

The Role of the Trustee in Subchapter V Cases





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The addition of Subchapter V to Chapter 11 of the U.S. Bankruptcy Code is an important innovation that introduces significant cost savings, allowing small business debtors an opportunity to reorganize. Most notably, Subchapter V transforms the role of the trustee from one of prosecutor to that of mediator, requiring the trustee to work hand-in-hand with the debtor and creditors.

With the addition of the trustee's facilitator role, debtors are able to realize the full benefits of a low-cost bankruptcy and ideally confirm a consensual plan in the process. The result is a more inclusive environment for reorganization than was previously available and had inhibited many small businesses from emerging from Chapter 11 successfully.

For small businesses, Subchapter V¹ was enacted with serendipitous timing, taking effect February 19, 2020, just one month before the nation's shutdown aimed at containing the spread of COVID-19. The statutory hope of the Small Business Reorganization Act of 2019 (SBRA) is that through small business reorganizations, more creditors will receive greater distributions, debtors will pay less in attorneys' fees, and more small businesses will survive and remain in business.²

After the Great Recession, then-President Barack Obama noted that small businesses create two of every three new jobs, and he recognized small businesses as "the backbone of our economy and the cornerstones of our communities."³ This is still true

today. Yet, battered by the impacts of the COVID-19 pandemic, small businesses now more than ever are struggling to keep their doors open.

Small businesses within the construction industry, for example, have struggled with shutdowns and holds placed on projects by owners since the start of the pandemic. While most states considered construction an "essential" service, following guidance from the Department of Homeland Security, some states and local municipalities took a narrower view, shutting down construction projects altogether.⁴ The National League of Cities found that 65% of cities were being forced to delay or completely cancel capital expenditures and infrastructure projects.⁵ According to a recent survey by the Associated General Contractors of America, 60% of responding firms have had at least one future project postponed or cancelled due to the virus, and 52% reported difficulty filling hourly craft positions.⁶

According to research conducted by Epiq, construction is one of the top five industry sectors taking advantage of the benefits of Subchapter V, along with professional and technical services, healthcare, hospitality and food service, and retail. Those five sectors account for approximately 40% of the total Subchapter V cases filed thus far. Unfortunately, industries like construction have probably not hit bottom yet, and more small businesses may have to seek the protections of Subchapter V.

"Subchapter V by its very nature is intended to be an expedited process. It provides qualifying debtors with some

powerful and cost-saving restructuring tools not otherwise available to Chapter 11 debtors."⁷ One of the tools is the mandatory appointment of a trustee in all Subchapter V cases.⁸ Although not all-inclusive, this article outlines some of the most important duties of the Subchapter V trustee and reviews the trustee's ability to retain counsel or other restructuring professionals.

Basic Duties

"The subchapter V trustee will act as a fiduciary for creditors, in lieu of an appointed creditors' committee. The subchapter V trustee is also charged with facilitating the subchapter V debtor's small business reorganization and monitoring the subchapter V debtor's consummation of its plan of reorganization."⁹ Additionally, Subchapter V trustee duties include several Chapter 7 trustee duties as incorporated in 11 U.S.C. Section 1183. These include, but are not limited to, the following:

- 1** Be accountable for all property received
- 2** Examine proofs of claims and object to the allowance of any claim that is improper
- 3** Oppose the discharge of a debtor if appropriate
- 4** Furnish such information concerning the estate and the estate's administration as is requested by a party in interest, unless the court orders otherwise

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Thus, with the earlier termination of the trustee, more costs savings may be realized by the debtor with a consensual plan than with a nonconsensual plan.

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5 Make a final report and file a final account of the administration of the estate with the United States Trustee and the court

11 U.S.C. Section 1183(b);
28 U.S.C. Section 704(a).

Consensual Versus Nonconsensual Plans

The Subchapter V trustee plays a limited traditional role as a trustee, since most debtors continue to operate the business and remain in possession of the debtor's assets. Subchapter V trustees, however, have a unique duty to "facilitate the development of a consensual plan of reorganization."¹⁰ No other trustee has this duty, and it generally requires the Subchapter V trustee to work with the debtor and actively engage with creditors to confirm a consensual plan.¹¹ This duty is instrumental to implement effectively the statutory purpose of the SBRA and confirm a consensual plan.

