

III. WHO ARE THE “PLAYERS” IN A BANKRUPTCY CASE?

A. Who May Be a Debtor?

Every *debtor* must reside in or have a domicile, a place of business or property in the United States, or be a municipality. The following entities cannot be a *debtor* under *chapter 7*:

- ✓ a railroad;
- ✓ a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a *small business* investment company, a credit union, industrial bank or similar institution insured under the Federal Deposit Insurance Act; and
- ✓ a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association or credit union engaged in such business in the United States.

A qualifying *debtor* under *chapter 9* is a municipality that:

- ✓ is specifically authorized to be a *debtor* under state law;
- ✓ is *insolvent*; and
- ✓ desires to adjust its *debts*, and
 - has the agreement of creditors holding a majority of the *claims* that will be *impaired*;
 - has negotiated in good faith with creditors and failed to obtain a majority agreement;
 - is unable to negotiate with creditors because negotiation is impracticable; or
 - reasonably believes that a creditor may attempt to obtain an *avoidable transfer*.

The term “person” is defined by the Code to include an individual, partnership and corporation, but does not include a *governmental unit*.

An individual does not qualify to be a *debtor* under any chapter unless, in the preceding 180 days, the individual (subject to certain exceptions) has received a briefing outlining opportunities for available credit counseling and assistance in performing a budget analysis from an approved nonprofit budget and credit counseling agency.

A person can be a *debtor* under *chapter 11* if the person:

- ✓ qualifies as a *debtor* under *chapter 7* (see *Toibb v. Radloff* case);
- ✓ is not a stockbroker or commodity broker; and
- ✓ is not a railroad.

A person can be a *debtor* under *chapter 13*, if the person:

- ✓ has regular income;
- ✓ owes on the date of filing noncontingent, liquidated, *unsecured debts* of less than \$336,900; and
- ✓ owes on the date of filing noncontingent, liquidated, *secured debts* of less than \$1,010,650.

A person can be a *debtor* under *chapter 12*, if the person is a *family farmer* or *fisherman* with a regular annual income.

An individual or *family farmer* or *fisherman* does not qualify to be a *debtor* under any chapter if, in the preceding 180 days, the person was a *debtor* under the Code and:

- ✓ The previous case was dismissed for willful failure to follow the court's orders or appear before the court; or
- ✓ The *debtor* requested and obtained voluntary *dismissal* of the case following the filing of a request for *relief from the automatic stay*.

The following foreign entities can be a *debtor* under *chapter 15*:

- ✓ a foreign entity that has assets in the United States;
- ✓ a foreign insurance company that has assets in the United States (even if it has a branch or agency in the United States); and
- ✓ a foreign bank that has assets in the United States but does not have a branch or agency in the United States.

B. Debtor's Duties

Upon filing bankruptcy, the *debtor* must file with the court:

- ✓ a list of creditors;
- ✓ a *schedule* of assets and liabilities;
- ✓ a *schedule* of current income and expenditures;
- ✓ a *statement of financial affairs*; and
- ✓ a list of property claimed as *exempt*.

If an individual *debtor* has *consumer debts* that are *secured by property of the estate*, the *debtor* must also file a *statement of intention* that indicates whether:

Some courts read *redemption*, *reaffirmation* and *surrender* as nonexclusive alternatives. They allow the *debtor* to retain property *post-petition* without *reaffirming* the debt, as long as timely payments are made. Other courts have held that *surrender*, *redemption* or *reaffirmation* are the *debtor's* only alternatives.

- ✓ the property is claimed as *exempt*;
- ✓ the *debtor* intends to *redeem* the property;
- ✓ the *debtor* intends to *reaffirm* the debt *secured* by the property; or
- ✓ the *debtor* intends to *surrender* the property.

In *chapter 11* cases, the *DIP* has the same responsibilities as a *debtor* or *trustee* in *chapter 7* cases, as well as a *trustee* appoint-

ed in a *chapter 11* case. In addition, the *DIP* must file monthly operating reports with the *U.S. Trustee*, detailing its financial performance and operations during the preceding month.

C. The U.S. Trustee

While the court judicially enforces the Code, the office of the *U.S. Trustee* performs the administrative functions required by the Code. The *U.S. Trustee* appoints *chapter 7 trustees* on a case-by-case basis from a panel, appoints standing chapter 12 and 13 trustees, and appoints trustees and examiners in chapter 11 cases as ordered by the court. Further, the *U.S. Trustee* appoints the creditors' committee in chapter 11 cases. In all cases, the Code affords the

U.S. Trustee the right to raise, appear and be heard on any issue in a case or proceeding commenced under the Code. Essentially, the **U.S. Trustee** can do just about anything under the Code that a **debtor** or creditor could do, except file a **plan of reorganization**. In Alabama and North Carolina, the equivalent of the U.S. Trustee is called the Bankruptcy Administrator.

