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Hon. Chief Judge Christopher S. Sontchi
United States Bankruptcy Court, District of Delaware
824 N. Market Street, 5th Floor
Wilmington, DE 19801

Re: *In re Paragon Offshore PLC (in administration)*, Case No. 16-10386

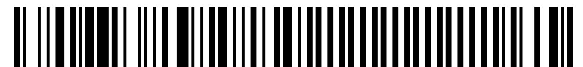
Dear Chief Judge Sontchi:

At the June 10, 2021 argument on the United States Trustee's motion to compel statutory fees pursuant to 28 U.S.C. § 1930, this Court questioned whether imposing fees against the Paragon Litigation Trust (the "Trust") would violate state trust law. The Trust believes it would. The Litigation Trust Agreement unambiguously provides that the Debtors irrevocably transferred their interests in any potential future settlement proceeds to the Trust "free and clear"—without a reversionary interest to or retention of control by Paragon. Under Delaware law (which applies here), a debtor's statutory requirement to pay fees while its chapter 11 case is open is not the kind of "in rem" obligation that "runs with" trust assets and can bind all successors. And there is no express federal command in section 1930(a) or elsewhere that can override state trust law in accordance with *Butner v. United States*, 440 U.S. 48 (1979). As a result, even if the Trust's payment of settlement proceeds to the Trust's beneficiaries could qualify as a "disbursement," state trust law precludes recovery of section 1930 fees from the Trust.

## I. The Trust's Property Interests Are Governed By Delaware Law.

The United States Trustee argues that the Trust is "liable for quarterly fees" because it "is the Debtors' successor, administrator, or assign with respect to the Noble claims." (D.I. 2244 ¶¶ 21-22.) The Trust is governed by Delaware law. (D.I. 1593, Ex. E-1 §10.3 ("This Agreement and the Litigation Trust created hereby shall be governed by and construed in accordance with the laws of the State of Delaware without giving effect to choice of law principles."). In *Butner*, the United States Supreme Court confirmed that "[p]roperty interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." 440 U.S. at 55. This principle applies equally to trusts. *See Goldberg v. N.J. Lawyers' Fund for Client Prot.*, 932 F.2d 273, 280 (3d Cir. 1991) (holding that whether "the trust relationship and its legal source exist" is "generally a question of state law"). Thus, "absent a countervailing federal interest, the basic federal rule is that state law governs" the





creation and scope of the property interests related to the Trust. *Integrated Sols., Inc. v. Serv. Support Specialties, Inc.*, 124 F.3d 487, 492 (3d Cir. 1997); *see also In re Net Pay Sols., Inc.*, 822 F.3d 144, 158 n.13 (3d Cir. 2016) ("Absent federal preemption, [courts] look to state law to determine the nature of a debtor's interest in property.").

As the movant, the United States Trustee bears the burden of proof. *In re Body Transit, Inc.*, 613 B.R. 400, 409 n.15 (Bankr. E.D. Pa. 2020) ("in general, absent a contrary provision in the Code or the Bankruptcy Rules, the movant bears the burden of proof when requesting relief from the court" (citation and quotation marks omitted)). Therefore, consistent with *Butner*, the United States Trustee must show that the Debtors' liability for quarterly fees passed to the Trust with the Trust Assets under Delaware law, or a clear "federal interest" requires preempting Delaware law to shift this obligation from the Debtor to the Trust. It cannot show either.

## II. Under Delaware Law, The Trust Assets Were Irrevocably Granted To The Trust And Were Not Burdened With An Obligation To Pay Paragon's Fees.

Under Delaware law, "[t]he intent of a settlor controls the interpretation of his trust." *In re Raymond L. Hammond Irrevocable Tr. Agreement*, 2016 WL 359088, at *4 (Del. Ch. Jan. 28, 2016). "The settlor's intent is drawn from language of the instrument, read as a whole, and in light of the circumstances surrounding its creation. Where the language of the trust is not ambiguous, the Court will not consider extrinsic evidence to construe the trust or determine the settlor's intent." *Id.*

Here, the settlor's intent is clear. The Litigation Trust Agreement defines "Trust Assets" as "the Noble claims and all proceeds thereon, vested in the Litigation Trust free and clear of Liens, charges, Claims, encumbrances, and other interests." (D.I. 1593, Ex. E-1 at 4.) Through this agreement, the Debtors—the settlors—"***unconditionally and irrevocably***" transferred "to the Litigation Trust all of their respective rights, title, and interests from time to time in and to [] the Trust Assets free and clear of all Claims, Liens, encumbrances, charges, and other interests." (*Id.* § 2.4 (emphasis added).) Paragon retained no "further interest in or with respect to the Trust Assets or the Litigation Trust" "[u]pon the transfer of the Trust Assets to the Litigation Trust." *Id.* The Litigation Trust Agreement also states that the Trust's "primary purposes" are "prosecuting and liquidating the Noble Claims and distributing the proceeds thereof for the benefit of the Litigation Trust Beneficiaries," not for the benefit of the Debtors. (*Id.* § 2.1.) Even Paragon agrees that it "does not have an interest in the cash being distributed by the Trust following the liquidation of the Noble Claims." (D.I. 2241 ¶ 14.) There is no doubt the settlor's intent was to irrevocably convey to the Trust the Trust Assets, including all settlement proceeds, for the benefit of the Litigation Trust Beneficiaries.

