Subchapter V Issues

Trustee's Employment of Professionals

Scheduling Issues

Trustee's Employment of Attorneys and Other Professionals

Section 327(a) permits a bankruptcy trustee to employ attorneys and other professionals "to represent or assist the trustee in carrying out the trustee's duties."

SBRA does not modify this provision for subchapter V cases. If a standing sub V trustee is appointed, the standing trustee presumably would follow the practice of standing trustees in chapter 12 and 13 cases and not retain counsel or other professionals except in exceptional circumstances.

A non-standing sub V trustee's employment of attorneys or other professionals has the potential of substantially increasing the administrative expenses of the case. In view of the intent of SBRA to streamline and simplify small business cases under chapter 11 to reduce administrative expenses, courts may be reluctant to permit a sub V trustee to retain attorneys or other professionals except in unusual circumstances. In this regard, a person serving as a sub V trustee might be presumed to have a sufficient understanding of applicable legal principles to perform the trustee's monitoring and supervisory duties, and to appear and be heard on specified issues, without the necessity of separate legal advice.

A question exists, however, as to whether a trustee who is not an attorney may appear and be heard in a bankruptcy case. Section 1654 of title 28 provides as follows:

> In all courts of the United States the parties may plead and conduct their own cases personally or by counsel as, by the rules of such courts, respectively, are permitted to manage and conduct causes therein.

The statute applies only to natural persons; it does not permit a corporation or other entity to appear in federal court except through licensed counsel. *E.g., Rowland v. California Men's Colony,* 506 U.S. 194, 202, 113 S.Ct. 716, 721 (1993) ("[T]he lower courts have uniformly held

that 28 U.S.C. § 1654, providing that 'parties may plead and conduct their own cases personally or by counsel,' does not allow corporations, partnerships, or associations to appear in federal court otherwise than through a licensed attorney.").

Courts have applied the rule to prohibit an individual who serves as the trustee for a trust or as the personal representative of an estate from representing the trust or estate unless the trust or estate has no creditors and the individual is the sole beneficiary.[1] Because a bankruptcy trustee acts as the representative of the estate, § 323(a), and creditors have an interest in the estate, the same rule would appear to require a non-attorney trustee to appear and be heard in a bankruptcy court.

The nature of reorganization proceedings in a bankruptcy court and, specifically, the facilitative, advisory, and monitoring role that subchapter V contemplates for the trustee, however, suggest that the rule applicable in a federal lawsuit between discrete parties should not be extended to apply to non-attorney subchapter V trustee unless the trustee is a party to a discrete controversy in an adversary proceeding or contested matter.

In this regard, 28 U.S.C. § 1654 and the case law establishing the rule have their roots in 18th and 19th century practice in federal courts when the availability of bankruptcy relief was either nonexistent or short-lived. The statute could not have contemplated a reorganization case involving many parties and many inter-related moving parts and issues that involve business issues and often require negotiations and compromise to achieve a successful outcome for all of the parties. In other words, a bankruptcy reorganization is quite different from a lawsuit that involves discrete parties asserting claims and defenses to establish their rights and obligations.

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[1] *E.g., Guest v. Hansen,* 603 F.3d 15 (2d Cir. 2009) (estate); *Knoefler v. United Bank of Bismarck,* 20 F.3d 347 (8th Cir. 1994) (trust); C.E. Pope Equity Trust v. United States, 818 F.2d 696 (9th Cir. 1987) (trust).

This distinction is particularly important in a subchapter V case. It is clear from the statute and the specific duties of the sub V trustee to facilitate the development of a consensual plan of reorganization, new § 1183(b)(7), and to appear and be heard on confirmation and other significant issues that relate to confirmation, new § 1183(b)(3), that the trustee's primary role is to work with the parties and then to *report* to the court, not to engage in litigation against them. Assuming that the non-lawyer trustee is knowledgeable about the reorganization positions (and a sub V trustee who is not knowledgeable should not be a sub V trustee), neither the debtor, creditors, nor the court need a lawyer to report the trustee's views to the court.

