

Trustee Talk

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Concerns About Being Left Holding the Bag: Addressing Payment of Subchapter V Trustee Fees



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The Small Business Reorganization Act of 2019 (SBRA), signed into law on Aug. 23, 2019, and effective on Feb. 19, 2020, added subchapter V to chapter 11 of the Bankruptcy Code “to streamline the process by which small business debtors reorganize and rehabilitate their financial affairs.”¹ Although the timing was purely coincidental, in retrospect the addition of subchapter V seems prescient given the onset of the COVID-19 pandemic just weeks after subchapter V went into effect.

To qualify for subchapter V, a debtor must meet the definition of a “debtor” under 11 U.S.C. § 1182(1), which includes a debt threshold. When initially enacted, the debt limit set forth in the SBRA was \$2,725,625. However, due to the significant impact of COVID-19 on small businesses, the Coronavirus Aid, Relief and Economic Security (CARES) Act increased the debt limit to \$7.5 million (inclusive of secured and unsecured debt, but excluding debts owed to affiliates or insiders) for subchapter V cases that were filed on or after March 27, 2020.

Due to the continuing global impact of the COVID-19 pandemic, Congress extended the increased \$7.5 million debt limit on two separate occasions through June 21, 2024. However, as of November 2024, Congress has not yet passed legislation to increase the debt limit, and thus, since late June 2024, the debt limit for subchapter V has been reduced to an adjusted original amount pursuant to 11 U.S.C. § 104 (\$3,024,725).

To make chapter 11 bankruptcies more feasible and affordable for small businesses, subchapter V aims to reduce administrative costs for the small business debtor. Namely, among other features, subchapter V bankruptcies eliminate the appointment of an unsecured creditors’ committee (unless otherwise ordered by the bankruptcy court for cause), provide the debtor with an exemption from the requirement to pay U.S. Trustee fees, eliminate the requirement to file a disclosure statement with a plan, provide an opportunity for the debtor’s owners to retain equity in the company, and mandate that a reorganization plan must be filed within 90 days of the petition date.

All told, subchapter V is designed to make the chapter 11 process more accessible and economical for small businesses that previously may have found chapter 11 to be too cost-prohibitive. Indeed, given these cost-saving measures since subchapter V became effective, it should not be surprising that annual subchapter V filings have increased approximately 150 percent.²

Another key feature of a subchapter V bankruptcy is the appointment of a subchapter V trustee, who plays a crucial role in these cases — namely, to supervise and monitor the bankruptcy and ensure that the debtor remains focused on “the development of [a] consensual plan of reorganization.”³ The duties of the subchapter V trustee are enumerated in 11 U.S.C. § 1183(b). Specifically, the subchapter V trustee is responsible for various aspects during the pendency of a subchapter V bankruptcy, including reviewing and objecting to proofs of claim; opposing the debtor’s discharge (if advisable); attending status conferences and hearings; preparing a final report and account; investigating the debtor’s financial affairs, including assessing the continued operation of the debtor’s business and its plan formulation; distributing property in accordance with a confirmed plan and ensuring that the debtor makes timely payments in compliance with the plan; operating the business and performing other duties assigned to the trustee in the event that the debtor ceases to be a debtor in possession; and facilitating the development of a consensual reorganization plan.⁴

Given the general absence of a creditors’ committee in subchapter V, coupled with the relatively fast time frame required for debtors to file a plan, perhaps the subchapter V trustee’s most important role is to serve as a *de facto* mediator in bringing debtors and creditors together to resolve issues and facilitate a consensual plan. Subchapter V trustees can play a vital role in getting parties to overcome

1 See Report of Committee on the Judiciary, House of Representatives, Report 116-171, 116th Cong., 1st Sess., on Small Business Reorganization Act of 2019, at 1.

2 In 2020, there were 1,118 subchapter V cases filed in U.S. Trustee Program (USTP) districts (which excludes Alabama and North Carolina). Through Sept. 30, 2024, there have been 2,647 subchapter V cases filed in USTP districts in 2024. See Chapter 11 Subchapter V Statistical Summary through September 30, 2024, USTP, available at justice.gov/ust/page/file/1499276/dl (last visited on Nov. 20, 2024). It remains to be seen what impact the reduced debt limit will have on the amount of subchapter V filings.