D. Trustees in Bankruptcy (other than the U.S. Trustee)

A **trustee** must be:

- ✓ an individual competent to perform the **trustee's** duties; or
- ✓ a corporation authorized to act as **trustee**.

A person who has served as an **examiner** in a case may not serve as **trustee** in the case.

A **trustee**, other than a **U.S. Trustee**, or an **examiner** may be removed by the court for cause after **notice and a hearing**. Once removed from a case, the **trustee** or **examiner** will be removed from all cases in which he is serving, unless the court orders otherwise.

The **trustee**:

- ✓ must file a bond securing faithful performance;
- ✓ represents the **estate** (see **Weintraub** case; **Campbell** case);
- ✓ may sue and be sued; and
- ✓ is entitled to reasonable compensation for services performed.

The **trustee's** compensation must be reasonable and must be approved by the court. In a **chapter 7** or **chapter 11** case, such compensation is as follows:

- ✓ compensation is not to exceed 25 percent on the first \$5,000;
- ✓ ten percent on amounts over \$5,000, up to \$50,000;

While all **chapter 11** monthly operating reports contain the same basic information, such as statement, basic balance sheet and receivable/payable data, each bankruptcy court utilizes its own report forms.

It is important for a lender to request placement on the service list to receive these reports, typically due the 15th day of the following month. The report should be reviewed regularly and compared with those from prior months.

- ✓ five percent on amounts over \$50,000, up to \$1 million;
- ✓ three percent on amounts in excess of \$1 million; and
- ✓ compensation is calculated on the amount of money disbursed to *parties in interest*.

Chapter 12 and *chapter 13* standing *trustees'* compensation is set by the Attorney General and funded via a percentage fee, generally not to exceed 10 percent, collected from payments received in cases the trustee administers. With court approval, after *notice and a hearing*, the *trustee* may also act as his own attorney in the case. The *trustee* is entitled to separate reasonable compensation, as approved by the court, for such services.

In a *chapter 7* case, the *U.S. Trustee* appoints a *disinterested person* from a panel to serve as interim *trustee*. The interim *trustee* becomes the permanent *trustee* unless creditors elect a *trustee* at the *section 341 meeting*.

In order to be eligible to vote for a *trustee*, a creditor must:

- ✓ hold a *claim* that is *allowed*, undisputed, fixed, liquidated, *unsecured* and entitled to distribution;
- ✓ not have an interest adverse to the *interests* of other creditors; and
- ✓ not be an *insider*.

Creditors may elect a new *trustee* if a *trustee* dies, resigns, fails to qualify or is removed.

In a *chapter 7* case, the *trustee's* duties are to:

- ✓ collect *property of the estate* and reduce it to money;
- ✓ be accountable for all property received;
- ✓ ensure that the *debtor surrenders, redeems* or *reaffirms* as promised;
- ✓ investigate financial affairs of the *debtor*, including review the *debtor's* claimed *exemptions*;
- ✓ review *proofs of claim* and object to improper *claims*;
- ✓ if appropriate, oppose *discharge* of the *debtor*;

- ✓ provide *parties in interest* information concerning the *estate*;
- ✓ if the *debtor's* business is being operated, file appropriate business reports;
- ✓ make a final report and file a final account with the court and the *U.S. Trustee*; and
- ✓ if there is a claim against the *debtor* for a *domestic support obligation* provide the applicable notice.⁷

In a *chapter 7* case, creditors may elect a *creditors' committee* of three to 11 creditors who hold allowable *unsecured claims*. The *creditors' committee* assists the *trustee* in administering the *estate*.

In a *chapter 11* case, the court may order the appointment of a *trustee* before *confirmation* of a *plan* on the request of a *party in interest* or the *U.S. Trustee* for cause, including fraud, dishonesty, incompetence or gross mismanagement by current management, or if the appointment is in the best interest of the *estate*. The *U.S. Trustee* is required to move for the appointment of a trustee if there are reasonable grounds to suspect fraud by management or in the *debtor's* public reporting. Moreover, if cause exists to dismiss or convert the case, a court may instead determine that the appointment of a *trustee* or *examiner* is in the best interest of creditors and the *estate*. Once the court orders appointment of a *trustee*, a *party in interest* may request a meeting of creditors for the purpose of electing a *disinterested person* as *trustee*.