A nonlawyer trustee does not need an attorney to work with the parties on business issues, to investigate and obtain information about the debtor and its business, to facilitate confirmation, and to report with the court. When the time comes to report to the court, the trustee should be permitted to perform the reporting function without a lawyer.

In short, unless a sub V trustee needs to *litigate* something,[2] the trustee does not need counsel. The statute and case law governing federal *litigation* should not be extended to the trustee's appearance in court to *report*.

The subchapter V trustee's primary role is analogous to the role of an examiner in a standard chapter 11 case, § 1106(b),[3] or to an expert witness that a court appoints, Fed. R. Evid. 706. Such parties provide information to the court and the parties and may do so without

[2] For example, a non-lawyer trustee might be required to employ counsel to perform the duties to object to proofs of claim, if a purpose would be served, and to oppose the discharge of the debtor, if advisable, new § 1183(b)(1) (making these duties of a chapter 7 trustee under § 704(a)(5) and (6) applicable to a sub V trustee).

[3] Although bankruptcy courts often authorize an examiner to employ counsel or other professionals, § 327(a) does not provide authority for an examiner to employ a professional person. *See generally* 5 *Norton Bankruptcy Law and Practice* § 99:29 (3d ed.). *See also In re W.R. Grace & Co.,* 285 B.R. 148, 156 (Bankr. D. Del. 2002) ("[T]he basic job of an examiner is to examine, not to act as a protagonist in the proceedings. The Bankruptcy Code does not authorize the retention by an examiner of attorneys or other professionals." 9citation omitted)).

counsel. A sub V trustee with similar advisory duties should similarly be permitted to provide information to the court without the necessity of having to do so through a lawyer.[4]

Finally, the trustee is an officer of the court. The court need not insist that its officer hire a lawyer to hear what the officer has to say.

If a non-lawyer is the sub V trustee, the trustee's ability to appear in court without a lawyer is critical to accomplishment of the objective of subchapter V of providing debtors – and creditors – with the opportunity to accomplish an expeditious and economic reorganization, hopefully on a consensual basis. Adding the necessity of employment of counsel adds an additional layer of expense that should not ordinarily be necessary and that threatens accomplishment of subchapter V's primary objective.[5] Moreover, if the additional expense of a lawyer must come with a non-lawyer trustee, the existence of the additional expense may as a practical matter preclude the appointment of a non-lawyer trustee.

If a court determines that the rule prohibiting a non-lawyer trustee from appearing in federal court requires the trustee to retain counsel in order to be heard, must employ counsel to be heard, considerations of economic administration may require a limitation on the scope of services that will be compensated to those for which a lawyer is legally required. Non-compensable services might include, for example, work in connection with the investigation of the debtor and its business or that involve facilitation of a consensual plan. And because it is the trustee, not the lawyer, who is to be heard, any written report concerning confirmation and other matters would seem to be the responsibility of the trustee, not the lawyer.

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[4] In some jurisdictions, some of the chapter 7 panel trustees are not lawyers. Informal discussions with some judges indicate that in some courts non-lawyer trustees appear without counsel when the matter does not require actual litigation.
[5] This consideration suggests that a court may invoke § 105(a) to permit a nonlawyer to appear without counsel as being "necessary or appropriate" to carry out the provisions of the Bankruptcy Code.

Scheduling Matters in Subchapter V Case

Time for Filing of Plan and Need for Bar Date

Only the debtor may file a plan. New § 1189(a). The debtor has a duty to do so.

The deadline for the sub V debtor to file the plan is 90 days after the order for relief. New § 1189(b). The court may extend the deadline if the need for extension is attributable to circumstances for which the debtor should not justly be held accountable. *Id.*

In a chapter 11 case, there is no bar date for the filing of proofs of claim until the court sets one. Courts will have to determine whether to set a bar date for subchapter V cases by local rule or general order (and provide for the clerk's office to give notice of it) or to wait until the debtor requests the court to set one.

Times for Certain Matters Based on Consideration of Disclosure Statement Under Existing Rules

The debtor does not have to file a disclosure statement unless the court orders otherwise because § 1125 does not apply unless the court orders otherwise. New § 1181(b). A number of timing matters related to the chapter 11 plan process are tied to steps in consideration of the disclosure statement under existing Bankruptcy Rules. Interim Rules address the need to provide for fixing these dates in a subchapter V case in which the court does not require a disclosure statement.

