

# CHAPTER 11 TRUSTEE HANDBOOK



*May 2004*

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## U.S. Department of Justice

Executive Office for United States Trustees

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Office of the Director

Washington, DC 20530

### **ACKNOWLEDGEMENTS**

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It is hoped that this *Handbook* will contribute to the advancement of understanding and competence in the Chapter 11 Trustees' administration of cases.



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**CHAPTER 1: INTRODUCTION**

**A. PURPOSE**

The United States Trustee<sup>1</sup> is charged with the responsibility of supervising the administration of cases and trustees in cases under chapters 7, 11, 12, and 13 of title 11 of the United States Code (the Bankruptcy Code). Further, upon the court's determination that the appointment of a chapter 11 trustee is appropriate, it is the duty of the United States Trustee to appoint the trustee after consultation with the parties. The appointment must be approved by the court. A chapter 11 trustee assumes management and control of the bankruptcy estate from the debtor, and serves as a fiduciary responsible to the various parties in interest in the case. It is the goal of the United States Trustee to appoint trustees who will capably and expeditiously administer the estate for the benefit of creditors, exercise appropriate business and professional judgment, and fully comply with the provisions of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure (the Bankruptcy Rules), and the policies of the United States Trustee.

This Handbook represents a statement of operational policy, and is intended as a working manual for chapter 11 trustees appointed (or elected) and supervised by the United States Trustee. This Handbook is not intended to represent a complete statement of the law. It should not be used as a substitute for legal research and analysis. The trustee also should be familiar with the Bankruptcy Code, the Bankruptcy Rules, any local bankruptcy rules, and relevant case law.<sup>2</sup>

**B. THE BANKRUPTCY LAWS**

The Bankruptcy Code consists of eight chapters.

- Chapter 1: General Provisions
- Chapter 3: Case Administration
- Chapter 5: Creditors, the Debtor and the Estate
- Chapter 7: Liquidation
- Chapter 9: Adjustment of Debts of a Municipality
- Chapter 11: Reorganization
- Chapter 12: Adjustment of Debts of a Family Farmer with Regular Annual Income
- Chapter 13: Adjustment of Debts of an Individual with Regular Income

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<sup>1</sup> All references to United States Trustee shall include the United States Trustee's designees, unless otherwise indicated. See 11 U.S.C. § 102(9) ("United States [T]rustee" includes designee).

<sup>2</sup> All statutory references herein refer to the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (2003), unless otherwise indicated.



The provisions of chapters 1, 3, and 5 apply to all cases under chapters 7, 11, and 13, and with the exception of § 361, apply to cases under chapter 12. The provisions of chapters 7, 9, 11, and 13 apply only to cases under each specific chapter. A chapter 11 trustee is concerned primarily with chapters 1, 3, 5, and 11, but should also be familiar with the other chapters.

### **C. JURISDICTION AND VENUE**

Pursuant to 28 U.S.C. § 1334, the district court has original and exclusive jurisdiction of all cases under title 11.

All bankruptcy cases and all proceedings arising under, arising in, or related to a title 11 case may be automatically referred by rule or order of the district court to the bankruptcy court, pursuant to 28 U.S.C. § 157(a). Section 157 makes further distinctions by the use of the terms “core” and “non-core” proceedings. See 28 U.S.C. § 157(b), (c). Bankruptcy judges may hear and determine, subject to appeal, all cases under title 11 and core proceedings arising under or in a title 11 case. 28 U.S.C. § 157(b)(1). The bankruptcy judge may also hear non-core proceedings that are “otherwise related to” cases under title 11, but the judge’s findings of fact and conclusions of law must be submitted to the district court for entry of the final order unless the parties agree to the entry of a final order or judgment by the bankruptcy court. 28 U.S.C. § 157(c).

The appropriate venue for a bankruptcy case is governed by 28 U.S.C. § 1408, which establishes four alternate tests: (1) the location of the debtor’s domicile; (2) the location of the debtor’s residence; (3) the location of the debtor’s principal place of business; or (4) the location of the debtor’s principal assets in the United States. 28 U.S.C. § 1408(1). Venue is also appropriate in the district in which one of these tests has been satisfied for the 180-day period preceding the filing, or in the district in which one of these tests has been satisfied for the longest portion of the 180-day period preceding the filing. *Id.* Venue is also appropriate in the district in which there is a pending bankruptcy case concerning the debtor’s affiliate, general partner, or partnership. 28 U.S.C. § 1408(2).

### **D. ROLE OF THE UNITED STATES TRUSTEE**

Prior to the enactment of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended in 11 U.S.C.), bankruptcy “referees” were involved in the day-to-day responsibilities of case administration. In the early 1970s, the Brookings Institution conducted an independent study of the referee system and reported, in part, that there was an appearance of political patronage in the appointment of trustees, that the quality of trustees appointed varied greatly, and that, in some instances, actions taken by trustees resulted in more of an economic benefit to the trustee than to the creditors. Further, debtors, creditors, and third parties litigating against bankruptcy trustees were concerned that the court, which previously had appointed and supervised trustees, might not impartially adjudicate their rights as adversaries of that trustee. To address all of these concerns, Congress assigned administrative functions within

the bankruptcy system to the United States Trustee Program in 1978. The United States Trustee Program began on October 1, 1979, the effective date of the 1978 Act, but only as a pilot program in eighteen judicial districts. The United States Trustee Program expanded to every judicial district with the exception of those in North Carolina and Alabama with the passage of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986). Pursuant to the Federal Courts Improvement Act of 2000, Pub. L. No. 106-518, 114 Stat. 2410 (2000), judicial districts in North Carolina and Alabama will only become part of the Program if they elect to do so, and none have done so to date.

The United States Trustee Program acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. It works to secure the just, speedy, and economical resolution of bankruptcy cases; monitors the conduct of parties and takes action to ensure compliance with applicable laws and procedures; identifies and investigates bankruptcy fraud and abuse; and oversees administrative functions in bankruptcy cases.

28 U.S.C. § 586 provides, in pertinent part, that each United States Trustee shall:

- (1) establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11;
- (2) serve as and perform the duties of a trustee in a case under title 11 when required under title 11 to serve as trustee in such a case;
- (3) supervise the administration of cases and trustees in cases under chapter 7, 11, 12, or 13 of title 11 by, whenever the United States trustee considers it to be appropriate –
  - (A) (i) reviewing, in accordance with procedural guidelines adopted by the Executive Office of the United States Trustee (which guidelines shall be applied uniformly by the United States trustee except when circumstances warrant different treatment), applications filed for compensation and reimbursement under section 330 of title 11; and
  - (ii) filing with the court comments with respect to such application and, if the United States Trustee considers it to be appropriate, objections to such application.
- (B) monitoring plans and disclosure statements filed in cases under chapter 11 of title 11 and filing with the court, in connection with hearings under sections 1125 and 1128 of such title, comments with respect to such plans and disclosure statements;

- (C) monitoring plans filed under chapters 12 and 13 of title 11 and filing with the court, in connection with hearings under sections 1224, 1229, 1324, and 1329 of such title, comments with respect to such plans;
  - (D) taking such action as the United States trustee deems to be appropriate to ensure that all reports, schedules, and fees required to be filed under title 11 and this title by the debtor are properly and timely filed;
  - (E) monitoring creditors' committees appointed under title 11;
  - (F) notifying the appropriate United States attorney of matters which relate to the occurrence of any action which may constitute a crime under the laws of the United States and, on the request of the United States attorney, assisting the United States attorney in carrying out prosecutions based on such action;
  - (G) monitoring the progress of cases under title 11 and taking such actions as the United States trustee deems to be appropriate to prevent undue delay in such progress; and
  - (H) monitoring applications filed under section 327 of title 11 and, whenever the United States trustee deems it to be appropriate, filing with the court comments with respect to the approval of such applications;
- (4) deposit or invest under section 345 of title 11 money received as trustee in cases under title 11;
  - (5) perform the duties prescribed for the United States trustee under title 11 and this title, and such duties consistent with title 11 and this title as the Attorney General may prescribe; and
  - (6) make such reports as the Attorney General directs.

28 U.S.C. § 586(a).

**CHAPTER 2: APPOINTMENT OF TRUSTEE**

Pursuant to § 1104(d), and in keeping with the bifurcation of administrative and adjudicative roles in the bankruptcy system, it is the duty of the United States Trustee to appoint one disinterested person, other than the United States Trustee, to serve as the chapter 11 trustee, if the court determines that it is appropriate.

**A. 11 U.S.C. § 1104, APPOINTMENT OF TRUSTEE OR EXAMINER**

**1. Trustee**

Section 1104(a) provides that the court shall order the appointment of a chapter 11 trustee at any time after a case is filed, but before a plan is confirmed, upon a motion of any party in interest or the United States Trustee, if after notice and a hearing the court finds (1) that cause exists, or (2) that such appointment would be in the best interest of creditors, equity security holders, and other interests of the estate. 11 U.S.C. § 1104(a). Cause includes, but is not limited to, fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management either before or after the commencement of the case. 11 U.S.C. § 1104(a)(1). The appointment of a chapter 11 trustee is generally considered an extraordinary remedy. Thus, although the provision is mandatory, a finding of sufficient cause for the appointment of a trustee is within the discretion of the bankruptcy judge.

If the court orders the appointment of a chapter 11 trustee, the United States Trustee, after consultation with the parties, will appoint one disinterested person to serve in that capacity, subject to court approval. 11 U.S.C. § 1104(d). The United States Trustee may, but is not required, to appoint a member of the chapter 7 panel of trustees to serve as a chapter 11 trustee. Further, in a case converted from chapter 7, the United States Trustee may, but is not required, to appoint a predecessor chapter 7 trustee as the chapter 11 trustee.

**2. Examiner**

Section 1104(c) provides that:

If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or

irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if –

- (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or
- (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed \$5,000,000.

11 U.S.C. § 1104(c). If the court orders the appointment of an examiner, the appointment of one disinterested person is made by the United States Trustee after consultation with the parties and subject to court approval. 11 U.S.C. § 1104(d).

## **B. ROLE OF THE TRUSTEE OR EXAMINER**

Upon court approval of the appointment, and fulfillment of the qualifications set forth in § 322, the trustee assumes control over the assets and business operations of the debtor. The trustee is an independent third party who “steps into the shoes” of the debtor’s management and becomes a fiduciary with an obligation of fairness to all parties in the case. Unless the court orders otherwise, by statute, a chapter 11 trustee is authorized to operate the debtor’s business. 11 U.S.C. § 1108. Further, a trustee is charged with certain duties under §§ 1106 and 704(2), (5), (7), (8), and (9) (incorporated by reference), as well as additional duties that will be discussed in Chapter 6, *infra*. The trustee has an obligation to obtain a bond conditioned upon the faithful performance of the trustee’s duties, in an amount determined by the United States Trustee, 11 U.S.C. § 322; safeguard the assets of the debtor, 11 U.S.C. § 704(2); provide adequate information to parties in interest, 11 U.S.C. § 704(7); and shepherd the case to resolution, 11 U.S.C. 704(1). *See* 11 U.S.C. § 1106(a)(1) (incorporating sections of § 704).

The role of an examiner in chapter 11 is generally more limited than that of a chapter 11 trustee and normally does not involve an assumption of control of the debtor’s business. An examiner may be directed to investigate the acts, conduct, assets, liabilities, business operations, and financial condition of the debtor. 11 U.S.C. § 1106(b) (incorporating § 1106(a)(3)). Unless otherwise directed, the examiner will assess the desirability of the continuance of the debtor’s business and any other matter that might be relevant to the case or the formulation of a plan. *Id.* In addition, an examiner is required to prepare and file a statement or report of any investigation, including “any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate.” *Id.* (incorporating § 1106(a)(4)(A)). The examiner is required to provide a copy or summary of a statement or report to any official committees of creditors or equity security holders, any indenture trustee, or any other entity that the court designates. *Id.* (incorporating § 1106(a)(4)(B)). The report should also be provided to the United States Trustee. The scope of the examiner’s investigation may be limited and discrete, or broad and multifaceted,

depending on the facts of the particular case and the order of the court. *See* 11 U.S.C. § 1106(b) (court may order examiner, rather than debtor in possession, to perform other “trustee” duties).

### C. SELECTION PROCESS

Upon a determination by the court that appointment of a chapter 11 trustee is appropriate, the United States Trustee commences the selection process. Pursuant to § 1104(d), the United States Trustee consults with the parties in interest, typically either in person or by telephone, to identify potential candidates. Thereafter, the United States Trustee has the discretion to interview some or all of the candidates and conduct appropriate inquiries to determine whether the candidate is qualified to perform the duties of a trustee in a particular case and whether the candidate is disinterested.

Although the United States Trustee appoints the chapter 11 trustee, the appointment is not effective until approved by the court. *See* 11 U.S.C. § 1104(d) (appointment subject to court’s approval). The United States Trustee files an application for the approval of the appointment of the trustee that sets forth the name of the appointee; a statement by the United States Trustee regarding the appointee’s known connections with the debtor, creditors, and other parties in interest, their respective attorneys and accountants, the United States Trustee, and any persons employed by the United States Trustee; and a list of the parties in interest with whom the United States Trustee consulted regarding the appointment. Fed. R. Bankr. P. 2007.1(c); *see also* Fed. R. Bankr. P. 2007.1(a) (motion to be made in accordance with Rule 9014); Fed. R. Bankr. P. 9014 (governing procedure in contested matters). If the trustee was elected rather than appointed, and the election is not disputed, the United States Trustee will file an application seeking approval of the appointment of an “elected” trustee. *See* Fed. R. Bankr. P. 2007.1(b)(3)(A). In either case, the application must be accompanied by a verified statement of the proposed trustee setting forth all connections with the persons listed above. *See* Fed. R. Bankr. P. 2007.1(c).

While § 1104(d) grants the court authority to approve the United States Trustee’s appointment of a chapter 11 trustee or examiner, the scope of the court’s review is limited. *See In re Lathrop Mobile Investors*, 55 B.R. 766, 768-69 (B.A.P. 9th Cir. 1985). In determining whether to approve an appointment, it is permissible for the court to consider factors including (1) whether the United States Trustee has properly consulted with parties in interest; (2) whether the appointee is a disinterested person; and (3) whether the United States Trustee has abused his/her discretion by appointing an unqualified or inexperienced person. *See In re Capital Servs. & Invs., Inc.*, 90 B.R. 382, 384-86 (Bankr. C.D. Ill. 1988). The court may not usurp the appointment process or otherwise seek to supplant the judgment exercised by the United States Trustee during that process. *See In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 830-32 (1st Cir. 1990).

### **CHAPTER 3: QUALIFICATIONS AND ACCEPTANCE**

#### **A. GENERALLY**

A chapter 11 trustee or examiner must be a “disinterested person,” successfully complete a background investigation, and, in the case of a trustee, post a bond. In addition, pursuant to § 321(a), the trustee must be competent to perform the statutory duties set out in § 1106, which are discussed in more detail in Chapter 6, *infra*. Additional considerations for the selection will be based on the unique circumstances of the specific case. The unique circumstances of the case frequently dictate the terms of the court order directing the appointment.

Some persons are automatically precluded from serving as a trustee or examiner. For example, an examiner appointed in a case may not serve as a trustee in the same case, 11 U.S.C. § 321(b); and the United States Trustee is precluded from serving as either a chapter 11 trustee, 11 U.S.C. §§ 321(c), 1104(d), or examiner, 11 U.S.C. § 1104(d). Finally, relatives of the United States Trustee in the region where the case is pending, or of the bankruptcy judge approving the appointment, are ineligible to serve. Fed. R. Bankr. P. 5002(a).

The United States Trustee does not select the chapter 11 trustee or examiner in isolation from other parties in the case. Section 1104(d) requires the United States Trustee to consult with the parties in interest prior to the appointment. 11 U.S.C. § 1104(d). The United States Trustee will give full and fair consideration to each candidate. Although the United States Trustee is not required to select one of the candidates nominated by the parties, the qualifications of the person(s) recommended and the views of parties in interest will be given due consideration. Further, unsecured creditors may seek the election of a trustee if they are dissatisfied with the United States Trustee’s selection. *See* Chapter 4, *infra*.

#### **B. A TRUSTEE OR EXAMINER MUST BE A “DISINTERESTED PERSON”**

The word “person” is defined at § 101(41) and includes partnerships and corporations, as well as individuals. Pursuant to § 321(a)(2), partnerships and corporations that are authorized by their charters or bylaws to act as trustee are eligible to serve as trustees. However, the United States Trustee generally appoints individuals.

The term “disinterested person” is defined at § 101(14). The trustee or examiner must not be one of the following:

- a creditor, equity security holder, or insider (which includes relatives of an individual debtor and persons in control of a debtor that is a corporation or partnership; see § 101(31) for definition of “insider”);

- an investment banker for any outstanding security of the debtor, either at present or at any time in the past;
- an investment banker for a security of the debtor within three years before the filing of the petition, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;
- a present director, officer, or employee of the debtor or of the debtor's investment banker;
- a former director, officer, or employee of the debtor or of the debtor's investment banker within the two years prior to the date of the filing of the petition;
- a person holding an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in the debtor or the debtor's investment banker or attorney for the debtor's investment banker.

See 11 U.S.C. § 101(14).

### **1. Full Disclosure**

When the United States Trustee files an application for court approval of the appointment of a trustee or examiner, the application must be accompanied by an affidavit of the person being appointed. Fed. R. Bankr. P. 2007.1(c). The application and affidavit must describe all of the connections of the proposed trustee or examiner to other persons involved in the case. *Id.* This allows the bankruptcy judge to ensure that the person appointed satisfies all the requirements for appointment, particularly the requirement of disinterestedness. Because the determination of "disinterestedness" can turn on so many variables, it is imperative that the trustee or examiner candidate disclose all connections to the debtor, all other parties, and all professionals in the case prior to selection. Determining these connections early in the process will also facilitate the appointment approval process if the person is selected.

In addition to the United States Trustee's application, Bankruptcy Rule 2007.1 also requires the designated person to submit a verified statement listing all connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, and any employee of the United States Trustee. *Id.* Although the term "connections" is not defined in the rules, the Advisory Committee note accompanying Bankruptcy Rule 2007.1 contains the following explanation:

The requirement that connections with the United States trustee or persons employed in the United States trustee's office be revealed is not intended to enlarge



the definition of “disinterested person” in § 101(13) [redesignated as § 101(14)] of the Code, to supersede executive regulations or other laws relating to appointments by United States trustees, or to otherwise restrict the United States trustee's discretion in making appointments. This information is required, however, in the interest of full disclosure and confidence in the appointment process and to give the court all information that may be relevant to the exercise of judicial discretion in approving the appointment of a trustee or examiner in a chapter 11 case.

Fed. R. Bankr. P. 2007.1 Advisory Committee Note (1991).

A former employee of the United States Trustee's office responsible for the case, or anyone with a past professional relationship with either the United States Trustee or an employee of the United States Trustee in the region where the case is pending, must disclose that relationship. Other factors may be significant and any reasonable doubts regarding the relevance of a particular set of circumstances should be resolved in favor of full disclosure. *See In re The Leslie Fay Cos., Inc.*, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994).

