkHJu
ANDY N. SALGADO-NAVA,	Bk. No. 09-41646
Debtor.	
R. SAM HOPKINS, Chapter 7 Trustee,	
Appellant,	
v.	**O P I N I O N**
ASSET ACCEPTANCE LLC; RECOVERY MANAGEMENT SYSTEMS CORP.; BONNEVILLE BILLING & COLLECTIONS; NCO PORTFOLIO MANAGEMENT; EASTERN IDAHO RMC; SPRINT NEXTEL CORRESPONDENCE; AMERICAN INFOSOURCE LP,	
Appellees.*	

Argued and Submitted on June 14, 2012
at Boise, Idaho

Filed - July 25, 2012

Appeal From The United States Bankruptcy Court
for the District of Idaho

*Appellant named all unsecured creditors who filed proofs of claim in the debtor's bankruptcy case as appellees. While none of them actively participated in the bankruptcy court proceedings leading up to this appeal or in the appeal itself, naming them as appellees was not inappropriate because each of them might be affected by the relief appellant seeks on appeal. See generally Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo), 408 B.R. 280, 298-99 (9th Cir. BAP 2009) (discussing criteria for appellee standing).

Honorable Jim D. Pappas, Bankruptcy Judge, Presiding

Appearances: Monte Gray of the Gray Law Offices, PLLC argued for appellant R. Sam Hopkins, chapter 7 trustee; Ronald R. Peterson of Jenner & Block LLP argued for amici curiae Jeremy Gugino and the National Association of Bankruptcy Trustees; and Cameron M. Gulden argued for amicus curiae the Office of the United States Trustee.

Before: MARKELL, HOLLOWELL and JURY, Bankruptcy Judges.

MARKELL, Bankruptcy Judge:

INTRODUCTION

R. Sam Hopkins ("Hopkins") sought $1,315.41 in fees for his service as a chapter 7[1] bankruptcy trustee. He based his request on the trustee compensation rates set forth in § 326(a). The bankruptcy court, however, found that the reasonable value of his services only amounted to $750 and limited Hopkins's fees to that amount.

We REVERSE the bankruptcy court's fee award and REMAND with instructions to enter a fee award of $1,315.41, the full amount Hopkins requested.

FACTS

Andy N. Salgado-Nava ("Salgado-Nava") commenced his voluntary chapter 7 bankruptcy case by filing his bankruptcy petition on October 22, 2009. Hopkins was then appointed to

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[1]Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all Rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

serve as trustee for Salgado-Nava's chapter 7 bankruptcy estate.

Hopkins initially determined that there were no non-exempt assets to distribute to creditors. He thus categorized Salgado-Nava's case, in line with most chapter 7 cases, as a no-asset case.[2] Hopkins had reached his decision after performing a number of tasks, including reviewing Salgado's schedules, his statement of financial affairs, his tax returns, and his responses to Hopkins's examination questions at the first meeting of creditors held pursuant to § 341(a). Because of Hopkins's no-asset determination, creditors and other parties in interest were told in January 2010 not to file proofs of claim in the case. See Rule 2002(e). Hopkins's only income expectation was a small $60 fee.[3]

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[2]Approximately 90% of all chapter 7 cases are classified as no-asset cases. LOIS R. LUPICA, THE CONSUMER BANKRUPTCY FEE STUDY FINAL REPORT 47 (2011), available at http://bapcpafeestudy.com/tag/final-report/ (last visited July 20, 2012) (finding 89.4% of chapter 7 cases after the 2005 Bankruptcy Code amendments are no-asset cases); see also W. Clarkson McDow, Jr., Protecting the Integrity of the Bankruptcy System in Chapter 7 No-Asset Cases, NABTALK (Fall 2001), available at http://www.justice.gov/ust/eo/public_affairs/articles/docs/nabtalkfall2001.htm (last visited July 20, 2012) (estimating approximately 96% of chapter 7 cases were no-asset cases).

That no-asset cases are all-too-common is underscored by Rule 2002(e), which allows trustees and clerks generally to tell creditors to dispense with filing proofs of claim unless the creditors are later notified that there will be assets to disburse.

[3]In a no-asset case such as Salgado-Nava's, Hopkins and all other trustees receive only a $60 fee, regardless of how much work is undertaken. § 330(b)(1) & (2). This amount has not changed since 1994, and Congress has not made this amount subject to the Code's provision indexing various amounts for inflation.

(continued...)

But Hopkins had also sent routine notices to various taxing authorities, including the State of Idaho. These notices told of Salgado-Nava's bankruptcy filing. They also requested that the recipients advise Hopkins of any tax refunds owed to Salgado-Nava, as Hopkins claimed that such refunds were property of the bankruptcy estate under § 541.

These notices brought results. As it turned out, Salgado-Nava had overpaid his state taxes for 2009 and 2010 by approximately $10,000. In compliance with the notices, Idaho sent Hopkins Salgado-Nava's tax refunds. Hopkins then withdrew his no-asset report. He also issued a new notice advising creditors that there might be a distribution of assets and directing them to file proofs of claim in order to share in that distribution. Seven creditors, appellees here, did so.

After Hopkins received the tax refunds, Salgado-Nava amended his bankruptcy schedules to list the tax refunds as assets and to claim $4,160 of his 2009 refund as exempt. No one contested Salgado-Nava's exemption claim. As a consequence, the exemption was deemed allowed pursuant to § 522(l) and Rule 4003(b). Part of his 2010 refund also was excluded from the estate.[4]

When all was said and done, Hopkins collected $11,099 in assets. He paid $5,445 to Salgado-Nava in respect of his allowed exemptions, which left $5,654 available to pay creditor dividends

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[3](...continued)
See § 104.

[4]Hopkins paid Salgado-Nava $1,285 of the 2010 refund because he determined that it had accrued postpetition, and thus was not property of the estate as it related to postpetition service income. See § 541(a)(6).

and Hopkins's chapter 7 trustee fees and expenses. Based on the trustee compensation rates set forth in § 326(a),[5] Hopkins filed a request in March 2011, along with his Final Report, asking the bankruptcy court to award him fees in the amount of $1,315.41, plus actual expenses of $46.10.[6]

Before hearing the matter, the bankruptcy court requested Hopkins provide additional information. Specifically, the court requested Hopkins file:

> a sworn affidavit in support of his requested compensation and expenses which includes an itemization setting for[th] the date and time spent providing all services rendered by Trustee for which he seeks compensation, together with a narrative discussion or explanation of any other information he wishes the Court to consider in support of his application.

Order to Trustee to File Supplementation of Record (April 12, 2011) at p. 1.

