ABI Task Force on Subchapter V Virtual Public Hearing

July 14, 2023

Remarks of Craig Goldblatt, Bankruptcy Judge,
U.S. Bankruptcy Court for the District of Delaware

I would like to thank the ABI and the Subchapter V Task Force, and in particular the Co-Chairs, Judge Harner and Megan Murray, for the important work you are doing and for the opportunity to address you today. My name is Craig Goldblatt. I am a bankruptcy judge sitting on the Bankruptcy Court for the District of Delaware.

As a preliminary matter, I want to share my high-level reaction, based on my two years or so on the bench, that subchapter V appears to be a terrific success story. Is every subchapter V case that files before us the kind of case that Congress had in mind when it enacted the Small Business Reorganization Act of 2019 – the corner grocer or local dry cleaner, run by a hard-working entrepreneur who has hit a bump in the road and is looking to save his small business? No. But from the cases I have seen, I do think it's clear that subchapter V has made chapter 11 reorganization more affordable for smaller companies that would have otherwise been crushed by the costs associated with a regular chapter 11 reorganization.

One important reason for the success of many cases under subchapter V has been the work done by the subchapter V trustees. The statute itself tells us very little about the role of the subchapter V trustee. Section 1183 gives the subchapter V trustee certain specific duties; explains that the subchapter V trustee is authorized to run the business if the debtor is dispossessed; and otherwise says that the job is to facilitate the development of a consensual plan of reorganization.

It may well be the case that part of the success of subchapter V is explained by this open-ended and sparse statutory mandate. In the absence of clearer direction from Congress, subchapter V trustees have largely exercised their own judgment in deciding how they might be most constructive to the success of the bankruptcy case. From what I have seen, a large part of the success in some of these cases is attributable to the presence of a party-in-interest who does not have his or her own financial stake in the case. In many cases the role of the subchapter V trustee turns out to be the one participant in the case whom everyone else views as an "honest broker." And having someone who is playing that role often proves critical to the parties' ability to forge a consensus around the terms of a plan.

One thing I have learned, in my two years on the bench, is to appreciate how much work in a chapter 11 case goes on outside of my field of vision. There is so much that we judges do not see. And my view is that judges should be careful not to jump to conclusions about what they think is happening in rooms that they are not in. But even with those caveats, I do want to emphasize the very high regard I have for the work of the subchapter V trustees that have appeared in cases before me.

There are certainly questions that one can fairly engage about the proper role of the subchapter V trustee. But no one should infer from any of these questions anything that is inconsistent with the appreciation of, and high regard for, the excellent work performed by the subchapter V trustees in the cases that I have seen.

Based on the two years' experience I have had in cases under subchapter V, there is one topic on which I believe the Task Force should consider recommending statutory language to solve a particular glitch in the current statute. I will also identify a handful of other areas where it is not clear to me, based on my own experience, that legislative intervention is presently warranted, but where it may make sense to continue monitoring how the caselaw and the practices evolve before deciding whether legislation would be either necessary or appropriate.

Compensating debtor's counsel in cases in which the subchapter V trustee ceases to be a debtor in possession.

The first issue – the one where I do believe a legislative fix would be appropriate – arises in the context of a debtor in subchapter V who is removed as debtor in possession. When a court orders such dispossession, the subchapter V trustee is authorized, under § 1183(b)(5), to step in and run the business of the debtor. The debtor, however, retains a crucial role. Section 1189(a) affords a debtor in subchapter V permanent exclusivity to file a plan. Absent dispossession, debtor's counsel could of course be paid for this work by filing an application for compensation under § 330(a), which allows all professionals properly retained under § 327 to be compensated for services rendered to the estate. Section 327, in turn, authorizes the "trustee," in the traditional sense, to retain professionals, and, in a subchapter V case, § 1184 gives the debtor in possession all the rights and obligations of a trustee.

Upon dispossession, however, the debtor ceases to be the debtor in possession and therefore loses its status as the "trustee." The problem, then, is as follows: how do we ensure that the debtor's counsel is properly compensated for the work it does on behalf of the debtor in filing a plan if the debtor is no longer the "trustee" whose counsel may be compensated under § 330?

The Supreme Court addressed this issue – albeit in a different context – in *Lamie v. United States Trustee*. In that case, counsel to a former chapter 11 debtor in possession continued to provide services to the estate after the case was converted to one under chapter 7. When counsel moved for compensation under § 330, his motion was denied. This issue ultimately reached the Supreme Court which held that § 330 authorized only counsel to the trustee to seek compensation out of the estate. Conversion, the Court reasoned, ended the debtor's tenure as trustee and therefore ended counsel's position as a professional retained by the trustee. As a result, if debtor's counsel wished to be compensated out of the estate for post-conversion services, counsel needed to be retained by the chapter 7 trustee going forward.

While there was a fair argument that the statutory language in *Lamie* simply contained a scrivener's error and that counsel to the debtor ought to be compensated out of the estate – at least for those services that are necessary to facilitate the debtor's cooperation with the chapter 7 trustee – in the context of an individual chapter 11 case that is converted to chapter 7, the decision is not unworkable, and arguably gives the trustee somewhat greater control over the estate's administrative liability. When a subchapter V debtor is removed as debtor in possession, however, the glitch in the statute creates a more serious obstacle to the successful resolution of the bankruptcy case. On the one hand, only the subchapter V debtor may propose a plan. Drafting and filing a plan requires the assistance of counsel. But as a result of *Lamie,* a subchapter V debtor's counsel cannot be compensated out of the estate for doing this necessary work.

