INDIVIDUAL CHAPTER 11 CASES AND UNITED STATES TRUSTEE OVERSIGHT

Avoid Problems By Understanding Roles

1. *Role of the United States Trustee* – chapter 7 trustees have the duties set forth in 11 U.S.C. § 704(a) and chapter 13 trustees have the duties set forth in 11 U.S.C. § 1302(b). In comparison, the United States Trustee's "mission is to promote the integrity and efficiency of the bankruptcy system by enforcing bankruptcy laws; . . . and ensuring that those involved in the process . . . fulfill their legal obligations." *United States Trustee Program Policy And Practices Manual* Vol. 1, § 1-4 at pg. 17 (available at: https://www.justice.gov/ust/united-states-trustee-program-policy-and-practices-manual) (hereinafter referred to as the "*Manual*").
    A. Volume 3 of the *Manual* describes in general terms the involvement of the United States Trustee in chapter 11 cases. Section 3-12 of the *Manual* relates specifically to chapter 11 cases filed by individuals.
    B. The United States Trustee will solicit and attempt to form a creditors' committee in every chapter 11 case.
        a. The involvement of the United States Trustee in a chapter 11 case depends, in part, on the level of creditor participation in the case. *Manual* Vol. 3, § 3-1 at pg. 2.
    C. In appropriate cases, the United States Trustee seeks the appointment of a chapter 11 trustee. *See* 11 U.S.C. § 1104.
        a. A chapter 11 trustee's duties are set out in 11 U.S.C. § 1106(a).

2. *Role of the debtor* – a debtor in possession is a fiduciary for the estate and creditors and must act accordingly. A debtor in possession is required to "perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of [title 11 of the United States Code], of a trustee serving in a case under [chapter 11 of the Bankruptcy Code]."
    a. "Small business case" and "small business debtor" – these terms are defined in 11 U.S.C. § 101(51C) and (51D). **Debtors in a small business case have additional filing requirements.** 11 U.S.C. § 1116. Such designation also impacts who may file a plan, when the disclosure statement and plan must be filed, and when the plan must be confirmed. 11 U.S.C. §§ 1121(e) and 1129(e).

Prepare Properly Before Filing The Case –

<u>Initial Debtor Interview</u> – gather and prepare documents.

1. *What is an initial debtor interview* – it is a meeting, generally held within 10 days of the petition date, that is conducted in the bankruptcy meeting room located in Roanoke, Virginia for the purposes of: (1) providing the United States Trustee with information "so that an early assessment can be made of the accuracy of the debtor's schedules and the statements of the debtor's financial ability to confirm a plan;" and (2) ensuring "that the

debtor is aware of its new fiduciary obligations and of the United States Trustee's role in administration of chapter 11 cases." *Manual* Vol. 3, § 3-3.1 at pg. 34.

2. *Who conducts it* – generally the United States Trustee's bankruptcy analyst conducts the initial debtor interview.
3. *What documentation is required* – after the petition is filed, the United States Trustee will send an email containing the *U.S. Trustee Guidelines*, an IRS notice to individual chapter 11 debtors, an blank Acord, a check conversion statement, a blank, sample 6 month operating projection, blank, sample operating report forms, and a list of banks approved to hold the debtor in possession's accounts. The documents are provided in the Appendix to the materials. The *U.S. Trustee Guidelines* set forth the documents that must be provided at least 36 hours before the initial debtor interview, and the documents include, among other things,: bank statements for the year prior to the petition date; last 3 years of tax returns; financial statements; proof of closure of prepetition accounts and opening of debtor in possession/tax accounts; proof of insurance; and cash flow projection.

Employment – critically analyze your relationship with the debtor and get employed.

1. *Retention must be approved* – a debtor in possession must obtain court approval to employ all professionals including counsel for the debtor.
2. *Applications to employ counsel* – must be filed within 14 days of the petition date to comply with the *Debtor In Possession Order*, but generally may not be approved until after 21 days after the petition date. Fed. R. Bankr. P. 6003.
    A. The United States Trustee reviews the application and counsel's verified statement in support of the application to ensure that counsel is disinterested. *See* 11 U.S.C. §§ 327(a) and 328(c); Fed. R. Bank. P. 2014 To that end, the *Manual* states:

> The retention process is designed to ensure public confidence in the bankruptcy system, prevent abuses, and achieve some degree of economy in the administration of the case by limiting the retention of professionals to only those instances where it can be demonstrated that the services are necessary. Furthermore, the requirements of section 327 "serve the important policy of ensuring that all professionals appointed pursuant to [the section] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994). 28 U.S.C. § 586(a)(3)(I) specifically requires the United States Trustee to monitor employment applications and, when appropriate, to file with the court comments with respect to the approval of such applications.
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> Court approval of a professional person's employment is contingent upon a finding that the applicant has met a two-pronged test:
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> 1. the professional must be disinterested, pursuant to section 327(a); and
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> 2. the professional must not hold or represent an interest adverse to the estate.
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> The question of whether a professional meets the standards of the law is one for the court to adjudicate after a full disclosure of the facts. A failure to disclose constitutes an independent basis for disqualification.

. . .

> The United States Trustee should promptly examine the application for employment and its accompanying verified statement not only to determine if the proposed professional service is necessary, but also to ascertain if any disclosures suggest questionable relationships, divided loyalties, or disqualifying adverse interests. Issues that may warrant closer scrutiny include multiple debtor representation, simultaneous representation of a limited partnership and a general partner, representation of a corporation and an affiliate or shareholder, receipt of a preference or unpaid fees, security interests taken to secure the payment of fees or other unusual arrangements for compensation, and prior or concurrent representation of a major creditor. Where appropriate, the United States Trustee should require further disclosure or comment on any unusual aspects of the application. The United States Trustee should object to the employment when the services are unnecessary or duplicative, the applicant is not disinterested, or representation of adverse interests warrants disqualification.

Manual Vol. 3, § 3-7.1 at pg. 104.

B. With respect to the content of an application to employ, the *Manual* states:

> The contents of an employment application are dictated by Fed. R. Bankr. P. 2014. It must contain all of the following elements:
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> 1. specific facts showing the necessity of the employment;
> 2. the name of the person to be employed;
> 3. the reasons for the selection;
> 4. the professional services to be rendered;
> 5. any proposed arrangement for compensation; and
> 6. all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the Office of the United States Trustee.

Id. at pg. 105.

Prepare Contemporaneous, Itemized Time Records

Compensation – keep contemporaneous, itemized time records pre-petition and post-petition.

1. *Compensation must be reasonable* – 11 U.S.C. § 330(a)(3) sets forth a non-exclusive list of factors a court must take into account. See *Johnson v. Georgia Highway Exp., Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974) for the often cited 12 factor test.
    a. Contemporaneous time records should be maintained in tenth of an hour increments to enable parties in interest to assess the services rendered to the debtor. If separate, discrete tasks are performed and the total time exceeds .5, then the separable tasks should be broken out.
    b. Rates should be comparable to the professional's non-bankruptcy rates.

2. *Fee guidelines* – the United States Trustee reviews fee applications in accordance with the "procedural guidelines adopted by the Executive Office of the United States

trustee," *Manual* Vol. 3, § 3-8.1.1 at pg. 117, and the guidelines are available at: https://www.justice.gov/ust/fee-guidelines.

3. *Avoid common mistakes* – the *Manual* sets forth the following 11 common mistakes made in connection with seeking compensation:

> 1. failure to obtain prior court approval of the employment;
> 2. inadequate disclosure of relationships or possible conflicts;
> 3. non-compliance with timing or format requirements;
> 4. inadequate descriptions of services rendered;
> 5. services performed outside the scope of employment;
> 6. inappropriate rounding or lumping of time;
> 7. duplication of effort, inefficient delegation, or excess time spent in performance of a given task;
> 8. services not reasonably likely to benefit the estate or not necessary to the administration of the case;
> 9. overhead items inappropriately billed or expensed;
> 10. inadequate documentation of expenses; and
> 11. excessive charges for preparing the fee application.

Manual Vol 3, § 3-8.1.1 at pg. 118

4. *Interim and final compensation* – interim compensation may be sought every 120 days "or more often if the court permits." 11 U.S.C. § 331. If you seek to be compensated on an hourly basis, be aware that you will need to obtain advance permission (e.g. in the employment application and order or pursuant to a separate motion and order) to seek compensation more frequently than every 120 days. In appropriate circumstances, the United States Trustee does not oppose shortening the frequency to every 60 days. After the plan is confirmed, professionals should seek final approval of all fees for the period of time between the petition date and confirmation of the plan.
    a. Flat fees – approval of compensation may possibly be tied to completion of stages (e.g. attendance at the initial debtor interview and meeting of creditors, approval of the disclosure statement, etc.).