3 See 11 U.S.C. § 1183(b)(7).

4 See 11 U.S.C. § 1183(b)(1)-(7).

issues to pave the way for a confirmable plan. It is likely not a coincidence that subchapter V cases between 2020 and 2023 had plans confirmed at a 52 percent rate, compared to just 22 percent for non-subchapter V small business chapter 11 cases.⁵

Understandably, subchapter V trustees will want to hit the ground running when assigned a case. The work from the outset can include reviewing the case filings (which can be particularly intensive if the debtor has filed first-day motions), attending the initial debtor interview and meeting of creditors, attending the initial status conference required under § 1188 of the Bankruptcy Code, and engaging with the debtor and creditors. The amount of ongoing work will depend on the issues in the case, including the extent of any disagreements among the debtor and creditors.

In addition, bankruptcy courts may also lean on subchapter V trustees to help resolve issues among debtors and creditors and in assessing a plan's feasibility. Consequently, subchapter V cases necessitate a certain volume of work from the subchapter V trustee. However, the SBRA is silent on the compensation of a subchapter V trustee, except for noting that such fees should be paid by the debtor and/or its estate as an administrative expense.⁶

Given all of the work that a subchapter V trustee performs throughout a subchapter V case, there has been growing concern about ensuring that subchapter V trustees are compensated for their efforts. While the debtor and its estate are responsible for the payment of subchapter V trustee's fees as administrative expenses, the fees are normally contingent on the debtor's successful reorganization unless something more proactive is done within the context of an individual case to ensure payment to the subchapter V trustee.

The concern is particularly acute given that approximately 44 percent of subchapter V cases convert or are dismissed without a plan being confirmed.⁷ In order to perform their duties and be effective in a case, subchapter V trustees may have to take on a large amount of work in a short amount of time, and do so with the expectation of eventual payment. However, they could be left holding the proverbial "bag" if a plan is not confirmed. This raises a growing concern that if subchapter V trustees are routinely not being compensated for their work or are having to chase down debtors for fees, they could become disincentivized from diving into cases, which could mitigate the potentially beneficial impact that subchapter V trustees can have on cases given the critical role the Bankruptcy Code envisions for subchapter V trustees in facilitating the development of a consensual plan.

In light of these concerns, there has been a growing discussion regarding payment of subchapter V trustees, and some case law and initiatives in various jurisdictions have emerged. In many cases, the subchapter V trustee's fees are addressed on a case-by-case basis, rather than the jurisdiction adopting a one-size-fits-all rule or procedure. For example,

bankruptcy courts may authorize the debtor to give a retainer to the subchapter V trustee, or perhaps condition dismissal of a case on payment of the subchapter V trustee's fees. However, such treatment has raised questions with respect to whether retainers or directives specifically for a subchapter V trustee's fees will result in improper unequal treatment favoring the subchapter V trustee over other administrative creditors in a case.

With this concern in mind, in December 2023 the U.S. Bankruptcy Court for the Southern District of New York issued a form case-management order regarding procedures in chapter 11 subchapter V cases, scheduling case conferences and setting deadlines for filing plans. These procedures require subchapter V debtors to set aside \$1,000 each month for payment of accruing administrative expenses, including subchapter V trustee fees.⁸

This issue was also discussed in *In re Roe*,⁹ in which the subchapter V trustee filed a motion requesting that the debtor post a \$7,500 retainer for its fees and expenses. The court held that payments to an account for the benefit of the subchapter V trustee would be a payment outside the ordinary course of the debtor's business under § 363(b). However, the court authorized the creation of a trust account for funds to be deposited and shared on a *pro rata* basis with all claimants who have administrative claims.