If the court does not order the appointment of a *trustee*, a *party in interest* or the *U.S. Trustee* may request the appointment of an *examiner*. The court must order appointment of an *examiner* if it determines, after *notice and a hearing*, that the appointment is in the interest of the *estate* or the *debtor* has fixed, liquidated *unsecured* debts exceeding \$5 million not owed for goods, services, or taxes or to *insiders*.

In a *chapter 11* case, the *trustee's* duties are to:

- ✓ be accountable for property received;
- ✓ examine *proofs of claim* and object to improper *claims*;

⁷ If the *debtor* is an individual, the *U.S. Trustee* must review all materials filed by the *debtor* and file with the court a statement as to whether the *debtor's* case would be presumed to be an abuse of the Code. If found to be an abuse of the Code, the *U.S. Trustee* must file a motion to dismiss or convert or a statement setting forth the reasons why the *U.S. Trustee* determined not to file such a motion.

- ✓ furnish information to *parties in interest*;
- ✓ file reports regarding the operation of the business;
- ✓ file any required information about the *debtor* not previously filed with the court;
- ✓ investigate the business and the desirability of continuing the business;
- ✓ report to the court and others the results of the investigation;
- ✓ file a *plan* or recommend *conversion* or *dismissal*;
- ✓ file unreported tax information with taxing agencies;
- ✓ after *confirmation*, file necessary reports; and
- ✓ make a final report and account to the court and the *U.S. Trustee*.

E. Professionals

The bankruptcy process depends heavily upon services provided by *professionals*, such as attorneys, accountants, appraisers and financial consultants. Accordingly, the *debtor* may hire one or more *professionals* to assist in the bankruptcy case.

The *debtor* must obtain court approval, after *notice and a hearing*, before employing *professionals*. Pursuant to the Code, those hired must be:

- ✓ *disinterested*; and
- ✓ not represent *interests* adverse to the *estate*.

Other points to remember regarding the employment of *professionals* include:

- ✓ a *professional* is typically not disqualified from employment solely because of prior representation or connection with a creditor;
- ✓ upon objection by a creditor or the *U.S. Trustee*, the court decides whether an actual conflict of interest exists that will prohibit employment as a *professional* in the case;
- ✓ *professionals* are entitled to “reasonable” compensation as approved by the court after *notice and a hearing*;

- ✓ after the case is concluded, the court may overrule prior determinations respecting what constitutes reasonable compensation. To do so, the court must find that its prior determinations were “improvident” in view of developments not anticipated earlier;
- ✓ the court may order *disgorgement* to either the *estate* or entity making the payment of excessive compensation; and
- ✓ the attorney for the *debtor* is subject to some special rules. Such counsel must disclose to the court:
 - the compensation paid by the *debtor* or agreed to within a year of the *petition*; and
 - the source of such compensation.

The **U.S. Trustee's** Office is very active in the area of professional compensation. In fact, it has developed a sophisticated set of written guidelines governing both the amount and format of compensation requests. Failure to comply with the guidelines almost certainly will draw an objection to a fee application.

With court approval, the *trustee* also may hire *professionals*. Those hired must be *disinterested* (in most cases) and not hold or represent *interests* adverse to the *estate*. The *trustee*:

- ✓ may not hire a person who has served as an *examiner* in the case;
- ✓ may hire, for special purposes, an attorney who has represented the *debtor*; and
- ✓ may act as attorney or accountant for the *estate* if the court so authorizes.

F. Governmental Entities

Various state and federal agencies are regularly encountered in bankruptcy cases. Among the most frequent players are:

- ✓ the Internal Revenue Service;
- ✓ the Environmental Protection Agency and its state counterparts;
- ✓ the Pension Benefit Guaranty Corporation;
- ✓ the Securities and Exchange Commission;

- ✓ the Department of Labor;
- ✓ state and local taxing authorities; and
- ✓ government guarantors of certain types of loans.

The Code contains many special provisions that expand (and sometimes limit) the rights of governmental entities in bankruptcy cases.

Sovereign immunity

- ✓ *Sovereign immunity* refers to a government’s right to be free from legal challenges and *claims*. A *governmental unit* has no *sovereign immunity* with respect to numerous sections of the Code. *See Seminole* case.
- ✓ A *governmental unit* waives its *sovereign immunity* as to *claims* arising from the same transaction when it files a *proof of claim* against a *debtor’s estate*.
- ✓ An *estate* may set off (1) *claims* by a *governmental unit* and (2) *claims* against that *governmental unit*, even though the *claims* arose from different events.