There are a handful of potential workarounds, none of which is terribly satisfying. For example, it has been suggested that counsel may be entitled to receive compensation as an "actual, necessary expense" under § 503(b)(3)(D). The problem with this reading of § 503 is that it may prove too much. After all, if a professional can be compensated out of the estate by meeting the requirements of § 503, then why would one ever need to comply with §§ 327 and 330? And this reading would essentially render superfluous § 503(b)(2), which expressly allows administrative expense claims for professionals retained under § 330.

Another way to tackle this problem might be to allow compensation on the theory that, at least in cases where counsel's retention application was approved prior to the debtor's dispossession, debtor's counsel remains, as a literal matter, a "professional person employed under section 327." That problem is in serious tension with *Lamie*, since the same argument could have been made with respect to the lawyer for the individual debtor in that case.

A third solution, although slightly more complicated, is to consider the dispossessed debtor to be the "trustee" for purposes of filing a plan and therefore allow the debtor to retain professionals under § 327 for that limited purpose. Recall that, under § 1189(a), "only the debtor" may file a plan in a subchapter V.

Section 1106(a)(5), however, describes the filing of a plan as one of "the trustee's" duties. An argument could be made that even when a debtor is dispossessed, to the extent the debtor is proposing a plan, it is still carrying out the responsibility of a "trustee." This argument also has its problems. For one thing, § 1106(a)(5) does not apply in cases under subchapter V.

For these reasons, I do think that this issue may warrant a legislative fix. I very much encourage the Task Force to consider making such a recommendation.

What does it mean to be an "honest broker"?

One important feature of subchapter V is the fact that, unless the Court orders otherwise, no unsecured creditors' committee is appointed. So what happens if the debtor proposes an insider transaction? Is it the role of the subchapter V trustee to serve as an independent estate fiduciary looking out for the interests of the estate as a whole? Ought a court to expect that the subchapter V trustee would raise an objection if such a transaction were bad for the estate as a whole? I do not believe that the answer to these questions can be found in the statute itself. And my impression is that different subchapter V trustees may come to different answers.

This concern about whether the subchapter V trustee is or is not playing the "watchdog" role that would traditionally be played by a committee becomes more important in cases in which subchapter V may be used strategically by debtors that technically meet the eligibility requirements but are, in substance, far more substantial businesses than anyone thought would file a petition under subchapter V. To the extent this strategic use coincides with proposed insider transactions, the sound administration of the bankruptcy system may require either that subchapter V trustees take on something of a "watchdog" role, or that courts be willing to appoint unsecured creditors' committees in such cases, notwithstanding the associated expense to the estate.

I view this issue, however, more as one to watch than one on which it makes sense to recommend a legislative fix. It might certainly be helpful for the Task Force to gather information and impressions about how courts ought to deal with cases presenting this kind of problem. Perhaps a set of best practices will emerge over time.

Concern about "expanded duties" and "mission creep".

The prior question also raises a related issue about cases in which the role of the subchapter V trustee may be expanded. One of the consequences of subchapter V trustees earning the trust, respect and admiration of all the parties in the case is that they are logical candidates to play other roles in which a truly neutral fiduciary can add value.

In a case in which the debtor's insiders may bid for the company, might the subchapter V trustee be engaged to lead the marketing effort and decide which offer is the highest and best? Might the subchapter V trustee serve as a trustee of a liquidating trust created under the terms of a plan? Should the subchapter V trustee play the role that might be assigned to an examiner in a regular chapter 11 case? May a subchapter V trustee be given derivative standing to act on behalf of the estate if the company's management has a conflict?

Here, too, the answers very well may be "it depends." On the one hand, to the extent subchapter V trustees can leverage the trust and respect they have earned, in a way that advances the case, that may well be a salutary development. On the other hand, there is at least reason to pause before we inadvertently create perverse incentives under which a subchapter V trustee might end up with a substantial and lucrative engagement, perhaps as a liquidating trustee pursuing estate causes of action, if a bankruptcy case happens to go off the rails. Here too, my own experience is too limited to permit me to form any conclusions. But this is another issue that I think may be worth watching.

How does the subchapter V trustee get compensated?

To end where I started, I can say from experience that subchapter V trustees play a critical role in these cases. One thing we are all struggling with, however, is ensuring that they get paid for their work. At least by statute, the subchapter V trustee's fees must be paid in order to confirm a plan, and the trustee has the same rights as any other holder of an administrative claim in the event the case is dismissed or converted.

But what happens when, as it sometimes does, a case turns out to be administratively insolvent? I understand that some courts have suggested requiring a subchapter V debtor to make regular payments to the subchapter V trustee or requiring the debtor's attorney to hold some amount in an attorney trust on behalf of the subchapter V trustee. I am not here with any particular proposal for how to deal with this, other than to suggest that as practices develop across the country, it might be helpful if a set of "best practices" were articulated and widely adopted.

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Thanks very much, again, to all of you for the important work you are doing. I am very happy to answer any questions you may have.