

Does the **326(a) Commission**  
Apply to Disbursements of  
**Non-Debtor Property?**

H. Jason Gold and John T. Farnum

**W**hether it is the proceeds of the sale of the debtor's residence co-owned with the debtor's spouse or the entire proceeds of property where the debtor's ownership interest is something less than 100%, the question of the trustee's right to calculate his or her commission on the total amount disbursed has recently become a hot issue.

In order to realize the value of co-owned property, a bankruptcy trustee is required by section 704 to liquidate the property if the statutory requirements are met. The plain language of section 326(a) and a majority of case law support allowing a commission on the disbursement of the proceeds of the non-debtor's interest in such property although the commission may not be charged against the non-debtor's share. Instead the entire commission is to be paid from the debtor's estate.

### **I. Plain Language of Section 326(a) Provides for Payment of Commission to Trustee Based Upon Disbursement of Moneys to Parties-in-Interest**

Congress, as we know, has long mandated an incentive-based framework governing compensation for chapter 7 trustees charged with identifying and liquidating assets of bankruptcy estates for the benefit of creditors. Fees for chapter 7 trustees are governed by section 326 and 330 of the Bankruptcy Code. See 11 U.S.C. §§ 326 and 330.<sup>1</sup>

Section 330(a)(7) 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.

11 U.S.C. § 330(a)(7).

In turn, section 326 provides a sliding scale for the commission payable to chapter 7 trustees. See 11 U.S.C. § 326(a). Specifically, section 326(a) provides:

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 \$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.

11 U.S.C. § 326(a). Importantly for this discussion, section 326(a) calculates the trustee's commission upon "all moneys disbursed or turned over in the case by the trustee" to "parties-in-interest." *Id.* (emphasis added). The commission-based compensation scheme prescribed by section 326(a) provides necessary incentives for trustees to identify and administer all available assets so as to maximize distributions to creditors. Similar to a contingent fee, commission-based compensation compensates for the risk of non-recovery and provides for a percentage of

recovery without requiring a trustee to account for hourly rates or provide time records detailing the hours worked.

The calculation of a trustee's commission under section 326(a) is seemingly unambiguous and as long as the moneys distributed by a trustee constitute "moneys disbursed or turned over"

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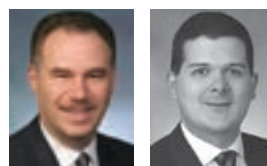
**The calculation of a trustee's commission under section 326(a) is seemingly unambiguous and as long as the moneys distributed by a trustee constitute "moneys disbursed or turned over" and the entity receiving the moneys is a "party-in-interest," the inquiry into whether the trustee may receive a commission for disbursement of such funds should end. However, as it relates to moneys distributed by a trustee from the liquidation of property in which a non-debtor co-owner holds an interest, payment of the trustee's commission on these disbursements does not go unchallenged.**

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Despite such challenges, the majority of what little case law addresses the issue supports payment of the trustee's commission based upon the distribution of such moneys to the non-debtor co-owner. See *In re Schautz*, 390 F.2d 797 (2nd Cir. 1968) (holding that the trustee could include within the disbursement base all proceeds from the sale of property owned in joint-tenancy with a non-debtor); *In re The Robert Plan Corp.*, 2012 Bankr. LEXIS 3838, at \*27-28 (Bankr. E.D. N.Y. Aug., 12 2012), *appeal filed* ("Whatever moneys the trustee disburses, whether estate property or not, is included in the [section 326(a)] formula."); *In re Rybka*, 339 B.R. 464 (Bankr. N.D. Ill. 2006) (holding that "[b]ecause actual monies were disbursed" to a third-party for the party's one-half interest in property jointly-owned with the debtor, "those funds should equitably be counted as part of the trustee's compensation for her services in relation to the sale of the property"); see also *In re Circle Investors, Inc., et al.*, 2008 Bankr. LEXIS 1066 (Bankr. S.D. Tex. April 2, 2008) (holding that under section 326(a)'s plain language, "moneys disbursed" by the trustee to a "party in interest" were included in the disbursement base); *In re Citi-Toledo Partners II*, 254 B.R. 155 (Bankr. N.D. Ohio 2000) (holding that a trustee who disbursed moneys to a trustee of a separate estate on account of a settlement could be included in the disbursing trustee's compensation base); *In re Guyana Dev. Corp.*, 201 B.R. 462, 474 (Bankr. S.D. Tex. 1996) (holding "it is appropriate to include the full amount of the proceeds of the sale of encumbered property in the basis for the percentage computation."); but see *In re Eidson*, 2012 Bankr. LEXIS 4997 (Bankr. E.D. Va. Oct. 24, 2012) (concluding that trustee's commission on the non-debtor spouse's interest in the property owned as tenants by the entirety was disallowed).