## **2. Full Disclosure – A Continuing Obligation**

The determination of “disinterestedness” does not end with the appointment. Any new connections that the trustee or examiner, or any professional employed by the trustee or examiner, establishes or discovers after appointment should be brought to the attention of the court and the United States Trustee through the filing of a supplemental verified statement. *See e.g., In re Granite Partners, L.P.*, 219 B.R. 22, 35 (S.D.N.Y. 1998) (Rule 2014 and § 327 contain implied duty of continuing disclosure). Failure to reveal connections that are later determined to have rendered the trustee or examiner not “disinterested” could result in removal as well as the denial or disgorgement of compensation. *See* 11 U.S.C. §§ 327, 328; *United States v. Schilling (In re Big Rivers Elec. Corp.)*, 355 F.3d 415 (6<sup>th</sup> Cir. 2004).

## **3. Conflicts and Related Estates**

In the interest of judicial economy and cost reduction, a single trustee is sometimes appointed to serve in two or more related chapter 11 cases. *See* Fed. R. Bankr. P. 2009(c)(2). Generally, the trustee appointed in multiple cases will employ the same set of professionals to represent each of the related estates. However, both the trustee and the professionals appointed to serve in more than one related case must be extremely sensitive to the independent duty imposed upon them to identify and disclose any actual or potential conflicts among the estates.

Although some courts have determined that multiple representation in related estates creates a rebuttable presumption that the representation is *per se* improper, *see, e.g., In re Lee*, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988), the greater weight of authority favors a case by case

review of the facts to determine the propriety of the representation. *See In re BH&P, Inc.*, 949 F.2d 1300, 1312 (3d Cir. 1991) (citing *In re Martin*, 817 F.2d 175 (1<sup>st</sup> Cir. 1987)).

Whenever the interests of separate, related estates diverge, the trustee should immediately consult with the United States Trustee and file such disclosures as are necessary and appropriate to protect each estate and the trustee from charges of a lack of “disinterestedness.” Based on the particular facts, a trustee appointed in multiple cases may be required to resign from one or more of the cases. *Accord* Fed. R. Bankr. P. 2009(d) (court shall order separate trustees for jointly administered estates where conflict of interest).

### **C. BACKGROUND INVESTIGATION**

All persons appointed to serve as trustees or examiners in a chapter 11 case must undergo a security background investigation. In addition to the initial application form, the appointee is required to complete an affidavit in a format prescribed by the Executive Office for United States Trustees and provide the information necessary for completion of name, fingerprint, tax, and credit checks. This information will be forwarded by the local Office of the United States Trustee to the Office of Review and Oversight (“ORO”), Executive Office for United States Trustees, within ten working days after an appointment is made. If additional or clarifying information is needed, ORO will contact the United States Trustee who will then notify the appointee. The resolution of questionable information may require an affidavit from the trustee or examiner, and/or additional information or documents.

New security application forms are not required if a background investigation is in progress or has been completed within the preceding five years in connection with another chapter 11, chapter 7, or standing trustee appointment.

### **D. BOND**

To qualify as a chapter 11 trustee, the trustee must post a bond in favor of the United States of America within five days after selection. 11 U.S.C. § 322(a). The initial amount and sufficiency of the bond is determined by the United States Trustee, 11 U.S.C. § 322(b)(2); however, it is the trustee’s duty to monitor the bond and ensure that it is maintained in an appropriate amount throughout the pendency of the case. The United States Trustee can assist the trustee in obtaining a bond by providing contact with bonding companies used by other trustees. If the trustee wishes to obtain a bond from a different company, the trustee must ensure that the company appears on Treasury Circular 570, which lists those companies holding certificates of authority as acceptable sureties on federal bonds. Only companies appearing on this list are approved by the United States Trustee as sureties on trustee bonds.

**CHAPTER 4: TRUSTEE ELECTIONS**

**A. REQUESTS FOR § 341 MEETING**

Pursuant to § 1104(b), any party in interest may request that the United States Trustee convene a meeting of creditors for the purpose of electing a chapter 11 trustee. 11 U.S.C. § 1104(b). The request must be made no later than thirty days after the court orders the appointment of a trustee under § 1104(a) and must be filed with the clerk of the bankruptcy court with a copy transmitted to the United States Trustee. *Id.*; Fed. R. Bankr. P. 2007.1(b)(1). The United States Trustee shall preside at the meeting of creditors, which must be recorded. Fed. R. Bankr. P. 2003(b)(1), (c). Pending the court’s approval of any person elected, the trustee who is appointed by the United States Trustee and approved by the court, shall serve as trustee. Fed. R. Bankr. P. 2007.1(b)(1).

**B. REQUESTS FOR ELECTIONS AND VOTING REQUIREMENTS**

Section 1104(b) states “[t]he election of a trustee shall be conducted in the manner provided in subsections (a), (b), and (c) of section 702 of this title.” 11 U.S.C. § 1104(b). Section 702(b) provides: “[C]reditors may elect one person to serve as trustee in the case if election of a trustee is requested by creditors that may vote under subsection (a) of this section, and that hold at least 20 percent in amount of the claims specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section.” 11 U.S.C. § 702(b). Therefore, although any single party in interest may request the United States Trustee to convene a meeting of creditors to elect a trustee, the twenty percent “requesting” requirement of § 702(b) must be met to validate any election result.

Pursuant to § 702(a), creditors are eligible to request and vote in an election only if they hold general unsecured claims that are allowable, undisputed, fixed, and liquidated and entitled to distribution under specified Code sections. *See* 11 U.S.C. § 702(a)(1). Further, a creditor will not be permitted to vote if the creditor is an insider or holds an interest materially adverse to the estate and its other creditors. 11 U.S.C. § 702(a)(2), (3). If qualified creditors holding twenty percent of the claims eligible to vote at an election request an election, § 702(c)(1) then requires that qualified creditors holding at least twenty percent in amount of the claims specified in § 702(a) actually vote in the election for the election to be valid.

**C. SOLICITATION OF PROXIES**

Not all creditors who wish to vote for a trustee will be present at the election. In cases with a significant number of creditors, the election is likely to be requested by a creditor holding

proxies. A proxy is defined in Bankruptcy Rule 2006(b)(1)<sup>3</sup> as a “written power of attorney authorizing any entity to vote the claim or otherwise act as the owner’s attorney in fact in connection with the administration of the estate.” Fed. R. Bankr. P. 2006(b)(1). The validity of a proxy is determined under Bankruptcy Rule 9010(c) and proxy holders who have solicited proxies for voting at the election of a trustee must follow the specific provisions set forth in the rules. See Fed. R. Bankr. P. 2006, 9010. The rules regulating the solicitation of proxies are strictly enforced to ensure that a trustee is elected only in cases where there is true creditor interest.

### **1. Authorized Solicitation**

A proxy may be solicited only in writing and only by the following individuals or committees: (A) a creditor owning an allowable unsecured claim against the estate on the date of the filing of the petition; (B) a committee elected pursuant to § 705 of the Code; (C) a committee of creditors selected by a majority in number and amount of claims of creditors (i) whose claims are not contingent or unliquidated, (ii) who are not disqualified from voting under § 702(a) of the Code, and (iii) who were present or represented at a meeting of which all creditors having claims of over \$500 or the 100 creditors having the largest claims had at least five days notice in writing and of which meeting written minutes were kept and are available reporting the names of the creditors present or represented and voting and the amounts of their claims; or (D) a bona fide trade or credit association, but such association may solicit only creditors who were its members or subscribers in good standing and had allowable unsecured claims on the date of the filing of the petition. Fed. R. Bankr. P. 2006(c). A committee of unsecured creditors appointed under § 1102 is also entitled to solicit a proxy for the purposes of the election of a chapter 11 trustee. See *In re Aspen Marine Group, Inc.*, 189 B.R. 859, 862 (Bankr. S.D. Fla. 1995).

### **2. Solicitation Not Authorized**

Bankruptcy Rule 2006(d) expressly prohibits solicitation (1) by an entity holding any interest other than that of a general creditor; (2) by or on behalf of any custodian; (3) by the interim trustee (or in a chapter 11 case, the chapter 11 trustee appointed by the United States Trustee), or by or on behalf of any entity not qualified to vote under § 702(a); (4) by or on behalf of a transferee of a claim for collection only; and (5) by or on behalf of an attorney at law. Fed. R. Bankr. P. 2006(d). This rule does not regulate communications between an attorney and the attorney’s regular clients. Fed. R. Bankr. P. 2006(b)(2).

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<sup>3</sup> Although Bankruptcy Rule 2006(a) specifically states that the Rule applies only to liquidation cases under chapter 7, Rule 2007.1(b)(2) makes portions of Rule 2006 applicable to the election of trustees in a chapter 11 case. Fed. R. Bankr. P. 2006(a), 2007.1(b)(2).

A verified list of the proxies to be voted and a verified solicitation statement must be filed with the court and served upon the United States Trustee by a holder of two or more proxies prior to the time voting commences at any meeting of creditors. Fed. R. Bankr. P. 2006(e).

#### **D. DETERMINING ELECTION RESULTS**

The election is void unless creditors holding at least twenty percent of the amount of eligible claims actually vote. See 11 U.S.C. § 702(c)(1). The successful candidate must receive votes from creditors holding a majority in the amount of claims that are held by creditors actually voting. 11 U.S.C. § 702(c)(2). The number of creditors voting for or against a candidate is irrelevant, as only the dollar amount of the claim is counted for voting purposes. The twenty percent "requesting" requirement of § 702(b) is independent of the twenty percent "quorum" requirement of § 702(c)(1). See *Berg v. Esposito (In re Oxborrow)*, 913 F.2d 751, 753-54 (9th Cir. 1990). An election must be requested by eligible creditors holding at least twenty percent in amount of the claims specified in § 702(a)(1) regardless of the number of creditors who actually cast votes at an election. *Id.*

#### **E. ELECTION REPORTS**

Upon completion of an undisputed election, the United States Trustee shall promptly file a report of the election including the name and address of the person elected as trustee and a statement that the election is undisputed. See Fed. R. Bankr. P. 2007.1(b)(3)(A). The United States Trustee shall also file an application for approval of the appointment of the elected trustee. See Fed. R. Bankr. P. 2007.1(b)(3)(A), (c). The report of the election shall constitute the appointment of the elected trustee, effective as of the date the court enters an order approving the appointment. Fed. R. Bankr. P. 2007.1(b)(3)(A).

If the election is disputed, the United States Trustee shall promptly file a report stating that the election is disputed, informing the court of the nature of the dispute, and listing the name and address of any candidate elected under any alternative presented by the dispute. Fed. R. Bankr. P. 2007.1(b)(3)(B). All parties in interest who requested a meeting under § 1104(b) and all committees appointed under § 1102 are to be served with the report. *Id.* A motion for resolution of the dispute must be filed within ten days after the date the United States Trustee files the report. *Id.* If no motion for resolution of the dispute is filed within the ten-day period, the person originally appointed by the United States Trustee in accordance with § 1104(d) shall continue to serve as trustee. *Id.* If a motion is timely filed and the court determines the result of the election and approves the person elected, "the report will constitute appointment of the elected person as of the date of entry of the order approving the appointment." *Id.*

**F. QUALIFICATION OF AN ELECTED TRUSTEE**

Like an appointed trustee, an elected trustee must be “disinterested.” *See* 11 U.S.C. § 1104(b). In addition, the elected trustee must meet the qualifications of § 321-- that is, the person elected to be trustee must be competent to perform the duties. 11 U.S.C. § 321(a)(1). If the elected trustee is a corporation, the corporation must be authorized by the corporation's bylaws or charter to act as a trustee. 11 U.S.C. § 321(a)(2). Additionally, the person cannot have served as an examiner in the case. 11 U.S.C. § 321(b). The elected trustee must post a bond in favor of the United States. 11 U.S.C. § 322(a). The amount of the bond and the sufficiency of the surety shall be determined by the United States Trustee. 11 U.S.C. § 322(b).

**G. DUTIES OF AN APPOINTED TRUSTEE PENDING ELECTION**

Pending the outcome of an election requested by a party in interest pursuant to § 1104(b) and court approval of the person elected, the chapter 11 trustee appointed by the United States Trustee must continue to perform all duties of a trustee, as appropriate. Fed. R. Bankr. P. 2007.1(b)(1). The appointed trustee must act as a fiduciary to protect and preserve assets of the estate without regard to the possibility of replacement by an elected trustee.

## **CHAPTER 5: TERMINATION AND REMOVAL**

### **A. TERMINATION OF A TRUSTEE'S APPOINTMENT**

Pursuant to § 1105, the court, on request of the United States Trustee or a party in interest and after notice and a hearing, may terminate the trustee's appointment and restore the debtor to possession. *See* 11 U.S.C. § 1105. The legislative history of § 1105 notes "[t]his section would permit the court to reverse its decision to order the appointment of a trustee in light of new evidence." H.R. Rep. No. 95-595 at 403 (1977). Further, the termination of the trustee may reflect a change in the circumstances under which the appointment was made. *See In re Eastern Consol. Utils., Inc.*, 3 B.R. 591, 592-93 (Bankr. E.D. Pa. 1980); *In re Curlew Valley Assoc.*, 14 B.R. 506, 514-15 (Bankr. D. Utah 1981). Pursuant to § 105(a), the court may raise *sua sponte* the issue of whether a trustee's appointment should be terminated.

### **B. REMOVAL OF TRUSTEE OR EXAMINER**

Pursuant to § 324(a) the court may, for cause, remove a trustee or an examiner. 11 U.S.C. § 324(a). The Bankruptcy Code does not list specific grounds constituting cause for removal. Determining whether circumstances warrant the removal of a trustee or examiner is necessarily left to the court on a case-by-case basis. To the extent that a chapter 11 trustee is not filing reports or otherwise complying with fiduciary obligations, a motion seeking removal could be filed by any party in interest, including the United States Trustee. The court may also initiate an action to remove a trustee. 11 U.S.C. § 105(a). Unless the court orders otherwise, the removal of a trustee or an examiner in any one bankruptcy case results in removal from all other cases in which that person is serving. 11 U.S.C. § 324(b).

A trustee who has been removed must still file a final report and account of the administration of the estate for each case. *See* 11 U.S.C. § 704(9) (made applicable to chapter 11 trustees by § 1106(a)(1)). The removed trustee must also turn over all books, records, and other assets of the estate to a successor trustee, and can be compelled to do so, if necessary. *See* 11 U.S.C. § 542(a); *Matter of Jim's Garage*, 118 B.R. 949, 951-53 (Bankr. E.D. Mich. 1989), *sub nom. on subsequent appeal*, *In re Grand Jury Proceedings*, 119 B.R. 945, 952-55 (E.D. Mich. 1990). The successor trustee appointed in any such case must segregate the books and records of the removed trustee. Finally, the successor trustee must file an accounting of the prior administration of the estate. Fed. R. Bankr. P. 2012(b)(2).

**CHAPTER 6: DUTIES OF A TRUSTEE**

**A. STATUTORY AND GENERAL DUTIES**

The statutory duties of a chapter 11 trustee are set forth in § 1106, which incorporates by reference certain chapter 7 trustee duties as specified in § 704.

The applicable duties prescribed by § 704 include the obligations to:

- (2) be accountable for all property received;
- (5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;
- (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;
- (8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires; and
- (9) make a final report and file a final account of the administration of the estate with the court and the United States trustee.

11 U.S.C. § 704 (made applicable by 11 U.S.C. § 1106(a)(1)). In addition to the duties described in § 704, the following provisions of § 1106(a) require a trustee to:

- (2) if the debtor has not done so, file the list, schedule, and statement required under section 521(1) of this title;<sup>4</sup>
- (3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of

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<sup>4</sup> Section 1106(a) is ambiguous in that it refers to the schedule that the debtor is required to file under § 521(1). However, it must be noted that § 521(1) actually requires two schedules - a schedule of assets and liabilities and a schedule of current income and expenditures. See 11 U.S.C. § 521(1).



such business, and any other matter relevant to the case or to the formulation of a plan;

- (4) as soon as practicable –
  - (A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and
  - (B) transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates;
- (5) as soon as practicable, file plan under section 1121 of [title 11], file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under chapter 7, 12 or 13 of this title or dismissal of the case;
- (6) for any year for which the debtor has not filed a tax return required by law, furnish, without personal liability, such information as may be required by the governmental unit with which such tax return was to be filed, in light of the condition of the debtor's books and records and the availability of such information; and
- (7) after confirmation of a plan, file such reports as are necessary or as the court orders.

11 U.S.C. § 1106(a). Finally, 28 U.S.C. § 959 provides that:

- (a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.
- (b) Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is

situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

28 U.S.C. § 959. (Leave of the bankruptcy court appointing the chapter 11 trustee may be required in order to sue the trustee for acts or transactions not related to carrying on business related to operating property of the estate. The authority for this is split among the circuits. In addition, trustees may be liable for negligence in some circuits while in others a gross negligence standard may be required for personal liability for the trustee.)

This is not an exhaustive list of all duties that a chapter 11 trustee is required to perform on behalf of the estate and its beneficiaries. For example, the trustee is required to make diligent inquiry into any professional's eligibility to be employed and compensated by the estate pursuant to § 326(d); protect monies of the estate in accordance with the provisions of § 345; give notice of the case to any entity holding money or property of the debtor pursuant to Bankruptcy Rule 2015(a)(4); file tax returns where appropriate under § 346(c)(2); withhold state and local taxes as required by law under § 346(f); and meet with a committee of creditors pursuant to § 1103(d). In addition, the court may expand the duties of the trustee, and, in some cases, the trustee must be willing to abandon other pursuits in order to devote full time to the case. In short, a chapter 11 trustee is a fiduciary charged with protecting the interests in the bankruptcy estate of all parties, including all classes of creditors and the debtor. The trustee must protect and preserve estate assets.

## **B. REVIEW OF THE CASE FILE**

Immediately upon appointment, approval, and qualification, the trustee must determine the status of the case. This can be accomplished by reviewing the case file; meeting with the United States Trustee, creditors, any appointed creditors' committees, or employees of the debtor; and examining the books and records. Within a very short period of time, the trustee should determine the necessity of seeking the employment of professionals to assist in the performance of the trustee's duties. *See* Chapter 10, *infra*.

### **1. Statement of Financial Affairs and Schedules of Assets and Liabilities**

Because a chapter 11 trustee is generally appointed after the case has been pending for a period of time, the case file should usually contain a petition, the debtor's statement of financial affairs, and schedules of the debtor's assets and liabilities. The schedules should include:

- Schedule A - Real Property
- Schedule B - Personal Property
- Schedule C - Property Claimed as Exempt (individual case)
- Schedule D - Creditors Holding Secured Claims
- Schedule E - Creditors Holding Unsecured Priority Claims
- Schedule F - Creditors Holding Unsecured Non-Priority Claims

Schedule G	-	Executory Contracts and Unexpired Leases
Schedule H	-	Co-Debtors
Schedule I	-	Current Income of Individual Debtor(s)
Schedule J	-	Current Expenditures of Individual Debtor(s)

See Official Form 6.