In response, Hopkins filed a one-page document entitled "Supplement to Trustee Fee Application," which provided a brief narrative summary of the services that Hopkins had provided in

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[5]Those rates are based on amounts disbursed or turned over by the trustee to parties in interest other than the debtor according to the following schedule: 25% of the first $5,000 or less; 10% for amounts in excess of $5,000 but not in excess of $50,000; 5% for amounts in excess of $50,000 but not in excess of $1,000,000; and 3% for amounts in excess of $1,000,000. See § 326(a).

[6]The Idaho district court had jurisdiction over the fee request as a matter "arising under" title 11, 28 U.S.C. § 1334(b), and then referred to the bankruptcy court from the district court's general order of reference permitted by 28 U.S.C. § 157(a). THIRD AMENDED GENERAL ORDER NO. 38 (D. Idaho April 24, 1995). The fee request was a core matter under 28 U.S.C. § 157(b)(2)(A), and thus the bankruptcy court could hear and determine the matter under 28 U.S.C. § 157(b)(1).

the bankruptcy case. It also summarized the results of those services: Hopkins had cash on hand which he estimated would be sufficient, after the payment of his requested trustee's fees, to pay $4,292 to unsecured creditors who had filed proofs of claim. This would result in a 39% dividend to creditors.

The Trustee also filed time records detailing the amount of time and services he and his staff had performed in the bankruptcy case. According to Hopkins, he and his staff spent approximately 14 hours on the case: Hopkins personally spent 3 hours, his bankruptcy administrator spent 6 hours, his office clerk spent 1 hour, and his paralegals accounted for the final 4 hours.

After the hearing, the bankruptcy court issued a memorandum decision awarding Hopkins only $750 of the $1,315.41 in fees requested. Relying on In re B & B Autotransfusion Servs., Inc., 443 B.R. 543 (Bankr. D. Idaho 2011), and on the other cases cited in B & B, the court held that $750 was a reasonable fee for Hopkins's services. According to the court, based on its consideration of the extent and difficulty of the services Hopkins and his paralegals had provided, the requested fees were unreasonable. In making this determination, the court reasoned:

> The only assets requiring administration by Trustee in this case were Debtor's tax refunds. Trustee has not shown that any significant efforts on his part were required to secure the refunds from Debtor; apparently, Debtor surrendered them to Trustee promptly. Beyond accepting and holding the tax refunds, Trustee was required to perform only routine, simple administrative tasks in this case. While all of those services are compensable (i.e., actual and necessary), they required no special skills or expertise, and required no significant amounts of time to complete. Indeed, most of those services were not performed personally by Trustee at all, but, instead, were provided by

> Trustee's support staff of "paralegals" and others. . . . When the Court focuses upon only those services of Trustee and his paralegals, and assigns appropriate reasonable value to those services, the requested fee is not a reasonable one.

Mem. Dec. (June 23, 2011) at pp. 3-4 (footnote omitted).

In addition, the bankruptcy court rejected Hopkins's argument that, under § 330(a)(7), he should receive $1,315.41 in fees as a commission based on the compensation rates set forth in § 326(a). As the court put it, § 326(a) in essence "caps" trustee compensation but does not alter or limit the court's duty and authority to determine a reasonable fee.

On June 30, 2011, the bankruptcy court entered its order approving Hopkins's Final Report and awarding Hopkins $750 in fees and $46.10 in expenses. The Trustee timely filed a notice of appeal on July 13, 2011, which gave us jurisdiction under 28 U.S.C. § 158(b).

DISCUSSION

A. Standard of Review

Although this Panel reviews a bankruptcy court's fee award pursuant to § 330(a) for abuse of discretion, Ferrette & Slater v. U.S. Trustee (In re Garcia), 335 B.R. 717, 723 (9th Cir. BAP 2005), we still must "determine de novo whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested." United States v. Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc). And that is the issue here: what is the "correct legal rule" set forth in § 330(a)(7)?

B. Interpreting § 330(a)(7)

We start with the paragraph's provenance. Congress added § 330(a)(7) when it adopted § 407 of the Bankruptcy Abuse

Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, § 407, 119 Stat. 23, 106 (2005) ("BAPCPA"). To determine what this new paragraph means and what it added, we begin with the text of the statute itself. Ransom v. FIA Card Servs., N.A., --- U.S. ----, 131 S. Ct. 716, 723-24, 178 L. Ed. 2d 603 (2011) (quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989)).

Section 330(a)(7) provides:

> In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326.

Somewhat surprisingly, the published decisions construing this paragraph conclude that it added little to the law of trustee compensation. These decisions rest primarily on the view that trustee compensation is always subject to a review for reasonableness. See, e.g., In re B & B Autotransfusion Servs., Inc., 443 B.R. 543, 550 (Bankr. D. Idaho 2011); In re Healy, 440 B.R. 834, 835-36 (Bankr. D. Idaho 2010); In re Ward, 418 B.R. 667, 675-78 (W.D. Pa. 2009); In re Coyote Ranch Contractors, LLC, 400 B.R. 84, 94-95 (Bankr. N.D. Tex. 2009); In re McKinney, 383 B.R. 490, 493-94 (Bankr. N.D. Cal. 2008); In re Phillips, 392 B.R. 378, 389-90 (Bankr. N.D. Ill. 2008) In re Mack Props., Inc., 381 B.R. 793, 799 (Bankr. M.D. Fla. 2007); In re Clemens, 349 B.R. 725, 729-31 (Bankr. D. Utah 2006).

There is, however, an alternate view of § 330(a)(7). This view, adopted by the Office of the United States Trustee,[7]

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[7]Trustee Compensation, in FREQUENTLY ASKED QUESTIONS (FAQS) FOR TRUSTEES (2006), available at

(continued...)

focuses on § 330(a)(7)'s terms – particularly the use of the term "commission" – which seem to alter the court's role in reviewing trustee compensation. See Kenneth N. Klee & Brendt C. Butler, The Bankrutpcy Abuse Prevention and Consumer Protection Act of 2005 – Business Bankruptcy Amendments, 28 CAL. BANKR. J. 270, 336 (2006) (stating that § 330(a)(7) is "supposed to ensure that the court will award compensation to a trustee on a commission basis using the upper limit in section 326 as a standard"); see also Tally M. Wiener & Nicholas B. Malito, On the Nature of the Chapter 7 Bankruptcy Trustee Fee, 18 NORTON J. BANKR. L. & PRAC. No. 2, Art. 3 (2009) ("The nature of the Chapter 7 trustee fee under the revised Bankruptcy Code is that it is a commission. It makes sense from a policy perspective to award Chapter 7 trustees commission-based awards because this method of compensation focuses on results achieved."); Samuel K. Crocker & Robert H. Waldschmidt, Impact of the 2005 Bankruptcy Amendments on Chapter 7 Trustees, 79 AM. BANKR. L.J. 333, 364 (2005) (stating that § 330(a)(7) "appears to overrule the circuit court decisions which have computed trustee compensation pursuant to the lodestar method, adjusted by enhancing factors such as the complexity of the case and extraordinary results.").