#### **A. The Co-Owner is a Party-in-Interest for Purposes of Section 326(a)**

The term party-in-interest is not specifically defined in the Bankruptcy Code. However, courts have interpreted the term to include "any party who has an actual pecuniary interest in the case, as well as to those parties who have a practical stake in the outcome of the case, or to those parties who will be impacted in any significant way by a decision made in the case." *In re Citi-Toledo Partners II*, 254 B.R. at 163 (citing *In re Cowan*, 235 B.R. 912, 915 (Bankr. W.D. Mo. 1999) (citing *In re Amatex Corp.*, 755 F.2d 1034, 1041-44 (3rd Cir. 1985); *Kapp v. Naturelle, Inc.*, 611 F.2d 703, 706 (8th Cir. 1979); *In re Johns-Manville Corp.*, 36 B.R. 743, 754 (Bankr. S.D. N.Y. 1984)). Where property is sold pursuant to section 363(h), the co-owner is a "party-in-interest." As the recipient of proceeds from the sale of the property and as a named defendant on a 363(h) complaint (or as a party consenting to the sale), a co-owner has a pecuniary interest, practical stake, and interest in the administration of the estate.

#### **B. Moneys Distributed to a Party-in-Interest Do Not Need to be Property of the Estate for Purposes of Calculating the Trustee's Compensation.**

Disbursed funds need not be property of the estate. Neither the plain language of section 326(a) nor the majority of courts interpreting the same read section 326(a) to require "moneys disbursed" be property of the estate. See *In re North American Oil & Gas, Inc.*, 130 B.R. 473, 478 (Bankr. W.D. Tex 1990) ("The base is not limited

to distributions of property of the estate, as a trustee may disburse monies to parties in interest, within the meaning of Section 326(a) without in the process having actually distributed property of the estate."); *In re D. Healy*, No. 00-12104 (Bankr. N.D. Ca. Nov. 3, 2003) (holding that section 326(a) does not limit computation of the trustee's commission to property of the estate and ruling that the return of a deposit for a sale never consummated may be included in the computation of the trustee's commission); but see *In re Market Resources Development Corp.*, 320 B.R. 841, 847 (Bankr. E.D. Va. 2004) (holding that the section 326(a) is limited to the disbursement of proceeds of property of the estate). This conclusion not only follows from the plain language of the statute, but also makes practical sense. Complicated factual and legal disputes that may otherwise cost the estate significant resources to litigate are often settled in bankruptcy court. Included amongst the issues settled may be those issues concerning whether property is property of the estate, meaning that issues otherwise settled may need to be re-litigated months or even years after the issue was initially brought before the court.

As noted above, the Bankruptcy Code's commission-based compensation scheme provides necessary incentives for trustees to identify and administer all available assets so as to maximize distributions to creditors. The likelihood or non-likelihood of receiving a commission for the distribution of moneys to a non-debtor co-owner, of course, doesn't change the trustee's fiduciary duties to creditors of the estate to maximize their return. However, a commission based upon such distribution recognizes that the challenges related to the liquidation of assets correlates more closely to the value of the entire asset and not just the portion deemed to be property of the estate.