If it is very early in the case or if the debtor in possession has simply failed to file the documents specified in Bankruptcy Rule 1007, the trustee may be required to prepare and file the list of creditors, the statement of financial affairs, and the schedules of assets and liabilities. 11 U.S.C. § 1106(a)(2). Even if the debtor has filed the statement of financial affairs and schedules, the trustee may find, after a reasonable investigation and review, that it is necessary to file appropriate amendments. The accuracy of the list of creditors, statement of financial affairs, and schedules of assets and liabilities is important for a number of reasons, including providing adequate notice of the case to all creditors, identifying and protecting estate assets, and ensuring that creditor claims are properly listed and identified as disputed, contingent, or unliquidated, where appropriate.

## **2. Pleadings and Monthly Operating Reports**

In addition to the petition, statement of financial affairs, and schedules, the trustee should review relevant pleadings and documents that have been filed in the case. Generally, these will involve the motion, responsive pleadings, and transcript for appointment of a chapter 11 trustee, if any, employment of professionals and retainer agreements, use of cash collateral, postpetition borrowing, sales of estate property, and assumption or rejection of unexpired leases or executory contracts. Finally, the trustee should carefully review all monthly operating reports filed by the debtor in possession. The monthly operating reports should provide the trustee with an overview of the debtor's financial activities since the commencement of the case.

## **C. EXAMINATION OF THE DEBTOR**

Section 341(a) provides “[w]ithin a reasonable time after the order for relief in a case under [title 11], the United States trustee shall convene and preside at a meeting of creditors.” 11 U.S.C. § 341(a). Pursuant to § 343, “[t]he debtor shall appear and submit to examination under oath at the meeting of creditors under section 341(a) of this title. Creditors, any indenture trustee, any trustee or examiner in the case, or the United States trustee may examine the debtor.” 11 U.S.C. § 343. The meeting must be conducted no fewer than twenty (20) days and no more than forty (40) days after the date of filing, unless the United States Trustee designates a place for the meeting that is not regularly staffed by the United States Trustee or an assistant who may preside. Fed. R. Bankr. P. 2003(a). In that case, the meeting must be convened no less than twenty (20) days and no more than sixty (60) days after the order for relief. *Id.* Further, the meeting can be adjourned or continued from time to time by an announcement of the new time and date at the meeting. Fed. R.

Bankr. P. 2003(e). Finally, the United States Trustee may call a special meeting of creditors on request of a party in interest or on the United States Trustee's own initiative. Fed. R. Bankr. P. 2003(f).

If a chapter 11 trustee is appointed prior to the conclusion of the § 341 meeting of creditors, the chapter 11 trustee has an immediate opportunity to conduct an examination of the debtor or the debtor's principals, under oath, at the creditors' meeting. If, however, the trustee is appointed after the § 341 meeting has been concluded, the trustee may request that the United States Trustee convene a special meeting of creditors. *See* Fed. R. Bankr. P. 2003(f). In addition, the trustee should carefully review the recordings of all meetings conducted prior to the trustee's appointment.

Alternatively, the trustee may seek court approval to examine the debtor, or any other entity, pursuant to Bankruptcy Rule 2004. *See* Fed. R. Bankr. P. 2004. A Rule 2004 examination "may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge . . . [or] to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan." Fed. R. Bankr. P. 2004(b).

#### **D. CONTROL AND PRESERVATION OF PROPERTY**

Upon court approval of the trustee appointment, it is imperative that the chapter 11 trustee secure the assets of the estate. The trustee must immediately assume control of all bank accounts held in the name of the debtor, whether or not they are designated as "debtor in possession" accounts, *see* Chapter 7, *infra*; identify, secure, and ascertain the value of the assets of the estate; review and implement internal controls of an operating debtor to safeguard assets; obtain and/or maintain adequate and appropriate insurance coverages, *see* Chapter 7, *infra*; and determine whether the initial bond set by the United States Trustee is sufficient to protect the estate against loss. *See* Chapter 3, *supra*. Monitoring insurance and bond coverage is an ongoing duty of the trustee. If a loss occurs as a result of a trustee's failure to ensure or otherwise protect property of the estate, the trustee could be liable.

#### **E. BANKRUPTCY CRIMES**

Chapter 11 trustees are often appointed after a judicial finding of "cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case." 11 U.S.C. §1104(a)(1). After the trustee assumes control of the debtor, it is the trustee's duty to investigate the affairs of the debtor and the status of the case. *See* 11 U.S.C. § 1106(a)(3). To the extent that the trustee either

discovers or verifies the existence of fraudulent activity, the trustee should notify the United States Trustee immediately.

### **1. Duty to Report Criminal Conduct**

Unless a judge or receiver has already made such report, 18 U.S.C. § 3057 requires a trustee to report suspected violations of federal criminal law to the appropriate United States Attorney. Section 586 of title 28 imposes a similar duty on the United States Trustee to refer any matter that may constitute a violation of criminal law to the United States Attorney and, upon request, to assist the United States Attorney in prosecuting the matter. 28 U.S.C. § 586(a)(3)(F).

A chapter 11 trustee should coordinate efforts with the United States Trustee in the criminal referral process. As noted above, if the trustee has reasonable grounds to believe that a crime has been committed, the trustee is required to refer the matter to the United States Attorney. 18 U.S.C. § 3057(a). However, depending on local practice, the trustee should either submit the referral through the United States Trustee or provide a copy of the referral to the United States Trustee. The mechanics of the actual referral should be discussed with the United States Trustee, the Assistant United States Trustee, or the Regional Criminal Coordinator for the Criminal Enforcement Unit, as they have developed specific procedures with the local offices of the United States Attorney and the Federal Bureau of Investigation.

In making a criminal referral, it is important to provide specific factual and documentary information. At a minimum, the referral should include:

- the bankruptcy case name, file number, and chapter;
- a chronological summary, including dates and specific facts related to the who, what, where, when, and how of the suspected crime;
- a brief narrative of what occurred in relation to each allegation, referring to copies of relevant documents;
- an estimate of the amount of loss involved;
- names, addresses, phone numbers, titles, and descriptions of likely witnesses;
- copies of all written documents relevant to the allegations; and
- a statement of other related referrals made to law enforcement agencies.

### **2. Types of Criminal Conduct**

The most common bankruptcy crimes are set forth in 18 U.S.C. § 152. Section 152 makes it a crime for any individual to “knowingly and fraudulently” (1) conceal property of the estate; (2) make a false oath or account in relation to a bankruptcy case; (3) make a false declaration, certification, verification, or statement in relation to a bankruptcy case; (4) make a false proof of claim; (5) receive a material amount of property from the debtor with intent to defeat the Bankruptcy Code; (6) give, offer, receive, or attempt to obtain money, property, reward, or

advantage for acting or forbearing to act in a bankruptcy case; (7) transfer or conceal property with the intent to defeat the Bankruptcy Code; (8) conceal, destroy, mutilate, or falsify documents relating to the debtor's property or affairs; or (9) withhold documents related to the debtor's property or financial affairs from a trustee or other officer of the court. 18 U.S.C. § 152.

Persons other than the debtor, the debtor's principals, or the debtor's management may commit bankruptcy crimes. For example, a chapter 11 trustee may discover potential theft or embezzlement by professionals employed by the debtor, or by the debtor's employees.

Sections 153 and 154 of title 18 are specifically directed to trustees and other officers of the court. Section 153 relates to the knowing and fraudulent misappropriation, embezzlement, or transfer of property, or destruction of any estate document, by the trustee or other officer of the court. The Bankruptcy Reform Act of 1994, Pub. L. 103-394, 108 Stat. 4106, 4139 (1994), broadened the scope of those affected by this statute to include an agent, employee, or other person engaged by the trustee or officer of the court.

Section 154 of title 18 prohibits a trustee or other officer of the court from knowingly purchasing, directly or indirectly, any property of the estate of which such person is a trustee or officer; or from knowingly refusing to permit a reasonable opportunity for the inspection of estate documents or accounts when directed by the court to do so. It also specifically identifies the United States Trustee as the only party in interest who does not require a court order directing the trustee or court officer to permit a reasonable opportunity for inspection. 18 U.S.C. § 154(3).

Section 155 of title 18 makes it a crime for any party in interest or its attorney to knowingly and fraudulently enter into an agreement with another party in interest or its attorney, for the purpose of fixing the fee or compensation to be paid them for services rendered in connection therewith, from assets of the estate. 18 U.S.C. § 155.

The Bankruptcy Reform Act of 1994 added 18 U.S.C. § 156, "Knowing Disregard of Bankruptcy Law or Rule," and 18 U.S.C. § 157, "Bankruptcy Fraud." See Pub. L. 103-394, 108 Stat. 4106, 4140 (1994). Section 156 makes it a misdemeanor if a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a "bankruptcy petition preparer" in any manner to disregard the requirements of the Bankruptcy Code or the Federal Bankruptcy Rules. 18 U.S.C. § 156. The term "bankruptcy petition preparer" does not include the debtor's attorney or an employee of the debtor's attorney, but applies to a person who prepares for compensation a document for filing by a debtor in bankruptcy court or district court. 11 U.S.C. § 110(a).

Section 157 is similar to the federal mail fraud and wire fraud statutes in that it requires a person to devise or intend to devise a scheme or artifice to defraud. A person, not only a debtor, commits bankruptcy fraud if, for the purpose of executing or concealing this scheme or artifice to defraud, that person:

- (1) files a petition under title 11;
- (2) files a document in a proceeding under title 11; or
- (3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title.

*See* 18 U.S.C. § 157.

If a person falsely claims to be in bankruptcy, this is a violation of § 157.

Further, the Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (2000), added 18 U.S.C. § 1519, making the “destruction, alteration, or falsification of records in federal investigations and bankruptcy” a felony. Under § 1519,

Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

18 U.S.C. § 1519.

There are several other criminal statutes that may be relevant to bankruptcy crimes including those relating to bank fraud, tax fraud, mail and wire fraud, and money laundering.

## **CHAPTER 7: OPERATIONS AND REPORTING REQUIREMENTS**

### **A. OPERATING GUIDELINES**

#### **1. Generally**

The United States Trustee is responsible for supervising the administration of cases and trustees in cases under chapters 7, 11, 12, and 13 of the Bankruptcy Code. 28 U.S.C. § 586(a)(3). In order to comply with this supervisory requirement, each region has established Operating Guidelines and Reporting Requirements for Chapter 11 Debtors and Trustees. The guidelines are established to assist a debtor in possession or a chapter 11 trustee in complying with §§ 1106 and 1107. The guidelines provide useful general information regarding noticing requirements; closing old bank accounts and opening new debtor in possession bank accounts; maintaining adequate insurance; filing monthly operating reports; paying taxes; employing professionals; and remitting quarterly fees. Regardless of when a chapter 11 trustee is appointed in a case, the guidelines apply. Failure to comply may be cause for the dismissal or conversion of the case to one under chapter 7. Therefore, a chapter 11 trustee should obtain a copy of the Operating Guidelines and Reporting Requirements established in the region in which the trustee has been appointed.

#### **2. Bank Accounts**

Upon appointment, the chapter 11 trustee must secure all assets of the estate. This includes taking control of every bank account belonging to the debtor, whether or not the account is designated as a “debtor in possession” account. The accounts must be maintained under the direction and control of the trustee at depositories that have agreed to abide by the requirements established by the United States Trustee. *See Chapter 7, infra.*

Generally, a trustee should utilize a single banking institution and should initially deposit funds to an interest-bearing account. Under no circumstances may monies of separate estates be aggregated or commingled. Bankruptcy-related funds may not be deposited to the trustee’s business, personal, or trust account.

All trustee bank accounts should include the trustee’s name, capacity as trustee for the estate, and the debtor’s name and case number. If the trustee takes control of “debtor in possession” accounts, the trustee has the option of either changing the title and signature cards of the existing bank accounts or closing such accounts and opening new ones. The trustee should also close all “non-debtor in possession” accounts and open new accounts that contain the appropriate information. All bank account information must be supplied to the United States Trustee.

The trustee “may make such deposit or investment of the money of the estate for which such trustee serves as will yield the maximum reasonable net return on such money, taking into



account the safety of such deposit or investment.” 11 U.S.C. § 345(a). Safe investments include certificates of deposit insured by the Federal Deposit Insurance Corporation (FDIC) and certain government securities. Absent court approval, the trustee is not permitted to use certain types of investments such as repurchase agreements, reverse repurchase agreements, non-bank money market accounts, mutual funds, stocks, corporate bonds, and commercial paper.

### **3. Requirements for Depositories Holding Estate Funds**

The trustee may only use a depository that has agreed to comply with 11 U.S.C. § 345, 31 C.F.R. § 225, and the requirements of the United States Trustee. Each region maintains a list of authorized depositories, which the chapter 11 trustee should request immediately upon appointment. If a bank wishes to be added to the list, it should contact the appropriate United States Trustee for the current requirements.

#### **a. Collateralization of the Trustee’s Deposits**

It is the responsibility of the trustee to ensure that the banking institution is in compliance with § 345 to the extent of the trustee’s deposits. If the aggregate funds on deposit for an estate in a single institution exceed the \$100,000 FDIC limits, the excess funds must be bonded or be collateralized by securities deposited with the appropriate Federal Reserve Bank. The trustee must notify the United States Trustee if the amount on deposit in any single depository exceeds or is expected to exceed \$100,000.

If a bond in favor of the United States is filed to protect the deposit of estate funds, the United States Trustee must approve the corporate surety securing the bond. 11 U.S.C. § 345(b)(1)(B). The United States Trustee can only approve a surety listed in Treasury Circular 570.

The United States Trustee obtains summaries of the amounts on deposit from each bank being used by a trustee to assist in monitoring trustee accounts and bonding requirements. The United States Trustee also receives a report from the Federal Reserve to review the sufficiency of the collateral posted by the banking institutions. The trustee must assist the United States Trustee in obtaining bank statements or summaries of amounts on deposit. An authorization for the bank’s release of information to the United States Trustee may be required from the trustee.

### **4. Insurance**

In securing the assets of the estate, the chapter 11 trustee is required to ascertain the existence and sufficiency of insurance and to maintain appropriate insurance for the estate. The insurance coverage must be adequate given the circumstances of the case but, at a minimum, the dollar amount of the insurance coverage must be sufficient to cover the fair market value of the

estate property. Additionally, to the extent necessary, and if reasonably available, the chapter 11 trustee must maintain the following types of insurance adequate to protect the estate:

- general comprehensive liability;
- fire and theft;
- workers' compensation;
- vehicle;
- product liability;
- flood and/or windstorm insurance; and
- other insurance as customary or prudent in the debtor's business or as required by law.

The chapter 11 trustee should provide the United States Trustee with proof of the required insurance coverage and any renewal information. The chapter 11 trustee should also ensure that the insurance companies are instructed to provide the United States Trustee with notification of any change, cancellation, or expiration of insurance. In the event the trustee is unable to obtain any necessary coverages, the trustee should confer with the United States Trustee, the debtor's officers, and any creditors' committee concerning the feasibility of going forward in chapter 11. It may be advisable to seek authority of the court to continue operations if such insurance cannot be obtained.

## **B. MONTHLY OPERATING REPORTS**

The Bankruptcy Code imposes a periodic reporting requirement on chapter 11 trustees:

if the business of the debtor is authorized to be operated, [the trustee shall] file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires.

11 U.S.C. §§ 704(8); (incorporated by 1106(a)(1)); *see also* Fed. R. Bankr. P. 2015(a) (duty to keep records and make reports).

These periodic reports are generally known as the Monthly Operating Reports. Form operating reports are generally included in the Operating Guidelines and Reporting Requirements and can be obtained from each office of the United States Trustee. These reports vary from region to region. The reports have been created to provide the court, the United States Trustee, and creditors with reliable, accurate information regarding the operations of the estate.

Monthly Operating Reports are required to be filed with the court, with a copy served on the United States Trustee on a calendar month basis on a specified date in the month following the reporting period. This date may vary from region to region. The report must also be served on any taxing authority. 11 U.S.C. §§ 1106(a)(1), 704(8). The timely filing of operating reports is crucial to the efficient administration of chapter 11 cases. While specific instructions are attached to the Operating Guidelines and Reporting requirements, the reports should at a minimum provide the following information.

- *Cash receipts and disbursements or statement of operations:* This information should include the receipts and disbursements of the estate, as well as separate account reconciliations for each bank account in the chapter 11 trustee's name. The statement should contain information regarding expenditures for inventory, salaries, and taxes.
- *Check registers:* In addition to the bank account reconciliations, the monthly reports should contain an itemization of all checks written or disbursements made by the chapter 11 trustee during the reporting period. All disbursements should be made by printed, pre-numbered checks or, if significant sums, by wire transfer (unless the trustee is using the trustee bankruptcy management accounting software in which checks are generated and automatically numbered by the software on check stock). The chapter 11 trustee should check with the United States Trustee's office in the appropriate region to determine whether wire transfers are acceptable. Proof of wire transfers should be included in the Monthly Operating Report. No cash disbursements should be made. The use of petty cash accounts requires United States Trustee prior approval and should be reconciled and reported monthly. Information contained in the check registers should include the date, payee, purpose of disbursement, and amount of disbursement. Computer generated registers are acceptable if they contain all of the foregoing information.
- *Schedules of postpetition accounts receivable and accounts payable:* These schedules should also contain aging analyses.
- *Tax reconciliation statement:* This statement is a useful method for determining whether the trustee is current with the estate's postpetition tax obligations. The report should specify whether employee taxes have been withheld and, if so, the amount of such taxes, where the taxes are deposited, and the taxing agency to which they must be paid (e.g., city, state, or federal).
- *Insurance confirmation:* Insurance information must be provided on a monthly basis even if no change in the insurance coverage occurred during the month.

The United States Trustee has discretion to require the chapter 11 trustee to file additional reports as necessary to ensure that a case is properly monitored and administered.

### **C. REPORT OF INVESTIGATIONS**

Section 1106(a)(3) requires the chapter 11 trustee to investigate the “acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor’s business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan.” 11 U.S.C. § 1106(a)(3). Section 1106(a)(4) requires the trustee to file a statement of the results of the investigation, setting forth any facts concerning “fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor . . .” 11 U.S.C. § 1106(a)(4)(A). A copy of this report is to be served on the United States Trustee and the committee of unsecured creditors, if one exists, and other parties designated by the court.

The trustee should complete a proper investigation of the business affairs of the debtor, but should not waste funds of the estate on matters that will have little benefit to the estate. Because each case is different, no standard rule can be applied with regard to the extent of a proper investigation. Rather, if concerned, the chapter 11 trustee should allow the court to resolve any question regarding the proper scope of an investigation. In many cases, it is advisable for the chapter 11 trustee to confer with the creditors’ committee and United States Trustee concerning the anticipated costs and benefits of any extraordinary investigations prior to seeking court guidance.

Investigations are extremely important when a chapter 11 trustee has been appointed based upon the fraud, gross mismanagement, or dishonesty of the principals of the debtor. The trustee will need to investigate the prior management to determine if significant causes of action against former officers and directors exist. However, the trustee should not unnecessarily duplicate investigative work that has already been performed by a creditors’ committee or other parties in interest.