Since all impaired classes accept a consensual plan, the debtor generally makes payments under the plan directly. Once the plan has been substantially consummated, the Subchapter V trustee's services are terminated.¹² Substantial consummation generally occurs upon "commencement of distribution under the plan."¹³ Thus, with the earlier termination of the trustee, more costs savings may be realized by the debtor with a consensual plan than with a nonconsensual plan.

If the plan is nonconsensual and approved through cramdown criteria, generally the Subchapter V trustee rather than the debtor makes the payments under the plan to the

creditors, unless the plan or court order provides otherwise.¹⁴ Services of the Subchapter V trustee continue until a court enters an order terminating them, but they generally continue until the debtor is discharged.

While the Subchapter V trustee makes payments under the nonconsensual plan, the trustee is not a mere disbursing agent. Unlike a Chapter 7, Chapter 11, or Chapter 13 trustee, a case-by-case Subchapter V trustee's compensation has nothing to do with the amount of funds disbursed, but instead is an hourly rate based on services rendered.¹⁵ If the Subchapter V trustee makes payments through an account managed by the trustee, it unnecessarily adds hourly costs and works against one of the primary purposes of the Subchapter V—to reduce costs to help businesses emerge from bankruptcy successfully.

After confirmation of the plan, the Subchapter V trustee is also required to file any necessary reports or any other reports that the court orders.¹⁶

Investigations and Reports

Pursuant to 11 U.S.C. Section 1106(a)(3), the Subchapter V trustee is also 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 to the formulation of a plan." Once the investigation is complete, the Subchapter V trustee must file a statement of the investigation that identifies "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."¹⁷

If the Subchapter V trustee is required to conduct an investigation, the inquiry should proceed without causing delay to the potentially successful reorganization of the case, and the trustee "should take care not to devote time or expense to matters that will have little benefit to the estate" or that are duplicative of other parties' efforts.¹⁸ For this reason, a Subchapter V trustee should be careful to not be overzealous; otherwise, the trustee runs the risk of not being compensated for those services.

Operating the Business and Possession of the Debtor's Assets

The court may remove a debtor in possession for cause,¹⁹ 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."²⁰ For instance, in *In re Dani Transport Service, Inc.*, the U.S. Bankruptcy Court for the Central District of California found cause existed to remove a Subchapter V debtor's nefarious management and expand the Subchapter V trustee's management duties in accordance with Section 1183 of the Bankruptcy Code.²¹ In these circumstances, the Subchapter V trustee must step into the shoes of the debtor and operate the business.²² At this point, the Subchapter V trustee "becomes a fiduciary with an obligation of fairness to all parties in the case."²³

More specifically, the Subchapter V trustee operating the business and in possession of the debtor's assets performs various duties specified in Section 704(a), including:

- Being accountable for all property received (Section 704(a)(2))
- Examining proofs of claim and objecting to improper claims (Section 704(a)(5))
- Providing information regarding the estate as requested to parties in interest, unless the court orders otherwise (Section 704(a)(7))
- Filing reports of operations if the debtor is authorized to be operated (Section 704(a)(8))
- Making a final report and filing a final account of the administration of the estate (Section 704(a)(9))
- Providing notice of the debtor's domestic support obligation (Section 704(a)(10))
- Administering any employee benefit plan (Section 704(a)(11))
- Taking reasonable steps to transfer patients if debtor is a healthcare business (Section 704(a)(12))

11 U.S.C. Section 1106(a)(1).

Ability to Retain Counsel, Other Professionals

While nothing in the Bankruptcy Code prohibits a Subchapter V trustee from retaining counsel and other professionals, policy concerns favor limiting a trustee's ability to retain counsel, absent a specific justification and purpose.²⁴

With the statutory purpose of the SBRA in mind, Subchapter V trustees should have a specific purpose for hiring counsel, and the services provided should not be unnecessary, duplicative, or outside the scope of the SBRA.²⁵

Conclusion

While 2020 was a turbulent year for many small businesses and the SBRA was a much-needed lifeline, it is highly likely that federal spending under the CARES Act and Paycheck Protection Plan (PPP) allowed many businesses to remain open, although hanging on by a thread. Depending on the fiscal policies of the new administration and whether local economies continue to struggle, it is likely there will be an increase in the number of Subchapter V cases filed over the next 12 to 18 months. As small businesses maneuver



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through this economic hardship, it is important to understand the pivotal role of the Subchapter V trustee in these cases and the other tools that will help promote the statutory purpose of the SBRA.