Moreover, just as a trust "cut[s] off control by the grantor," a grantor's liabilities do not automatically pass to a trust. *Husband C. v. Wife C.*, 391 A.2d 745, 746 (Del. 1978); *PHL*

*Variable Ins. Co. v. Price Dawe 2006 Ins. Tr., ex rel. Christiana Bank & Tr. Co.*, 28 A.3d 1059, 1078 (Del. 2011) (treating the terms "settlor or grantor" as synonyms). Rather, "the settlor's creditors generally cannot reach the trust property so long as the settlor is not also a beneficiary of the trust." Henry Hansmann & Ugo Mattei, *Trust Law in the United States. A Basic Study of Its Special Contribution*, 46 Am. J. Comp. L. Supp. 133, 139 (1998); *see also Holmes v. Wooley*, 792 A.2d 1018, 1022 (Del. Super. Ct. 2001) ("[A] creditor cannot have his debt satisfied out of property held in trust for another, no matter how completely his debtor may have exercised ownership over it"). For example, "[i]f a settlor, prior to the creation of the trust, made a contract which referenced the trust property, a trustee who later accepts the trust is not liable upon the contract unless he or she expressly assumed liability. The acceptance of the trust does not constitute an implied assumption of the liabilities of the settlor with regard to the trust res." Bogert's The Law of Trusts and Trustees § 719 (June 2021); *see also Paradee v. Paradee*, 2010 WL 3959604, at *10 (Del. Ch. Oct. 5, 2010) (citing Bogert favorably). The exception is if the settlor "fastened an in rem obligation on property which later became the trust res" such that this obligation "'runs with' the property." Bogert § 719 (explaining that "a settlor may have taken a conveyance of land subject to a restrictive covenant that binds later transferees of the land with notice, or the settl[o]r may have become a tenant and made covenants to pay rent or repair which obligate assignees of the leasehold interest"). Under Delaware law, restrictive covenants like this are "strictly construed" and only "recognized and enforced … where the parties' intent is clear and the restrictions are reasonable." *New Castle Cnty. v. Pike Creek Recreational Servs., LLC*, 82 A.3d 731, 745–46 (Del. Ch. 2013), *aff'd,* 105 A.3d 990 (Del. 2014).

These principles establish that Paragon's obligation to pay quarterly fees did not pass to the Trust with the Trust Assets. The Trust did not "expressly assume" this obligation from Paragon in the Litigation Trust Agreement. Instead, the Plan and Confirmation Order provide that "[e]ach and every one of the Debtors shall remain obligated to pay quarterly fees" until the end of the case. (D.I. 1614 ¶ 35; *id.* Ex. A § 12.5.) That Paragon and the United States Trustee have tried to shoehorn these mandatory statutory fees into the general categories related to "reasonable and documented" costs listed under "Litigation Trust Expenses" (D.I. 2241 ¶ 15; D.I. 2244 at 9 n.3) shows there is no "express" provision regarding these fees in the agreement.

Nor was the Debtors' statutory fee obligation "fastened" to the Trust Assets. To the contrary, the Debtors conveyed the Trust Assets "free and clear of all Claims, Liens, encumbrances, charges, and other interests." (D.I. 1593, Ex. E-1 § 2.4.) Indeed, it is difficult to see how section 1930 fees could travel in rem with Trust property—whether that property is cash, litigation trust interests, or litigation claims. Unlike an easement linked to specific real property, section 1930 fees are triggered by the total "disbursements" of a "particular debtor" in a given quarter for "each open and reopened case under chapter 11 of title 11 … until the case is closed, converted, or dismissed." 28 U.S.C § 1930(a)(6)(B)(i); *Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.)*, 402 F.3d 416, 422 (3d Cir. 2005); (*accord* D.I. 1614 ¶ 35 (tying the obligation to pay fees to when "that particular Debtors case" ends); *id.* Ex.