Any investigation conducted by the trustee should proceed when practicable without causing delay to the potential successful reorganization of the case. For example, negotiations regarding a plan of reorganization should continue if the information available is sufficient for creditors to determine whether a prompt confirmation is warranted or whether a more detailed investigation is needed. Further, the trustee should not request that the court postpone a hearing under § 1125 unless the trustee believes that the investigation is necessary for the court to evaluate the accuracy of the information provided in the plan or disclosure statement. The pendency of an investigation should, however, be included in any proposed disclosure statement.

## D. OTHER REPORTS

### 1. Report in Lieu of Plan

In a case where a plan is not going to be filed, § 1106(a)(5) requires a trustee as soon as practicable to either (1) file a report explaining why the trustee cannot file a plan; or (2) recommend the dismissal of the proceeding or the conversion to a case under chapter 7. 11 U.S.C. § 1106(a)(5). Ordinarily, a chapter 11 trustee should not administer a case if no intention to file a plan exists. Rather, the trustee should take the appropriate action to move the court to dismiss or convert the proceeding to chapter 7. Allowing a case to remain in chapter 11 when no likelihood of reorganization exists may be detrimental to creditors because valuable assets may be lost in the process. The trustee should not unnecessarily delay closing a business when no chance for reorganization exists.

### 2. Post-Confirmation Report

Section 1106(a)(7) requires a trustee to file post-confirmation reports as necessary or mandated by the court. 11 U.S.C. § 1106(a)(7). Despite the language of § 1106(a)(7), the role of a chapter 11 trustee appointed pursuant to § 1104 terminates upon confirmation of a plan. See Chapter 9, Section D, *infra*. To the extent that a chapter 11 trustee appointed pursuant to § 1104 is transformed by the order of confirmation into a “plan” trustee, the trustee should refer to the local rules regarding what, if any, post-confirmation reports are required.

### 3. Final Reports

Section 1106(a)(1) incorporates by way of reference § 704(9), which requires a trustee to file a final report and final accounting of the administration of the estate. This final report is to be filed with the court and served on the United States Trustee. 11 U.S.C. § 704(9). The report should include an “exit inventory” of property to be returned to the debtor. The report is not a substitute for any actions to be taken to “close” a chapter 11 case that does not have a confirmed plan of reorganization; if no plan is confirmed, a chapter 11 case may only be dismissed or converted.

## E. QUARTERLY FEES

Bankruptcy Rule 2015(a)(5) requires the chapter 11 trustee or debtor to prepare quarterly reports and calculate the United States Trustee’s fees to be paid pursuant to 28 U.S.C. § 1930(a)(6). Fed. R. Bankr. P. 2015(a)(5). Quarterly reports and payments are due on the last day of the month immediately following the end of the calendar quarter, *id.*, and should be accompanied by any invoices mailed to the trustee. Failure to receive an invoice does not excuse the obligation to timely pay United States Trustee’s fees.

Section 1930(a)(6) of title 28 establishes a sliding scale of fees due based upon the total disbursements made during the calendar quarter. Even if no disbursements are made, the minimum fee will be due. The fees are due as follows:

<u>Disbursement Range</u>	<u>Fee Due</u>
Less than \$15,000	\$ 250
\$15,000 to \$74,999.99	\$ 500
\$75,000 to \$149,999.99	\$ 750
\$150,000 to \$224,999.99	\$ 1,250
\$225,000 to \$299,999.99	\$ 1,500
\$300,000 to \$999,999.99	\$ 3,750
\$1,000,000 to \$1,999,999.99	\$ 5,000
\$2,000,000 to \$2,999,999.99	\$ 7,500
\$3,000,000 to \$4,999,999.99	\$ 8,000
\$5,000,000 or more	\$10,000

28 U.S.C. § 1930(a)(6).

Disbursements include all payments made by the debtor or by the debtor’s successor in interest (e.g., the reorganized debtor) during the quarter. This includes, but is not limited to, cash collateral payments pursuant to cash collateral orders and payments made on behalf of the estate by third parties (e.g., monies held in escrow). The United States Trustee does not consider transfers “in kind” as disbursements to be included in the calculation of the fee owed. For example, the assumption of debt by a third party as consideration for the purchase of an asset is not considered a disbursement.

United States Trustee’s fees are due and payable for any calendar quarter until the case is no longer pending under chapter 11. This means that fees are due until the chapter 11 case is dismissed, converted, or closed pursuant to the entry of a final decree. *See* 28 U.S.C. § 1930(a)(6). Fees will be due for partial quarters based upon the docketing date of the order of dismissal or conversion or final decree, and will be based upon the disbursements made while the case was in chapter 11.

The failure to pay United States Trustee’s fees is cause for the dismissal or conversion of a chapter 11 proceeding pursuant to § 1112(b)(10). In addition, a plan cannot be confirmed unless all fees are paid in full or the plan provides for payment in full by the effective date of the plan. 11 U.S.C. § 1129(a)(12).

## **CHAPTER 8: CASE ADMINISTRATION**

### **A. INTRODUCTION**

This chapter describes a variety of issues relating to the collection, preservation, and disposition of estate assets, including the pursuit of causes of action on behalf of the estate as well as various tax considerations.

### **B. THE ESTATE**

#### **1. Property of the Estate**

The commencement of a bankruptcy case creates an “estate” that is broadly and inclusively defined. *See* 11 U.S.C. § 541(a). The trustee should review § 541 in detail to ensure that all property of the estate has been identified.

With certain limited exceptions set forth in § 541(b) and (c)(2), the trustee succeeds to all of the legal or equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541(a)(1). The trustee must review not only tangible property of the debtor, but also intangible property of the debtor, including any potential claims and causes of action the debtor may have had when the case was commenced. *See generally* 11 U.S.C. § 541.

In addition to the debtor’s property interests and rights, the Bankruptcy Code gives the trustee certain rights and powers that the debtor did not have prepetition. Any property resulting from the exercise of those rights and powers is automatically included in the estate. *See* 11 U.S.C. §§ 541(a)(3) and (a)(4). For example, the trustee may seek to avoid certain preferential or fraudulent transfers, or may assert rights that otherwise could be exercised only by particular creditors of the estate. *See generally* 11 U.S.C. §§ 544-553. These provisions are discussed in Chapter 8, Section E, *infra*. The Bankruptcy Code thereby preserves the rights of particular creditors under state law, but does so for benefit of the estate as a whole, ensuring equality of distribution for all similarly situated creditors.

As discussed generally in chapter 6, *supra*, the trustee is required to investigate and report on the debtor’s affairs as required under §§ 1106(a)(3) and (a)(4), and then evaluate the extent to which any causes of action may have value to the estate. In reviewing causes of action that are property of the estate, the trustee should consider all of the circumstances that led to the court’s order directing the appointment of the trustee. Such causes of action may arise under state law for fraud or for the unlawful diversion of assets. In addition, there may be grounds to pierce the corporate veil that exists between the debtor and other persons or related entities, or there may be causes of action against insiders based on their breach of fiduciary duties owed to creditors of an insolvent corporation. In appropriate circumstances, the court may substantively consolidate the separate cases of the same debtor, which may substantively affect the rights of the parties. Fed. R.

Bankr. P. 1015(a); *compare* Fed. R. Bankr. P. 1015(b) (court may “jointly administer” cases of “related” debtors). Some of these various causes of action may have existed prior to the commencement of the case, while others arise under the trustee’s “strong arm” or transfer avoidance powers set forth in §§ 544-549.

The estate also includes property and rights that may first arise some time after the case is filed. For example, the estate includes “[p]roceeds, product, offspring, rents, and or profits of or from property of the estate . . .” 11 U.S.C. § 541(a)(6). This generally includes proceeds of the debtor’s ongoing business operations, at least to the extent that there are not liens on such assets. Earnings based on postpetition services by an individual debtor are not included in the estate. *Id.*

To the extent that assets of the estate may have been transferred improperly postpetition, the trustee may seek to void such transfers under § 549. Any property or proceeds recovered as a result of such actions by the trustee are included in the estate. 11 U.S.C. § 551 (transfer avoided under § 549 preserved for benefit of estate); § 541(a)(4) (interest preserved under § 551 is property of estate).

## 2. Exempt Property in Individual Cases

Exempt property should not be an issue for a chapter 11 trustee unless the debtor is an individual. In an individual case, the trustee should examine § 522, applicable state exemptions and homestead laws, if asserted, and Bankruptcy Rule 4003(a). The trustee should file any objections within thirty (30) days following the conclusion of the § 341 meeting of creditors or the filing of any amendment to the list or supplemental schedules unless, within such period, further time is granted by the court. Fed. R. Bankr. P. 4003(b); *see also Taylor v. Freeland and Kronz*, 503 U.S. 638, 643-645 (1992).

## C. PRESERVING THE ESTATE

### 1. The Automatic Stay

The trustee must be concerned with preserving the property of the estate. Fortunately, the Bankruptcy Code provides protection of estate property with the automatic stay, which takes effect immediately upon the filing of a bankruptcy petition. *See* 11 U.S.C. § 362(a). The stay restricts most efforts to take possession of or alter the debtor’s rights in property of the estate. *See id.* Specifically, the stay prohibits the commencement or continuation of most legal proceedings, enforcement of judgments, imposition of most liens, and other actions designed to improve one creditor’s position relative to other creditors. *Id.*

The automatic stay is subject to certain limited exceptions set forth in § 362(b). These exceptions include the “police powers” exception, 11 U.S.C. § 362(b)(4), which permits the continuation of many actions brought by government agencies or officials; certain actions by taxing



authorities designed to determine tax amounts owed, 11 U.S.C. § 362(b)(9); and actions by a lessor of non-residential real estate when the lease has terminated before the filing, 11 U.S.C. § 362(b)(10).

Unless a creditor or other party in interest obtains judicial relief from the automatic stay, it remains in effect as long as the property is part of the “estate,” or until the case is closed or dismissed. 11 U.S.C. § 362(c). Actions taken in violation of the automatic stay may be determined to be void or voidable, and, in appropriate circumstances, may lead to the imposition of sanctions for contempt of court.

A creditor has two statutory grounds for relief from the automatic stay. First, the creditor may establish “cause” for relief, which would include the lack of adequate protection of that creditor’s interest in the estate’s property. 11 U.S.C. § 362(d)(1). Second, the creditor may show that the estate property is not necessary for an effective reorganization and that the estate has no equity in the property. 11 U.S.C. § 362(d)(2). A creditor seeking relief from the stay must file the appropriate motion under Bankruptcy Rule 4001(a), which the court is required to address within the applicable time constraints of § 362(e) and (f). Fed. R. Bankr. P. 4001(a).

Most motions for relief from stay will be filed by secured creditors. If the trustee considers the property burdensome to the estate, then the trustee may wish to consent to relief from the automatic stay and to consider abandonment as well. *See* Chapter 8, Section C.3, *infra*. If the issue is one of simply protecting the creditor’s interest in collateral, the trustee may wish to negotiate terms of adequate protection. *See* 11 U.S.C. § 361. “Adequate protection” is defined by § 361, and can include periodic cash payments, replacement liens on new or additional collateral, and other protections. Whatever its form, adequate protection is not intended to improve the creditor’s position, but only to protect that creditor from any decrease in the value of that creditor’s interest in property. For example, a creditor whose claim is secured by personal property that is declining in value should be compensated for that decline. By contrast, a creditor whose collateral is appreciating in value may not be entitled to adequate protection.

On occasion, an unsecured creditor will seek relief from the stay, usually for the purpose of proceeding with litigation in another forum. For example, if a debtor is also involved in a divorce proceeding, the trustee may consent to relief from the stay so that the dissolution of the marriage and division of any exempt property can go forward. While often creditors seek relief from the stay to proceed with actions that are being defended by the debtor’s insurance company, in some cases and jurisdictions the insurance proceeds themselves will be property of the estate and stay relief would be detrimental to the estate. The chapter 11 trustee must carefully analyze each insurance situation and be familiar with the status of insurance proceeds in that particular jurisdiction.

## **2. Turnover Actions**

The trustee should immediately take control of all estate assets in the debtor's possession or control, including not only physical assets but also bank accounts and intangible assets. The trustee's right to turnover extends to the debtor's books and records and may, after notice and hearing, extend to books and records of the debtor that are in possession of the debtor's accountants or attorneys. 11 U.S.C. § 542(e). The trustee may also need to seek the turnover of property from other persons, to the extent appropriate under §§ 542 and 543.

Section 542 requires persons, other than custodians, to turn over certain estate property over which they have possession, custody, or control. 11 U.S.C. § 542. Such property must be turned over to the extent that the trustee may use, sell, or lease such assets under § 363, unless the assets are of inconsequential value or benefit to the estate.

Section 543 addresses the turnover obligations of custodians. A "custodian" is defined at § 101(11), and includes a state court receiver, an assignee for the benefit of creditors, and a non-bankruptcy trustee. *See* 11 U.S.C. § 101(11). A custodian must generally turn over the property in the custodian's control and must file an accounting, but the custodian is entitled to compensation and may ask the court to permit the custodian to retain possession or control of the property if that would be in the best interests of creditors or if other conditions apply. 11 U.S.C. § 543.

If the debtor fails to turn over property, the trustee can file a motion asking the court to order the debtor to do so. By contrast, if a third party refuses to turn over property, then the trustee must file an adversary proceeding. Fed. R. Bankr. P. 7001(1). Because an adversary proceeding may take time, the trustee should exhaust informal efforts to obtain turnover first.

## **3. Abandonment**

Not all property of the estate will be valuable or necessary for operation of the debtor's business. In fact, some property may expose the estate or the trustee to liability. The trustee has the power to abandon property that is "burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a).

Property should be abandoned if it is not needed in the debtor's business operations and if the total amount to be realized from the sale of the property would not result in a meaningful distribution to creditors or would redound primarily to the benefit of the trustee and professionals.

In determining whether property has consequential value to the estate, the trustee should consider issues such as:

- The amount, validity, and perfection of purported security interests or other liens against such property. In evaluating such liens, the trustee should consider the extent to which the liens may be avoidable under §§ 544, 545, 547, and 548.
- The value of the property. Value can be determined in various ways. The trustee can consult with the debtor and debtor's attorney, have the secured party provide documentation as well as the pay-off statement, obtain price lists, conduct physical inspections or appraisals, and use common sense. The precision with which value is determined often depends on the margin between the lien or encumbrance and the estimated value of the property.
- Tax considerations.
- Administrative expenses and litigation costs to be borne by the estate resulting from the recovery and sale of the property.
- Liabilities that may result for the estate--for example, where the property is contaminated or hazardous.

An order granting relief from the automatic stay does not remove property from the estate. If a creditor obtains relief from the stay in order to proceed against specific property without also obtaining abandonment of that property, in most instances the trustee should take formal steps to abandon the property.

Creditors are entitled to notice of a proposed abandonment. 11 U.S.C. § 554(a); Fed. R. Bankr. P. 6007. A notice of abandonment should identify each asset to be abandoned by reference to the description provided in the debtor's schedules and should clearly describe any unlisted assets. The notice should also provide additional information needed to demonstrate the basis upon which the decision to abandon was made, such as the following: the amount by which secured claims exceed the value of the asset; the costs of recovering and/or liquidating the asset are estimated to exceed its value to the estate; or the expenses of preserving the asset are estimated to exceed its value to the estate.

#### **D. USE, SALE, OR LEASE OF ESTATE PROPERTY**

##### **1. Transactions in the Ordinary Course of Business**

If the chapter 11 trustee is operating the debtor's business, then the trustee may generally use, sell, or lease property of the estate to the extent that such transactions are in the ordinary

course of that debtor's business. 11 U.S.C. § 363(c)(1). However, the trustee must first determine that such transactions are indeed within the ordinary course of the debtor's business, and that other persons do not have interests in the property that need to be protected.

When considering whether a transaction is "in the ordinary course," the trustee should be guided by the past conduct of the debtor as well as the conduct of similar businesses. For example, the ongoing sale of inventory on normal terms may be in the ordinary course of the debtor's business, but the complete liquidation of inventory at the debtor's "going out of business" sale would generally be outside of the ordinary course of a debtor's business. When in doubt, the trustee should be cautious and obtain a court order approving the proposed transaction under § 363.

## **2. Transactions Outside the Ordinary Course of Business**

The trustee may determine that it would be appropriate to use, sell, or lease property of the estate outside the ordinary course of business. Notice of the proposed use, sale, or lease must be given pursuant to Bankruptcy Rules 2002 and 6004, so parties in interest have sufficient notice of the transaction and an opportunity to object. Fed. R. Bankr. P. 2002, 6004. Additional requirements for sales of estate property are set forth in Bankruptcy Rule 6004. *See* Fed. R. Bankr. P. 6004.

When evaluating whether to sell assets of the estate outside of the ordinary course of business, the trustee must determine whether there are valid liens against the asset and whether the asset's value exceeds the liens. The trustee must also consider whether the costs of administration or the tax consequences of any sale will significantly erode or exhaust the estate's equity interest. If the sale would result in little or no equity for the estate to benefit creditors, the trustee should generally abandon the asset rather than sell it.

It is a violation of federal criminal law for a trustee to purchase directly or indirectly, or to otherwise deal in, property of the estate for which the trustee serves. 18 U.S.C. § 154(1). In addition, if the trustee becomes aware of any indications of secret sales to insiders or of collusion in bidding, the sale should be immediately stopped and the matter reported to the United States Trustee.

Special requirements apply when a proposed sale or transaction affects other persons' rights in the estate assets—for example, when the property is "cash collateral" or when the trustee wishes to sell a particular asset "free and clear" of liens and other interests. Those requirements are briefly discussed in the following sections.

### **3. Cash Collateral**

Immediately upon being appointed, the chapter 11 trustee should evaluate the extent to which cash collateral needs to be used in the estate's ongoing business operations. Pursuant to § 363, a debtor in possession or trustee may not use, sell, or lease "cash collateral" unless each entity having an interest in the property consents or the court authorizes such use, sale, or lease. 11 U.S.C. § 363(c)(2). "Cash collateral" consists of:

cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of [title 11], whether existing before or after the commencement of a case under [title 11].

11 U.S.C. § 363(a).

The restrictions on cash collateral reflect the potential for misuse of liquid assets that may, in many cases, be the proceeds of other types of collateral. If there is cash collateral, the debtor in possession or trustee must obtain the secured creditor's consent or seek court authority for any use, sale, or lease of the collateral. 11 U.S.C. § 363(c)(2); *see also* Fed. R. Bankr. P. 4001(b) (procedural requirements for obtaining permission to use cash collateral). In the absence of any such court order or consent, the trustee must segregate cash collateral. 11 U.S.C. § 363(c)(4).

If the debtor in possession previously obtained an order authorizing the use of collateral, the trustee upon being appointed should immediately review the extent to which the estate is in compliance with the order, as well as any pending budgetary constraints imposed by the order. The trustee may need to seek additional authority to use cash collateral if beneficial to the estate. The court may grant a proposed use of cash collateral, but require the trustee to satisfy certain conditions, including the provision of adequate protection. *See* 11 U.S.C. § 363(e). The terms of adequate protection are set forth in § 361.