1. Parsing § 330(a)(7)

It is against this background of published cases, administrative commentary, and academic opinion that we interpret § 330(a)(7). On its face, § 330(a)(7) is made up of an

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[7](...continued)
http://www.justice.gov/ust/eo/bapcpa/trustees_faqs.htm#trust_issue4 (last visited July 20, 2012).

introductory dependent clause – "In determining the amount of reasonable compensation to be awarded to a trustee" – followed by an independent clause – "the court shall treat such compensation as a commission, based on section 326." In reading this statutory directive, we think the most natural reading of this provision is that the independent clause states a mandatory rule, while the dependent clause states when that rule applies.

a. The Commission Clause

If this reading is accepted, it means that we should start with the independent clause – which we will call the commission clause. On its face, this clause requires bankruptcy courts to treat a trustee's fee request as if the trustee were requesting payment of a commission – a fixed amount – based on the rates set forth in § 326. If correct, this reading would change our prior view that § 326 simply "capped" trustee compensation by setting forth maximum compensation rates. See Arnold v. Gill (In re Arnold), 252 B.R. 778, 788 n.12 (9th Cir. BAP 2000).

This change is warranted. Congress's addition of the commission clause changed both the function of § 326 and its relationship with § 330(a). The amendment fixed a statutory commission for chapter 7 trustees tied to – or, in the language of the last provision of the commission clause, "based on" – § 326's compensation scheme.

No other reading of the phrase "based on section 326" seems plausible, especially given the use of the word "commission." If Congress did not want to link a trustee's commission to the rates set forth in § 326, it could have ended the commission clause after the word "commission;" that is, it could have omitted the

phrase "based on section 326." Or it could have created a new and separate list of commission rates. Moreover, if Congress had merely meant to reiterate in § 330(a)(7) that a trustee's commission was subject to the caps set forth in § 326, it could have used the phrase "subject to section 326." For an example of how that phrasing would work, one only has to look at § 330(a)(1) ("subject to section[] 326, . . . the court may award . . .").

But Congress chose to use different words to refer to § 326 in §§ 330(a)(1) and (a)(7). The use of different words presumably means that Congress intended that the different words had different meanings and effects. See Sosa v. Alvarez-Machain, 542 U.S. 692, 711 n.9 (2004). Put another way, standard canons of statutory interpretation require us to give "based on section 326" a different interpretation from one we would give if the phrase read, as its cognate phrase in § 330(a)(1) does, "subject to section 326." In short, we follow established precedent by giving each word and provision of the commission clause meaning. See Corley v. United States, 556 U.S. 303, 314 (2009) ("[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant . . ." (internal quotation marks omitted)); see also Meyer v. Renteria (In re Renteria), 470 B.R. 838, 843 (9th Cir. BAP 2012) (interpreting § 1322(b)(1) so as to give effect to all of the words and phrases in the statute).

That said, we need to examine the remainder of the commission clause, including the relationship the phrase "based on" has to the word "commission" and, in turn, the meaning of the word "commission." One key indicator of the substantive

relationship among these terms and phrases is indicated by the spatial relationship of each in the statute's text. The words "based on" follow the main portion of the commission clause, a placement and ordering which generally means that the former limits, qualifies or refines the meaning of the latter. See In re Renteria, 470 B.R. at 842 (citing 2A NORMAN J. SINGER, SUTHERLAND ON STATUTORY CONSTRUCTION § 47.33 (7th ed. 2011) (explaining the rule of the last antecedent). In short, the use of "commission" before the words "based on" indicates that the normal meaning of commission starts the analysis of the main text, with the addition of "based on section 326" indicating a refinement or limitation of that accepted meaning.

Turning to the accepted meaning of "commission" in normal parlance, a "commission" is a form of compensation set as a fixed percentage of what is sold or transferred. See BLACK'S LAW DICTIONARY 306 (9th ed. 2009) (defining commission as "[a] fee paid to an agent or employee for a particular transaction, usu[ally] as a percentage of the money received from the transaction <a real-estate agent's commission>."); OXFORD ENGLISH DICTIONARY (2d ed. 1989), available at http://www.oed.com/view/Entry/37135 (last visited July 20, 2012) (defining commission as "[a] remuneration for services or work done as agent, in the form of a percentage on the amount involved in the transactions; a pro rata remuneration to an agent or factor.").

Outside of bankruptcy, commissions generally are not subject to a review for reasonableness unless an agreed-upon commission rate is not duly fixed before the commission is earned. As

stated in the Restatement (Third) of Agency:

> The amount of compensation due may be determined by the terms of agreement between principal and agent and may be fixed in amount or made contingent on whether the agent achieves stated outcomes or on other criteria. . . . If an agent has a right to be paid compensation by a principal but the amount due cannot be determined on the basis of the terms of the parties' agreement, the agent is entitled to the value of the services provided by the agent.

RESTATEMENT (THIRD) OF AGENCY § 8.13, Comment d (2006).[8]

Much the same analysis applies in bankruptcy when, for example, a court pre-approves a professional's percentage-based fee or a contingency fee arrangement before the work is performed. See § 328. If the fee arrangement is properly authorized under § 328, the bankruptcy court does not conduct a standard § 330(a) reasonableness review of contingency fees or percentage-based fees it has pre-approved under § 328. See Friedman Enters. v. B.U.M. Int'l, Inc. (In re B.U.M. Int'l, Inc.), 229 F.3d 824, 829 (9th Cir. 2000) (citing Pitrat v. Reimers (In re Reimers), 972 F.2d 1127, 1128 (9th Cir. 1992)); see also In re Confections by Sandra, Inc., 83 B.R. 729, 731-32 (9th Cir. BAP 1987). Indeed, a bankruptcy court only can disturb such pre-approved fees when it finds that the pre-approval of such fees turned out to be "improvident in light of developments not capable of being anticipated at the time" the court fixed the fees. § 328(a); see also In re Reimers, 972 F.2d at 1128.