G. Secured Creditors

The rights of a *secured* creditor in bankruptcy are often governed by a combination of its *pre-petition* contractual agreements with the *debtor* and *applicable nonbankruptcy law* rather than the Code. Typically, a *secured* creditor has the following goals in bankruptcy:

- ✓ recognition or determination of its *secured* status, including proper perfection of its *security interests*, under *applicable non-bankruptcy law*;
- ✓ regarding collateral, obtaining *adequate protection* or *relief from stay* during *estate administration* (or finalize a *reaffirmation* agreement in a consumer case);
- ✓ protecting its *pre-petition* payments received upon the underlying debt from *post-petition* recovery actions and *avoidance powers*; and
- ✓ maximizing return upon the value of its collateral after the case

concludes.

H. Lessors

The rights of lessors are principally controlled by the *executory contract* and unexpired lease provisions of the Code. Often, the most critical issue is determining whether a particular transaction involves a true lease as opposed to a *financing lease*, *true sale* or *disguised security interest*.

In general, lessors have the following objectives in bankruptcy cases:

- ✓ if appropriate, prove the lease either was terminated *pre-petition*, so the *debtor* or *trustee* has no *assumption* or *rejection* powers, or is of the type that may not be *assumed* and *assigned*;
- ✓ upon *assumption*, demand *pre-petition* defaults, including arrearages, be promptly cured and *adequate assurance* of future performance be given;
- ✓ assure the *debtor* makes *post-petition* payments or otherwise performs under the lease during the Code-provided *assumption/rejection* period (mandatory for business equipment leases and nonresidential real estate leases);
 - regarding nonresidential real estate, such period is 120 days from the *order for relief*, unless otherwise extended by the court, but the court can only extend this period for an additional 90 days; thereafter, any extension requires the prior written consent of the landlord.⁸
 - Regarding residential real estate and personal property, the period to *assume* or *reject* is 60 days in *chapter 7* cases, but through the date of *confirmation* in *chapter 9, 11, 12*, and *13* cases, unless the court orders otherwise upon the lessor's request; and
- ✓ If the lease is *rejected*,
 - demand immediate *surrender* of the leased property;
 - assert an *administrative* or *priority claim* for *any post-petition* arrearage and, if the lease was assumed *post-petition* and later

⁸ Section 365(d)(4) of the Code, which limits the assumption/rejection period to 210 days absent the prior written consent of the landlord, applies to cases filed on or after Oct. 17, 2005.

rejected, assert an *administrative claim* for all amounts payable under the lease during the two years following *rejection*, without any reduction or offset; and

- file an *unsecured proof of claim* for damages resulting from *rejection* in connection with the balance of the lease.

I. Unsecured Creditors

Unsecured creditors typically have limited leverage in bankruptcy. However, particularly in a *chapter 11* case, they can become a significant force by participating on a *creditors' committee* appointed by the *U.S. Trustee*.

While relatively modest, *unsecured* creditors do have some bankruptcy remedies. The bankruptcy process works best when the “players” all participate according to their respective interests. While they do not necessarily work together, often players will find that their interests are mutually aligned. When players band together and form a united front on a particular issue, they are a formidable force. In bankruptcy, there definitely exists safety in numbers. Unless absolutely critical, it is rarely in a lender’s best interest to isolate itself.

remedies, including:

✓ if appropriate, pursue *reclamation* rights and force either the return of goods sold or award of an *administrative claim*;

✓ in *chapter 7* or liquidation cases, obtain a *dividend* from the *debtor’s* nonexempt unencumbered property or through use of the *trustee’s avoidance powers*;

✓ if necessary to the *debtor’s* reorganization effort, negotiate favorable *post-petition* business terms in *chapter 11* cases and preserve the *debtor* as a customer; and

✓ in *chapter 11, 12, or 13* cases, obtain a *dividend* under the *debtor’s plan* through either negotiation, use of *avoidance powers*,

or other objections to *confirmation* recognized by the Code.

J. Equity-Holders

Particularly in *chapter 11* cases, the *debtor’s* owners are significant players. No other group of *interests* has as much incentive to assure the *DIP* survives and emerges financially rehabilitated, thereby potentially preserving the investment of equity-holders.

Holding *claims* of the lowest distribution priority, equity-holders rarely receive anything in a *chapter 7* case or upon liquidation. However, in *chapter 11* cases, they do have certain objectives:

- ✓ assure the continuation of the *debtor's* business operations during *estate administration*;
- ✓ through negotiation or use of the *new value exception* to the *absolute priority rule*, secure an ownership interest in the *reorganized debtor* or obtain some form of *dividend* through *confirmation* of a *plan*; and
- ✓ regarding partnerships and other noncorporate debtors, avoid adverse tax consequences arising from the bankruptcy case.