### **4. Sales Free and Clear of Liens and Other Interests**

If persons other than the estate have liens or other interests in estate assets, the trustee may sell such assets subject to those interests, as set forth above. To protect the rights of others, however, the court may still condition the transactions on the provision of adequate protection under § 361.

The Bankruptcy Code also provides authority for the sale of estate assets free and clear of other interests, but only if certain additional requirements are satisfied. *See* 11 U.S.C. § 363(f)-(j). The trustee must demonstrate that one of the following conditions is satisfied:

- applicable non-bankruptcy law permits the sale free and clear of interests;
- the entity with the interest in the property consents to the sale;
- the interest is a lien and the price at which the property will be sold exceeds the aggregate value of all the liens on the property;
- the interest is in bona fide dispute; or
- the entity could be compelled in a legal or equitable proceeding to accept money satisfaction of its interest.

11 U.S.C. § 363(f). Frequently, courts will direct that any liens or other interests attach to the proceeds of the sale. To the extent that the trustee then disputes the nature, extent, and validity of any liens or other interests in the sale proceeds, the trustee must generally file an adversary proceeding. *See generally* Fed. R. Bankr. P. 7001.

At a sale of assets free and clear, unless the court orders otherwise, any lienholder having an allowed secured claim may bid and, if successful, offset its lien claim against the purchase price. *See* 11 U.S.C. § 363(k). Special rules governing the sale of property held as joint tenants, tenants in common, or tenants by the entirety also appear at § 363(h)-(j).

## **E. THE TRUSTEE'S "STRONG ARM" AND "AVOIDANCE POWERS"**

### **1. Overview**

A fundamental goal of the Bankruptcy Code is to ensure equality of distribution among similarly situated creditors. To ensure that some creditors do not receive better treatment than other creditors, the trustee is empowered to seek the avoidance of transfers that benefit one creditor at the expense of others of the same class. *See* 11 U.S.C. §§ 544, 545, 547-549, 553. These provisions should be read in conjunction with § 546, which sets forth certain limitations on the trustee's powers; § 550, which sets forth the liability of transferees of an avoided transfer; and § 551, which preserves for the estate the lien status as to any avoided liens and is useful if there are junior lienholders.

Some of the powers described below will be relevant to the trustee's responsibility under §§ 1106(a)(3) and (a)(4) to investigate and report on the debtor's financial affairs. Specifically, the trustee shall file "as soon as practicable" a statement describing the trustee's investigation, "including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate." 11 U.S.C. § 1106(a)(4)(A). The trustee's analysis of litigation

options will also be important for purposes of drafting any disclosure statement and chapter 11 plan.

The facts of the specific case will determine whether avoidance actions should be filed. The trustee will need to assess the existence and viability of such actions, but must also weigh the likely costs of the action against the expected benefit to the estate.

The Bankruptcy Code sets forth a federal statute of limitations for actions by the trustee under the “strong arm” and “avoiding” powers of §§ 544, 545, 547, 548, and 553. Such actions generally must be brought within two years of the commencement of the case. *See* 11 U.S.C. § 546(a). Assuming that a trustee has been appointed before the expiration of that time period, however, the trustee is not barred until one year following the appointment or the expiration of the two-year period, whichever occurs later. 11 U.S.C. § 546(a). The trustee should also be aware of any applicable statutes of limitations arising under non-bankruptcy law, such as limitations on state fraudulent conveyance actions that the trustee may consider pursuing under § 544(b). These non-bankruptcy statutes of limitations are generally extended for two years after the entry of the order for relief in the case, or until the statutory period expires naturally, whichever date is later. 11 U.S.C. § 108(a).

## **2. Section 544 - Trustee as Successor to Various Rights**

Pursuant to the “strong arm” provisions of § 544(a), the trustee is vested with the powers of a hypothetical judicial lien creditor or bona fide purchaser of real property under state law. *See* 11 U.S.C. § 544(a). By affording the trustee these rights of a hypothetical person as of the date the bankruptcy case is commenced, the statute empowers the trustee to avoid unperfected and secret liens as of that date, even if the debtor or trustee had knowledge of such liens. *See* 11 U.S.C. § 544(a)(1), (a)(3); *see* 5 Collier on Bankruptcy ¶ 544.03 and n.4 (15<sup>th</sup> ed. rev’d)(debtor in possession not charged with actual notice when exercising trustee’s section 544 powers). The trustee is also extended the rights of a hypothetical creditor who has obtained an unsatisfied execution against property of the debtor as of the commencement of the case. *See* 11 U.S.C. § 544(a)(2). This provision affords the trustee access to certain state equitable remedies such as the right, in some circumstances, to insist on the marshaling of assets, or the right to perform discovery in aid or execution.

Pursuant to § 544(b), the trustee may exercise the rights of an unsecured creditor to avoid liens under state fraudulent and preferential conveyance laws, or to avoid defective bulk transfers. 11 U.S.C. § 544(b). This provision is particularly useful for attacking fraudulent and preferential transfers that occurred outside of the one-year limitation found in §§ 547 and 548. Section 544(b) may also provide authority for the trustee to pursue other types of actions—for example, to pierce the corporate veil that exists between the debtor and other persons or entities, or to sue insiders based on their breach of fiduciary duties owed to creditors of an insolvent corporation.

In contrast to the strong arm powers, the trustee can invoke the rights of an actual unsecured creditor only when acting under § 544(b). Consequently, the trustee may be subject to defenses that can be raised against a particular creditor, including defenses of estoppel or the prepetition running of a statute of limitations under state law.

**3. Section 545 - Statutory Liens**

Section 545 empowers the trustee to avoid certain statutory liens, such as landlord liens, against the debtor's property within the terms and conditions set out in the section. *See* 11 U.S.C. § 545. "Statutory lien" is defined at § 101(53).

**4. Section 547 - Preferences**

The trustee's right to avoid preferential transfers is probably the most frequently used avoidance power. The trustee may avoid any transfer of an interest of the debtor in property:

- to or for the benefit of a creditor;
- for or on account of an antecedent debt owed by the debtor before the transfer was made;
- made while the debtor was insolvent;
- made on or within ninety days of the date the petition was filed (or if the transfer was to an "insider" as defined at § 101, made within one year before the date the petition was filed); and
- that enables the creditor to receive more than the creditor would have received if the case were a case under chapter 7 and the transfer had not been made.

11 U.S.C. § 547(b).

The "transfer" in question is broadly defined at § 101 and may include the granting or perfection of a lien or security interest as to property of the debtor. 11 U.S.C. § 101(54).

Section 547(c) sets forth defenses to the trustee's avoidance power. For example, the trustee may not be able to avoid transfers made by the debtor in contemporaneous exchange for new value, or payments by the debtor in accordance with the ordinary course of business dealings between the parties. *See* 11 U.S.C. § 547(c).

**5. Section 548 - Fraudulent Transfers**

Section 548 allows the trustee to avoid transfers that are of a different nature than the preferential transfers described above. While preferential transfers are most often made to creditors, fraudulent transfers are frequently made to family or friends. The Religious Liberty and Charitable Contribution Protection Act amended § 548 so that an individual debtor's contribution



to a qualified religious or charitable organization is not a constructive fraudulent conveyance if it does not exceed fifteen percent of the debtor's gross annual income for the year in which the transfer was made. 11 U.S.C. § 548; Pub. L. No. 105-183, 112 Stat. 517 (1998). Even if the amount exceeds fifteen percent, it is not a fraudulent conveyance if the transfer is consistent with the debtor's past practice. 11 U.S.C. § 548(a)(2).

In corporate cases, the possibility for attacking leveraged buyouts as fraudulent conveyances should be explored. Note, however, that there is no *per se* rule that a leveraged buyout loan collateralized with the target's own assets is subject to avoidance as a fraudulent conveyance. *Mellon Bank v. Metro Communications, Inc.*, 945 F.2d 635, 644-650 (3<sup>d</sup> Cir. 1991), *cert. denied*, 503 U.S. 937 (1992).

Subject to the above caveats, the trustee may avoid a transfer or obligation made or incurred within one year before the date of the filing when:

- the transfer or obligation involved an actual intent to hinder, delay, or defraud creditors, without regard to the solvency or insolvency of the debtor; or
- the debtor received "less than a reasonably equivalent value" in exchange for the transfer where (1) the debtor was or became insolvent as a result of the transfer; (2) the debtor was left with unreasonably small capital for its business; or (3) the debtor intended to incur debts beyond its ability to pay them as they mature.

11 U.S.C. § 548(a).

As noted above, the trustee should be aware of state fraudulent conveyance laws that may allow avoidance of transfers beyond the one-year period, through application of § 544(b).

## **6. Section 549 - Postpetition Transactions**

Section 549 recognizes the trustee's right to avoid any transfer of property made after the commencement of the case that is not specifically authorized by the Bankruptcy Code or by the court. *See* 11 U.S.C. § 549.

## **7. Section 553 - Setoff**

Section 553 recognizes the right to offset for mutual, prepetition, allowed claims and takes such transactions out of the preference category. *See* 11 U.S.C. § 553. The section places limits on the right of the offset as to claims to which the creditor became entitled to within ninety (90) days before the filing of the petition. *See id.*

## **F. CLAIMS AGAINST THE ESTATE**

While much of the trustee's initial activity in the case will involve the collection and preservation of estate assets, including any ongoing business activity of the debtor, the trustee must also examine the claims made against the estate. Most claim issues will involve the review of proofs of claims, although lawsuits against the estate may also need to be addressed.

### **1. Types of Claims**

There are three types of claims against a bankruptcy estate— secured, priority, and unsecured. Secured claims impose a charge or lien upon specific property of the estate. In chapter 11 cases, it is not uncommon for a bank or other lender to have a lien upon all or most of the estate's assets. Where the amount owed is less than the value of the collateral, the holder of such a secured claim is entitled to interest and reasonable fees, including attorney fees, if the contract with the debtor so provides. *See* 11 U.S.C. § 506(a), (b).

Priority claims are not secured, but nevertheless must be paid in full under a chapter 11 plan, absent an agreement by the creditor to take less. Nine classes of priority claims are set forth in § 507, and generally each class is entitled to be paid in full before the next lower class is paid any amount. 11 U.S.C. § 507(a).

Creditors having general unsecured claims cannot look to any specific property of the estate for payment in the manner of secured creditors, nor do their claims enjoy any particular priority in payment. How much of the general unsecured claims are paid under a chapter 11 plan is subject to the financial exigencies of the case and plan negotiation. Although secured and priority claims generally have to be paid in full and general unsecured claims do not, general unsecured claimants may be paid their dividends in advance of the full payment of secured and priority claims.

### **2. Proofs of Claims**

The trustee, if a purpose is to be served, should examine proofs of claim and object to the allowance of any claim that is improper. 11 U.S.C. § 704(5) (made applicable by § 1106(a)(1)). The chapter 11 trustee should request the court to fix a bar date for filing claims as soon as it appears likely that a confirmed plan is a better way to conclude the case than conversion or dismissal. *See* Fed. R. Bankr. P. 3003(b)(3). A reasonable bar date is sixty days, though local practice may vary. Governmental units cannot have a bar date imposed upon them that is less than 180 days after the order for relief. *See* 11 U.S.C. § 502(b)(9).

The claims review process should begin as soon as practicable so that the trustee will have an understanding of the debtor's obligations. Objections to claims should be filed and, if practicable, resolved prior to voting on the confirmation of the plan. While creditors must file a proof of claim in order to receive a dividend in chapter 7 cases, in chapter 11 cases creditors whose

claims are not scheduled as disputed, contingent, or unliquidated need not file claims, but may rely on the debtor's schedules for purposes of voting on the plan and receiving a distribution thereunder. *See* 11 U.S.C. § 1111(a); Fed. R. Bankr. P. 3003(b)(1), (c)(2). The chapter 11 trustee should carefully review the debtor's schedules. If the trustee determines that some claims should have been scheduled as disputed, contingent, or unliquidated, the trustee should amend the schedules prior to requesting a bar date from the court. The trustee should also be aware that the status of a particular claim could be important for purposes of a purported creditor's right to vote on a chapter 11 plan, and claims may need to be estimated for voting purposes. *See* 11 U.S.C. § 502(c).

Some issues to consider when reviewing claims are listed below.

- Appropriate documentation, e.g., a UCC Financing Statement, is required for all secured claims. The trustee should review this documentation to determine whether the secured creditor's lien is subject to avoidance pursuant to §§ 544-553. The trustee should verify that the claim was properly perfected at least ninety (90) days prior to the filing (or one year for insiders). The trustee may be able to avoid a lien perfected within ninety (90) days (or one year) pursuant to § 547. Bankruptcy Rule 3002 does not require a secured creditor to file a proof of claim. Therefore, prior to selling estate assets, the trustee should perform a lien search to verify that all liens have been identified.
- Tax claims should be verified. In most instances, a taxing entity will file only one claim that may include liens, as well as priority and general unsecured taxes.
- Unsecured claims should be reviewed for appropriate documentation, accuracy, and timeliness.
- Judgments and liens listed in the schedules should be compared to claims that are filed.

### **3. Objections to Claims**

A trustee should file objections to the allowance of claims, if appropriate. *See* Fed. R. Bankr. P. 3007 (procedural requirements for objections to claims). Possible reasons for objecting to a claim include:

- sufficient documentation is not provided;
- the claim amount is in error;
- the claim has been previously paid;
- the claim is not owed;

- the claim is a duplicate of another claim; or
- the claim is filed late.

Other grounds for objection may be found in § 502.

#### **4. Subordination of Claims**

The Bankruptcy Code empowers the trustee to obtain a court order subordinating certain claims to other claims for purposes of distribution. Section 510(a) empowers the trustee to enforce subordination agreements to the extent they are enforceable under non-bankruptcy law. *See* 11 U.S.C. § 510(a). Section 510(b) subordinates the claims of certain stockholders who might otherwise try to elevate their shareholder interests to general claims by rescinding their stock purchases. *See* 11 U.S.C. § 510(b). Most important for the chapter 11 trustee, § 510(c) empowers the trustee to seek subordination of a claim under principles of equitable subordination. *See* 11 U.S.C. § 510(c). Generally, equitable subordination requires misconduct on the part of the creditor that has injured the debtor or conferred an unfair advantage on the creditor. Subordination may be particularly relevant in regard to claims against the estate by creditors who are also insiders. Unless accomplished through a plan, subordination requires an adversary proceeding. *See* Fed. R. Bankr. P. 7001(8).

#### **5. Surcharge of Claims**

Section 506(c) provides that “[t]he trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.” 11 U.S.C. § 506(c). For example, if the trustee insures estate property subject to a lien, the cost of the insurance may often be deducted from the creditor’s claim. This provision reflects a concern that unsecured creditors not bear costs that are incurred primarily to preserve a secured creditor’s interest in collateral. The trustee should consider the facts of the case to determine whether administration could result in a surcharge, as well as whether such a surcharge may have been waived or otherwise impaired by earlier events in the case. The right of surcharge resides in the estate, not other parties in interest, and the proceeds come into the estate for the benefit of all creditors. *See Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 7 (2000).

#### **6. Administrative Expenses**

Generally, proofs of claims cover debts that either were incurred, or are deemed to have been incurred, prior to the commencement of the case. Obligations incurred after the filing of the case and not paid in the ordinary course of business constitute administrative expenses if the expenses were necessary to preserve the estate. *See generally* 11 U.S.C. § 503. Entities that have such unpaid obligations do not submit proofs of claims, but instead file requests for payment of

administrative expenses. 11 U.S.C. § 503(a). In reviewing such a request, the trustee must consider whether the expense was necessary for the estate, whether the claimant provided the service or goods as a mere volunteer or subject to contract and, if the latter, whether the terms and conditions of the contract were fulfilled. If the request is made by a professional whose retention by the court is a precondition of payment, the trustee should object if no order of employment was previously entered. *See, e.g., In re Milwaukee Engraving Co., Inc.*, 219 F.3d 635, 638-39 (7<sup>th</sup> Cir. 2000), *cert. denied*, 531 U.S. 1112 (2001) (no professional compensation allowed where employment application denied for lack of disinterestedness).

## G. CONTESTED MATTERS AND ADVERSARY PROCEEDINGS

### 1. Contested Matters

Much of the chapter 11 trustee's court activity proceeds through contested matters such as objections to claims. Bankruptcy Rule 9014 provides that in a "contested matter" relief shall be requested by motion and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. Fed. R. Bankr. P. 9014(a). Unless the court orders or local rules provide otherwise, no response to a motion is required. *Id.* In essence, contested matters are disputes not designated as adversary proceedings by Bankruptcy Rule 7001.

### 2. Adversary Proceedings

Adversary proceedings are lawsuits commenced by a complaint. The avoidance actions noted above are examples of actions that are brought through adversary proceedings. Unlike motion practice, adversary proceedings involve the service of a formal complaint and summons on the defendant. In most ways, these suits are like those brought in a district court pursuant to the Federal Rules of Civil Procedure. In fact, rules governing adversary proceedings incorporate by reference many of the civil procedure rules. *See* Fed. R. Bankr. P. 7001-7087.

Bankruptcy Rule 7001 defines the types of actions that must be brought by adversary proceedings. *See* Fed. R. Bankr. P. 7001. These actions include proceedings:

- to recover money or property, except a proceeding to compel the debtor to deliver property to the trustee or a proceeding under §§ 554(b) or 725, or Bankruptcy Rules 2017 or 6002;
- to determine the validity, priority, and extent of a lien or other interest in property;
- to approve of the sale of both the interest of the estate and of a co-owner in property;
- to object to or revoke a discharge;
- to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan;
- to determine the dischargeability of a debt;

- to obtain an injunction or other equitable relief, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for the relief;
- to subordinate any allowed claim or interest, except in chapter 9, chapter 11, chapter 12, or chapter 13 plans;
- to obtain a declaratory judgment; or
- to determine a claim or cause of action removed to a bankruptcy court.

### **3. Compromises and Settlements**

Contested matters and adversary proceedings often are not resolved by trial to conclusion or appeal, but instead by compromise and settlement. Bankruptcy Rule 9019 requires the chapter 11 trustee to obtain court approval of such compromises. *See* Fed. R. Bankr. P. 9019. To obtain that approval, the trustee must show that the settlement is in the best interest of the estate and that notice of the compromise has been served upon creditors so they have an opportunity to review the proposed settlement and object. Generally, courts give substantial deference to the trustee's business judgment in such matters.

## **H. TAX CONSIDERATIONS**

### **1. Overview**

Many of the matters discussed in this Handbook could have tax implications. This Handbook is not intended to answer all of the tax questions that might arise in each bankruptcy case. Tax advice should be sought on a case-by-case basis as the need arises. In particular, the trustee should consider (i) the need to file various tax returns on behalf of the debtor or the estate; (ii) employment tax issues that arise from operation of the debtor's business; (iii) tax consequences of sales and abandonments; (iv) the economic value of certain tax attributes, such as net operating loss carry-forwards; and (v) "quick audit" procedures that the trustee can use for the expeditious determination of taxes by the Internal Revenue Service under § 505(b). *See* IRS Publication No. 908 (Bankruptcy Tax Guide); 11 U.S.C. §§ 346 (special tax provisions), 1146 (special tax provisions); 26 U.S.C. §§ 1398, 1399 (no separate taxable entity for partnerships and corporations).