[8]This concept is not new to the law of agency. Both the Restatement (Second) of Agency and the initial Restatement of Agency articulate the same concept and reference cases and annotations reflecting the existence of this concept. See RESTATEMENT (SECOND) OF AGENCY § 443 (1958) and accompanying comments, annotations and cases; RESTATEMENT OF AGENCY § 443 (1933) and accompanying comments, annotations and cases.

As a result of this analysis, the plain language of the commission clause leads us to conclude that § 330(a)(7) sets commissions for bankruptcy trustees based on the rates set forth in § 326. Given this, if the commission clause stood alone, independent of the rest of § 330, we could immediately hold that trustee fees should not be disturbed absent circumstances like those required in order to disturb fees pre-approved under § 328, or like the circumstances that might justify reformation or rescission of a commission agreement outside of bankruptcy.

b. Section 330(a)(7)'s Dependent Clause

But the commission clause does not stand alone. We still must construe the remainder of § 330(a)(7), because ascertaining the plain meaning of statutory text requires a contextual reading. State Comp. Ins. Fund v. Zamora (In re Silverman), 616 F.3d 1001, 1006 (9th Cir. 2010) ("To determine plain language we consider the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." (internal quotation marks omitted)); Carpenters Health & Welfare Trust Funds for Cal. v. Robertson (In re Rufener Constr., Inc.), 53 F.3d 1064, 1067 (9th Cir. 1995) ("When we look to the plain language of a statute in order to interpret its meaning, we do more than view words or sub-sections in isolation. We derive meaning from context, and this requires reading the relevant statutory provisions as a whole.")

This requires us to look at the dependent clause that immediately precedes the commission clause. Its wording and placement suggests that bankruptcy courts still must consider the reasonableness of trustee fees because it specifies that

bankruptcy courts must apply the commission clause "in determining the amount of reasonable compensation to be awarded to a trustee . . . ." We should not ignore the contents of this dependent clause any more than we should ignore the contents of the commission clause itself.[9]

The starting place for a reasonableness analysis component of trustee compensation might be § 330(a)(3). Before BAPCPA's enactment in 2005, § 330(a)(3) required bankruptcy courts, when considering the reasonableness of all trustee fees under all relevant chapters, including chapters 7, 11, 12, and 13, to consider:

> (A) the time spent on such services;
>
> (B) the rates charged for such services;
>
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
>
> (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
>
> (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

BAPCPA changed this. It amended § 330(a)(3) so that the only types of trustees that come within its ambit are chapter 11 trustees; chapter 7 trustees no longer are subject to its terms. BAPCPA, Pub. L. 109-8, § 407, 119 Stat. 23, 106 (2005). As a

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[9]Nor can we ignore the language in § 326 and elsewhere in § 330(a) indicating that bankruptcy courts are authorized to award trustee fees only to the extent those fees are reasonable.

consequence, the factors of reasonableness specified in paragraph (3) no longer directly apply to chapter 7 trustees such as Hopkins when reviewing their fee requests.

Section 330(a)(7), however, applies to all trustees under all chapters. This indicates a shift in treatment and analysis of chapter 7 trustee fees from paragraph (3) and its catalogue of factors, to paragraph (7) and its explicit incorporation of commission rates.

But the shift was not complete. Notwithstanding the applicability of paragraph (7) to chapter 11 trustees, they are still specifically included in paragraph (3) with its litany of reasonableness factors. As a result, we cannot construe paragraph (7) to require a fixed commission in all cases regardless of chapter. Otherwise, we would create an absurd situation in which § 330(a)(3) requires what § 330(a)(7) prohibits.

This requires us to search for an interpretation of the § 330(a)(7) that harmonizes the various provisions. See, e.g., Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 661-66 (2007); Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana, 472 U.S. 237, 249 (1985). In this endeavor, it is not our role to pick and choose between statutory provisions and only give effect to some of them. See Nigg v. U.S. Postal Serv., 555 F.3d 781, 785-86 (9th Cir. 2009) (citing Morton v. Mancari, 417 U.S. 535, 551 (1974)).[10]

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[10]If either provision had to give way, it would be § 330(a)(3). As later enacted and more specific, § 330(a)(7) (continued...)

c. Synthesis: Fixed Commissions for Non-extraordinary Duties

The challenge is, if possible, to give a meaning to both § 330(a)(3) and § 330(a)(7) that can be applied in all cases regardless of the applicable chapter.[11] In the process, we must try to minimize any potential conflict between the two provisions. Fortunately, non-bankruptcy federal law suggests a possible solution. There are certain instances outside of bankruptcy when federal law requires federal agencies and federal courts to consider the reasonableness of percentage-fee or commission-based compensation. See Bjustrom v. Trust One Mortg. Corp., 322 F.3d 1201, 1207-08 (9th Cir. 2003) (applying a two-part test developed by the U.S. Dept. of Housing and Urban Development to determine whether certain fees paid to mortgage brokers were reasonable and hence permissible under § 8(c) of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607(c)); Schuetz v. Banc One Mortg. Corp., 292 F.3d 1004, 1014

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[10](...continued)
would be entitled to primacy. See Bulova Watch Co. v. United States, 365 U.S. 753, 758 (1961).

[11]We could give an alternate and plausible meaning to both § 330(a)(3) and § 330(a)(7) if we were to assume that Congress actually meant for § 330(a)(7) to apply to all trustees except chapter 11 trustees, who would be subject only to § 330(a)(3). But we cannot assume that Congress inadvertently included chapter 11 trustees within the scope of § 330(a)(7). If Congress's inclusion of chapter 11 trustees in § 330(a)(7)'s coverage was inadvertent, it is up to Congress to fix the statute. See Lamie v. U.S. Trustee, 540 U.S. 526, 542 (2004).

(9th Cir. 2002) (same);[12] see also Bank of Lexington & Trust Co. v. Vining-Sparks Sec., Inc., 959 F.2d 606, 613-14 (6th Cir. 1992) (applying test articulated by Municipal Securities Rulemaking Board to determine whether securities broker's markup on certain securities constituted an unreasonable and hence fraudulent fee under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and under SEC Rule 10b-5).[13]

While these types of reasonableness reviews vary somewhat, their overarching purpose is consistent and clear: to determine whether there is a rational relationship between the duties to be compensated by the commission rate and the nature and range of services actually provided. When a rational relationship exists, the fee is presumed reasonable. Moreover, in each of these instances, federal courts applied standards that did not require a lodestar analysis to determine the reasonableness of the fees in question.