§ 1111(b) election

Section 1111(b) permits a secured creditor to make an election under certain circumstances for allowance or disallowance of its claim the same as if it had recourse against the debtor on account of such claim, whether or not it has recourse. If the election is made, the claim is allowed as secured to the extent it is allowed. Bankruptcy Rule 3014 provides for the

election to be made at any time prior to the conclusion of the hearing on the disclosure statement. Alternatively, if the disclosure statement is conditionally approved under Bankruptcy Rule 3017.1 and a final hearing on the disclosure statement is not held, the election must be made within the date fixed for objections to the disclosure statement under Bankruptcy Rule 3017.1(a)(2) or another date fixed by the court.

Interim Rule 3017 takes account of the fact that subchapter V does not contain a requirement for a disclosure statement unless the court orders otherwise. It provides that, in a subchapter V case, the election may be made not later than a date the court may fix.

Times For Voting on Plan, Determination of Record Date for Holders of Equity Securities, Hearing on Confirmation, Transmission of Plan, and Related Notices

Bankruptcy Rule 3017: (1) requires the court for fix the time for holders of claims or interests to vote to accept or reject a plan on or before approval of the disclosure statement; (2) provides that the record date for creditors and holders of equity securities is the date that the order approving the disclosure statement is entered or another date fixed by the court; (3) permits the court to set the date for the hearing on confirmation in connection with approval of the disclosure statement; and (4) requires that, upon approval of the disclosure statement, the court must fix the date for transmission of the plan, notice of the time for filing acceptances or rejections, and notice of the hearing on confirmation.

New Interim Rule 3017.2 provides for the court to establish all of these times in a subchapter V case in which the disclosure statement requirements of § 1125 do not apply.

Projected Disposable Income in Sub V Cases:

Can the Court Require Payments Based on Actual Results?

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In a subchapter V case, § 1191(b) permits cramdown confirmation in the absence of any class accepting the plan if it does not discriminate unfairly and is "fair and equitable."

Section 1191(c) changes the "fair and equitable" requirement with regard to unsecured claims[1] by eliminating the absolute priority and requiring that the plan meet the projected disposable income ("PDI") test set forth in § 1191(c)(2). The fair and equitable requirement also includes a feasibility finding and plan provisions for "appropriate remedies" in the event of default. § 1129(c)(3).

Yogi Berra is reputed to have said, "It's difficult to make predictions, especially about the future."[2] And so it is with the "projected disposable income" of a small business.

Given the difficulties of predictions, and possibly because the debtor has an incentive to minimize its future disposable income, out of both prudence and self-interest in paying less, creditors may want to request that the court require the debtor to pay disposable income based on actual results rather than projections. The question is whether the court may do so.

An initial reaction to the question is that the answer is obviously not. The statute itself refers to "projected" disposable income, clearly indicating that the debtor makes payments based on expectations of what its income and expenditures will be.

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[1] The "fair and equitable" requirement in § 1129(b)(2)(A) with regard to secured claims applies in subchapter V cases under § 1191(c)(1), even though § 1129(b) does not apply in a subchapter V case. § 1181(a).

[2] Perhaps he did, but it appears that the idea originated in the Danish legislature in its 1937-38 session. See https://quoteinvestigator.com/2013/10/20/no-predict/.

This is what happens under the PDI test in chapter 13 cases. § 1325(b). In general, it calls for determination of "current monthly income" and deduction of permitted expenditures. The balance – a specifically stated amount – must be paid in regular payments to the trustee for distribution to creditors.

The court in in *Anderson v. Satterlee (In re Anderson)*, 21 F.3d 355 (9th Cir.1994), rejected the chapter 13 trustee's insistence that the debtor commit to paying *actual* income over the term of the plan as a condition to confirmation. The *Anderson* court ruled that § 1325(b)(1)(B) requires payment of PDI as calculated at the time of confirmation. *Id.* at 358.