Sections 346 and 728 of the Bankruptcy Code, as well as §§ 1398 and 1399 of the Internal Revenue Code, 26 U.S.C. § 1, *et seq.*, set forth special tax provisions with which the trustee should be familiar. These sections generally provide that the trustee must prepare and file appropriate income tax returns for any estate income earned during the administration of the estate. If the debtor has not already done so, the trustee also may consider filing prepetition tax returns, especially where it appears the estate would be entitled to a refund. The trustee cannot sign an individual tax return for a period that ended before the bankruptcy filing. If the debtor will not sign

the return, the trustee can have the returns prepared and then ask the taxing authority to file the return.

In preparing estate tax returns, the trustee should review the debtor's prior year returns. If the debtor cannot or will not provide copies of these returns, the trustee can request copies from the IRS using Form 4506. *See* 26 U.S.C. § 6103(e)(4)-(5). Such requests should be directed to the Service Center where the debtor's tax returns were filed. The trustee may wish to contact the local IRS Small Business/Self-Employed Insolvency Territory Manager to determine if it can obtain the returns more quickly.

Under certain limited circumstances, the IRS may grant the trustee relief from filing a particular estate tax return. The trustee may wish to consult with the IRS Small Business/Self-Employed Insolvency Territory Technical Services Unit for further information. *See also* Rev. Rul. 84-123, 1984-2 C.B. 244 (filing requirements); Rev. Proc. 84-59, 1984-2 C.B. 504 (procedure where bankrupt corporation has no assets or income).

## **2. Individual Debtors**

For both federal and state tax purposes, the individual and the bankruptcy estate are treated as separate taxable entities and a separate tax identification number is required for the estate. If a husband and wife file a joint petition under § 302, absent substantive consolidation, two separate estates and two separate taxable entities are created. Each estate obtains its own tax identification number and files its own tax returns. For tax years beginning in 2002, the requirement to file a return for a bankruptcy estate only applies if gross income is at least \$6,925.

The trustee files a return for an individual's estate using Form 1041 (U.S. Income Tax Return for Estates and Trusts) as a transmittal form, along with a Form 1040 (U.S. Individual Income Tax Return) and appropriate forms and schedules. The tax to the estate is computed generally in the same manner as for an individual and the rate schedules used are those for married individuals filing separate returns under 26 U.S.C. § 1(d), pursuant to 26 U.S.C. § 1398(c). For joint debtors, a separate Form 1041 and the related attachments are filed for each spouse's estate.

The estate is entitled to deduct administrative expenses allowed under § 503 and any fees and charges assessed by the court to the extent such deductions are not otherwise disallowed by other provisions of the Internal Revenue Code. 26 U.S.C. § 1398(h)(1).

The debtor's tax attributes are transferred to the estate upon commencement of the case. The attributes are determined as of the first day of the taxable year in which the petition is filed. Generally, this is January 1 of the year of filing but, if the debtor makes a short-year election, the attributes are determined as of the date of filing. The debtor's discharge may affect the use of tax

attributes by the estate. The trustee should consider the effects of 26 U.S.C. § 108 (income from discharge of indebtedness) on the debtor's tax attributes.

The debtor can make a short-year election that terminates the debtor's taxable year on the date before the petition is filed and begins a second taxable year on the date of filing. 26 U.S.C. § 1398(d)(2). If the debtor makes this election, any tax owing for the prepetition short year is treated as a priority tax claim against the estate.

The trustee has the option to follow the individual debtor's taxable year, which is usually the calendar year, or adopt a fiscal taxable year. The trustee also is permitted to change the estate's annual accounting period once without the approval of the Secretary of the Treasury, as otherwise required. 26 U.S.C. § 1398(j)(i). These options enable the trustee to do some tax planning to minimize any tax liability and to expedite closure of the case.

The trustee must disclose to the debtor all information contained in the estate tax returns that can affect the debtor's future or past returns, since the debtor acquires the tax attributes of the estate upon its closing. *See* 26 U.S.C. § 1398(i).

### **3. Partnership and Corporate Chapter 11 Debtors**

*(Note: Limited liability corporations (LLCs) and limited liability partnerships (LLPs) are treated the same as partnerships.)*

The filing of a bankruptcy petition by a partnership or corporation does not create a separate taxable entity. There is no break in the accounting period of the partnership or corporation and the tax return, filed under the debtor's tax identification number, must reflect the pre- and postpetition income and deductions. The trustee files a corporate income tax return using Form 1120 (U.S. Corporate Income Tax Return) or Form 1120S (U.S. Income Tax Return for an S Corporation), and a partnership tax return on Form 1065 (U.S. Partnership Income Tax Return), with appropriate forms and schedules attached to each.

Unless a corporation is exempt from income tax under 26 U.S.C. § 501(a), corporate returns must be filed by the trustee regardless of whether the corporation has income. The trustee must also file state income tax returns for a corporation. Upon application to the IRS Small Business/Self-Employed Insolvency Territory Technical Services Unit, the IRS may waive the requirement to file federal returns if the corporate debtor has ceased business operations and has neither assets nor income. *See* Rev. Rul. 84-123, 1984-2 C.B. 244; Rev. Proc. 84-59, 1984-2 C.B. 504.

The same rule also generally applies to S corporations. The trustee is required to file such a tax return if the trustee "has possession of or holds title to all or substantially all the property or business of a corporation." 26 U.S.C. § 6012(b)(3).



Unlike an ordinary (or “C”) corporation, an S corporation does not normally incur any income tax liabilities. Instead, the income or losses are allocated and passed on to the shareholders, who are personally liable for the tax on their share of income.

Section 6012 of the Internal Revenue Code, title 26 U.S.C., sets forth when a trustee for a corporation must file a return.

- (a) General rule. Returns with respect to income taxes under subtitle A shall be made by the following:

....

- (2) Every corporation subject to taxation under subtitle A;

....

- (b) Returns made by fiduciaries and receivers.

....

- (3) Receivers, trustees and assignees for corporations. In a case where a . . . trustee in a case under title 11 . . . has possession of or holds title to all or substantially all the property or business of a corporation . . . such . . . trustee . . . shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

26 U.S.C. § 6012; *see also* 26 U.S.C. § 6062 (trustee required to sign return pursuant to § 6012(b)(3)).

S Corporations are required to make a return of their income for each taxable year:

Every S corporation shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable . . . . Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

26 U.S.C. § 6037(a). This form is Form 1120-S, U.S. Income Tax Return for an S Corporation.

Because § 6012(b)(3) plainly states that trustees shall file returns “in the same manner and form” as corporations are otherwise required to file, and § 6037 requires S corporations to file returns, trustees must file returns for S corporations. 26 U.S.C. § 6012(b)(3). *See also* Treas. Regs., 26 C.F.R. § 1.6012-3(b)(4) (2003).

For partnership cases, the chapter 11 trustee must file the federal and state tax returns regardless of the amount of gross income.

#### **4. Employment Taxes and Other Tax Forms**

If the debtor was an employer, the trustee must file any Form 941 (Employer’s Quarterly Federal Tax Return) for withheld federal income and FICA taxes, or Form 940 (Employer’s Annual Federal Unemployment Tax Return) for unemployment taxes, that was not filed by the debtor before commencement of the bankruptcy case. Failure to file these returns may lead to the imposition of penalties against the trustee or the estate.

In addition, the trustee must withhold all applicable federal and state income, social security, and medicare taxes from any wages or wage claims paid by the estate. The taxes must be properly and timely deposited with a financial institution or paid with the return. Further, depending upon the debtor’s business, the trustee may need to file sales, excise, and other tax returns to establish the amount of the taxing authority’s claim.

The trustee may also have to file information returns (Form 1099 series) if certain payments are made. For example, Form 1099-INT must be supplied to the payee and to the IRS when a trustee makes a payment of interest aggregating \$10 or more. *See* 26 U.S.C. § 6049. Similarly, the trustee may be required to file a return and issue a Form 1099-MISC when \$600 or more in fees are paid to accountants and other professionals for their work in assisting in the administration of the estate. Payments aggregating more than \$600 in a calendar year to an attorney for legal services (regardless of whether those legal services were performed for the trustee) must also be reported to the IRS and a Form 1099-MISC must be issued. The trustee should consult his/her accountant and the General Instructions for IRS Form 1099 (Information Returns) for more information.

#### **5. Employee W-2 Forms**

If the trustee pays wages, including prepetition wage claims, the trustee is responsible for preparing and filing W-2 forms for the wages paid and for sending copies to the employees. If the trustee does not pay any wages, but wages were paid by the debtor during the calendar year of the bankruptcy petition, the trustee will receive requests from the employees for wage withholding information to complete their personal income tax returns. In these circumstances, the trustee may complete W-2 forms to give to the employees based on the corporate records or may make those records available to the former employer or former employees to assist them in reconstructing the

information. In any event, if an employee cannot obtain Form W-2 for wages paid by the debtor prepetition, the employee should be instructed to secure Form 4852 from the IRS and attach it to Form 1040 to obtain credit for the estimated amount of taxes withheld. For further information, the trustee may consult IRS Circular E (the Employer's Tax Guide).

## 6. Sales and Abandonments

When estate property is sold, the estate recognizes a taxable gain or loss. Any resulting tax liability is treated as an administrative expense. The trustee should abandon assets that will not generate net proceeds sufficient to pay any tax liability generated by the sale. For example, the estate is liable for any tax gain upon the sale of property, even if the proceeds are abandoned. See *Erickson v. United States Trustee (In re Bentley)*, 916 F.2d 431 (8<sup>th</sup> Cir. 1990). In an individual case, the estate also is liable for any taxable gain from foreclosure after relief from the automatic stay is granted if the property is not abandoned before the foreclosure sale.

Some courts have held that when a trustee abandons property of an individual's chapter 7 estate, whether during the bankruptcy under § 554(a) or at the close of the case under § 554(c), the abandonment is a tax-free transaction and any tax liabilities resulting from the subsequent disposition of the property are borne by the individual. Thus, if an asset is sold or foreclosed upon after abandonment, any tax liabilities as a result of the sale or foreclosure are the responsibility of the debtor, not the trustee. For the minority view, see *In re A.J. Lane & Co., Inc.*, 133 B.R. 264 (Bankr. D. Mass. 1991); *In re Rubin*, 154 B.R. 897 (Bankr. D. Md. 1992). Unlike an individual bankruptcy case, the abandonment or failure to abandon property by the trustee in a corporate or partnership case does not relieve the corporate or partnership taxable entity from recognizing and reporting the tax effects of a subsequent sale or foreclosure of the property. This is because no separate taxable entity is created upon the commencement of a corporation or partnership bankruptcy case. See 26 U.S.C. § 1399.

## 7. Failure to Pay

The trustee must file appropriate returns and pay tax liabilities on behalf of the estate. A trustee who fails to comply with the federal withholding provisions runs the risk of being held personally liable for trust fund taxes not collected and paid over to the government. Similarly, the trustee may be held personally liable when an estate does not have sufficient funds to pay the taxes due from the sale of estate assets.

In some circumstances, the trustee can seek relief under 26 U.S.C. § 6658 from the imposition of penalties under 26 U.S.C. § 6651, 6654, or 6655 for failure to pay certain taxes. Such relief is conditioned on showing that (1) the failure to pay taxes incurred by the estate resulted from a court order finding probable insufficiency of funds; or (2) the tax was incurred by the debtor prepetition, and either the petition was filed prior to the tax return due date or the

penalty was imposed after the petition was filed. 26 U.S.C. § 6658(a). However, relief under this section is not available for cases involving the failure to pay employment taxes. See 26 U.S.C. § 6658(b).

## **8. Quick Audits**

Under § 505(b), the trustee may request determination of unpaid estate liabilities for any taxes incurred during the administration of the case by filing the tax return and requesting that determination from the appropriate tax agency. 11 U.S.C. § 505(b). The procedure, which is known as the “quick audit,” allows the trustee to wind up the administration of the case expeditiously.

In the case of federal taxes, the trustee must file a written application with the IRS. Rev Proc. 81-17 § 3.01, 1981-1, C.B. 688. The trustee should send the request to the Small Business/Self-Employed Insolvency Territory Manager for the territory in which the bankruptcy case is pending. *Id.* The application must be submitted in duplicate and executed under penalty of perjury. The application must be accompanied with an exact copy of the return(s) filed by the trustee and a statement as to where the original return(s) were filed. *Id.* Any tax shown owing on the return must have been paid. The envelope should be marked: “Request for Prompt Determination. DO NOT OPEN IN MAIL ROOM.” *Id.*

The agency must give notice within sixty (60) days whether the return has been selected for an examination or is being accepted as filed, Rev. Proc. 81-17 § 3.02, 1981-1 C.B. 688, and has 180 days to complete an examination unless an extension of time is granted by the court. *Id.* If the agency does not give notice or complete its examination within the applicable time limits, the trustee is discharged from liability, absent fraud or a material misrepresentation in the return. *Id.* at § 202. The trustee also is discharged upon paying the tax determined to be due by the agency or by the court upon completion of the quick audit. *Id.*

The trustee should consult Revenue Procedure 81-17, 1981-1 C.B. 688, for the quick audit procedures applicable to federal taxes.

**CHAPTER 9: DISCLOSURE STATEMENTS, PLANS, AND ALTERNATIVES**

**A. TRUSTEE'S DUTIES**

Pursuant to § 1106(a)(3), the chapter 11 trustee is required “to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor’s business and the desirability of the continuance of such business, and any other matter relevant to the case or the formulation of a plan.” 11 U.S.C. § 1106(a)(3). Further, pursuant to § 1106(a)(4), the trustee must file a statement or report regarding the trustee’s investigation. *See* Chapter 7, *supra*. Completion of the investigation and preparation of the statement should form the basis of the trustee’s next course of action. Section 1106(a)(5) directs the trustee to, as soon as practicable, file a plan under § 1121, file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under chapter 7, 12, or 13 of this title or dismissal of the case. 11 U.S.C. § 1106(a)(5).

While this section seems to give the trustee only three options – file a plan, recommend conversion, or recommend dismissal – the unique circumstances of the case may suggest an alternative recommendation that combines portions of these options. *See generally* Chapter 9, Section E, *infra*.

**B. FILING A DISCLOSURE STATEMENT AND PLAN OF REORGANIZATION**

If, after conducting the investigation required by § 1106(a)(3), the trustee determines that the debtor can be reorganized or that the debtor should be liquidated while in chapter 11, the trustee should prepare and file a disclosure statement and a plan of reorganization or liquidation. Both documents are intended to be circulated to creditors whose votes will be solicited. However, no acceptance or rejection of a plan may be solicited “after the commencement of the case under [title 11] from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.” 11 U.S.C. § 1125(b).

**1. Disclosure Statement**

A disclosure statement must contain “adequate information,” which is defined in § 1125(a)(1) as:

information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor’s books and records, that would enable a hypothetical reasonable investor typical of holders

of claims or interests of the relevant class to make an informed judgment about the plan.

11 U.S.C. § 1125(a)(1).

As noted in the legislative history to § 1125, what constitutes adequate information will vary from case to case. “Courts will take a practical approach as to what is necessary under the circumstances of each case, such as the cost of preparation of the statements, the need for relative speed in solicitation and confirmation, and, of course, the need for investor protection. There will be a balancing of interests in each case. In reorganization cases, there is frequently great uncertainty. Therefore the need for flexibility is greatest.” H.R. ReP. No. 95-595, at 409 (1977).

In considering the meaning of “adequate information,” courts have developed lists of topics that should be discussed in the disclosure statement. Absence of any particular category might not be fatal to the disclosure statement, but a trustee should consider addressing each of the topics below:

- description of debtor’s business;
- reasons for financial difficulties and correction of those factors;
- historical and current financial information;
- material postpetition events;
- outline of the plan;
- means of effectuating the plan;
- securities to be issued, if any;
- projections, if any;
- post-confirmation management and control;
- insider and affiliate claims, and transactions with insiders/affiliates;
- disputed claims;
- ongoing legal proceedings involving debtor;
- tax consequences for debtor;
- existence and future of any committees; and
- liquidation analysis.

What constitutes “adequate information” must be considered in conjunction with the concept of a hypothetical investor typical of holders of claims or interests of a relevant class. As defined at § 1125(a)(2), an “investor typical of holders of claims or interests of the relevant class” means an investor having –

- (A) a claim or interest of the relevant class;
- (B) such a relationship with the debtor as the holders of other claims or interests of such class generally have; and

- (C) such ability to obtain such information from sources other than the disclosure required by this section as holders of claims or interests in such class generally have.

11 U.S.C. § 1125(a)(2). Thus, what constitutes adequate disclosure for a particular class of claimants will vary depending on the availability of information to and the level of sophistication of the claimants in the class.

When preparing the disclosure statement, a trustee is not expected to attain the understanding of the debtor's history and operations possessed by the debtor's principals. Indeed, in cases where the books and records are incomplete or in disarray, recreating them may not be a prudent use of the estate's resources. The trustee should acknowledge in the disclosure statement if efforts to obtain a complete picture of the debtor's affairs have been stymied, and should reveal any known risks to the estate arising from failure to recreate the records.

Other factors that can affect the quantity and quality of information included in the disclosure statement include (1) the nature of the proposed plan, and whether it contemplates reorganization or liquidation; (2) the sophistication of the various holders of claims and interests and their familiarity with the debtor and its business; (3) whether the expense of the disclosure would substantially outweigh its anticipated benefit to creditors and stockholders; (4) the peculiarities of the debtor's business or financial condition; (5) the need for an expeditious resolution of the case; and (6) any requirements mandated by local rules.

Although disclosure statements are not expected to follow a prescribed format, use of some standard language is appropriate and there may be local rules, prescribed forms, or standard practices in place in the district where the case is pending which should be consulted. Each disclosure statement should note that any representations made to secure a vote in favor of the plan that are not included in the disclosure statement should be reported to the trustee, the creditors' committee, the United States Trustee, and the court. Each disclosure statement should state that the plan, once approved, becomes a legally binding arrangement and should be read in its entirety, as opposed to relying on the summary in the disclosure statement. Other standard language would include the following:

- a statement that approval of the disclosure statement is not approval of the plan;
- a definition of impairment and list of impaired classes entitled to vote;
- a description of voting requirements found in § 1126;
- instructions for the submission of ballots;
- a statement that the court's approval of the disclosure statement does not constitute a ruling or an opinion of the court as to the merits of the plan; and
- a statement that various tax issues or any tax consequences flowing from confirmation of the plan should be considered independently by the creditor's accountant.

