

Controlling Expenses in Small Business Chapter 11 Cases

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We previously informed you that if you are a small business that needed to file bankruptcy to save your company, you may be able to take advantage of Subchapter V of Chapter 11 of the Bankruptcy Code.

Subchapter V was part of the Small Business Reorganization Act (SBRA), which became law in February. It created a more streamlined and less

expensive Chapter 11 reorganization path for small business debtors, and it has the potential to help small businesses reorganize and survive during the COVID-19 pandemic.

In Chapter 11, a debtor expects certain administrative expenses. First, the debtor must retain an attorney approved by the court to file and manage the case. Second, under Subchapter V, the court will appoint a trustee, and the debtor must pay the Subchapter V trustee's expenses. So the debtor must pay its attorney and the trustee. Must the debtor also pay for the trustee to hire an attorney?

In Chapter 7 (or Chapter 11 cases where the court appoints a trustee), the court routinely approves legal counsel to represent the trustee. Often, the trustee will hire himself or his law firm to provide legal services outside the scope of the trustee's administrative duties. Can a Subchapter V trustee do the same?

A bankruptcy court in the Eastern District of North Carolina recently said "NO," holding that a Subchapter V trustee may not retain legal counsel automatically. The case involved Penland Heating and Air Conditioning, Inc., which operates a heating and air conditioning business throughout North Carolina. They are winding down and intend to file a plan to liquidate their assets after completion of jobs in progress. They have court-approved counsel representing them. The Subchapter V trustee applied to retain counsel "as a matter of course," like he would in a Chapter 7 case.

The Court denied the request, holding the trustee had no current need for legal representation. The Court pointed out that the SBRA was intended to streamline reorganization for small business debtors and that approving an attorney for the trustee could substantially increase administrative expenses. The Court held that a trustee does not need an attorney to fulfill his basic duties. A Subchapter V trustee's role is more like a Chapter 12 trustee (for family farmer bankruptcies) than a traditional Chapter 7 or 11 trustee. The Subchapter V trustee does not take possession of a debtor's assets and lacks the ability to sell those assets. The trustee is more like an advisor and handler -- facilitating the development of a consensual reorganization

plan, appearing at major hearings, and ensuring that the debtor makes timely payments under the plan.

Absent a specific need based on the particular circumstances of a case, the court held it would not authorize a subchapter V trustee to retain an attorney. Stressing the imperative of keeping expenses low, the Court cautioned "overzealous and ambitious Subchapter V trustees" that the Court might not approve compensation for unnecessary or duplicative services or other fees incurred outside of the scope and purpose of the SBRA.

If other courts follow this ruling, it should help to reduce administrative expenses in Subchapter V cases, which will free up more money the debtor can use to pay creditors. And without an additional lawyer in the mix, it may keep the case more streamlined.

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