But a different rule emerged in chapter 12 cases, despite the fact that the chapter 12 PDI language in § 1225(b) was materially the same as chapter 13's. Courts in chapter 12 cases required an accounting at the end of the case to determine whether, based on the debtor's actual results, the debtor had paid all disposable income to the trustee for distribution to creditors. *E.g., Yarnall v. Rowley (In re Rowley)*, 22 F.3d 190, 191 (8th Cir. 1994). The debtor had to pay disposable income, determined retroactively, in order to obtain a discharge. Otherwise, the case would be dismissed.

In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), widely known for its addition of the so-called "means test" in chapter 7 cases, similar changes to the PDI test in chapter 13, and other creditor-friendly provisions.

BAPCPA also did two significant things with regard to chapter 12. First, it enacted chapter 12 on a permanent basis. Second, it amended the chapter 12 PDI test.

The BAPCPA amendment to the chapter 12 PDI test added a second method of satisfying it. Prior to BAPCPA, both the chapter 12 and 13 PDI tests (now § 1225(b)(1)(B) and

§ 1325(b)(1)(B)) required the payment of "all of the debtor's projected disposable income" for the prescribed period.

BAPCPA added an alternative for chapter 12 cases, § 1225(b)(1)(C). It permits confirmation if

> the value of the property to be distributed [during the plan term] is not less than the debtor's projected disposable income for such period.

The purpose of the amendment was to eliminate the retroactive determination of PDI in chapter 12 cases, which had posed a hardship for family farmers. Susan A. Schneider, *Bankruptcy Reform and Family Farmers: Correcting the Disposable Income Problem,* 38 Tex. Tech. L. Rev. 309, 331 (2006).

BAPCPA also added the PDI requirement in chapter 11 cases of individuals. § 1129(a)(15)(B). Curiously, the chapter 11 PDI requirement uses the alternative chapter 12 language that BAPCA added, not the chapter 13 and original chapter 12 language.

Like chapter 12, the subchapter V PDI test in § 1191(c)(2) includes both alternatives.

Clause (A) requires "all of the projected disposable income of the debtor" to be applied to make payments under the plan during its term.

Clause (B) requires that the value of property distributed under the plan during its term be not less than the projected disposable income of the debtor.

From the creditor standpoint, the argument is that Clause (A) permits the court to require payment of disposable income based on actual results under the chapter 12 interpretation of the statute. Arguably, the chapter 12 approach is the better one in the sub V context because sub V, like chapter 12, involves business income that, unlike regular income from salary or wages in a chapter 13 case, is subject to market conditions and other variables.

A debtor has two responses.

The first is that the chapter 12 approach ignores the plain meaning of the statute, which refers to "projected," not actual, disposable income. As a matter of statutory construction, therefore, the chapter 13 approach is the correct one.

The second response is that Clause (B) permits the debtor to satisfy the test through payment of projected, not actual, disposable income, consistent with the purpose of the addition of the alternative to chapter 12 in BAPCPA. Because the two methods are alternatives and the debtor proposes the plan, payment of projected income is appropriate under clause (B) even if clause (A) requires payment of actual income.

Perhaps a creditor could convince a court that the existence of the two alternatives permits the court to choose between them. Or perhaps the language of clause (B) does not actually eliminate the pre-BAPCPA chapter 12 approach.

Creditors may raise a policy justification for their position. The amendments to Chapter 13 in 1984 that added the PDI test also changed the provisions for postconfirmation modification in § 1329(a) to permit the trustee or an unsecured creditor to seek modification. Chapter 12 similarly allowed such parties to seek postconfirmation modification. The reason is that the trustee or an unsecured creditor can propose a modification to require the debtor to pay more money based on an increase in disposable income.

Subchapter V does not permit postconfirmation modification at the instance of anyone except the debtor. § 1193. Thus, although a sub V debtor can seek postconfirmation modification to reduce payments if its actual results turn out to be worse than projected, creditors do not have a similar remedy to get more money if the debtor does better than expected. Creditors may, therefore, justly complain that the result gives the debtor all of the upside and

puts all of the downside risk on them. Payment of disposable income based on actual results rectifies the problem.