**2. Plan of Reorganization or Liquidation**

Unlike the disclosure statement, the plan will become the binding legal document that determines the rights of creditors and parties in interest after confirmation. Accordingly, § 1123(a) lists specific items which must be part of every plan. Section 1123 provides:

- (a) Notwithstanding any otherwise applicable non bankruptcy law, a plan shall—
  - (1) designate, subject to section 1122 of [title 11], classes of claims, other than claims of a kind specified in section 507(a)(1), 507(a)(2), or 507(a)(8) of [title 11], and classes of interests;
  - (2) specify any class of claims or interests that is not impaired under the plan;
  - (3) specify the treatment of any class of claims or interests that is impaired under the plan;
  - (4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;
  - (5) provide adequate means for the plan's implementation, such as—
    - (A) retention by the debtor of all or any part of the property of the estate;
    - (B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;
    - (C) merger or consolidation of the debtor with one or more persons;
    - (D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;
    - (E) satisfaction or modification of any lien;
    - (F) cancellation or modification of any indenture or similar instrument;
    - (G) curing or waiving of any default;
    - (H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;
    - (I) amendment of the debtor's charter; or
    - (J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;



- (6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; and
- (7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee.

11 U.S.C. § 1123(a). In addition, § 1123(b) enumerates certain provisions that may be included in the plan, but that are not mandatory. 11 U.S.C. § 1123(b).

Because of the importance of the plan, the trustee must look for any omissions or ambiguities in drafting that might create problems after confirmation. For example: Who will be responsible for implementing the plan? When and how will creditors be paid? Are all foreseeable contingencies to plan completion addressed? Have consequences been set forth? What will be the court's role or jurisdiction after confirmation? What, if any, will be the role of the chapter 11 trustee after confirmation? What about the creditors' committee? Again, the United States Trustee may be able to provide guidance on some issues.

## C. CONFIRMATION PROCESS

### 1. Approval of the Disclosure Statement

The confirmation process has multiple steps. First, the court must determine whether the disclosure statement contains adequate information. *See* Chapter 9, Section B.1, *supra*. Pursuant to Bankruptcy Rule 3017(a), after the plan and the disclosure statement have been filed, but before the disclosure statement is approved, both documents must be mailed to the debtor, any trustee or committee appointed under the Bankruptcy Code, the Securities and Exchange Commission, the United States Trustee, and any party in interest who requests a copy in writing. Fed. R. Bankr. P. 3017(a). A hearing is scheduled to consider the sufficiency of the disclosure statement. *Id.* All creditors, equity security holders, and other parties in interest must be given at least 25 days notice of the hearing. *Id.*; *see also* Fed. R. Bankr. P. 2002(b). The notice of hearing may include a bar date for filing objections to the disclosure statement; however, if no bar date is set, parties in interest may file objections to the disclosure statement at any time until the disclosure statement is approved. Fed. R. Bankr. P. 3017(a). Any objections to the disclosure statement must be filed and

served on the debtor, any trustee or committee, the Securities and Exchange Commission, the United States Trustee, and any other entity designated by the court. *Id.*

Upon approval of the disclosure statement, the court will direct the distribution of the approved disclosure statement, the plan, or a court-approved summary of the plan; the order approving the disclosure statement; a ballot; notice of the time fixed for filing acceptances or rejections of the plan; the time fixed for filing objections to the plan and the time and date of the confirmation hearing; and any other documents deemed important by the court. Fed. R. Bankr. P. 3017(d). The entire package must be mailed to all creditors and all equity security holders, except as the court orders otherwise with respect to a class or classes of unimpaired creditors or equity security holders. *See id.*

Generally, the plan proponent is responsible for distributing the confirmation package and for receiving and counting ballots. However, in some jurisdictions, the bankruptcy clerk may serve one or both functions. The trustee should check the practice in the area where the case is pending.

## **2. Confirmation of the Plan**

Bankruptcy Rule 3020(b) sets out the procedure the court will follow in considering confirmation of the plan. *See* Fed. R. Bankr. P. 3020(b). At a confirmation hearing, the court must determine whether the plan complies with the elements of § 1129. *See* 11 U.S.C. § 1129(a) (court may confirm plan only if requirements are met); *see also* 11 U.S.C. § 1128(a) (confirmation hearing required). The court must find that the plan meets all the requirements of § 1129(a), including the requirement that each class of claims has accepted the plan or is not impaired under the plan. *See* 11 U.S.C. § 1129(a)(8). “Acceptance” is defined by § 1126. *See generally* 11 U.S.C. § 1126.

If the plan satisfies all requirements of § 1129(a) except that an impaired class has not accepted the plan, then the court must determine whether the non-accepting class can be “crammed down” under § 1129(b). The court may still confirm the plan if it does not “discriminate unfairly, and is fair and equitable with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.” 11 U.S.C. § 1129(b)(1). The condition that the plan be “fair and equitable” is further defined at § 1129(b)(2), and depends on whether the non-accepting class is a secured claim, or consists of unsecured claims or interests. *See* 11 U.S.C. § 1129(b)(2). Discussion of the absolute priority rule and the new value exception may occur at this phase of the confirmation process. Those concepts are beyond the scope of this Handbook, but are discussed at length in most bankruptcy treatises.

The confirmation process is detailed and can be complicated. Accordingly, a chapter 11 trustee must seek guidance beyond the scope of this Handbook with regard to specific legal requirements.

#### **D. POST-CONFIRMATION DUTIES**

Pursuant to § 1141(b), “the confirmation of a plan vests all of the property of the estate in the debtor.” 11 U.S.C. § 1141(b). Accordingly, once the plan is confirmed, the duties of the chapter 11 trustee appointed pursuant to § 1104 are essentially completed. (The trustee will be required to perform certain ministerial duties such as filing a final report.) However, in some instances, the plan provides for a trustee to perform post-confirmation duties. This person is generally referred to as a “plan trustee” or a “post-confirmation trustee” and is a separate and distinct entity from the previously appointed chapter 11 trustee. While a chapter 11 trustee appointed pursuant to § 1104 is appointed by the United States Trustee and directed by statutory mandates of the Bankruptcy Code, the Bankruptcy Rules, and requirements of the United States Trustee, a “plan trustee” is selected and generally governed by the terms of the plan. This is true even if the chapter 11 trustee and the plan trustee are the same person.

A plan trustee or post-confirmation trustee who assumes responsibility for plan implementation will have additional duties beyond those imposed by the plan. The trustee must provide post-confirmation reports to the United States Trustee, and must ensure the payment of quarterly fees that accrue post-confirmation. The trustee should contact the local office of the United States Trustee regarding the reports that are required post-confirmation.

Post-confirmation modification of the plan may also become necessary. Section 1127(b) controls such modifications. Changes can be made as long as the plan has not been substantially consummated. *See* 11 U.S.C. § 1127(b). Although substantial consummation is defined at § 1101(2), in many jurisdictions, courts have issued opinions which refine the definition of substantial consummation.

The trustee must also take steps to close the case at the appropriate time. A case closes after the trustee or some other party requests a final decree. Bankruptcy Rule 3022 provides that the court shall enter the final decree on its own motion or on motion of a party in interest “after an estate is fully administered.” Fed. R. Bankr. P. 3022; *see also* 11 U.S.C. § 350(a) (court shall close case after estate fully administered and trustee discharged). The term “fully administered” is not defined, but case closure does not have to wait for plan completion. The trustee should be certain that continuing involvement by the court is no longer necessary before requesting a final decree. Once the final decree has been issued and the case is closed, the obligation to pay quarterly United States Trustee fees terminates. Case closing is discussed further in Chapter 11 Section B, *infra*.

## **E. ALTERNATIVES**

Proceeding to confirmation is not the only option available to the trustee. The trustee may also recommend conversion to a case under chapter 7, 12, or 13, or may recommend dismissal. *See* 11 U.S.C. §1106(a)(5).

### **1. Conversion of a Case to Chapter 7**

Conversion to chapter 7 may be appropriate if the trustee concludes that the estate should be liquidated. In addition to recommending conversion to chapter 7 in the report of investigation, the trustee has the power to file a motion seeking such conversion. *See* 11 U.S.C. § 1112(b). After notice and hearing, the court may convert a case to chapter 7 for “cause.” *Id.* By contrast, while a trustee may recommend that a debtor’s affairs could be better administered under chapter 12 or 13, only a debtor can seek conversion to one of those chapters. *See* 11 U.S.C. § 1112(d).

Pursuant to § 348(e), conversion terminates the services of the chapter 11 trustee. The United States Trustee will then appoint an interim trustee pursuant to § 701. Although the United States Trustee may appoint the former chapter 11 trustee as the interim trustee, there may be occasions when it is not in the best interest of creditors to do so. The decision will turn on the facts of the case.

The chapter 11 trustee should consider the alternative of conversion in a number of circumstances. First, if the economics of the case make it impossible to satisfy the requirements of confirmation set forth in § 1129, then conversion of the case may be the best alternative. For example, if the estate will never have sufficient funds to pay administrative claims in full and the claimants will not agree to accept different treatment, confirmation is not a possibility. *See* 11 U.S.C. § 1129(a)(9). Accordingly, the time and effort expended toward that end is an exercise in futility.

Even when confirmation of a plan is a possibility, it may not be in the best interest of creditors in view of the time and expense incident to the confirmation process—for example, the cost of preparing the plan and disclosure statement and the attendant costs of obtaining confirmation including professional fees. Rather, the trustee may determine that creditors will be best served by converting the case and distributing the funds of the estate in accordance with the priorities set forth in the Bankruptcy Code. For example, if the debtor’s business is no longer operating, the assets have been liquidated, and the estate consists only of cash and causes of action, conversion to chapter 7 may be the most appropriate course of action.

Notwithstanding that conversion to chapter 7 may be inevitable, the trustee may not want to seek conversion immediately. Timing of a conversion may be critical with regard to maximizing the benefit to creditors. For example, when a debtor’s business can be operated and sold as a going concern in a chapter 11 case for an amount greater than could be realized by “piecemeal”

liquidation, the trustee should seek a buyer for the operating business rather than immediately seek conversion to chapter 7.

## 2. Dismissal of the Case

Based on the facts of the case, the chapter 11 trustee may decide that dismissal rather than conversion is in the best interests of creditors and the estate. *See* 11 U.S.C. § 1112(b). In making that decision, the trustee must consider the consequences of dismissal as provided in § 349. Unless the court orders otherwise, dismissal will nullify previously entered avoidance and turnover orders, reinstate pre-bankruptcy custodianships, and revest property of the estate in whoever held the property prepetition. 11 U.S.C. § 349(b). The trustee should consider whether asking the court to forgo some of these effects would be in the best interests of creditors.

When no plan is confirmable, dismissal and conversion are the only viable alternatives. In certain situations, dismissal is preferable to conversion. For example, an intervening event, such as new financing, may allow the debtor to work out its problems with creditors without the need for additional court intervention. Further, if the estate assets are totally encumbered by liens, a conversion offers no benefit to creditors. There will be no dividend available for unsecured creditors, and secured creditors will be needlessly delayed in enforcing their rights to their collateral.

Finally, dismissal may be appropriate in a case where a chapter 11 plan has been confirmed and is in default, if the plan did not preclude all property of the estate from vesting in the debtor at confirmation. In such a case, there may be nothing for the chapter 7 trustee to administer and the conversion would be pointless. *See generally In re K & M Printing, Inc.*, 210 B.R. 583 (Bankr. D. Ariz. 1997); *In re T.S.P. Indus., Inc.*, 120 B.R. 107 (Bankr. N.D. Ill. 1990); *but cf. Pioneer Liquidating Corp. v. United States Trustee (In re Consol. Pioneer Mortgage Entities)*, 264 F.3d 803, 807-09 (9th Cir. 2001) (conversion affirmed, in part, on provisions of confirmed chapter 11 plan).

When deciding whether to seek dismissal or conversion, the trustee should consider a variety of factors, including the following:

- whether some creditors received preferences that could be recovered under chapter 7 for more equitable distribution;
- whether the debtor would file another case if the present one were dismissed;
- whether conversion or dismissal would maximize the estate's value as an economic enterprise;

- whether a non-bankruptcy forum would be the better place to resolve any remaining issues;
- whether the estate contains a single asset or assets that are encumbered and not likely to be administered under chapter 7; and
- whether the debtor engaged in misconduct and should be subjected to denial of discharge proceedings.

7 *Collier on Bankruptcy* ¶ 1112.04[6] (15<sup>th</sup> ed. rev'd 2003).

The trustee should also consider whether the estate possesses valuable bankruptcy causes of action that will be lost upon dismissal of the case.

**CHAPTER 10: EMPLOYMENT AND SUPERVISION OF PROFESSIONALS  
AND TRUSTEE COMPENSATION**

**A. INTRODUCTION**

Pursuant to § 327, a chapter 11 trustee may employ professionals, including attorneys, accountants, appraisers, or auctioneers to "represent or assist the trustee in carrying out the trustee's duties" under the Bankruptcy Code. 11 U.S.C. § 327(a). Those professionals may be awarded compensation for actual and necessary services and reimbursement for actual and necessary expenses, pursuant to § 330. 11 U.S.C. § 330; *see also* 11 U.S.C. § 331 (award of interim compensation).

The employment of professionals must be approved by the court. *See* 11 U.S.C. § 327. Court approval should be sought prior to the rendering of any services. Issues such as disinterestedness and necessity of employment are more appropriately addressed when court approval is sought and obtained prior to work by the professional. *See id.* (requiring professional persons to be disinterested and hold no interest adverse to the estate). Generally, courts do not authorize compensation for services rendered prior to court-ordered employment. Some courts permit retroactive or *nunc pro tunc* orders of employment in special circumstances, but even where permitted such orders should be rarely sought.

**B. DEFINITION OF PROFESSIONALS**

In determining whether to seek court approval for employment, a threshold issue is whether the trustee is seeking to employ a "professional person" for purposes of § 327. The list provided by § 327(a) - attorneys, accountants, appraisers, auctioneers - is not exhaustive. *See* 11 U.S.C. § 327(a) (list includes "or other professional persons"). The trustee may find it necessary to employ brokers, underwriters, farm managers, private investigators, and so forth. If an issue arises regarding the need to obtain court approval of the employment, the trustee should consider the following.

- Will the person play a central role in the administration of the estate?
- Will the person possess discretion or autonomy over some part of the estate?
- Does the person have special knowledge or skill usually achieved by study and educational attainments?
- Does the person operate under a license or governmental regulation?

When in doubt, the trustee should err on the side of caution and seek court approval of the employment.

### **C. EMPLOYMENT STANDARDS**

The threshold question for the employment of any professional is whether the employment is necessary. The trustee should determine at the outset the level of professional work required and the estimated costs associated with the work, as well as whether the expected benefits of the services warrant the employment.

As a general rule, professional persons employed by a trustee must be disinterested and must not have an interest adverse to the estate. 11 U.S.C. § 327(a); *see also* 11 U.S.C. § 101(14) (defining “disinterested person”). Additional considerations are set forth in § 327(b)-(f), as follows. In an operating chapter 11 case, the trustee may generally retain or replace professional persons who have been regularly employed by the debtor on salary. 11 U.S.C. § 327(b). Representation of a creditor does not disqualify a person from representing the trustee, unless there is an objection from another creditor or the United States Trustee and the court finds an actual conflict of interest. 11 U.S.C. § 327(c). The trustee may retain an attorney for a “specified special purpose,” even though the attorney previously represented the debtor, if the attorney does not hold or represent an adverse interest to the debtor or the estate with respect to the subject matter of the employment. 11 U.S.C. § 327(e). The trustee should be aware that the disinterestedness requirement under § 327(a) does not apply to attorneys employed pursuant to § 327(e). Finally, the trustee may not employ a person who has served as an examiner in the case. 11 U.S.C. § 327(f).

The trustee must diligently inquire into factual circumstances that may preclude the employment of professionals. The employment of a professional with a conflict of interest can result in denial of compensation to the professional under § 328(c) and to the trustee under § 326(d).

The United States Trustee Program has embarked upon a comprehensive initiative designed to open and strengthen the system by increasing representation of minorities and women in all facets of the bankruptcy process. The success of this initiative depends upon the support and commitment of all participants in the system. The trustee is encouraged to consider what efforts can be made to achieve greater diversity among the professionals employed.

### **D. EMPLOYMENT PROCEDURES**

Section 327 does not require notice and hearing procedures to hire professionals, only court approval. However, the trustee must provide a copy of the employment application to the United States Trustee. Fed. R. Bankr. P. 2014(a).



Bankruptcy Rules 2014 and 6005 generally govern the information that applications for the employment of professional persons must contain. Bankruptcy Rule 2014 requires that the application state the following:

- the specific facts necessitating employment;
- the name of the person to be employed;
- the reasons for selecting the firm or individual;
- the professional services to be rendered;
- the proposed arrangements for compensation; and
- to the best of the applicant's knowledge, the professional's connections with the trustee, debtor, creditors, and other parties in interest and their respective professionals, the United States Trustee, and any person employed in the office of the United States Trustee.

Fed. R. Bankr. P. 2014(a).

The application should be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, and any other party in interest, including the trustee, their respective attorneys and accountants, the United States Trustee, or any person employed by the United States Trustee. *Id.*

Bankruptcy Rule 6005 governs the employment of appraisers and auctioneers and requires that the order approving the retention of an appraiser or auctioneer must "fix the amount or rate of compensation." Fed. R. Bankr. P. 6005.

Prior to employment, the trustee and the professional person should discuss and agree upon the terms and conditions of employment, including the manner of compensation. The professional must be advised that the court will ultimately determine the professional's compensation, and may increase or decrease it depending upon the circumstances, even to the extent of recapturing monies paid as interim fees. *See* 11 U.S.C. §§ 327, 328(a); *see also Lamie v. United States Trustee*, 124 S. Ct. 1023, 1031 (2004) (attorney for chapter 11 debtor in possession not entitled to fees from estate for post-conversion services absent employment by chapter 7 trustee under § 327). Fee sharing arrangements are prohibited. 11 U.S.C. § 504.

Professionals sometimes request a trustee to retain them with compensation to be set under § 328, in order to limit court review of any compensation they receive under § 330. This position threatens to undermine the safeguards of §§ 327 and 330.

For a professional whose compensation arrangement is governed by § 328, court review of compensation is limited to determining whether the "terms and conditions" of the compensation were "improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." 11 U.S.C. § 328(a) (court may allow reasonable

compensation). This standard is a more narrow standard than the "reasonableness" standard under § 330(a).

Nevertheless, § 328 does not create a standard separate from the standard under §§ 327 and 330 for reviewing compensation, but is an integral part of the structure for retention and compensation under the Bankruptcy Code. Section 327 provides the authority and limits for retention of professionals in a bankruptcy case; § 328 provides that any reasonable terms are permissible once agreed to and approved by the court; and § 330 provides that, whatever the terms, the compensation paid to the professionals must meet a test of reasonableness.

Professionals also sometimes request the trustee to include as part of the employment agreement to be approved under § 328 a promise to indemnify the professional against any damages caused by their own misconduct during the employment. Generally, absent a showing of good cause, the United States Trustee opposes bankruptcy professionals' efforts to obtain indemnification for claims arising from their work in a case. Therefore, the trustee should exercise caution in agreeing to any indemnification provisions requested by professionals contemplated to be retained by the estate. In no event should the trustee agree to any indemnification that would not be available under state law to other officers or agents of the estate.

