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Post-Bankruptcy Compensation Standards for Receivers

Do Statutory Alternatives Make a Practical Difference?

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By and large, the Bankruptcy Code requires that administrative expense claims arise after a bankruptcy case commences and provide a post-petition benefit to the estate in order for such claims to achieve priority treatment over all other unsecured claims. One statutory exception is the claims of receivership estates when receivers remain in possession at the time that a bankruptcy petition is filed.

There are three distinct time periods that might apply to such situations: (1) the time period between the appointment of a receiver and the filing of a bankruptcy petition; (2) the time period between the petition date and the date that a receiver turns over property of the debtor and its proceeds to a trustee or debtor in possession; and (3) the time period after a receiver is no longer in possession of a debtor's property. The availability of at least two separate statutory bases for determining and awarding receiver compensation and reimbursement — namely §§ 543(c)(2) and 503(b)(3)(E) of the Bankruptcy Code — further complicates the proper resolution of such claims.

This article examines the facially conflicting standards under these Code sections. Next, it considers a recent case decided by the U.S. Bankruptcy Court for the Northern District of Illinois and analyzes the court's attempts to harmonize these sections into a coherent analytical framework. Finally, it shares the best practices in pragmatically addressing these standards and obtaining compensation and reimbursement.

The Unique Status of Receivers and the Conflicting Standards for Compensation and Reimbursement

State and federal court receivers expressly fall within the Code definition of a "custodian," which includes a "receiver ... of any property of the debtor appointed in a case or proceeding not under this title."[1] Unlike other parties-in-interest, custodians are subject to separate rules governing whether they are required to turn over estate property upon the commencement of a bankruptcy case. Section 543 provides the analytical framework for custodian turnover and court-excused compliance. If turnover compliance is excused under § 543(d), receivers will remain in possession of the debtor's property following the commencement of a case.

The Bankruptcy Code provides at least two separate statutory bases for determining and awarding compensation for services rendered by "custodians" and for the reimbursement of costs and expenses they incur: Sections 543(c)(2) and 503(b)(3)(E).[2] The linguistic differences in these statutory alternatives are present, but subtle. Section 543(c)(2) provides, in relevant part, as follows:[3]

> The Court, after notice and hearing, shall —
>
> (2) provide for the payment of *reasonable compensation* for services rendered and *costs and expenses* incurred by such custodian.[3]

By contrast, § 503(b)(3)(E) provides, in relevant part, as follows:

> After notice and a hearing, there shall be allowed, administrative expenses ... including —
>
> (3) *the actual, necessary expenses ...* incurred by —

1 11 U.S.C. § 101(11)(A).

2 Professionals retained by custodians (*i.e.*, attorneys and accountants) are subject to similar statutory uncertainty. Arguably, the governing standard for approval of compensation for services and reimbursement of expenses is subject to §§ 543(c)(1) and (c)(2) and 503(b)(4). *See In re Stainless Sales Corp.*, 583 B.R. 717 (Bankr. N.D. Ill. 2018) (ruling on fee application of professionals retained by assignee for benefit of creditors). The same holds true for allowing and paying pre-petition creditors of custodians, who have the facial options of proceeding under §§ 543(c)(1) and 503(b)(3)(E). *See In re Stainless Sales Corp.*, 579 B.R. 836 (Bankr. N.D. Ill. 2017) (analyzing claims of parties to whom assignee for benefit of creditors has become liable).

3 11 U.S.C. § 543(c)(2) (emphasis added).

(E) a custodian superseded under section 543 of this title, and *compensation* for the services of such custodian.[4]

Upon close scrutiny, these sections appear to contain different standards for allowing compensation for services rendered and reimbursement of costs incurred. Section 543(c)(2) requires that the applicant demonstrate that the requested compensation is "reasonable."[5] It is unclear whether § 543(c)(2) imposes any limitation upon requests for reimbursement of expenses.[6] By contrast, § 503(b)(3)(E) is silent with regard to what must be shown in order to receive "compensation for services," and only expressly requires that the applicant show that expenses were "actual" and "necessary."[7]

In addition to different standards for allowance, these Code sections could be construed to contemplate different mechanisms for their treatment and for the timing of payments. Section 503(b)(3)(E) could be construed to contemplate deferred payment, protected by the grant of an "administrative expense" priority. While not explicit, § 543(c)(2) could be construed to contemplate the possibility of an immediate payment.

Depending on how strongly a bankruptcy court adheres to strict statutory construction, the selection of the governing standard could result in a more lenient standard applying to compensation of services versus reimbursement of expenses. It could also affect the timing of when receivers obtain payment and reimbursement.

Recent Attempts to Harmonize These Different Standards

In *Montemurro*, the U.S. Bankruptcy Court for the Northern District of Illinois grappled with the determination of the appropriate standard for compensating a receiver that was still in possession on the petition date.[8] Prior to the bankruptcy, a building in Chicago was managed by two individuals, who owned the property through an Illinois land trust.[9] After the property became vacant and was otherwise unsafe, the City of Chicago commenced an abatement action in state court, where it sought and obtained the appointment of a receiver. The receiver was to prepare the property for demolition and raze the building. The receiver performed the primary duties set forth in various receivership orders when the owners of the building filed a joint individual chapter 11 case. As of the petition date, the receiver had not yet repaired a property line fence, nor had it filed papers for its compensation and reimbursement.