#### **C. Tenants by the Entireties Property is Property of the Bankruptcy Estate.**

Furthermore, even assuming that section 326(a) does require that moneys disbursed be property of the estate, moneys disbursed to a non-debtor spouse from the sale of property owned as tenants by the entirety are indeed the proceeds of property of the estate. This is because the property owned as tenants by the entirety is "seized per mi et per tout, - that is, each of them has the entire possession of his part as well as of the whole." *Funches v. Funches*, 243 Va. 26, 30 (1992) (describing four requirements of a joint tenancy, which are also four of the five requirements of a tenancy by the entirety). Thus, when a debtor files for bankruptcy the tenants by the entirety property becomes property of the estate. *Chippenham Hosp., Inc. v. Bondurant (In re Bondurant)*, 716 F.2d 1057, 1058 (4th Cir. 1983) (concluding that property of the estate includes property held as a tenant by the entirety); *Napotnik v. Equibank and Parkvale Sav. Assoc.*, 679 F.2d 316, 318 (3d Cir. 1982) (construing section 541 to include the debtor's interest in entireties property). The filing of a bankruptcy petition by one spouse does not sever the ownership as tenants by the entirety. See *In re Ford*, 3 B.R. 559, 570 (Bankr. D. Md. 1980), *aff'd sub nom. Greenblatt v. Ford*, 638 F.2d 14, 15 (4th Cir. 1981). Thus, while moneys disbursed under section 326(a) need not be property of the estate, moneys disbursed to a co-owner from the proceeds of property held with the debtor as tenants by the entirety are nevertheless property of the estate.

#### **II. Section 363(j) Lends Further Support to the Conclusion**

**that a Bankruptcy Trustee is Entitled to a Commission on Proceeds Distributed to a Non-Debtor Third-Party from the Liquidation of Property Owned with the Debtor.**

Reading sections 326(a) and 363(j) together lends further support to the conclusion that payment of moneys by a trustee from the liquidation of property owned by a debtor and a non-debtor third-party qualifies for inclusion as part of the calculation of the trustee’s commission. Together, sections 326(a) and 363 provide, among other things, the method for calculating the compensation of the trustee for carrying out his duties and statutory mechanisms for the trustee to carry out certain of his duties, including the means for the trustee to reduce property to money. See 11 U.S.C. sections 326(a) and 363 (b), (f), (g), (h).

Specifically, section 363(j) governs the distribution of the proceeds of a sale under sections 363(g) and (h) and provides that

After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor’s spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.

See 11 U.S.C. § 363(j). “The plain meaning of § 363(j) is that only costs and expenses which do not include the compensation of the trustee may be deducted from proceeds before they are divided.” *In re Flynn*, 418 F.3d 1005, 1007 (9th Cir. 2005). Thus, none of the trustee’s commission under section 326(a) may be deducted from the amount distributed to the co-owner, although

other costs of sale are charged against the proceeds of the sale prior to distribution. If the calculation of the trustee’s commission under section 326(a) did not include the portion distributed to the co-owner, the language specific to the trustee’s compensation in section 363(j) would be unnecessary because then no amounts would be chargeable to the non-debtor proceeds. Even though this may seemingly reduce the amounts payable to creditors of the bankruptcy estate, presumably the sale of the co-owned property is more beneficial to the estate than no sale at all. Accordingly, while the plain language of section 326(a) supports the conclusion that moneys distributed to a non-debtor constitutes “moneys disbursed or turned over” to a “party-in-interest,” reading section 326(a) in conjunction with section 363(j) provides additional statutory support for such a conclusion.

**CONCLUSION**

The disbursements to a non-debtor co-owner are properly included in the calculation of the trustee’s commission under section 326(a). The plain language of section 326(a) as well as the majority case law supports this conclusion and reading section 326(a) together with 363(j) lends further support. ■

**FOOTNOTES:**

<sup>1</sup> It should be recalled that section 330(a)(3), which identifies several factors to be considered in making determinations concerning the award of compensation payable to estate professionals, applies only to examiners, chapter 11 trustees, and professionals—but not chapter 7 trustees. Thus, while an award of chapter 7 trustee compensation must be approved by the court, the plain meaning of sections 326 and 330 compels an award of fees in the statutory commission amount absent exceptional circumstances.

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