A § 12.5 (same)). "UST quarterly fees" are not based on settlements, but "are user fees associated with the debtors' use of the bankruptcy system." *In re Exide Techs.*, 611 B.R. 21, 32 (Bankr. D. Del. 2020). The Trust's payment of settlement proceeds has no bearing on whether Paragon's chapter 11 case remains open. And there is no provision in the Litigation Trust Agreement that shows Paragon's "clear" intent to burden future settlement proceeds that might never materialize with a covenant to pay such statutory user fees. *See Genger v. TR Invs., LLC*, 26 A.3d 180, 198 (Del. 2011) (holding that an agreement to vote a specific person as a proxy for all stock "now or hereafter owned by the Trust" could not bind "any *subsequent* owner of those shares").

Because the Debtors intended to "irrevocably" convey the Trust Assets to the Trust "free and clear" of encumbrances, the Trust did not expressly assume the Debtors' fee obligation, and the Trust Assets were not burdened with this obligation as a restrictive covenant, Delaware law precludes repurposing the Trust Assets to satisfy Paragon's statutory fee obligation.

**III. No Countervailing Federal Interest Requires Relieving A Debtor Of Its Obligation To Pay Statutory Fees And Shifting That Burden To A Litigation Trust.**

The United States Trustee also cannot show that any "federal interest requires a different result" from Delaware law. *Butner*, 440 U.S. at 55. Indeed, the United States Trustee has already admitted it is "generally agnostic about who pays the quarterly fees." (D.I. 2244 ¶ 1.) If the "watchdog" with "responsibility to enforce the laws as written by Congress" is indifferent about this question (D.I. 2231 ¶ 3), this Court has no reason to override state law.

Even apart from the United States Trustee's agnosticism, no countervailing federal interest justifies shifting the burden to pay statutory fees from the Debtors to the Trust. To start, the statute directs the obligation to pay fees to the "parties commencing a case under title 11." 28 U.S.C. § 1930(a). As the cases cited by the United States Trustee show, the fact that this language appears only in section (a) but not subsection (a)(6) is irrelevant. *See U.S. Tr. v. Pettibone Corp.*, 251 B.R. 335, 344 (N.D. Ill. 2000) ("While the language of the statute does change from active to passive voice in subsection (a)(6), there is no indication that Congress intended to depart from the initial focus on 'the parties commencing the case.'") (cited at D.I. 2244 ¶ 8). In fact, if subsection (a)(6) applied to anyone other than debtors, it would create a non-uniformity with "districts that are not part of a United States trustee region," since subsection (a)(7) mandates that "the Judicial Conference of the United States shall require ***the debtor in a case*** under chapter 11 of title 11 to pay fees equal to those imposed by paragraph (6) of this subsection." 28 U.S.C. § 1930(a)(7) (emphasis added). Far from showing a focus on trusts, the relevant federal interests as defined by section 1930 point squarely at debtors.

Furthermore, the United States Trustee's own cases underscore that any federal interests in quarterly fees do not require overriding state law—even if it decreases the federal

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government's recovery. In *In re Meyer* (cited at D.I. 2231 ¶ 25), the court first assessed whether a husband (the debtor) and his estranged wife (a non-debtor) held their property as tenants by the entirety under Missouri law. 187 B.R. 650, 652 (Bankr. W.D. Mo. 1995). Because this state law finding dictated that "only one-half of the proceeds of the sale of the Real Estate became property of the bankruptcy estate," the court held that only "one-half of the disbursements to secured creditors in satisfaction of their liens came from the bankruptcy estate" and could be counted as a "distribution subject to quarterly fees." *Id.* at 652-53. The court did not conclude it was necessary to override state law for the purpose of maximizing section 1930 fees or add the wife as a supplemental source to recover fees. Similarly, courts refuse debtors who seek to shift statutory fees to a trust without any suggestion that doing so potentially contravenes some federal policy. *See Pettibone*, 251 B.R. at 344 (rejecting debtors' argument that a product liability liquidating trust "should be responsible for the fees because it is the administration of the Trust that is causing the case to remain open," noting the Plan language "requiring [the debtor], not the [Product Liability] Trustee, to pay pre-confirmation fees lends support to the conclusion that [the debtor] is responsible for post-confirmation fees due under the amended statute").

In short, there is no federal interest in preempting state trust law for the sole purpose of relieving debtors of their obligation to pay statutory quarterly fees under section 1930. The interests all cut the other way: state law should be left undisturbed under *Butner* because the federal interests in paying statutory fees—under section 1930, the Plan, and Confirmation Order—rest solely with "the Debtors." (D.I. 1614 ¶ 35; *id.* Ex. A § 12.5.)

## IV. Conclusion

Accordingly, apart from having no liability under federal bankruptcy law, the Trust is also not liable for section 1930 quarterly fees as a matter of Delaware law because the Debtors' liability for fees did not transfer with the Trust Assets and no federal interest warrants overriding that outcome "simply because an interested party is involved in a bankruptcy proceeding." *Butner*, 440 U.S. at 55.

Sincerely,

Jeffrey J. Zeiger, P.C.