We acknowledge that these nonbankruptcy commission cases are

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[12]The Bjustrom/Schuetz test provides that a mortgage broker's fees are reasonable for purposes of RESPA § 8(c) when: "(1) the mortgage broker performed services that contributed to the transaction, and (2) . . . the total compensation received by the mortgage broker . . . was reasonably related to the services provided." Bjustrom, 322 F.3d at 1207 (citing Schuetz, 292 F.3d at 1006).

[13]The Bank of Lexington test "requires brokers to sell municipal securities at a price that is 'fair and reasonable, taking into consideration all relevant factors, including the best judgment of the broker . . . as to the fair market value . . . , the expense involved in effecting the transaction, the fact that the broker . . . is entitled to a profit, and the total dollar amount of the transaction.'" Bank of Lexington & Trust Co., 959 F.2d at 613 (quoting Municipal Securities Rulemaking Board Manual-General Rules, G-30 (CCH) ¶ 3646 (1985)).

not directly comparable with § 326's commission rates. Most significantly, Congress has set chapter 7 trustee commission rates rather than the market. But we know of no reason why courts should second-guess Congress's clearly expressed intent to fix trustee commission rates for the vast majority of cases, especially given that Congress has set the duties that trustees such as Hopkins must perform to earn that commission.

Accordingly, absent extraordinary circumstances, chapter 7, 12 and 13 trustee fees should be presumed reasonable if they are requested at the statutory rate. Congress would not have set commission rates for bankruptcy trustees in §§ 326 and 330(a)(7), and taken them out of the considerations set forth in § 330(a)(3), unless it considered them reasonable in most instances. Thus, absent extraordinary circumstances, bankruptcy courts should approve chapter 7, 12 and 13 trustee fees without any significant additional review. Indeed, the Office of the United States Trustee has indicated that it will not object in these circumstances if the trustee does not even keep contemporaneous time records.[14]

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[14]The statement appears on the United States Trustee's web site in the form of a Frequently Asked Question on Trustee Compensation as follows:

> Q: Are time records necessary to support a trustee's compensation?
>
> A: United States Trustees will not require a trustee to provide time records to support trustee compensation with regard to cases filed after October 17, 2005. It may, however, be prudent for a trustee to keep time records to address objections raised by other parties or to satisfy requirements of the court.

FREQUENTLY ASKED QUESTIONS (FAQS) FOR TRUSTEES, available at

(continued...)

Against this background, we must assume that Congress already has approved fees set as commissions in § 326 as reasonable for the duties it has set out for such trustees in § 704 and elsewhere in the Code. In effect, Congress has set both the duties of a trustee and the "market" rate for compensation related to the delivery of those services.

On the other hand, if extraordinary circumstances exist, or if chapter 11 trustee fees are at issue, the bankruptcy court may be called upon in those cases to determine whether there exists a rational relationship between the amount of the commission and the type and level of services rendered. In the case of a chapter 11 trustee, this determination necessarily requires consideration of the § 330(a)(3) factors, and also ordinarily includes a lodestar analysis. As for chapter 7, 12, and 13 trustee fees, when confronted with extraordinary circumstances, the bankruptcy court's examination of the relationship between the commission rate and the services rendered may, but need not necessarily include, the § 330(a)(3) factors and a lodestar analysis. But bankruptcy courts still must keep in mind that tallying trustee time expended in performing services and multiplying that time by a reasonable hourly rate ordinarily is beyond the scope of a reasonableness inquiry involving commissions. Simply put, a bankruptcy court that diminishes a trustee's compensation from the statutorily-set rate errs if the only basis offered for this diminution is a lodestar analysis.

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[14](...continued)
http://www.justice.gov/ust/eo/bapcpa/trustees_faqs.htm#trust_issue4 (last visited July 20, 2102).

Although the legislative history is silent on the specific meaning and purpose of § 330(a)(7), our construction of § 330(a)(7) generally is consistent with the overall purpose of § 330, pursuant to which Congress sought to balance the general bankruptcy interest of conserving estate assets with the goal of fairly compensating bankruptcy trustees and professionals.[15] Especially now, when the most a chapter 7 trustee can expect in 90% of his or her cases is a flat $60 fee, a commission-based system for the other 10% has a certain symmetry to it. Under the system as Congress envisaged it, competent individuals with marketable skills and experience will have incentives to work in the bankruptcy area. In that sense, § 330(a)(7) represents Congress's latest effort to balance various competing policy interests with respect to the work assigned and the compensation paid to chapter 7 trustees.

C. Applying § 330(a)(7) to This Case

Based on the law set forth above, the bankruptcy court erred in determining Hopkins's fees. The bankruptcy court did not treat Hopkins's compensation as a commission based on § 326(a). Instead, the court compared the fees requested to what it considered a reasonable rate of compensation for the time Hopkins and his paralegals actually spent working on the case. The court offered no other grounds for its decision. In short, the bankruptcy court substituted a different standard for the

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[15]For a detailed discussion of this legislative history, see Burgess v. Klenske (In re Manoa Fin. Co.), 853 F.2d 687, 689-90 (9th Cir. 1988) (citing H.R. Rep. No. 95-595, at 329-30 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6286; and, 124 Cong.Rec. 33,994 (1978), reprinted in 1978 U.S.C.C.A.N. 6505, 6511).

appropriate method and rate of compensation for Hopkins in place of the method and rate set by Congress.

When the bankruptcy court does not select and apply the correct law, we typically remand so that the bankruptcy court can apply the correct law to the facts of the case. However, an appellate court may decide a case on the facts previously found when the record is sufficiently developed and there is no doubt as to the appropriate outcome. See, e.g., Wharf v. Burlington N. R.R. Co., 60 F.3d 631, 637 (9th Cir. 1995); see also Weisgram v. Marley Co., 528 U.S. 440, 456 (2000); Cuddeback v. Florida Bd. of Educ., 381 F.3d 1230, 1236 n.5 (11th Cir. 2004).

In this instance, no further proceedings are necessary to apply the facts to the correct law. The record is complete and establishes that there was nothing unusual, let alone extraordinary, about the bankruptcy case or Hopkins's services.[16]

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[16]We thus leave for another day the issue of what facts might qualify as extraordinary for purposes of activating the bankruptcy court's duty to determine the reasonableness of the § 326(a) commission rates.

Cf. Trustee Compensation, in the United States Trustee's Frequently Asked Questions about trustee compensation:

> Q: Is a trustee entitled to full statutory trustee fees in all circumstances?
>
> A: 11 U.S.C. § 330(a)(7) provides that the trustee fee is to be "treated as a commission." Absent extraordinary factors, the United States Trustee will not object to a trustee receiving full commission on 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." Extraordinary factors are expected to arise only in rare and unusual circumstances and include situations such as where the trustee's case administration falls below acceptable standards, or where it appears a trustee has delegated

(continued...)