Progress The Case Towards Confirmation

Monitoring – chapter 11 is not a parking lot.

1. *What is progress* – the *Manual* provides:

> The United States Trustee is charged by statute with the responsibility of supervising the administration of chapter 11 cases. 28 U.S.C. § 586(a)(3). The administrative process should be designed to ensure that cases move through the system in an expeditious manner. Cases that lack a realistic prospect of reorganization within a reasonable period of time must be identified and appropriate action taken to seek the dismissal or conversion of such cases.

Manual Vol. 3, § 3-10.1 at pg. 142.

Proper progress of a case entails, among other things, timely filing of schedules, provision of required documents, attendance at the Initial Debtor Interview, attendance at the meeting of creditors, management of issues related to executory contracts and unexpired leases, proposal of a disclosure statement and plan, and confirmation of a plan.

a. The United States Trustee may seek the entry of an order requiring a disclosure statement and plan to be filed within 120 days of the petition date.

2. *Review of disclosure statements* – debtors may craft their own disclosure statements and in such cases, the "United States Trustee's review . . . focuses on the adequacy of disclosure." What is adequate information is case dependent. *Manual* Vol. 3, § 3-11.1 at pg. 159. While the United States Trustee does not advocate a "checklist" approach to a review of disclosure statements:

> Several factors can affect the appropriate quantity and quality of disclosure in a given case, including:
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> 1. the nature of the proposed plan of 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; and
> 6. the access of a plan proponent, other than the debtor, to factual information regarding the debtor.
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> An inordinately long or complex disclosure statement may confuse rather than enlighten creditors. In such cases, the deletion of certain materials or the preparation of a summary may be suggested; care must be taken, however, to ensure that significant material is not deleted.

Manual Vol. 3, § 3-11.2.3 at pg. 161. A disclosure statement should, among other things, address the following matters: who can vote; standards for confirmation; description of the debtor's business; reasons for the debtor's financial problems; financial information and projections; a liquidation analysis; information on cram down if confirmation may be sought in that fashion, material post-petition events; a summary of the plan; and a description of the means for effectuating the plan. *See Manual* Vol. 3, § 3-11.3.1 at pgs. 161-175 for a more detailed discussion.

a. **Drafting a disclosure statement or plan from scratch is not required.** A form small business case disclosure statement is available at http://www.uscourts.gov/forms/bankruptcy-forms. A form small business plan is available there as well.

3. *Plans* – "Plans should subject debtors to clear, enforceable payment obligations. . . . Creditors should not have to guess whether a debtor has defaulted under a confirmed plan." *Manual* Vol. 3, § 3-12.3 at pg. 188.
    a. Having clear obligations also benefits debtors. Individual debtors, unlike corporate debtors, generally do not receive a discharge upon confirmation. 11 U.S.C. § 1141(d)(5). Therefore, individual debtors have an incentive, as discussed below, to close their cases subject to reopening for purposes of receiving a discharge. However, closure of the case terminates the stay and, because the debtor has not received a discharge, there is no discharge injunction. All parties in interest, however, are bound by the terms of the plan so that protects the reorganized debtor provided the reorganized debtor is not in default of the plan. Thus, it is critical that the plan be clear. *Id.*

4. *Achieving confirmation* – after approval of the disclosure statement, solicitation of acceptance of the plan may begin. The standards for confirmation are set forth in 11 U.S.C. § 1129.
    a. Confirmation hearings – the debtor should be ready and able to provide evidence of all the factors. The United States Trustee will object to confirmation if the factors are not met, and the *Manual* sets forth a number of other issues that may lead the United States Trustee to object to confirmation. *Manual* Vol. 3, § 3-11.5 at pg. 176.

Post-confirmation Issues

<u>Substantial Consummation And Case Closure</u> – confirmation is not the end of the case.

1. Reporting – monthly operating reports are no longer required. Instead, reorganized debtors are required to file quarterly reports.
2. Quarterly fees continue to accrue.
3. Cases may be closed and reopened for the granting of a discharge after the completion of all payments under the plan. This allows reorganized debtors to avoid incurring quarterly fees.

a. The *Manual* sets out the 7 non-exclusive factors that are considered with respect to a request to close a case subject to reopening. *See Manual* Vol. 3, § 3-12.3 at pgs. 187-88.