The receiver filed an application for allowance and payment of administrative expenses with respect to pre-petition and post-petition services and expenses. The bankruptcy court noted that a close reading of the statutory language in §§ 543(c)(2) and 503(b)(3)(E) points to differing standards for evaluating such applications.[10]

> **[A]pplicants should be prepared to demonstrate that custodians (and their professionals) seek "reasonable compensation" for services rendered and the reimbursement of "actual, necessary expenses."**

Section 543(c)(2) contemplates allowance of "reasonable" compensation, but is silent as to services. Section 503(b)(3)(E) does not speak to the yardstick for compensation, but requires a demonstration that expenses were "actual" and "necessary." However, the Bankruptcy Code's plain language provides no guidance as to the required conditions for applying one standard over the other.

To address this gap, the bankruptcy court held that the determination of the appropriate standard turns on the receiver's status and the source of the receiver's payment. If a receiver has been excused from compliance under § 543(d), then allowance of compensation is subject to the lower "reasonableness" standard of § 543(c)(2). If a receiver has been required to turn over the debtor's property (and is thus a "superseded custodian"), then the applicable standard turns on the source funding the receiver's request. If a receiver is to be paid with estate property, then the heightened standard of "actual and necessary" in § 503(b)(3)(E) should be followed. If a receiver is paid from another source, the lower "reasonableness" standard of § 542(c)(2) should apply.[11] In reaching this conclusion, the bankruptcy court turned to the phrase "provide for the payment of reasonable compensation for services rendered" as a signal that § 542(c)(2) contemplates funding from non-estate property.[12]

An Imperfect Solution to an Imperfect Statutory Scheme

The *Montemurro* approach is not without its problems. The determination of which Code section applies to a given set of facts appears to turn on the status of the custodian. Section 503(b)(3)(E) facially applies to "superseded" custodians (*i.e.*, those removed from possession of the debtor's property). Section 543(c)(2) contains no such limitation; it appears to apply equally to "superseded" custodians and those who are excused from turnover and remain in possession. If this is the "correct" interpretation of the statute, it might greatly influence receivers' incentives of whether or not to remain in possession, and potentially places their economic self-interest and fiduciary duties at odds.

As observed by one court, whether a custodian remains in possession should have no bearing on whether or not a cus-

4 11 U.S.C. § 503(b)(3)(E) (emphasis added).

5 The factors for determining reasonableness of a custodian's fees include:

> [T]he time and labor expended by the custodian; the benefit of the custodian's services to the debtor and the estate; the size and/or complexity of the estate; what the custodian would have received if he or she had been appointed as trustee for the debtor; and the quality of the custodian's services.

In re Forde, 507 B.R. 509, 521 (Bankr. S.D.N.Y. 2014).

6 *In re Montemurro*, 581 B.R. 565, 577-78 (Bankr. N.D. Ill. 2018).

7 In interpreting and applying § 503(b)(3)(E), courts have construed "actual" and "necessary" as requiring a benefit to the estate. *See Szwak v. Earwood (In re Bodenheimer, Jones, Szwak & Winchell LLP)*, 592 F.3d 664, 672-73 (5th Cir. 2009).

8 *See In re Montemurro*, 581 B.R. 565 (Bankr. N.D. Ill. 2018).

9 In an Illinois land trust, legal title to real property is held by a nominal trustee, which is often a financial institution while the beneficial interest is held by individuals or entities with full power to direct the management and disposition of the real property.

10 *See In re Montemurro*, 581 B.R. at 572.

11 *Id.* at 575-76.

12 *Id.* at 575.

todian should receive payment upon making an otherwise-proper application:

> It makes absolutely no sense to put the prepetition obligations of a receiver on a worse footing if a receiver is excused from turnover than if he is not. If it were otherwise, the receiver and the receivership creditors would be placed in the position of having an interest in whether or not turnover occurred, something which they should manifestly not have, and a position that has been rejected since long before the adoption of the Bankruptcy Code. The rights of the secured creditor who opposes turnover to the debtor would not be protected if the receiver, or the receivership creditors, opposed the secured creditor's position in order to protect their own.[13]

It is abundantly clear that the statutory framework for evaluating the claims of receivers is muddled and, as noted by Hon. **Timothy A. Barnes** in *Montemurro*, in desperate need of legislative overhaul.[14] Until that happens, how should receivers (and their professionals) navigate these interpretive uncertainties?

The answer to this question, in part, depends on whether the subtle differences in the wording of §§ 542(c)(2) and 503(b)(3)(E), practically speaking, make a difference in how professionals should prepare fee applications for receivers and argue for their allowance. The most conservative approach would be to argue that it does not matter which section governs. Instead, applicants should be prepared to demonstrate that custodians (and their professionals) seek "reasonable compensation" for services rendered and the reimbursement of "actual, necessary expenses."

It is difficult to imagine that one would (or should) advocate for the payment of "unreasonable compensation" or the reimbursement of "unnecessary expenses." Applicants likewise ought to demonstrate that their efforts, regardless of when they occurred, benefited the bankruptcy estate. Doing so mitigates against the risk of delay or denial of payment and reimbursement requests. abi

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13 *400 Madison Ave. Ltd. P'Ship*, 213 B.R. 888, 898-99 (Bankr. S.D.N.Y. 1997).
14 *In re Montemurro*, 581 B.R. at 576.