

Delaware Bankruptcy Court Decision Supports Pathway to Make Chapter 11 Cases Less Expensive

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Section 1930(a)(6) of Title 28 requires the payment of quarterly fees to the United States Trustee (the “UST”) for each quarter that a bankruptcy case is open. The amount of fees is calculated based on the amount of disbursements made by the debtor during each quarter. But, are these fees payable when a trust, established by a confirmed plan, makes distributions rather than a debtor? This question was answered recently by Delaware Chief Bankruptcy Judge Sontchi who entered a letter ruling denying the UST’s motion to compel payment of additional fees under section 1930 for distributions made by a litigation trustee. Judge Sontchi’s ruling is likely to have an immediate impact upon plans of liquidation and post-confirmation trust documents.

The Facts

On February 14, 2016, Paragon Offshore plc (“Paragon”) and its affiliated debtors (collectively, the “Debtors”) filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. On June 7, 2017, the Court confirmed the Debtors’ fifth joint chapter 11 plan (the “Plan”). The Plan became effective on July 18, 2017 (the “Effective Date”).

The Plan established, among other things, the Paragon Litigation Trust (the “Trust”) to pursue claims against Noble Corporation plc (“Noble”) and others “for the benefit of holders of the Litigation Trust Interests.” After the transfer of the claims to the Trust, the Debtors and their estates agreed that they “will have no further interest in or with respect to the Trust Assets or the Litigation Trust.” The Litigation Trust Agreement, which sets forth the Trust’s rights, powers, and obligations, also became effective on the Effective Date.

For the quarters between July and September 2017 when the Plan became effective and the Debtors effectively transferred the Noble claims to the Trust, the Debtors’ distributions exceeded \$623 million. During those quarters, the Debtors paid the UST the maximum UST fee payable at the time.

In December of 2017, the Trust commenced actions against several Noble entities. After months of negotiations, during which Noble filed its own Chapter 11 case, the Trust settled its claims for \$90,375,000 and filed a motion with the Court seeking approval of the settlement. The Court approved the settlement with the Noble parties and on March 19, 2021, the Trust received the payments required under the settlement (the “Settlement Proceeds”).

The Trust then sought to make distributions to the holders of the Litigation Trust Interests in accordance with the Plan. On May 12, 2021, the UST filed a motion seeking to “compel Paragon and the Paragon litigation trust, as applicable, to pay all Quarterly Fees in full when due” in connection with the Settlement Proceeds. Given the dollar amount of the Settlement Proceeds, the motion sought to compel payment of \$250,000 in statutory fees to the UST.

The parties briefed the issue, and the Court held a hearing on the motion on June 10, 2021. The UST argued that, while this is technically not a disbursement made by the Debtors, the Trust does not exist in a vacuum without the Debtors and that the Trust was created by and exists to facilitate the Plan. Therefore, the UST reasoned, payments from the Trust are sufficiently tied to Debtors to entitle the UST to the applicable UST Fees. On the other hand, the Trust and the Debtors argued that the distribution of the Settlement Proceeds does not constitute a payment by or on behalf of any of the Debtors because the Trust is a separate entity.

The Court’s Holding Denying Further UST Fees

Judge Sontchi reviewed applicable case law on the definition of “disbursements” in the context of section 1930(a)(6) fees and found that the term is associated with “payments by or on behalf of the debtor” and is often understood to be “generated from the liquidation of the debtor’s assets.” The Court further explained that “the common thread that appears to bind many of those decisions together is the fact that the debtor had some interest in, or control over, the money disbursed.” (citing *In re Hale*, 436 B.R. 125, 130 (Bankr. E.D. Cal. 2010)).

With this in mind, Judge Sontchi ultimately denied the UST’s request for payment of additional statutory fees in connection with the Settlement Proceeds. The Court explained that the UST received the fees to which it was entitled under section 1930(a)(6) in July and September 2017 when the Debtors transferred assets to the Trust. The distribution of the Settlement Proceeds to Litigation Trust Beneficiaries, by contrast, are distributions by the Trust “for the benefit of holders of the Litigation Trust Interests,” not by or on behalf of the Debtors. Indeed, the Debtors disavowed any interest in the Trust Proceeds, as Trust Assets, and had no control over the Settlement Proceeds.

Takeaways

In denying the motion, the Court both praised the office of the UST for performing admirably its role as watchdog over the integrity of the bankruptcy process and simultaneously expressed profound disappointment in the UST’s attempt to “double, or triple, collect its tax” through “absurd[]” reasoning. If Judge Sontchi’s holding prevails, chapter 11 debtors who convey assets and claims to litigation trust will not need to close a bankruptcy case as soon as possible to limit the amount of UST Fees paid. To that end, Judge Sontchi’s analysis provides a good framework for drafting plans and litigation trust documents in order to disassociate the chapter 11 debtors from the succeeding trust. USTs on the other hand will be forced to argue claim valuation at the plan confirmation stage to ensure that the UST can recover the greatest possible UST Fees allowable on account of assets conveyed to a litigation trust.

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