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The Complex Role of Trustees as Mediators in Subchapter V Bankruptcy Cases

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THE COMPLEX ROLE OF TRUSTEES AS MEDIATORS IN SUBCHAPTER V BANKRUPTCY CASES

KEY POINTS:

- Within subchapter V bankruptcy, fulfilling the trustee's primary duty to "facilitate the development of a consensual plan of reorganization" (under § 1183(b)(7)) often requires the trustee to operate in a mediator-like role.
- Subchapter V trustees must balance and reconcile the competing interests of creditors and debtors while serving as a mediator.
- When executed successfully, the trustee-as-mediator role will expedite the process, reduce costs, and reach consensus on a plan that balances the interests of all parties.
- By following key principles outlined below, subchapter V trustees can more successfully navigate their role as a mediator.
- As their responsibilities continually evolve over time and with every new case, trustees will likely find more answers and strategies to help strike a balance between their fiduciary role and their role as mediators.

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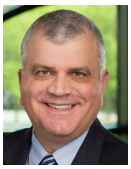
Within subchapter V bankruptcy, fulfilling the trustee's primary duty to "facilitate the development of a consensual plan of reorganization" (under § 1183(b)(7)) often requires the trustee to operate in a mediator-like role. Within other chapters of bankruptcy, many subchapter V trustees have served in both the capacity of debtor attorney and trustee, and even as counsel for secured and unsecured creditors. But how involved should the trustee be in the role of mediator? From the debtor attorney's perspective, what are the expectations of the subchapter V trustee as a mediator, and is relying heavily on the trustee for negotiations with creditors appropriate? Despite the difficulty of providing definitive answers to these questions, further analysis of various perspectives and considerations can help us gain a better understanding of this unique position.

The Role of Mediation in Subchapter V Bankruptcy

Mediation can particularly benefit the small business debtor while moving towards confirming a consensual plan. By streamlining the process and lowering filing costs, mediation can contribute to the objective of the Small Business Reorganization Act (SBRA), which added subchapter V bankruptcy to the U.S. Bankruptcy Code. Mediation may also be advantageous for creditors in subchapter V proceedings, as described below.

Traditionally, mediators engaged in legal matters would have no independent responsibility other than to remain impartial. However, when a subchapter V trustee is in the position of serving as a quasi-mediator, the court will often look to them as a party in interest, which they technically are. Indeed, subchapter V trustee's duties expressly include certain duties of chapter 7 and 11 trustees, including (a) where appropriate, examining and objecting to proofs of claim and opposing the debtor's discharge and (b) investigating the acts, conduct, assets, liabilities, and financial condition of the debtor and the operation of the debtor's business. They also have separate, specific duties in small business cases, including to appear and be heard at the subchapter V status conference and any hearing that concerns the value of collateral, plan confirmation, and the sale of property (See § 1183(b)).

About the Authors



Sam Della Fera, Jr. brings nearly 30 years of experience representing the interests of his clients – which include individual and corporate debtors, trustees, creditors' committees, secured creditors, landlords and other parties – in commercial litigation, bankruptcy, debtor and creditors' rights, and in financial restructurings and workouts both in and outside of court. He is seasoned in all aspects of Chapter 11 and Chapter 7 matters and is both a Subchapter V bankruptcy trustee and a New Jersey Bankruptcy Court approved mediator.

As Managing Director, Dave draws on nearly 20 years of bankruptcy know-how to skillfully facilitate case-management, providing nuanced direction across Stretto's service-oriented disciplines. He brings substantive insight and hands-on experience working closely with a multitude of departments including Client Services, Banking Services and Technical Support. Recognized as an industry expert, Dave utilizes his in-depth industry knowledge to assist clients, ensuring seamless case administration. Trustees and Administrators consult Dave when seeking new opportunities to maximize operational efficiency. Focused on the northeast region, clients rely on his keen ability to understand complex regulatory issues as well as day-to-day operational challenges they may face. Dave is an active member of NABT and serves on Stretto's Executive Management Team.

Balancing Competing Interests

Subchapter V trustees must balance and reconcile the competing interests of creditors and debtors while serving as a mediator. If a subchapter V trustee believes that a plan of reorganization is not feasible or there is a legitimate objection from a creditor, they may have to step out of their mediator role to advocate against confirmation. It is in these situations that the subchapter V trustee must simultaneously balance between acting as a mediator and fiduciary, all while supporting the bankruptcy process.

In most bankruptcy cases, creditors risk receiving drastically lower amounts than what is owed. That risk is even more pronounced in subchapter V cases, where plans may be confirmed without any creditor support. Consequently, the creditor's initial reaction is often to object to the debtor's plan. But a well-developed subchapter V plan, with the assistance of the subchapter V trustee, may provide creditors with far more value than either a plan in a standard chapter 11 case or, as any confirmed plan must, in a liquidation. That is due in large part to the substantially reduced costs of administration in subchapter V: no creditors' committees, no quarterly fees payable to the United States Trustee, and a streamlined process from start to finish. But it can also be due to the active involvement of the subchapter V trustee.