Indeed, the bankruptcy court described both the case and Hopkins's services as "routine." Based on the law we have articulated above, we are left with no doubt that, on these facts, the court should have awarded Hopkins $1,315.41 in fees – the full amount Hopkins had requested based on the compensation rates set forth in § 326(a).

CONCLUSION

For the reasons set forth above, we REVERSE the bankruptcy court's fee award and REMAND this matter, with an instruction to enter a new fee award in the full amount requested by Hopkins, $1,315.41.

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[16](...continued)
a substantial portion of his duties to an attorney or other professional.
FREQUENTLY ASKED QUESTIONS (FAQS) FOR TRUSTEES, available at http://www.justice.gov/ust/eo/bapcpa/trustees_faqs.htm#trust_issue4 (last visited July 20, 2012).

DEEPENING INSOLVENCY AND PONZI SCHEMES-LATEST DEVELOPMENTS

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Deepening Insolvency and Ponzi Schemes-Latest Developments

Deepening Insolvency

I. Deepening Insolvency

A. Background-The Deepening Insolvency cause of action is grounded in the failure of corporate governance in the months or years leading up to the commencement of an insolvency proceeding. It is akin to and often plead alongside claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and is otherwise in the nature of fraud.

B. Causes of Action-against corporate insiders and deep-pocket outside professionals including auditors, attorneys and underwriters for wrongdoing that caused the corporation to incur unpayable debt that "deepened" the corporation's insolvency.

C. Zone of Insolvency-What are the fiduciary duties of corporate officers and directors and their hired professionals when the corporation, on a balance sheet basis, becomes insolvent. Do the fiduciary duties shift from protecting the interests of shareholders or equity to protecting the interests of creditors. California law on this subject is clear in requiring that the duties of the corporate officers and directors shifts when the "zone of insolvency" is reached.

D. Earlier/Typical Case Law-The case of Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d. 340 (3d Cir., 2001)-In order to alleviate the financial difficulties of one corporation, the insiders of that corporation formed a second corporation. The second corporation was wholly-owned by the first, however, the insiders marketed it as a separate entity. They utilized the second corporation to raise more debt for the benefit of the first. When the corporations filed for chapter 11, the Committee

brought on an action for deepening insolvency in connection with this ponzi scheme situation alleging that the scheme was perpetrated, in part, by the Debtors' outside professional advisors whose opinions of the corporations' financial status served as the basis and necessary predicate to the registration of public offerings and debt securities.

E. What About the Standing Issue-The standing issue was central to the Lafferty decision as that decision permitted the Creditors Committee to pursue claims that belonged to the corporation. The analysis engaged in by the Third Circuit was whether under applicable State Law (Pennsylvania) would permit the cause of action for Deepening Insolvency to be maintained.

F. Theories of Damages-Two different theories of damages--(1) wrongfully-incurred debt that may inflict costs of financial distress upon the corporation. These costs include administrative costs of bankruptcy, declines in assets, profits from reputation, and other losses. or (2) The amount of the corporation's wrongfully-incurred unpayable debt is a measure of damages.

G. In Pari Delicto- Courts have previously held that this doctrine can be a bar to recovery in Deepening Insolvency cases. In Cenco, Inc. v. Seidman & Seidman, 686 F.2d. 449 (7th Cir., 1982) held that auditors of a corporation under Illinois law could raise the issue of the corporation's officers' misconduct as a defense against claims of breach of contract, negligence and fraud. In the Lafferty case, the court held under Pennsylvania law that the Committee was barred from recovery because the corporation's sole shareholder dominated and controlled the debtors. Thus, the corporation was responsible for giving such responsibility to an agent.

1. But, may represent a misapplication of the doctrine-relief will typically be denied with the in pari delicto defense if the parties involved are "equally at fault." This means that the fault of the parties must be (a) clearly mutual, simultaneous, and relatively equal, (b) the plaintiff must be an active, essential, and knowing participant in the illegal activity, and (c) the effect on the investing public or on the regulatory scheme caused by permitting the defense, must be so slight that it does not interfere with the objectives of the securities laws. Miller v. Interfirst Bank Dallas, N.A., 608 F.Supp. 169 (N.D. Tex., 1985)

2. Therefore, where there is unequal fault between the victim corporation and the directors, officers, stockholders and other professionals engaged in the deepening insolvency conduct, the doctrine will not apply. Kalb, Voorhis & Co. v. Am. Fin. Corp., 8 F.3d. 130(2nd. Cir., 1993)

3. Additional Arguments Defeat the In Pari Delicto Defense-these include the fact that the doctrine's application--

(a) undermines the purposes of the bankruptcy code as Congress sought to create a statutory scheme that would, in relevant part, reduce the potential for fraud or self-dealing. Application of this defense is contrary to those purposes

(b) Enforcement of the doctrine would wipe out the ability of a corporation to hold its officers, directors and controlling shareholders responsible for their actions---to call the corporation itself responsible for the acts of its agents and therefore subject to the in pari delicto defense is both circuitous and effectively wipes out the doctrine

(c) Automatic Benefit Exception-That conduct that prolongs the corporate life of the business cannot be actionable against those that created this "benefit"--however, this is not a valid assumption and is simply not consistent with common sense

(d) Generally, to immunize corporate officers, directors and controlling shareholders from liability under the in pari delicto doctrine would allow this equitable doctrine to be utilized to achieve an inequitable result. It would give the wrong-doers all the motivation to hide or conceal a corporation's real financial status as long as possible rather than creating a policy that the corporation cannot be operated in this manner

II. The Third Circuit's Opinion in Official Committee of Unsecured Creditors v. Arthur Baldwin; Linda Cobb; Jerome Bullock, et. al. (In re Lemington Home for the Aged)

A. Procedural Background-a committee of unsecured creditors on behalf of a nonprofit corporation's estate, appealed the decision of the United States District Court for the Western District of Pennsylvania that granted summary judgment in favor of appellees, the officers and directors of the corporation, on breach of fiduciary duty and deepening insolvency claims. The district court had applied the business judgment rule and the doctrine of in pari delicto to find that the complaint filed by the Committee against the insiders failed to state a claim upon which relief could be granted.