The court reasoned that the Bankruptcy Code requires that claims of equal priority be treated the same, and explained that "a subchapter V trustee may use the trustee's rights and powers under the Bankruptcy Code to the extent it is necessary for a subchapter V trustee to fulfill the statutory duties given to subchapter V trustees in section 1183."

In *In re Lager*,¹⁰ the bankruptcy court noted that "the Northern District of Texas changed its Subchapter V procedures, enacting a requirement that debtors electing treatment under Subchapter V of Chapter 11 must make interim payments [in the amount of \$1,000] to their Subchapter V trustees on a monthly basis in order to ensure payment of the Subchapter V trustees' professional fees upon confirmation or dismissal." The Clerk's Notice 22-01 providing the amendment further clarified that "[t]he amount of interim compensation is subject to adjustment by the Court, after notice and hearing upon request of any interested party, and subject to final approval by the Court under 11 U.S.C. § 330. [The] Debtor shall include this interim compensation in any proposed cash collateral budget."

The U.S. Bankruptcy Court for the Eastern District of Virginia suggested that the U.S. Trustee may also share responsibility to monitor a debtor's financials so that accruing legal fees and subchapter V trustee fees do not go unpaid. In *In re Hao*,¹¹ the U.S. Trustee filed a motion to convert or dismiss the debtor's subchapter V case based on the debtor's bad-faith conduct and continuing loss to or diminution of the bankruptcy estate. The court noted that "[t]here are continuing losses because the Debtor is accruing legal fees, and

5 See USTP statistics, *supra* n.2.

6 Another notable feature of subchapter V is that if a plan is a "cramdown plan" confirmed under § 1191(b) of the Bankruptcy Code, rather than a consensual plan confirmed under § 1191(a), administrative claims (including professional and subchapter V trustee fees) can be paid over time through the plan rather than on the effective date as is required in a regular chapter 11 (unless a party agrees to alternative treatment).

7 See USTP statistics, *supra* n.2.

8 Whether \$1,000 per month for administrative expenses is sufficient in a case is another question. No. 23-32077-THP11, 2024 WL 206678 (Bankr. D. Ore. Jan. 18, 2024).

10 No. 22-30072-MVL11, 2024 WL 3928157, fn.9 (Bankr. N.D. Tex. Aug. 23, 2024).

11 644 B.R. 339 (Bankr. E.D. Va. 2022).

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Subchapter V Trustee fees, that his monthly operating reports indicate he has no ability to pay.” Instead of dismissing the case, the bankruptcy court ultimately converted the case to chapter 7, as it was in the best interests of the creditors.

The U.S. Bankruptcy Court for the District of New Jersey recently updated its subchapter V status report to include a specific question asking subchapter V debtors to explain how they intend to pay for administrative expenses, including subchapter V trustee fees.¹² The goal is to raise the issue of the subchapter V trustee fees early in the case and tee it up if necessary for discussion at the status conference required under § 1188(a). In addition, by formalizing the issue, the hope is that over time, subchapter V debtors and their professionals will become more accustomed to considering the issue at the outset of cases.¹³

Conclusion

For the most part, subchapter V bankruptcies have been considered a success and have been praised for their efficiency. However, subchapter V’s continued success necessitates the continued participation of subchapter V trustees. A subchapter V trustee needs to be fully engaged in the case to effectively perform their statutory duties without being concerned about the payment of their fees. This discussion will likely continue, and the initiatives discussed herein in certain jurisdictions are likely just initial initiatives to address the issue. **abi**

Editor’s Note: *ABI’s Subchapter V Task Force’s Final Report and recommendations to Congress is posted at subvtaskforce.abi.org. All members are invited to submit their experiences with subchapter V at abi.org/subvstories.*

¹² Section 1188 of the Bankruptcy Code requires that a status conference be held in subchapter V cases within 60 days after the entry of the order for relief and that a status report be filed no later than 14 days before the status conference. 11 U.S.C. § 1188.

¹³ In this vein, another potential way to get subchapter V debtors to address subchapter V trustee fees early in a case could be to require that it be addressed in motions seeking use of cash collateral (to the extent such motions are filed in subchapter V cases).