Therefore, it can be argued that if a subchapter V trustee can successfully execute the role of mediator, thereby decreasing the legal fees and other costs associated with contested confirmations, then there is an increase in the likelihood of success for the debtor's plan under subchapter V. Creditors, in turn, can have a higher probability of receiving at least some portion, or even more, of their claim against their debtors.

From the perspective of debtor's counsel, the subchapter V trustee may face conflicting expectations in the mediator role. As one of the goals of subchapter V bankruptcy is to resolve the proceedings quickly and effectively in order to file a confirmable plan of reorganization within 90 days, the trustee-as-mediator must balance these time pressures by building consensus among all parties. In the interest of time, the debtor's counsel may look to the trustee as an ally in resolving whatever issue is the driving the restructuring, whether it be from a lender or a landlord. While debtor's counsel may look to the trustee as an advocate for the estate and the process, this can be precarious when their role is to maintain an independent point of view.

Although subchapter V bankruptcy is more streamlined than a traditional chapter 11 case, it entails many of the same processes and responsibilities of debtor's counsel. These include the requirements to (a) timely file monthly operating reports, (b) provide adequate protection to secured creditors, (c) timely assume or reject leases, and (d) analyze assertable avoidance actions, none of which are within the purview of the subchapter V trustee. Debtor's counsel may expect that the trustee will get the plan confirmed quickly but there is much more to the process than they may realize. In some cases, they may view the trustee as an ally to convince the creditor that the plan should be confirmed according to their interests. In others, debtor's counsel may want to keep the trustee-as-mediator role at arm's length and will look to the trustee to simply support the process.

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Best Practices and Considerations

Ultimately, the goal of subchapter V bankruptcy and the chapter 11 process is to maximize recoveries for all involved parties. When executed successfully, the trustee-as-mediator role will expedite the process, reduce costs, and reach consensus on a plan that balances the interests of all parties.

By following key principles, subchapter V trustees can more successfully navigate their role as a mediator. Following are a few strategies and best practices to consider:

- Consult immediately upon appointment with counsel for the debtor and the other primary stakeholders, including landlords, secured lenders, and major vendors, to explain the trustee's role and the subchapter V process, and to understand the concerns and goals of all parties;
- Review the debtor's current and recent financial statements, executory contracts and leases, and related information, to understand the debtor's financial challenges and opportunities, and to assist the small business debtor and counsel in doing the same;
- Calendar and periodically remind debtor's counsel of approaching deadlines, outstanding operating reports, and other obligations to help avoid needless distractions and mistrust caused by non-filings and inadvertent oversights; and
- Monitor important case related dates and documents through a cloud-based case management system. The ability to create custom dates, track them within the case calendar and access current filings using technology tools and resources will support you in keeping both parties up to date as the case progresses.

The Importance of Subchapter V and the Trustee-as-Mediator Role

As inflation and interest rates fluctuate and speculation continues about whether the U.S. economy is entering a recession, subchapter V bankruptcy remains a viable option for distressed small businesses. It is ultimately subchapter V bankruptcy's goal to help small businesses survive, as they remain vital to the economy.

An independent review of the liquidation analyses of a group of plans of reorganization from across various districts supports our previous assertions. We found that in comparison to liquidating under chapter 7, a plan of reorganization under subchapter V has benefits for both secured and unsecured creditors as well as the small business debtor. Based on the scenarios reviewed, only 20 percent of liquidations would result in unsecured creditors receiving a distribution, while 90 percent of subchapter V plans would be able to distribute pro rata to unsecured creditors.

A two-year extension of the Bankruptcy Threshold Adjustment and Technical Corrections Act (S. 3823, as amended) (the "Bankruptcy Corrections Act") raised the subchapter V allowable debt limit to $7,500,00.00 on April 7, 2022. Furthermore, it added debtors affiliated with non-publicly traded companies to the definition of small business debtors, correcting a technical flaw in the CARES Act. Having been passed by the House on June 7, 2022, and applied retroactively to bankruptcy cases filed between March 28, 2022 and June 21, 2022, President Biden signed the Bankruptcy Corrections Act on June 21, 2022. Congress and the bankruptcy industry will have had the opportunity to thoroughly assess the effectiveness of subchapter V bankruptcy as well as the impact of the subchapter V trustee in consummating a successful reorganization plan when this statute that increased the debt limit for debtors to qualify under the SBRA sunsets on June 21, 2024.

In conclusion, subchapter V bankruptcy has added new layers of complexity to the trustee's role in facilitating and helping to achieve the goals of the restructuring process. As their responsibilities continually evolve over time and with every new case, trustees will likely find more answers and strategies to help strike a balance between their fiduciary role and their role as mediators.