B. Questions of the Fiduciary Duties of the Officers and Directors-

1. Pennsylvania law provides that, absent breach of fiduciary duty, lack of good faith, or self-dealing, any act as the board of directors, a committee of the board, or an individual director shall be presumed to be in the best interests of the corporation

2. The business judgment rule should insulate officers and directors from judicial intervention in the absence of fraud or self-dealing, if challenged decisions were within the scope of the directors' authority, if they exercised reasonable diligence, and if they honestly and rationally believed their decisions were in the best interests of the company. A court must examine the circumstances surrounding the decisions in order to determine if the conditions warrant application of the business judgment rule. Underlying the business judgment rule is the assumption that reasonable diligence has been used in reaching the decision which the rule is invoked to justify. Factors bearing on the board's decision include whether (a) the board was disinterested, (b) whether it was assisted by counsel, (c) whether it prepared a written report, (d) whether it was independent, (e) whether it conducted an adequate investigation, and (f) whether it rationally believed its decision was in the best interests of the corporation. Whether the duty of care has been met is a question of fact to be determined by an examination of all the circumstances in the case.

C. Applicable Pennsylvania Law-Pennsylvania recognizes directors' and officers' liability for negligent breach of fiduciary duty. Even in the absence of fraud, self-dealing, or proof of personal profit or wanton acts of omission or commission, the directors of a corporation may be held personally liable where they have been imprudent, wasteful, careless, and negligent, and such actions have resulted in corporate losses.

D. In Pari Delicto- There is an exception to the applicability of in pari delicto, when the complained-of action did not actually benefit the corporation. Thus, although principals generally are responsible for the acts of agents committed within the scope of their authority, where an agent acts in his own interest, and to the corporation's detriment,

imputation generally will not apply. This adverse interest exception is set forth as follows: Under the law of imputation, courts impute the fraud of an officer to a corporation when the officer commits the fraud (1) in the course of his employment, and (2) for the benefit of the corporation. As to whether an officer's conduct is motivated by self-interest and benefits the corporation, the appropriate approach is best related back to the underlying purpose of imputation, which is fair risk-allocation, including the affordance of appropriate protection to those who transact business with corporations.

1. Other Cases Raising the In Pari Delicto Issue in Deepening Insolvency Cases-Jones v. Wells Fargo Bank, N.A., 666 F.3d 955 (5th Cir., 2012); Official Comm. of Unsecured Creditors of Allegheny Health v. PriceWaterhouse Coopers, 607 F.3d 346, 350 (3rd. Cir., 2010)

E. Deepening Insolvency in the State of Pennsylvania-A deepening insolvency cause of action has not been formally recognized by Pennsylvania state courts. Nevertheless, relying on decisions interpreting the law of other jurisdictions and on the policy underlying Pennsylvania tort law, the United States Court of Appeals for the Third Circuit has found that the Pennsylvania Supreme Court would determine that deepening insolvency may give rise to a cognizable injury. Deepening insolvency in Pennsylvania is defined as an injury to a debtor's corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life. For such a claim to succeed, it is necessary to demonstrate that the directors' actions caused the deepening of insolvency. Fraud is necessary to support a claim of deepening insolvency, and a claim of negligence cannot sustain a deepening-insolvency cause of action.

Ponzi Scheme Issues

I. Ponzi Schemes-the Starting Point: The financial collapse which first gained public attention in the Spring, 2008 with the demise of Bear Stearns and became complete in September, 2008 with the Chapter 11 filing for Lehman Brothers also spelled the end of many Ponzi Schemes who were hit with redemptions by existing "investors" as well as the complete cessation of new investors in order to keep the fraud going. The collapse of any number of Ponzi Schemes became complete with the largest (though not the last) collapse of Bernard Madoff's firm coinciding with his arrest on December 11, 2008.

A. Clawback Litigation: This litigation by the Bankruptcy Trustee is the first thing that many people associate with Ponzi Scheme bankruptcy cases. The "Ponzi Scheme Presumption", Bear, Stearns Sec. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.), 310 B.R. 500 (Bankr. S.D.N.Y., 2002) states that any transfers made by a debtor running a Ponzi Scheme were presumptively made with the intent to "hinder, delay and defraud" under Federal and State Fraudulent Transfer Laws. Intent is a factually issue that the Court is typically called upon to consider in these cases, however, in the Ponzi Scheme situation, wrongful intent is presumed. "…knowledge to a substantial certainty constitutes intent in the eyes of the law…" Manhattan Inv. Fund, Ltd, at page 507. Therefore every payment to earlier investors was made with the "intent" to defraud the later ones. This obviously makes it much easier for the Bankruptcy Trustee to prove his/her case and the transferee.

1. That the "transfers" to the Ponzi Scheme investors of "profits" were not transfers made for reasonably equivalent value. In re Bayou Grp., LLC, 362 B.R. 624 (Bankr. S.D.N.Y., 2007). They are viewed as "fictitious profits" and refer specifically to any interest payments made to investors in excess of their principal investment in the venture.

They are not deemed made for value and accordingly are avoidable by the Trustee. In re Tiger Petroleum Co., 319 Bankr. 225 (Bankr. N.D. Okla, 2004); In re Independent Clearing House, 77 B.R. 843 (Bankr. D. Utah, 1987).

2. "Value"-The rationale for this rule stems from the definition of "value" in both federal and state fraudulent transfer law as including satisfaction of an antecedent debt. An investor who entrusts money to an entity that eventually becomes a debtor in bankruptcy holds a valid claim against such debtor for the return of his original investment - the investor's "principal undertaking." Interest payments above this amount in the Ponzi scheme context, however, are subject to a separate analysis. As they come not from the debtor's legitimate earnings, but rather from funds that "rightfully belonged to other, defrauded undertakers," some courts have held an investor's right to payment of supposedly earned interest unenforceable as against public policy. More importantly, though, most courts have held that the investor's allowance of the debtor's use of his money for the period of investment was not given for equivalent "value" under fraudulent transfer law. In Re Independent Clearing House, 77 B.R. at 857

B. Bernard L. Madoff Investment Securities, LLC, 654 F.3d. 229 (2nd. Cir., 2011); cert. denied 6/2012-Over objections by claimant customers of a debtor firm's Ponzi scheme, the U.S. Bankruptcy Court for the Southern District of New York upheld a Securities Investor Protection Act (SIPA), 15 U.S.C.S. § 78aaa et seq., trustee's decision to apply the Net Investment Method (NIM) for distributions, thus crediting customers with cash deposits, less amounts withdrawn, with no credit for fictitious earnings. An immediate appeal was certified.

