

# Not All Distributions Are ‘Disbursements’ Subject to US Trustee Fees

## WRITTEN BY

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Nowhere else is the old saying “you can’t escape death and taxes” better exemplified than in Chapter 11. Under the Bankruptcy Code, debtors are subject to stringent reporting and fee requirements imposed by the Department of Justice and the Office of the U.S. Trustee. The U.S. Trustee fees, which have been significantly increased over the last several years, are based on the amount of “disbursements” made by a debtor during the prior reporting period. Therefore, a tension exists between a debtor’s interest in characterizing payments made during the case as something other than a disbursement, in contrast to the U.S. Trustee’s goal to deem all such payments as disbursements subject to fees. In a recent case from the Bankruptcy Court for the District of Delaware, *In re Paragon Offshore PLC*, 629 B.R. 227 (Bankr. D. Del. 2021), the bankruptcy court provided guidance on whether a post-plan effective date litigation trust’s distributions constituted disbursements subject to the U.S. Trustee fee “tax.”

In *Paragon*, a litigation trust was formed pursuant to the debtors’ confirmed plan of reorganization, one purpose of which was to pursue estate claims against Noble Corp. Once the plan became effective, the Noble claims were transferred to the litigation trust, free and clear of all liens, claims, and interests. Consistent with grantor trust law, the plan provided that the transfer of assets, including the Noble claims, was deemed to be a transfer from the debtors to trust beneficiaries and then a transfer of those assets by the beneficiaries to the litigation trust. As a result, the Paragon debtors and estates no longer held any interest in the trust assets (including the Noble claims) or the litigation trust.

The order confirming the plan made clear that statutory fees owed to the U.S. Trustee pursuant to 28 U.S.C. Section 1930 would be paid on the plan’s effective date and obligated the reorganized debtors to file post-confirmation reports and pay quarterly fees to the U.S. Trustee until the bankruptcy cases were closed. For the quarter during which the plan went effective and the Noble claims transferred to the litigation trust, the Paragon debtors paid the maximum quarterly fee of \$250,000 to the U.S. Trustee.

Subsequently, the litigation trust brought suit against Noble and certain of its directors. Prior to trial, however, Noble and certain related entities commenced their own Chapter 11 cases in Texas. Ultimately, the litigation trust and Noble reached a settlement pursuant to which the Noble defendants agreed to pay over \$90 million to the trust. The settlement was approved by the Delaware Bankruptcy Court following which Noble paid \$7.7 million to the trust. On April 29, Noble, in its own bankruptcy, filed a post-confirmation report and paid the maximum

quarterly fee of \$250,000 to the U.S. Trustee, in part as a result of Noble's settlement payment. On May 12, the U.S. Trustee filed a motion to compel the Paragon reorganized debtors or the Paragon litigation trust to file post-confirmation reports and pay statutory fees under 28 U.S.C. Section 1930(a)(6) related to the distribution of settlement payments received by the trust from the Noble defendants.

The bankruptcy court began its decision by acknowledging the Office of the U.S. Trustee's role as a watchdog over the bankruptcy system, but expressed dismay over the U.S. Trustee acting as a tax collector as a result of increased quarterly fees—often expanding a debtor's administrative burden and reducing recoveries to creditors.

The bankruptcy court then turned to and analyzed 28 U.S.C. Section 1930(a)(6), which requires debtors and post-confirmation debtors to pay fees to the U.S. Trustee based on that entity's "disbursements" over the prior monthly or quarterly period. Importantly, the court noted that a determination of whether a payment is a "disbursement" by a debtor subject to U.S. Trustee fees depends on whether "the debtor had some interest in, or control over, the money disbursed." Contrary to the U.S. Trustee's argument that fees are owed in every instance when any entity pays any third party for any reason and from any source, the court found that a "disbursement" is limited to situations where the payment is made by a party on behalf of a debtor subject to Section 1930(a)(6).

Applying this rationale under Section 1930(a)(6) to the distribution by the Paragon litigation trust of the Noble settlement funds to its beneficiaries, the bankruptcy court held that such distributions were not "disbursements" subject to U.S. Trustee fees because the distributions were not made on behalf of any of the debtors. Rather, the distributions by the trust were trust assets distributed for the benefit of trust beneficiaries—the distributions of the Noble settlement were not made on behalf of the Paragon debtors and the Paragon debtors had disclaimed any interest in such assets when they were transferred to the trust, free and clear, pursuant to the plan. The disbursements subject to U.S. Trustee fees occurred when the Paragon debtors and estates transferred the Noble claims to the litigation trust on the Plan's effective date, and the Paragon debtors paid the maximum quarterly U.S. Trustee fees in that same quarter. Thus, the bankruptcy court denied the U.S. Trustee's motion to compel payment of any U.S. Trustee fees related to the litigation trust's distribution of the Noble settlement proceeds to trust beneficiaries.

The impact of U.S. Trustee fees on creditor recoveries is real and often substantial. The *Paragon* decision is therefore important because it provides at least some relief once assets are transferred to a post-effective date trust. The opinion will certainly guide plan structuring decisions, such as whether assets are liquidated before or after transfer to a trust. However, because this will impact the amount of U.S. Trustee fees collected, unlike the certainty of death and taxes, *Paragon* may not be the last word on the issue.

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