#### **E. TRUSTEE AS ATTORNEY OR ACCOUNTANT FOR THE ESTATE**

A trustee, with court approval, may act as an attorney or accountant for the estate if such employment is in the best interest of the estate. 11 U.S.C. § 327(d). The trustee should be sensitive to any conflict of interest problems or appearance of impropriety that may be posed by acting as his or her own attorney or accountant. If there is any question as to the necessity or appropriateness of such services, the trustee should consult with the United States Trustee prior to filing the application.

Detailed time records of the tasks performed as a trustee and as an attorney or accountant must be maintained. A trustee acting as an attorney or accountant under § 327(d) may receive compensation only for services performed in that capacity and not for the performance of regular trustee duties. 11 U.S.C. § 328(b). Similarly, attorneys and accountants may not be compensated for performing the statutory duties of the trustee. *See* 11 U.S.C. § 704 (duties of trustee); Fed R. Bankr. P. 2015(a) (duty to keep records and make reports). The following list includes examples of services considered to fall within the duties of a trustee:

1. preparing for and examining the debtor at the § 341(a) meeting in order to verify factual matters;
2. examining proofs of claim to eliminate duplicate claims and to identify those that are in addition to or differ in amounts from claims listed on the debtor's schedules;
3. investigating the financial affairs of the debtor;
4. furnishing information to parties in interest on factual matters;

5. collecting and liquidating assets of the estate by employing auctioneers or other agents and soliciting offers;
6. preparing required reports;
7. performing banking functions;
8. supervising professionals; and
9. engaging in any specific duties assigned pursuant to court order.

The aforementioned trustee duties are not compensable as legal or accounting services unless there is sufficient documentation to show that special circumstances exist.

## **F. SUPERVISION OF PROFESSIONALS**

The trustee must actively supervise estate professionals to ensure the prompt and appropriate execution of duties, compliance with required procedures, and the reasonableness and necessity of fees and expenses. The trustee should pay particular attention to the activities of professionals who are not closely regulated by state authorities or who take physical possession of estate property and funds, such as auctioneers, liquidators, brokers, collection agents, and property managers.

## **G. AUCTIONEERS AND BROKERS**

### **1. General Standards**

With certain limitations, the trustee may find it necessary or appropriate to sell assets prior to confirmation. The trustee may then employ auctioneers and/or brokers as professional persons pursuant to §§ 327(a) and 328(a) to sell property of the estate. To the extent that professionals may be employed for such purpose post-confirmation, the trustee may also find it appropriate to address the role and compensation of the professionals in the plan and disclosure statement. *See* Chapter 11, *infra*.

The trustee must actively supervise the activities of the auctioneers, brokers, and other professionals to ensure that estate property is protected against loss, property is sold for reasonable prices to independent buyers, sale proceeds are promptly and fully remitted, professionals timely submit accurate sale reports, and expenses of professionals are actual and necessary and paid in accordance with legal requirements. Methods by which a trustee can supervise such professionals include personally attending the sales, thoroughly reviewing sales reports and closing documents, and independently verifying reported information. The trustee should advise the United States Trustee of concerns with respect to auctioneers and other sales professionals, and must report situations that could result in a loss to the estate. Failure to supervise such professionals appropriately may result in claims against the trustee individually.

## **2. Auctioneers**

Like all professionals employed pursuant to § 327(a), an auctioneer's compensation must be approved by the court. *See* 11 U.S.C. § 328; Fed. R. Bankr. P. 6005. Further, any buyer's premium must be fully disclosed in the employment application and considered in determining the reasonableness of the total compensation. Although auctioneers, outside of a bankruptcy context, usually deduct their commissions and expenses from the sales proceeds and remit the net amount to the seller, this practice may not be employed with regard to bankruptcy estate funds unless it is specifically authorized by order of the court. However, the order authorizing the employment may specify the percentage fee to be charged by the auctioneer and authorize the deduction of the commission and the costs of sale from the sales proceeds, with the effect of the auctioneer remitting the net sales proceeds to the trustee. The auctioneer must, in any event, present an affidavit or declaration with the report of sale listing all costs and expenses incurred.

The trustee must ensure that auctioneers are adequately bonded prior to taking possession of estate property, in an amount sufficient to cover all receipts from the sale. The bond should be in favor of the United States and is distinct from any other auctioneer's bond required under state law. The amount of the bond will be established by local bankruptcy rule or the United States Trustee. The trustee should contact the United States Trustee to ensure that the auctioneer is bonded in an appropriate amount to cover all estates for which the particular auctioneer has been employed. All original bonds should be forwarded to the United States Trustee. The trustee also should determine if the auctioneer maintains insurance for lost or stolen property, since the trustee may wish to make a claim against the insurer for any such losses. When the auctioneer assumes control over estate property for a period of time prior to sale, the trustee should keep an inventory of the items stored and periodically verify that the assets still exist and are in good condition. Insurance claims for lost or stolen property should be made promptly, and the trustee should inform the United States Trustee of such claims.

The auctioneer must submit an itemized statement of the property sold, the name of each purchaser, and the price received for each item or lot, or for the property as a whole if sold in bulk. Fed. R. Bankr. P. 6004(f)(1). The trustee must ensure that the auctioneer's report is promptly submitted upon completion of the auction. If the report has not been provided within thirty (30) days after the auction, the trustee should request a copy and ensure that it has been filed with the court and United States Trustee, or as otherwise provided by local rules and practices. The trustee must compare the auctioneer's report to the initial inventory and obtain an explanation for any discrepancies. The trustee also should inquire about items marked "stolen" or "missing." The trustee should attempt to recover the value of lost or stolen items by filing a claim with the auctioneer's insurer or by initiating a proceeding against the auctioneer's bond, as appropriate.

### **3. Internet Auctions**

A trustee may consider selling assets through an internet auction website. Before conducting a sale on the internet, the trustee should examine the suitability of using the internet to sell a particular asset, review the fees charged by internet auction providers, and carefully review the terms and conditions for use of a particular internet auction website.

An internet auction provider usually does not perform the services of a traditional auctioneer. It usually does not take possession of assets, “call” auctions, collect proceeds of sale, or in any way act as a trustee’s agent. Instead, most sites merely provide an automated “venue” for the trustee to conduct an auction sale. Because of their limited role in a sale, internet auction providers should not be considered “auctioneers” or “other professionals” requiring an order of employment under § 327 unless they specifically contract to perform substantial additional services beyond simply providing a website to market estate assets.

The law in this area is uncertain, and the trustee should always fully disclose the terms and conditions of the proposed sale and the respective duties and responsibilities of the internet auction provider in an appropriate sale motion filed with the court and properly noticed to creditors. The trustee may also consider obtaining guidance from the court regarding the need for court approval of internet auctioneer employment in doubtful cases. For example, if an internet auction provider collects deposits or sale proceeds, or takes physical possession of the property to be sold, the provider is providing substantial additional services and an order pursuant to § 327 should be obtained.

## **H. PROFESSIONAL AND TRUSTEE FEE APPLICATIONS**

Pursuant to § 330, after notice and a hearing, and subject to §§ 326, 328, and 329, the court may award the trustee or a professional person employed pursuant to § 327 reasonable compensation for actual, necessary services. *See* 11 U.S.C. § 330. Section 330 also allows the recovery of actual, necessary expenses. *Id.* Overhead expenses of a trustee or professional are not reimbursable from the estate.

Unless otherwise permitted by the court, the professional may make application for interim compensation and reimbursement of expenses not more than once every 120 days. *See* 11 U.S.C. § 331. The trustee has a fiduciary obligation to review professional fee applications and to object when appropriate.

In determining the amount of reasonable compensation to be awarded under § 330, the court considers the nature, extent, and value of the professional's services, taking into account all relevant factors, including the following:

- the time spent on such services;
- the rates charged for such services;
- whether the services were necessary to the administration of the case, or beneficial at the time at which the services were rendered;
- whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
- whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under title 11.

Pursuant to Bankruptcy Rule 2016, each application for interim or final fees and expenses must include the following:

- a detailed statement of services rendered, time expended, and expenses incurred;
- a statement of the amount of fees and expenses requested;
- a statement of payments received or promised for services rendered or to be rendered in any capacity in connection with the case;
- a statement of the source of compensation paid or promised; and
- a statement of whether an agreement or understanding exists for the sharing of compensation received or to be received.

Fed R. Bankr. P. 2016(a).

Unless otherwise ordered by the court, all creditors and parties in interest must receive notice of all fee applications over \$1,000. Fed. R. Bankr. P. 2002(a)(6). Trustee compensation is governed by § 330, subject to the limitations imposed by § 326(a). The limits are set as percentages of 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.

Pursuant to 28 U.S.C. § 586(a)(3), as amended, the United States Trustee reviews professional and trustee fee applications in accordance with the procedural guidelines adopted by the Executive Office for United States Trustees. *See* 28 C.F.R. Part 58, Appendix A (guidelines for review of fee applications). The trustee should be familiar with the fee guidelines, which state, in part, that "[f]ee applications submitted by trustees are subject to the same standard of review as are applications of other professionals and will be evaluated according to the principles articulated in these Guidelines." *Id.* at (6). The trustee should keep time records in every asset case.

A court order must be obtained prior to interim or final payment of trustee compensation. When a trustee is heavily engaged in the administration of a case over an extended period of time and the trustee is providing substantial services to the estate, those factors may present good cause for the trustee to seek interim compensation.

**CHAPTER 11: POST-CONFIRMATION CASE ADMINISTRATION**

**A. INTRODUCTION**

The trustee must be concerned about three primary issues with regard to post-confirmation case administration. First, certain provisions should be included in the plan to avoid complications and delay in case closing. Next, the trustee must comply with post-confirmation reporting requirements. Finally, the trustee must understand both the timing and elements of a final decree.

**B. PLANNING FOR POST-CONFIRMATION CASE ADMINISTRATION**

The trustee may either be the plan proponent or recommend a plan filed by the debtor, a creditors' committee, or another party in interest. *See* 11 U.S.C. § 1121 (who may file a plan). Regardless of whose plan ultimately is confirmed, the trustee should support plan provisions designed to expedite case closing and avoid post-confirmation difficulties.

**1. Defining the Trustee's Post-Confirmation Role**

Confirmed chapter 11 cases may have several possible outcomes. The debtor may continue in business and pay creditors during the life of the plan. The debtor's business may be sold or liquidated and the proceeds paid to creditors during the life of the plan. The debtor may partially liquidate, distribute those proceeds through the plan, and make further payments from ongoing operations.

A trustee who is the plan proponent must be cautious about interposing himself or herself into either the life of the rehabilitated debtor or the liquidating plan. A significant ongoing role created by the trustee may be perceived as self-dealing, an attribute inconsistent with the trustee's original role as a fiduciary. *See United States v. Schilling (In re Big Rivers Elec. Corp.)*, 355 F.3d 415 (6<sup>th</sup> Cir. 2004) (examiner whose actions arguably brought \$145 million to estate ordered nonetheless to disgorge \$1 million in legal fees as a result of examiner's undisclosed negotiations and agreements with creditors in violation of fiduciary duty).

In addition, while the plan may refer to and denominate the trustee as "trustee" both before and after confirmation, the order of confirmation is transforming. Prior to confirmation, the trustee either is an appointee of the United States Trustee approved by the court, or is elected to office, with duties set forth in the Bankruptcy Code. After confirmation, the trustee serves pursuant to the terms of a plan approved by the court. That plan contractually defines the trustee's role, including rights, powers, privileges, duties, and obligations. The differences between the pre-confirmation statutory trustee and the post-confirmation plan trustee may sometimes be minimal in practice, but as a matter of law the two are significantly different. *See* 11 U.S.C. § 1104(a) (trustee may be appointed postpetition but pre-confirmation); *Tracar v. Silverman (In re American Preferred Prescription, Inc.)*, 250 B.R. 11, 18 (E.D.N.Y. 2000) (no trustee may be appointed post-



confirmation in absence of plan authorization), *rev'd on other grounds sub nom.* 255 F.3d 87 (2d Cir. 2001).

Whatever the details of the plan, the trustee should insist that it define what role, if any, the trustee will play after confirmation. Further, the plan should provide a mechanism for trustee succession if the trustee dies, resigns, or is otherwise unable to fulfill the duties under the plan. The mechanism should not provide for appointment of a successor by the United States Trustee in view of the United States Trustee's lack of statutory authority to make such an appointment.

## **2. Bonding**

Prior to confirmation, the trustee must maintain a bond in favor of the United States conditioned on the faithful performance of official duties. 11 U.S.C. § 322(a). Once the plan is confirmed, however, the trustee's statutory duties are superseded by the duties, if any, pursuant to the plan. Bonding may or may not be appropriate depending upon the terms of the plan.

Courts occasionally require trustees who continue to serve post-confirmation to maintain a bond. This practice is not mandated by the Bankruptcy Code, but is sound and in keeping with general precepts of fiduciary law. The details of the requirement, whether imposed or excused, should be set forth in the plan. If bonding continues, the new bond should be in favor of the beneficiaries under the plan, conditioned on the "plan trustee's" faithful performance of duties imposed under the plan.

## **3. Compensation**

Trustee compensation for pre-confirmation services is governed by § 330 and limited by the cap imposed by § 326. Those statutory sections do not apply to services rendered by the "plan trustee" post-confirmation. Instead, compensation is governed by the terms of the plan. The trustee, therefore, should insist that the plan delineate terms of post-confirmation compensation, including whether such compensation must be approved by the court. Even though statutory limitations do not apply, the trustee's compensation must be reasonable, in keeping with the trustee's status as a fiduciary and to avoid any perception of self-dealing.

## **4. United States Trustee Quarterly Fees**

Under 28 U.S.C. § 1930, quarterly fees based upon disbursements must be paid until a chapter 11 case is converted to chapter 7, dismissed, or closed. 28 U.S.C. § 1930(6). Responsibility for payment of the fees sometimes becomes an issue after confirmation, particularly when it is unclear who is the successor to the debtor. Therefore, the trustee should insist that the plan clearly specify who shall be deemed the debtor's successor for purposes of quarterly fee payments. This will avoid litigation that could delay closing the case.

As the case proceeds, the trustee should ensure that sufficient funds are reserved to pay the quarterly fees. Although computation of amounts owed sometimes becomes an issue, all post-confirmation disbursements are subject to the fee, not simply those made to creditors under the plan. See 28 U.S.C. § 1930(6); *Walton v. Jamko, Inc. (In re Jamko, Inc.)*, 240 F.3d 1312, 1315 (11<sup>th</sup> Cir. 2001).

## 5. Unclaimed Funds

Uncashed dividend checks are commonplace in a chapter 11 case and, pursuant to § 347(b), those funds revert to the debtor or the entity acquiring the debtor's assets under the plan rather than being paid over to the clerk of the bankruptcy court. 11 U.S.C. § 347(b). Thus, where a chapter 11 trustee has replaced the debtor because of fraud or criminal conduct, the statute can have unfortunate consequences. The trustee should anticipate the possibility of unclaimed funds, and make specific provision in the plan for the disposition of those funds. For example, the plan could provide that dividends uncashed after ninety (90) days will be redistributed to other creditors or contributed to a charitable institution.

## 6. De Minimus Funds

The economics of the chapter 11 case may result in the trustee having cash on hand to distribute to creditors, but in amounts so small that it is not economical to do so. As with unclaimed funds, the trustee should anticipate the possibility of *de minimus* dividends and provide for them in the plan.

## 7. Defaults

While the trustee cannot guarantee that the financial elements of a plan will be completely performed, the trustee can insist that the plan make provision for handling defaults if they occur. For example, the plan could provide that property of the estate that vested in the debtor at confirmation revert to the estate upon material default under the plan and that the case thereupon be converted to chapter 7. The trustee should anticipate the possibility of post-confirmation default and plan for it, rather than let such circumstances hinder case closing.

## C. POST-CONFIRMATION REPORTING REQUIREMENTS

One of the hallmarks of an unconfirmed chapter 11 case is financial disclosure of the debtor's operations. See Chapter 7, Section B.1, *supra*. If the business of the debtor is authorized to be operated, the trustee is required to file periodic reports with the court, the United States Trustee, and certain taxing authorities. 11 U.S.C. § 704(8) (made applicable by 11 U.S.C. § 1106(a)(1)); see also Fed. R. Bankr. P. 2015(a) (duty to keep records and make reports). The reports must include summaries of the operation of the business, a statement of receipts and disbursements, and other information required by the United States Trustee or the court. The form

of the reports (known as Monthly Operating Reports) will vary somewhat by United States Trustee region, and the United States Trustee will provide the chapter 11 trustee with the proper forms.

Pursuant to § 1106(a)(7), a chapter 11 trustee, whether appointed or elected under § 1104 or created by the provisions of a confirmed plan, is required to file such reports after confirmation as are necessary or as the court orders. 11 U.S.C. § 1106(a)(7). The primary function of the post-confirmation reports is to inform the United States Trustee, the court, and all parties in interest of the progress made in consummating the plan.

In addition, a chapter 11 trustee appointed or elected under § 1104 is required to file a final report and account of the administration of the estate with the court and the United States Trustee pursuant to § 704(9) (made applicable by 11 U.S.C. § 1106(a)(1)). The final report should provide a complete record of the trustee's administration including the receipt of, intervening transactions involving, and distribution or disposition of all estate property at the conclusion of the trustee's administration. Because the estate ceases to exist upon confirmation, a final report and account should be filed by the trustee as soon as confirmation has occurred. If the case is either dismissed or converted to one under chapter 7, the trustee is also required to file a final report and accounting. In any event, a chapter 11 case should not be closed unless these reporting requirements have been met. Although the trustee's duty to make financial reports will terminate once the case is closed, the trustee's obligation to report criminal activity in connection with the case continues notwithstanding case closure. *See* 18 U.S.C. § 3057(a).

#### **D. THE FINAL DECREE**

Bankruptcy Rule 3022 provides that “[a]fter an estate is fully administered in a chapter 11 reorganization case, the court, on its own motion or on motion of a party in interest, shall enter a final decree closing the case.” Fed. R. Bankr. P. 3022. Generally, once the plan has been substantially consummated, *see* 11 U.S.C. § 1101(2) (defining “substantial consummation”), and there are no matters pending before the court, the trustee should request that the court enter a final decree closing the case. The 1991 Advisory Committee Note to Bankruptcy Rule 3022 states:

Entry of a final decree closing a chapter 11 case should not be delayed solely because the payments required by the plan have not been completed. Factors that the court should consider in determining whether the estate has been fully administered include (1) whether the order confirming the plan has become final, (2) whether deposits required by the plan have been distributed, (3) whether the property proposed by the plan to be transferred has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business or the

management of the property dealt with by the plan, (5) whether payments under the plan have commenced, and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved.

Fed. R. Bankr. P. 3022 advisory comm. note (1991).

Unless there are local rules to the contrary, the trustee's motion for a final decree should track the six elements referenced in the Advisory Committee Note. Since the Bankruptcy Rules are silent regarding the parties to be served with the motion, the trustee should consult local rules and practice on that question.