Over the next several years, corporate restructuring professionals will determine if the SBRA was effective in reducing cost and improving efficiencies for small businesses looking for Chapter 11 protections. Certainly, the transformative role of the trustee will play an instrumental role in the success of Subchapter V reaching the statutory goals of the SBRA. By better understanding and taking advantage of the role and obligations of a Subchapter V trustee, more small businesses will emerge from bankruptcy successfully and in a better position to operate within the new post-pandemic environment. ■

Impacts of COVID-19 (June 23, 2020).

⁶ Associated Gen. Contractors of America (AGC), AGC Coronavirus Survey Results (MAY 4-7) (2020).

⁷ *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 346 (Bankr. S.D. Fla. 2020).

⁸ See 11 U.S.C. Section 1183(a).

⁹ *In re Ventura*, 615 B.R. 1, 13 (Bankr. E.D.N.Y. 2020) (citing 11 U.S.C. Section 1183(b)).

¹⁰ 11 U.S.C. Section 1183(b)(7).

¹¹ U.S. Dep't of Justice, Handbook for Small Business Chapter 11 Subchapter V Trustees, 1-7 (2020).

¹² 11 U.S.C. Section 1183(c)(1).

¹³ 11 U.S.C. Section 1101(2).

¹⁴ 11 U.S.C. Section 1194(b).

¹⁵ See *In re Tri-State Roofing*, 2020 WL 7345741 (Bankr. D. ID 2020) (approving the hourly rate compensation under 11 U.S.C. §§ 503 and 330(a) for the Subchapter V trustee).

¹⁶ 11 U.S.C. Section 1106(a)(7).

¹⁷ 11 U.S.C. Section 1106(a)(4).

¹⁸ U.S. Dep't of Justice, Handbook for Small Business Chapter 11 Subchapter V Trustees, 3-7 (2020).

¹⁹ 11 U.S.C. Section 1185(a).

²⁰ 11 U.S.C. Section 1104(a)(1).

²¹ *In re Dani Transport Service, Inc.*, No.6:20-bk-11234. Order at 2 (C.D. Cal. Feb. 23, 2021) (The debtor-in-possession fraudulently applied for a PPP loan, diverted the PPP loan proceeds, and failed to disclose the PPP loan to the Bankruptcy Court by motion or in monthly operating reports, justifying "cause" for the court to remove the debtor-in-possession.)

²² 11 U.S.C. Section 1183(b)(5).

²³ U.S. Dep't of Justice, Handbook for Small Business Chapter 11 Subchapter V Trustees, 3-8 (2020).

²⁴ *In re Penland Heating & Air Conditioning Inc.*, 2020 WL 3124585 (Bankr. E.D.N.C. 2020); see also U.S. Dep't of Justice, Handbook for Small Business Chapter 11 Subchapter V Trustees, 3-17 (2020) ("Although the trustee may employ professionals under section 327(s), SBRA is intended to be a quick and low cost process to enable debtors to confirm consensual plans in a short period with less expense while returning appropriate dividends to creditors. Therefore the services required of outside professionals, if any, will be limited in many cases.").

²⁵ *In re Penland Heating & Air Conditioning Inc.*, 2020 WL 3124585, at n.2.

¹ Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (2019); 11 U.S.C. Sections 1181-1195.

² H.R. Rep. No. 116-171, at 2 (2019) (citing the Unofficial Transcript of "Hearing on Oversight of Bankruptcy Law and Legislative Proposals Before the Subcomm. on Antitrust, Commercial, & Admin. Law of the H. Comm. on the Judiciary," 116th Cong. 27 (2019).

³ Katelyn Sabochik, "Small Businesses Are the Backbone of Our Economy and the Cornerstones of Our Communities," The White House: President Barack Obama (Aug. 27, 2010), obamawhitehouse.archives.gov/blog/2010/08/17/small-businesses-are-backbone-our-economy-and-cornerstones-our-communities.

⁴ See National Conference of State Legislatures, "COVID-19: Essential Workers in the States," NCSL (Jan. 11, 2021), ncsl.org/research/labor-and-employment/covid-19-essential-workers-in-the-states.aspx

⁵ Press Release, National League of Cities, Canceled Infrastructure Project, Furloughs and Economic Ripple Effects: NLC Survey Shares Latest Financial