1. Second Circuit Decision-The NIM limited distributions to customers

who invested more than they withdrew: only they had positive "net equity" (NE). Objecting customers argued they had a legitimate expectation that their last customer statements (LCS) were accurate, that SIPA was designed to protect that legitimate expectation, and the NIM undermined that. SIPA prescribed no single means of calculating "NE." The NIM was more consistent with the statutory definition of "NE" for 15 U.S.C.S. §§ 78fff-2(b)(2), (c)(1)(B), 78lll(11). If the LCSs were used, those who had withdrawn funds in excess of their investments would receive more favorable treatment by profiting from the investments of those who withdrew less than deposited, yielding an inequitable result. The LCSs were not useful for ascertaining "NE." "Net equity" in § 78lll(11) had to be read with § 78fff-2(b), which required paying net equity claims only insofar as such obligations were ascertainable from the debtor's books and records or otherwise established to the trustee's satisfaction. The NIM method was appropriate given the Ponzi scheme, but an LCS could be more appropriate of calculating "NE" in a conventional case.

2. A "Customer" for Purposes of the Securities Investor Protection Act-If claimants are not "customers," 15 U.S.C.S. § 78lll(2)(A), they are not entitled to the protection of the Securities Investor Protection Act (SIPA) at all. Under SIPA, the term "customer" includes any person who has deposited cash with the debtor for the purpose of purchasing securities. 15 U.S.C.S. § 78lll(2)(B)(i). It also includes a person who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral, security, or for purposes of effecting transfer. 15 U.S.C.S. § 78lll(2)(A).

3. Intersection of the Bankruptcy Code and SIPA-The Securities Investor Protection Act (SIPA), 15 U.S.C.S. § 78aaa et seq., and the Bankruptcy Code intersect to grant a SIPA trustee the power to avoid fraudulent transfers for the benefit of customers. In re Adler, Coleman Clearing Corp., 263 B.R. 406 (Bankr. S.D.N.Y., 2001)[1]

C. Miscellaneous Ponzi Scheme Cases Involving Fraudulent Transfer Issues-

1. In re Sentinel Mgmt. Group, 2012 U.S. App. LEXIS 16546 (7th Cir., 8/9/2012)-Plaintiff trustee filed an adversary proceeding alleging that the debtor fraudulently used customer assets to finance a loan to cover its house trading activity and that defendant bank knew about it. There were claims of fraudulent transfer, preferential transfer, equitable subordination, and invalidation of the lien. The U.S. District Court for the Northern District of Illinois, Eastern Division, rejected the claims. The trustee appealed. The court found that the trustee's claim that the transfers of customer assets out of segregation and into lienable accounts constituted fraudulent transfers under 11 U.S.C.S. §§ 548(a)(1)(A) & 544(b) failed because that the debtor failed to keep client funds properly segregated was not, on its own, sufficient to rule that the debtor acted with actual intent to hinder, delay, or defraud its customers. The trustee failed to show where the district court clearly erred in finding that the bank did not engage in the type of misconduct that warranted equitable subordination, under 11 U.S.C.S. § 510(c), because, at worst, bank

[1] There has been significant law review articles written since the Madoff proceeding was commenced. These include, Kull, *Symposium: A Conference on Restitution and Unjust Enrichment: Topic III: Common-Law Restitution and Ponzi Schemes: Common-Law Restitution and the Madoff Liquidation,* 92 B.U.L. Rev. 939 (May, 2012); Livermore, *Symposium: A Conference on Restitution and Unjust Enrichment: Topic III: Common-Law Restitution and Ponzi Schemes: Rethinking Ponzi-Scheme Remedies in and Out of Bankruptcy,* 92 B.U.L. Rev. 969 (May, 2012); Sullivan, *When the Bezzle Bursts: Restitutionary Distribution of Assets After Ponzi Schemes Enter Bankruptcy,* 68 Wash & Lee L. Rev. 1589 (Fall, 2011); Nelson, *Note: Turning Winners Into Losers: Ponzi Scheme Avoidance Law and the Inequity of Clawbacks,* 95 Minn. L. Rev. 1456 (April, 2011)

officials acted negligently, but not fraudulently, and the bank's failure to somehow ensure segregation compliance would not have supported the required level of egregious behavior. The claim that the debtor's contracts with the bank were inherently illegal was correctly dismissed because although the agreements may have created a structure for abuse, the agreements were not the cause of the debtor's under-segregation, and the trustee failed to point to any provision in the contract that required the debtor or the bank to do anything even remotely illegal.

2. Perkins v. Haines, 661 F.3d 623 (11th Cir., 2011)-Appellant plan trustee alleged that transfers to appellee investors prior to the collapse of a Ponzi scheme were fraudulent transfers under 11 U.S.C.S. § 548(a)(1)(A) and applicable state law. The investors asserted an affirmative defense under 11 U.S.C.S. § 548(c).[2] The trustee appealed an order by United States Bankruptcy Court for the Northern District of Georgia denying his motion partial summary judgment.

The appeal presented an issue of first impression. For purposes of this appeal, as in the bankruptcy court, it was presumed that all of the debtors' transfers to the investor defendants qualified as fraudulent transfers under § 548(a)(1)(A) and applicable state law. The trustee relied on a line of cases holding that transfers to redeem an equity investment in an insolvent entity, initially made free of fraud, could not constitute a transfer for value. The decisions did not apply because they did not involve Ponzi schemes. The trustee asked

[2] Section 548(c) provides a transferee with an affirmative defense where the transferee acts in good faith and gives value to the debtor in exchange for such transfer. The term value is defined to include satisfaction or securing of a present or antecedent debt of the debtor. 11 U.S.C.S. § 548(d)(2)(A). Although antecedent debt is not defined, the term debt is stated to include liability on a claim. 11 U.S.C.S. § 101(12). Claim is broadly defined as the right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured

the court to focus solely on the form of the investment to the exclusion of all other factors, and to ignore the realities of how Ponzi schemes operated. However, no court to date had applied that form over substance rule in fraudulent transfer actions involving Ponzi schemes.[3]

[3] In the case of Ponzi schemes, the general rule is that a defrauded investor gives value to the debtor in exchange for a return of the principal amount of the investment, but not as to any payments in excess of principal. Courts have recognized that defrauded investors have a claim for fraud against the debtor arising as of the time of the initial investment. Thus, any transfer up to the amount of the principal investment satisfies the investors' fraud claim--an antecedent debt--and is made for value in the form of the investor's surrender of his or her tort claim. Such payments are not subject to recovery by the debtor's trustee. Any transfers over and above the amount of the principal, i.e., for fictitious profits, are not made for value because they exceed the scope of the investors' fraud claim and may be subject to recovery by a plan trustee. Perkins v. Haines, 661 F.3d, at 627